Finance Watch
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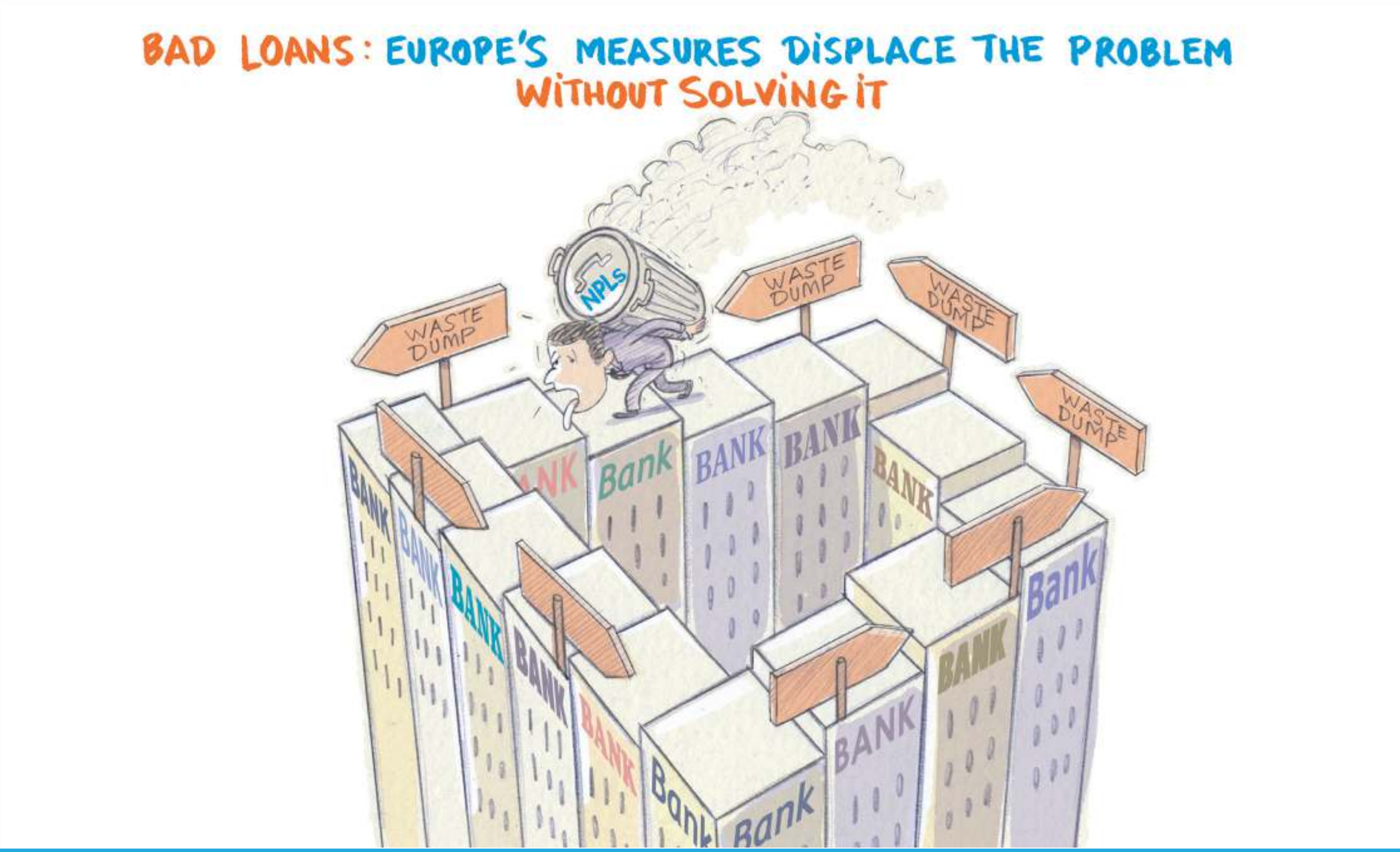
Ten Years After

"Would you mind holding this for me?"

The (increasingly desperate) search for an answer to Europe's Non-Performing Loans problem



Content

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Summary

The European Commission's latest proposals for addressing the European ➡ NPL crisis are, mostly, a step in the right direction:

- Tighter rules on the **recognition of non-performing loans** have been long overdue. By imposing a legal backstop on banks, forcing them to acknowledge – and provision for – problem assets, the Commission's proposed amendment to the CRR[1] could play a role in preventing the excessive build-up of NPLs in the future.
- The extent of **under-provisioning** identified by the Commission and the ECB[2] highlights the need to hurry along the adoption of ➡ IFRS 9 provisioning rules and confirms that the generous transition arrangements currently granted to EU banks by the legislators[3] leave Europe exposed to a known, substantial risk to financial stability.
- The NPL crisis should serve as a reminder that European banks' **capitalisation levels** are, in many cases, still not sufficient to absorb the effects of a lengthy economic downturn. Bank capital levels need to be further strengthened and banks that cannot be restored to health should be allowed to exit the market, either by way of a merger or sale or under the BRRD framework.[4]
- Finance Watch cautions against promoting solutions that allow banks to solve their NPL problems once again at taxpayers' expense, e.g. by selling them to **taxpayer-funded vehicles**, possibly at inflated valuations, or by passing on their risk to capital market investors in a non-transparent and unsafe way through structured debt transactions **(securitisation)**.
- We agree that a well-functioning, transparent and professional **secondary market for NPLs** could be an important part of the solution provided it does not undermine credit standards or lead to aggressive and inappropriate enforcement actions. Harmonised rules for NPL investors and credit servicers should be conducive to this effort. This market, and all actors in it, need to be properly supervised, however. There is no need to create yet another regulatory regime for (non-bank) ➡ credit purchasers and ➡ credit servicers. Entities that buy and manage NPLs (or other loan portfolios) for their own account are conducting investment business and should be regulated under existing frameworks, i.e. MiFID II,[5] AIFMD[6] or Solvency II.[7] Entities that manage NPLs on behalf of credit purchasers should be considered as providing 'ancillary services' under MiFID II.
- We are concerned about the impact that a single EU secondary market for consumer NPLs could have on distressed borrowers. It is therefore essential that **high levels of consumer protection in debt collection practices** are included in the proposal to expand the secondary market for NPLs.
- Legislators should consider the Directive's **impact on bank competition and culture** to ensure that it does not harm relationship banking, weaken underwriting standards, or distort competition between different types of credit provider.
- Member States' legal regimes for the enforcement of contracts, in general, and loan debts, in particular, need to be harmonised and strengthened to reduce the duration and cost of proceedings while preserving high levels of protection for debtors, in particular vulnerable groups such as private households and micro-enterprises. Both should be exempted from the proposed accelerated extrajudicial enforcement of collateral. Proposed legislation to harmonise insolvency rules and introduce debt restructuring procedures ('second chance') for businesses, particularly SMEs, should be advanced.
- There are currently no common minimum standards in the EU for dealing with the over indebtedness of individuals and households: **personal bankruptcy and 'second chance'** procedures are not available in all member state and few countries have data on successful second chance proceedings.[8] Finance Watch would encourage the EU legislators to extend their ongoing initiative on the harmonisation of insolvency proceedings and 'second chance'[9] to introduce common principles for personal bankruptcy, and ensure that the proposed directive is implemented together with this extended 'second chance' package.[10]

Definitions

Non-performing loan (NPL) – according to the EBA's definition a loan is deemed 'non-performing' when it is:

- 90 days past due; or
- unlikely to be repaid in full without realisation of the collateral, regardless of the existence of any past-due amount or of the number of days past due; or
- considered in ➡ default according to Art. 178 CRR or ➡ impaired according to the applicable accounting framework.

Non-performing exposure (NPE) – includes, in addition to ➡ NPLs, assets that a bank has acquired as a result of taking control of the collateral of an NPL (e.g. by foreclosing on a property).

1– Introduction

As Europe emerges, slowly, from the wreckage of a series of financial crisis and economic crises that have rocked the continent, in particular its Southern edge, since 2012, its financial system continues to grapple with the aftermath. After spending years in denial policymakers woke up, towards the end of 2016, to the realisation that European Union banks had piled up a staggering **€ 1 trillion of NPLs**. The slow rate of progress since then[11] has prompted the European Commission to announce, on 14 March 2018, a package of measures intended to harmonise the approach towards NPLs across the EU and to speed up their resolution.[12]

The proposed measures include:

- a Regulation to amend the Capital Requirements Regulation (CRR) so that banks have sufficient loan loss coverage when newly originated loans become non-performing;
- a Directive that sets out general rules for participants in the secondary market for NPLs and introduces harmonised procedures for the enforcement of collateral used to secure business loans; and
- a Blueprint to help member states create Asset Management Companies (AMCs), or 'bad banks', to deal with the NPLs from banks in resolution.

Finance Watch welcomes the Commission's initiative to address the NPL problem. We are of the view, however, that the proposed Action Plan should be considered as **part** of a wider package, which includes the proposed common legal framework for insolvency and 'second chance' for entrepreneurs and small businesses as well as an analogous bankruptcy framework for households. These elements should be designed and progressed jointly to deliver a coherent and comprehensive solution that addresses the NPL problem as well as its causes.

2 – What are NPLs?

The concept of 'non-performance' is being used as a broad, 'catch all' term to reconcile different technical terms and concepts used in accounting and regulatory reporting to describe bank assets, such as loans, that are considered unlikely to be repaid in full:

- The regulatory definition of ➡ default serves as the basis for supervisors' assessment of asset quality, in particular the quality of a bank's loan book, and for the calculation of regulatory (Pillar 1 and 2) capital requirements;
- The accounting definition of ➡ impairment matters for the determination of a bank's profits, as reported in its financial statements, and, a consequence, for the determination of staff bonuses and dividends to shareholders.

Default – under Art. 178 CRR a debtor is considered to be in default when:

- the bank considers that the debtor is unlikely to pay its obligations in full, without realisation of the collateral;
- the debtor is past due more than 90 days on any material credit obligation, e.g. an interest payment or (partial) payment of the principal. For certain loans (retail exposures secured by residential property or SME commercial property, exposures to public sector entities) the supervisory authority may extend the 90 day threshold to 180 days.

Impairment – a financial reporting concept defined, in great detail, by the relevant global accounting standards

➡ IAS 39 ('Financial Instruments: Recognition and Measurement') and

➡ IFRS 9 ('Financial Instruments').

Note: impairment of other, non financial assets, such as property, plant and equipment and goodwill, is governed by a different accounting standard, IAS 36 ('Impairment of Assets').

As a general rule:

- The definition of 'default', in accordance with Basel III rules and Art. 178 CRR, tends to be wider than that of 'impairment'. Loans that are 90/180 days 'past due', for instance, may be 'in default' but if sufficient collateral is available, may not be deemed 'impaired';
- Assets that are deemed 'in default' (in accordance with Art. 178 CRR) or classified as 'impaired' in the bank's financial reports should also be considered 'non performing' for regulatory purposes.[13]

There are still material differences, however, in the specific implementation of these concepts across EU Member States:

- Although a common statutory definition of 'default' has been introduced already since 2006 (Art. 178 CRR), interpretations of that definition continue to vary materially across institutions and jurisdictions, e.g. in respect of the 'past-due' criterion, indications of unlikeliness to pay, the effects of distressed loan restructuring, specific provisions for retail clients (e.g. 180 instead of 90 days 'past due') and criteria for a loan to return to 'non-defaulted' status.[14]
- Similarly, there are material differences in the implementation of accounting standards governing impairment across EU Member States.[15] There are, for instance, no uniform rules for writing off impaired loans or for the valuation of collateral in the event of impairment.[16]

A common definition of non-performing loans (exposures), published by EBA in 2014,[17] has not conclusively removed these divergences as it still relies on the concepts of 'default' and 'impairment'.[18] At the beginning of last year EBA issued detailed guidelines which should finally harmonise the application of the 'default' criterion by 31 December 2020.[19]

The introduction of ➡ IFRS 9, which was originally scheduled to come into force in January 2018, is widely expected to reduce the amount of under provisioning in banks' financial statements[20] and further narrow the gap between accounting and regulatory provisions. Its implementation in the EU is subject to a generous, five-year transition period, however, so that EU banks will not be obligated to fully provision for ➡ expected losses in line with IFRS 9 until January 2023.

The ESRB notes in its July 2017 report on 'Resolving Non Performing Loans in Europe' that "*the recent financial crisis showed how hard it can be for auditors to correctly assess problematic parts of banks' balance sheets. In addition, information on the loans is very poor and of dubious quality, in particular for loans of smaller size. Finally, the assumptions taken by banks' management for valuation of loans and collateral were sometimes based on excessively optimistic outlooks […].*" To prevent these problems from causing systemic risk, the ESRB goes on to recommend close regulatory scrutiny of individual banks' asset valuation practices by their supervisors on an ongoing basis and, from time to time, sector-wide Troubled Asset Reviews (TARs) or Asset Quality Reviews (AQRs).[21]

IAS 39 ('Financial Instruments: Recognition and Measurement') – the international accounting standard in force until 31 December 2017 that governed the valuation of financial assets, such as loans, on bank balance sheets, based on the ➡ 'Incurred loss' principle

IFRS 9 ('Financial Instruments') – the international accounting standard in force since 01 January 2018, subject to a five-year phase-in period, that governs the valuation of financial assets, such as loans, under the ➡ 'expected loss' principle

'Expected loss' principle – financial assets (e.g. bank loans) have to be reclassified when a significant increase in credit risk is observed. Upon reclassification the credit loss expected over the entire lifetime of the loan has to be provisioned for.

'Incurred loss' principle – losses on financial assets (e.g. bank loans) are recognised only when there is already objective evidence of impairment. Only past events and current conditions are considered when determining the amount of impairment. The effects of future credit loss events cannot be considered, even when they are expected.

3 – How do NPLs come about?

Causes for high and rising NPLs are often country-, sector- or bank-specific. A build-up of NPLs tends to be associated typically with one or several of the following **extrinsic and intrinsic factors**:

Extrinsic factors

- Extended periods of recession and/or subdued economic growth, often coupled with low inflation;
- Bursting of asset price bubbles (often in the property markets) resulting in large stocks of overvalued loan collateral;
- Inadequate legal mechanisms for the enforcement of contracts and/or inefficient insolvency procedures, leading to excessively long and costly legal proceedings and low recovery rates.

Intrinsic factors

- Weaknesses in banks' business models and governance, e.g. overexposure to certain customer groups or market segments, reckless lending practices, poor credit risk management , lack of NPL management capacity and expertise;
- Moral hazard, i.e. the expectation of bank management and investors that banks with high levels of NPLs, caused by reckless lending practices, will be recapitalised with public funds;
- Lack of incentives for, and/or supervisory pressure on, banks to reduce NPLs, e.g. restrictions on the tax deductibility of loan loss provisions, lack of supervisory scrutiny of internal credit risk models and valuation practices;
- Insufficient loss-absorbing capacity (equity capital and reserves) to write off loan losses, restricted access to fresh capital.

Much of the public discussion tends to **focus on extrinsic factors**, in particular the impact of the global financial crisis of 2008 and the Eurozone crisis of 2010. Whereas the impact of the twin crises is, of course, undeniable other, **intrinsic factors** play no less of a role in the predicament faced by large parts of the European banking sector today.

In fact, NPLs are rarely ever an unfortunate, accidental by-product of an economic downturn. While it is true that most banks' NPL ratios tend to go up in an economic downturn it is equally true that NPLs are not distributed evenly – they tend to occur in a concentrated manner,[22] i.e. some banks are more likely to accumulate bad loans than others. This could be deliberate, as some banks may chase risky business hoping that higher interest rates and fees on these loans will compensate higher losses. This is often the case in **overbanked** markets where too many banks compete for the same business, a problem that has been highlighted, again and again, by various EU institutions over recent years.[23] It could also be less deliberate if banks have **poor risk management** systems and managerial controls or if bank management's incentives are distorted so that senior personnel stands to benefit from writing new business, regardless of risk, but is never called upon to face the consequences (i.e. losses) when loans turn sour because their bank is invariably bailed out by the taxpayer (**moral hazard**).

At Finance Watch we have long cautioned against the vicious circle that develops when poorly-run banks are kept in business with taxpayers' money. It would be regrettable if the Commission's NPL initiative were to end up achieving just that.

Among extrinsic factors it is worth singling out the link between NPLs in the banking sector and the **efficiency of the legal system** in enforcing contracts and dealing with bankruptcy. It is probably not by coincidence that the three Member States with the highest NPL ratios in the EU[24] also rank among the worst-performing jurisdictions worldwide when it comes to enforcing contracts.[25]

The availability of extrajudicial procedures, as proposed by the Commission, may be useful as a short-term fix to accelerate the effectiveness of enforcement procedures and reduce the burden on the judicial system. It does not, however, fully address the underlying cause of the problem: where the ineffectiveness of the judicial system is such that citizens are faced with years of litigation, often at very high cost, to enforce their legal rights in court they are, arguably, at risk of being deprived of their **right to 'due process'**. In the EU, which has enshrined the 'rule of law' as one of its core values (Art. 2 TEU) and which has already been challenged to be seen to uphold these values on a number of occasions recently, this cannot be a satisfactory solution.

Finance Watch would endorse a renewed, concerted effort between EU institutions and Member States to **harmonise legal frameworks** for enforcement and insolvency proceedings on the basis of 'best practice', striking an equitable balance between delivering safe, universal access to justice for citizens and protecting the rights of debtors, especially vulnerable groups such as private households and small businesses. Out of court settlements may be part of the solution but should in no way preclude citizens' right to effective redress in the courts.

4 – Why do NPLs matter?

In its proposal, the Commission argues that an excessive build-up of NPLs causes problems in the banking system – and the economy at large – in a variety of ways:

- High levels of NPLs reduce banks' capacity to lend to the real economy and act as an impediment to growth;
- High levels of NPLs weigh down the real economy and distort competition by keeping technically bankrupt companies in business;
- High NPL ratios erode banks' capital base and hence their capacity to absorb losses; as a result, banks are more fragile and likely to fail.

Much of the policy discussion regarding NPLs revolves around the concern that banks with high NPL ratios may refrain from **lending to the real economy**, creating a drag on the recovery and economic growth. This argument is less compelling than it seems, however: there is no empirical evidence at the present time of a shortage of bank credit in the EU[26] but there has been a large body of research recently pointing to the negative effects of excessive credit growth on the real economy.[27] Even the argument that banks with already high NPL ratios will be less likely to issue new loans is not always borne out by the facts: banks that expect to be bailed out by the State, in particular, may be tempted to compete more aggressively and accept riskier, higher-yielding business to compensate for their losses. There are certainly well-documented precedents of the negative impact on the economy of non-viable banks and companies being kept afloat, e.g. the experience of Japan in the 1990s.[28]

No less importantly, though, NPLs that sit on a bank's balance sheets without sufficient provisioning are a **prudential risk**. They present a misleading picture of its health to investors, supervisors, policymakers, customers and the general public. In the case of a 'systemically important' bank this may, by itself, be enough to create a potential systemic risk. But even a large number of smaller banks with unsustainably high levels of NPLs may pose a systemic risk if they all fail at the same time.

5 – How are they dealt with?

Provisioning

Generally, banks are expected to build up provisions on their balance sheets against losses from loans that are not repaid, either in full or partially. Different rules for provisioning apply for financial accounting and regulatory reporting purposes (see 'What are NPLs?' above).

The amount of the provision is off-set from the nominal (gross) amount of the loan and reduces its net value on the bank's balance sheet (the 'net book value'). When the provision reaches 100% of the loan's nominal value its net value to the bank becomes zero and it should, under normal circumstances, be written off.

Provisions are normally deducted from the bank's profit and loss statement and reduce its profits for the period which leads to a number of **second-round effects**:

- Provisions reduce the bank's equity capital (CET1) and erode its regulatory capital ratios; that, in turn, constrains the overall capacity of the bank to issue new loans;
- A reduction in profits due to an unexpected rise in provisions undermines investors' confidence in the quality of the bank's assets; to compensate for the perceived increase in risk, investors demand higher returns - it becomes more expensive for the bank to refinance itself;
- Distributions to shareholders (dividends) generally depend on the availability of profits (and reserves); a cut or cancellation of dividends exposes management to pressure from disappointed shareholders and is often seen as a signal of distress by the markets;
- Variable remuneration (bonuses), which often accounts for a substantial proportion of bank management and senior staff compensation packages is often directly dependent on reported profits.

Write off

When a loan is written off it is removed completely from the bank's books, i.e. its assets. Any provisions against this loan that have been accrued on the liabilities side of the bank's balance sheet are removed as well. If a loan has not been fully provisioned for by the time it is written off, the unprovisioned amount must be deducted from retained earnings, i.e. core equity capital (CET1).

Obviously, this causes problems for banks that are already operating with **inadequate levels of equity capital**. In its 2015 study on the NPL crisis in Europe the IMF observed: "*Weak capital buffers and difficulties in realizing collateral increase banks' reluctance to address NPLs. Low profitability and thin capital buffers constrain banks' ability to increase provisions and discourage the timely recognition of credit losses. The high level of NPLs relative to banks' going concern loss-absorbing capacity (that is, common equity plus reserves) also constrains banks' ability to accept further credit losses.*"[29]

Sale of NPL portfolios

NPLs may be sold, too, usually to other banks, insurance companies or specialised financial investors, e.g. alternative investment funds (AIFs). For that purpose, loans with similar characteristics (e.g. type of debtor, type of loan, secured/unsecured) are bundled into portfolios, which may range in size from ca. €50 million to several billion. If sold to another bank, the portfolio will be processed by that bank's workout department, much as it would deal with the bank's own NPL. If sold to a non bank ➡ credit purchaser, such as a fund, day-to-day management of the portfolio is usually placed in the hands of a ➡ credit servicer.

When NPLs are sold they are removed from the bank's balance sheet. If the purchase price is less than the 'net book value' at which the loans were carried on the balance sheet the bank must, once again, recognise the difference as a loss, which is deducted from its core equity capital (CET1). Because NPLs are sold at steep discounts (often at 25-50% of their nominal value) these losses can be very substantial.

Transfer of NPLs to a 'bad bank'

The most frequent argument for the creation of an Asset Management Company (AMC), commonly known as a 'bad bank', is that it allows smaller banks that may not individually have the capacity and expertise to manage large inventories of NPLs to pool their distressed assets in a new entity and appoint management and staff who have the relevant experience and are incentivised, and dedicated to, managing these assets.

The 'bad bank' must be capitalised, however, so that it is capable of absorbing the losses from its portfolio of NPLs. As long as the participating banks are ready and able to capitalise the 'bad bank' themselves, without recourse to public funds, the creation of a 'bad bank' is purely a private-sector transaction. More often than not, however, 'bad banks' benefit from some level of public-sector financial support.[30]

Credit purchaser – any (natural or legal) person other than a bank which purchases a loan ('credit agreement') in the course of their trade, business or profession.

Credit servicer – any (natural or legal) person other than a bank which performs certain services on behalf of a creditor, e.g.

- monitoring of the performance of the credit agreement;
- collection and management of information about the status of the credit agreement, of the borrower and of any collateral used to secure the credit agreement;
- information of the borrower of charges or payments due under the credit agreement;
- renegotiation of terms and conditions of the credit agreement; and
- enforcement of the creditor's rights and obligations under the credit agreement.

6 – What does the European Commission propose?

The Commission's initiative consists of three main instruments:

- a **regulation** amending the Capital Requirements Regulation (CRR)[31] that will require banks to have sufficient loan loss coverage for newly originated loans if these become non-performing. The amendment introduces a uniform 'statutory prudential backstop' in order to prevent the risk of under-provisioning of NPLs. This measure will be applicable only to new NPLs, i.e. loans that become non-performing after the date of publication of the proposal, i.e. 14 March 2018. The regulation also introduces a common definition of non performing exposures (NPE), in line with the one published by EBA for supervisory reporting purposes, to ensure consistency in the prudential framework;
- a **directive**[32] that should enable banks – or other creditors – to deal in a more efficient way with loans once these become non-performing by improving conditions to either enforce the collateral used to secure the credit or to sell the credit to third parties. The Commission notes that the proposed accelerated extrajudicial enforcement procedure would be complementary, and not in contradiction, to its proposal on harmonising Member States' legal frameworks on insolvency and restructuring[33] as it could not be applied if a stay of enforcement actions had been granted, e.g. under a restructuring plan. In cases where banks face a large build-up of NPLs and lack the staff or expertise to properly service them, the directive facilitates the outsourcing of the servicing of these loans to a specialised credit servicer or the sale of the credit agreements to a credit purchaser. The proposal also removes the need for NPL investors to obtain banking licences and/or to entertain business establishments in every Member State where they operate. Instead a passporting regime is proposed; and
- a '**blueprint**'[34] for the creation of an Asset Management Company (AMC) ('bad bank') in line with existing EU resolution and State Aid frameworks.

7 – Finance Watch's view on the EU proposals

Tackle the causes, not just the effects

In principle, Finance Watch supports the Commission's endeavour to set out uniform, **harmonised rules for the sale and management of NPL portfolios**. We note, however, that the sale of an NPL portfolio should be considered, by bank management and supervisors alike, as an ***'ultima ratio'*** measure to resolve a deterioration of the bank's asset base that threatens its continued viability; it should not be considered as being part of the ordinary course of business. Inherent in such a sale, in most cases, will be the admission that the bank's risk management processes have failed and that it lacks the internal capacity to restore its stock of assets to full health.

It is equally important to consider how it might affect the culture and practice of commercial banking. **Selling loans breaks the relationship between customer and bank** which can result in loss of value for the customer, as acknowledged in the Directive's Impact Assessment.[35] Customer relationships help banks gain a direct understanding of the economic activities and the risks involved with a loan and provide a more stable supply of credit through the financial cycle.[36] The inherent risks of a banking system that relies on selling on loans to third-party investors as soon as they have been originated (**'originate to distribute'**) have been exposed, to devastating effect, by the financial crisis of 2008. At the time, the emergence of the 'originate to distribute' model, and of the structured credit (securitisation) markets as an outlet for dubious credit, distorted banks' incentives and led to a catastrophic decline in lending standards. Finance Watch has cautioned for a long time against the mislabelling of structured (tranched and synthetic) securitisation as 'simple and transparent' under the Commission's 'Simple and Transparent Securitisation' ('STS') initiative and we use this opportunity to reiterate our warnings here.

The **first priority** for legislators and supervisory authorities, in our view, should be to ensure that banks' loan origination, credit risk management and NPL management processes are adequately reported, regulated and properly supervised. We welcome the initiative by the ECB to issue guidelines to the banks under its direct supervision regarding the appropriate recognition and management of NPLs[37] and are looking forward to EBA issuing a corresponding framework for all EU banks by the end of 2018.[38] In the interest of providing better transparency and as an 'early warning mechanism' to flag any build-up of NPLs in specific segments of the economy we would also propose the inclusion of more granular reporting and disclosure on NPLs by banks, e.g. by geography and segment.

Banks that lack the financial resources to cope with their NPLs without having recourse to public funds should be **restructured or resolved** under BRRD rules. We note that Member States' approaches to the application of the BRRD still vary considerably, as do national frameworks for bank liquidation. Since the BRRD entered into force in all Member States, in January 2016, **only one** failed bank (Banco Popular) has been placed into resolution; three others, by contrast, were either handled under the 'precautionary recapitalisation' escape clause (Art. 32/4/d BRRD) or under national insolvency law, at a total cost to the taxpayer in excess of **EUR 10 billion**.[39] The use of public funds has been facilitated, in each of these cases by the Commission's **2013 Banking Communication**,[40] a document that effectively provides for a **parallel legal regime** that allows banks to be recapitalised with public funds at terms that are significantly less stringent than those of the BRRD. In particular, recapitalisation under this framework does not require senior unsecured creditors to be 'bailed in' and is not constrained by the 'burden sharing requirement' (Art. 44/5 BRRD).[41] We reiterate in this context our demand that the review of the **'precautionary recapitalisation'** clause under Art. 32/4 BRRD, which is now more than **two years overdue(!)** be carried out without further delay and that Art. 32/4/d/lit. iii BRRD be either fundamentally recast or removed altogether. We also call upon the institutions to review the continued need for the 2013 Banking Communication and, at a minimum, to fully align its burden sharing rules with Section 5 of Chapter IV of the BRRD.

Secondary credit markets: A journey into the shadows

The Commission proposal notes that investors who purchase loan portfolios on the secondary markets currently face very different regulatory frameworks across the EU. Whereas the activity is barely regulated at all in some Member States others impose strict requirements, in some cases amounting to a full banking licence. Finance Watch concurs that it is desirable, for a variety of reasons – including legal certainty, transparency, 'level playing field' considerations and consumer protection – to harmonise regulation at the EU level.

We note, however, that every sale of a loan portfolio, performing or not, from the banking sector to a non-bank financial institution represents a transfer out of the traditional, regulated banking sector towards the under regulated ➡ shadow banking sector, which has been, for some time now, identified as a major potential source of systemic risk.[42] Already today, the shadow banking sector accounts for more than one-third of all financial assets in the EU[43] but very little tangible progress has been made so far in regulating these markets, apart from a general agreement to monitor developments.[44] The proposed directive explicitly covers the sale of both performing and non performing loans to non-bank investors and could leave the door wide open to large-scale ➡ regulatory arbitrage.

Regulatory arbitrage – the transfer or (financial) activities from one jurisdiction to another in order to take advantage of more favourable regulatory conditions.

Shadow banking – typical banking activities, in particular credit intermediation, that are performed by entities outside of the regular banking system.

We believe that the regulatory framework for non-bank credit purchasers and credit servicers should be closely **aligned with existing financial services regulation** to limit the scope for regulatory arbitrage. We note that, from the investor's point of view, loans are financial assets much in the same way as debt securities and purchasers of large loan portfolios tend to be, and should be, sophisticated professional investors. Instead of creating yet another category with yet another set of rules, ➡ credit purchaser should therefore conform to existing regulatory frameworks, specifically AIFMD or MiFID II.

A final concern is whether it is appropriate to define higher NPL transaction prices as a **'public interest' objective**. The primary objective of the Action Plan, in our view, should be to remove the systemic risk of NPLs from European banks' balance sheets, not to encourage transactions at inflated prices and/or to justify public subsidies to mitigate banks' losses. The success of the proposed Action Plan should be measured by whether it has restored NPL ratios across the European banking sector to their normal, long-term average levels and whether it has allowed for the orderly removal of underperforming banks from the market.

Retail borrowers and small businesses must be adequately protected

While Finance Watch recognises the need to tackle European banks' NPL problem and the prudential risk it causes we would also remind policymakers of the need to consider the counterfactual: each one of these loans is a debt owed by a European citizen or business. Regardless of why these loans turned sour, debtors' rights have to be preserved and adequately protected.

It is important to bear in mind that removing a loan from the bank's balance sheet does not automatically void the underlying claim, although courts in some Member States have sometimes refused to enforce claims on collateral when the underlying loan has been written off. In principle, however, claims, and the right to enforce collateral, remain in place until the liability has been extinguished – usually by way of insolvency proceedings in court. This is why it is critical for the EU to ensure that all Member States have **insolvency law** frameworks that are capable of delivering **fair and predictable outcomes** within a **reasonable period of time**, at **reasonable cost**, while **protecting vulnerable debtors**, in particular households and small businesses. Equally importantly, statutes of limitation must be designed so as to give debtors a **'second chance'** by placing time limits on debt recovery. Although some progress has been made by Member States in terms of updating their insolvency frameworks, harmonisation at the European level is essential.

European **households** account for ca. EUR 6 trn of residential mortgage lending[45] and ca. EUR 1 trn of consumer loans.[46] Even if NPL rates on private household debt are below the average,[47] these figures point to a total of ca. **EUR 350 bn** of distressed loans. Overindebtedness of private households is a genuine concern: it is socially and economically divisive and carries huge economic and social costs.[48] The activities of ➡ credit servicer have come under increasing public scrutiny in recent times. In the U.S., a survey by the Consumer Financial Protection Bureau (CFPB) published in January 2017 reported widespread use of aggressive and abusive practices by debt collectors.[49] In the EU, the European Court of Justice (ECJ) recently confirmed in a precedent case (*Gelvora*)[50] that debt collectors' activities are covered by the Unfair Commercial Practices Directive.[51]

We do not think this provides sufficient protection for distressed borrowers. The proposal will open new business opportunities for third-party credit servicers and investors, including non-EU investors, while distressed borrowers across Europe would be exposed to those firms established abroad and potentially to bad treatment and home repossessions. It is therefore essential that **high levels of consumer protection in debt collection practices** be included in the Commission proposal.

With the sale of NPL portfolios to financial investors the need for the protection of borrowers, in particular consumers and small businesses, becomes even more

urgent because the original customer relationship between debtor and creditor is cut, with the loan becoming purely a financial asset whose recovery value for the new creditor has to be maximised. We would argue therefore that credit servicers who manage loan portfolios, for their own account or on behalf of non-bank credit purchasers, should be considered as providers of 'ancillary services' to these investors and their activities **should be regulated in accordance with MiFID II (Annex 1 Section B)**.

The highest incidence of NPLs, by far, relates to the **small business sector (SMEs)**, where the rate of NPLs is nearly three times the average. This is a concern since this segment is often held up as the backbone of economic activity – and success – in Europe. It also comprises countless **sole trader and small family businesses**, blurring the boundary between commercial credit and household debt. The Commission has proposed specifically to carve out loans to consumers and loans that are secured by a business borrower's own residential property from the proposed accelerated extrajudicial collateral enforcement mechanism in the Directive. However, we are not convinced that these exclusions are sufficient to protect sole traders and micro-enterprises, in particular, as these groups tend to have a have fewer alternative sources of funding, very limited stock of assets to be pledged as collateral and often lack the resources to fight long lawsuits. We would therefore propose, at the very least, to **extend this exception to micro-enterprises**. Additional protection may be required for the most vulnerable debtors, in particular individuals and households.

The taxpayer should not be the 'investor of last resort' for NPLs

Finance Watch does not support the use of public funds to facilitate the disposal of NPLs unless there is a genuine and acute risk of systemic contagion. According to the BRRD, any bank that receives public funds, directly or indirectly (through an AMC), to cover the losses on its NPLs should be deemed in receipt of 'extraordinary public financial support' and should be placed into **resolution or liquidation**.

Finance Watch does not sign up to the narrative that is being put forward, time and again, to justify public-sector intervention in the NPL crisis: the fact that NPL portfolios are often sold at **steep discounts** to their nominal value does not, by itself, indicate that the secondary market for NPLs is underdeveloped and prices skewed in favour of the purchaser. Equally, the fact that there is only a **limited number of buyers** does not necessarily imply that the market is imperfect and could be improved by throwing it open to all comers or by putting the taxpayer into harm's way. Much to the contrary, all of these observations testify to the fact, mentioned before, that NPLs are **inherently high risk** assets and **very difficult to value**, except for a small number of professional market participants.

Unless there is a real need to avert the clear and present danger of a systemic crisis the public-should not act as an 'investor of last resort' for NPLs:

- The public sector has no advantages, in terms of information, resources or expertise, that would enable it to value distressed loans any better than professional private-sector investors;

- There is no empirical evidence to suggest that NPL portfolios managed by the public-sector achieve higher recovery rates than privately-managed ones;

- There is no reason why the public should accept a lower rate of return for taking on the same risk as a private investor.

We agree, in principle, with the Commission's objective to harmonise national rules so that professional private-sector investors can operate across the EU under a single regulatory framework. As and when a harmonised market offers opportunities for professional investors, they can usually be relied upon to take them. In the meantime we see no reason why the public (i.e. taxpayers) should have any obligation to step into the breach.

'Bad banks' are not a taxpayer-funded service

The Commission's blueprint states, correctly, that "*setting up an AMC with State Aid should not be seen as the default option*". Nevertheless it goes on to describe in detail how an AMC should be constructed to qualify under the State Aid framework. There are several aspects that should give taxpayers cause for concern:

- The blueprint points out that the acquisition of NPLs by a public-sector entity does not constitute State Aid when carried out at market value or, indeed, 'estimated market value'. Why the State should compete with private-sector investors to buy distressed loan portfolios at market prices is anybody's guess. If the assets have been offered to the market for sale and offers have been received these offers should, arguably, represent the best approximation to market value; if they have not been offered, or no offers have been received, the question must be asked why it should be in the public interest for the State to buy a portfolio of private-sector NPLs at a hypothetical price;

- The blueprint highlights the option of combining 'precautionary recapitalisation' (Art. 32/4/d BRRD) with the creation of a taxpayer-funded AMC. As set out in earlier Finance Watch publications,[52] 'precautionary recapitalisation' is an escape clause that allows banks – and policymakers – to by-pass the stringent 'bail-in' and burden sharing' requirements of the BRRD in favour of the more lenient and malleable State Aid rules of the 2013 Banking Communication. Billed originally as an instrument to be applied in exceptional circumstances only, 'precautionary recapitalisation' has figured prominently in three out of the five major resolution cases so far;[53]

- The blueprint also points out that a State-funded AMC could also be set up when a failed bank is liquidated under national insolvency proceedings. This would apply when resolution of the bank is not considered to be in the public interest, i.e. the resolution authority does not expect its liquidation to trigger systemic risk. In practice, this could lead to the result, that national authorities can still step in and use public funds to support the liquidation of a bank, and/or subsidise the acquisition of its healthy assets by a private-sector acquirer, even though the resolution authority has officially found no 'public interest' justification for doing so.[54] Once again, this approach paves the way for the application of the State Aid rules of the 2013 Banking Communication, which are not in alignment with the BRRD.

AMCs supported with public funds are a **resolution tool** under the BRRD and should be utilised only in that context – as a way of removing poorly run banks from the market while containing systemic risk. They should certainly not be used as a way of subsidising the cleaning up of a failed bank at taxpayers' expense before it is sold to another private-sector competitor.

Financial engineering is a problem for the future, not a solution for the present

Finance Watch is very sceptical about the wisdom of selling distressed debt on the capital markets by way of issuing **structured debt securities (securitisation)**. Distressed debt is, by definition, a high risk asset class: it has to be managed actively by professionals and returns are closely linked to the performance of the work out team or asset manager. Recovery rates are likely to be best, arguably, if the incentives of portfolio managers and investors are aligned as closely as possible. In a securitisation deal, by contrast, management of the portfolio typically remains with the originator, i.e. the bank or a credit servicing firm: they continue to collect fees while the investors who bought the securities bear the financial risk. As with other structured credit securities, such as collateralised debt obligations (CDOs) which are widely held responsible for the 2008 financial crisis, these instruments are often tranched and repackaged before being sold, rendering them nearly impossible to analyse and value for all but a very small group of sophisticated financial investors.[55] **Mis-selling risk** is therefore huge. This indicates that on-sales of distressed portfolios to the market by way of securitisation should not be encouraged.

The financial crisis of 2008 should serve as a potent reminder of what happens when unsuspecting investors were sold **complex, intransparent securities** whose primary raison d'être was to conceal the poor quality of the underlying assets they contain. Replace the phrase 'non performing' with 'sub prime' and we are back to the fatal and discredited game of 'pass the parcel' that was at the root of the last financial markets cataclysm. Securitising NPLs is not the panacea it is made out to be by banking-sector interest groups and some policymakers. It is, more likely, merely a way of **storing up trouble** for later.

Footnotes

1. Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms ('Capital Requirements Regulation', 'CRR'), OJ L 176, 27.June 2013, pgs. 1–337
2. As of September 2017, only half (50.7%) of the loans deemed to be non-performing have been provisioned for on banks' balance sheets (European Commission, Second Progress Report on the Reduction of Non-Performing Loans in Europe, Staff Working Document SWD(2018)072 final, 14 March 2018, pg. 6)
3. Regulation (EU) 2017/2395 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State, OJ L 345, 27 December 2017, pgs. 27–33
4. Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms, OJ L 173, 12 June 2014, pgs. 190–348
5. Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments ('Markets in Financial Instruments Directive', 'MiFID II'), OJ L 173, 12 June 2014, pgs. 349–496
6. Directive 2011/61/EU of the European Parliament and of the Council of 08 June 2011 on Alternative Investment Fund Managers ('Alternative Investment Fund Managers Directive', 'AIFMD'), OJ L 174, 01 July 2011, pgs. 1–73
7. Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II), OJ L 335, 17 December 2009, pgs. 1 155
8. Civic Consulting, The Over-Indebtedness of European Households: Updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact, Report Part 1: Synthesis of findings, conducted for Directorate General Health and Consumers (DG SANCO), 4 December 2013, pgs. 223-225
9. European Commission, Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, COM (2016) 0723 final, 22 November 2016
10. See also Financial Services User Group, Non-Performing Loans (NPLs) – Letter to the European Commission, 27 February 2018; (https://ec.europa.eu/info/sites/info/files/fsug-opinions-180227-npls_en.pdf)
11. As of 31 December 2017, the total volume of NPLs across the EU still stood at EUR 813 bn (European Banking Authority, Risk Dashboard – Data as of Q4 2017, 05 April 2018, pg. 3; (https://www.eba.europa.eu/documents/10180/2175405/EBA+Dashboard+-+Q4+2017.pdf)
12. European Commission, Commission measures to address the risks related to NPLs, 14 March 2018 (https://ec.europa.eu/info/publications/180314-proposal-non-performing-loans_en)
13. European Central Bank, Guidance to Banks on Non-Performing Loans – NPL Recognition, March 2017, pg. 62 (https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf)
14. European Banking Authority, Report on the Dynamics and Drivers of Non-Performing Exposures in the EU Banking Sector, 22 July 2016, pg. 14 (https://www.eba.europa.eu/documents/10180/1360107/EBA+Report+on+NPLs.pdf)
15. European Central Bank, Stocktake of National Supervisory Practices and Legal Frameworks Related to NPLs, June 2017, pgs. 10-14 (https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.stock_taking2017.en.pdf)
16. Aiyar, Shekhar / Bergthaler, Wolfgang / Garrido, José M. / Ilyina, Anna / Jobst, Andreas / Kang, Kenneth / Kovtun, Dmitriy / Yan, Liu / Monaghan, Dermot / Moretti, Marina, A Strategy for Resolving Europe's Problem Loans, IMF Staff Discussion Note SDN/15/19, 19 September 2015, pg. 16 (https://www.imf.org/external/pubs/ft/sdn/2015/sdn1519.pdf)

17. European Banking Authority (EBA), Final Draft Implementing Technical Standards on Supervisory Reporting on Forbearance and Non-Performing Exposures under Article 99(4) of Regulation (EU) No 575/2013, EBA/ITS/2013/03/rev1 of 24 July 2014
18. European Commission, An EU Strategy for Tackling NPLs: Presentation by Peter Grasmann at the 81st East Jour Fixe of the Austrian National Bank, 18 September 2017, pg. 4 (https://www.oenb.at/dam/jcr:4a03c512-0040-4381-96fb-5f2e4e746231/FGrasmann-Session-2.pdf)
19. European Banking Authority, Guidelines on the Application of the Definition of Default under Article 178 of Regulation (EU) No 575/2013, EBA/GL/2016/07, 18 January 2017 (https://www.eba.europa.eu/documents/10180/1721448/Guidelines+on+default+definition+%28EBA-GL-2016-07%29_EN.pdf)
20. see Footnote 12
21. European Systemic Risk Boards (ESRB), Resolving Non-Performing Loans in Europe, 11 July 2017 (https://www.esrb.europa.eu/pub/pdf/reports/20170711_resolving_npl_report.en.pdf)
22. The ECB's asset quality review ('Comprehensive Assessment'), completed in October 2014, found that 25 out of 130 banks reviewed (ca. 20%) accounted for 100% of the capital shortfall of EUR 25 bn that was found in the sample. Asset quality (i.e. valuation) adjustments applied by the ECB varied widely even between banks in the same Member State and with similar business models (European Central Bank, Aggregate Report on the Comprehensive Assessment, October 2014; https://www.ecb.europa.eu/pub/pdf/other/aggregatereportonthecomprehensiveassessment201410.en.pdf)
23. e.g., among others, European Systemic Risk Board, Is Europe Overbanked?, Reports of the Advisory Scientific Committee No. 4, June 2014 (https://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_4_1406.pdf); European Central Bank, Too Much of a Good Thing? The Need for Consolidation in the European Banking Sector, Speech by Danièle Nouy, Chair of the Supervisory Board of the ECB, at the VIII Financial Forum, Madrid, 27 September 2017 (https://www.bankingsupervision.europa.eu/press/speeches/date/2017/html/ssm.sp170927.en.html)
24. Greece (45%), Cyprus (39%), Portugal (15%) and Italy (11%) as of 31 December 2017; (European Banking Authority, Risk Dashboard – Data as of Q4 2017, 05 April 2018, pg. 30; (https://www.eba.europa.eu/documents/10180/2175405/EBA+Dashboard+-+Q4+2017.pdf).
25. In Cyprus, Greece and Italy the process for enforcing a contractual claim takes between 3 and 4 years, on average, and costs between 14% and 23% of the nominal value of the claim. They rank 138th, 131st and 108th, respectively, of 190 jurisdictions (World Bank, Doing Business 2018: Reforming to Create Jobs, World Bank, Washington (DC), 2018; pgs. 156, 163 and 169; (http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB2018-Full-Report.pdf). Italy has since passed a reform of its insolvency laws in October 2017 (Law 155/17 of 19 October 2017) with the aim of accelerating insolvency proceedings and improving their efficiency.
26. In the ECB's semi-annual Survey on the Access to Finance of Enterprises in the Euro Area (SAFE), 'access to finance' has been ranked as the least important concern of Eurozone SMEs for the sixth consecutive time (European Central Bank, Survey on the Access to Finance of Enterprises in the Euro Area (April to September 2017), 29 November 2017 (https://www.ecb.europa.eu/press/pr/date/2017/html/ecb.pr171129.en.html)
27. e.g., among others, Cecchetti, Stephen G. / Kharroubi, Enisse, Why Does Financial Sector Growth Crowd Out Real Economic Growth?, BIS Working Papers No. 490, February 2015 (https://www.bis.org/publ/work490.htm); Sahay, Ratna / Cihak, Martin / N'Diaye, Papa, et. al., Rethinking Financial Deepening: Stability and Growth in Emerging Markets, IMF Staff Discussion Note SDN/15/08, May 2015 (https://www.imf.org/external/pubs/ft/sdn/2015/sdn1508.pdf)
28. e.g. Fuji, Mariko / Kawai, Masahiro, Lessons from Japan's Banking Crisis 1991-2005, ADBI Working Paper Series No. 222, June 2010 (https://www.adb.org/sites/default/files/publication/156077/adbi-wp222.pdf); Inaba, Nobuo / Kozu, Takashi / Sekine, Toshitaka / Nagahata, Takashi, Non-Performing Loans and the Real Economy: Japan's Experience in: Bank of International Settlements (ed.), Investigating the relationship between the financial and real economy. BIS Papers No. 22, 02 April 2005 (https://www.bis.org/publ/bppdf/bispap22g.pdf)
29. see Footnote 12
30. Among recent precedents in Europe, the Italian Atlante fund represents an example of a private sector vehicle that

does not officially benefit from State Aid – although the fund was initiated by the Italian govern-ment and state-owned bank Cassa dei Depositi e Prestiti (CDP) and Poste Italiane are among its core investors. Other 'bad banks', such as UKAR (UK), SAREB (Spain) and NAMA (Ireland) were set up with a combination of State and private-sector funding. The German 'bad bank' FMS, which took over the assets of failed mortgage lender Hypo Real Estate, is fully government-owned and –funded; see also Medina Cas, Stephanie / Peresa, Irena, What Makes a Good Bad Bank?: The Irish, Spanish and German Experience, European Economy Discussion Paper 036/2016, European Commission, September 2016 (https://ec.europa.eu/info/sites/info/files/dp036_en.pdf)

31. European Commission, Proposal for a Regulation of the European Parliament and of the Council on amending Regulation (EU) No 575/2013 as regards minimum loss coverage for non-performing exposures, COM (2018) 134 final, 14 March 2018
32. European Commission, Proposal for a Directive of the European Parliament and of the Council on credit servicers, credit purchasers and the recovery of collateral, COM (2018) 135 final, 14 March 2018
33. European Commission, Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU, COM (2016) 0723 final, 22 November 2016
34. European Commission, Commission Staff Working Document: AMC Blueprint. Accompanying the document 'Communication from the Commission to the European Parliament, the European Council the Council and the European Central Bank: Second Progress Report on the Reduction of Non-Performing Loans in Europe', COM (2018) 133 final, 14 March 2018
35. see Footnote 32, pg. 77
36. Global Alliance for Banking on Values, 'Real Banking for the Real Economy: Comparing Sustainable Bank Performance with the Largest Banks in the World', October 2013
37. European Central Bank, Guidance to Banks on Non–Performing Loans, 20 March 2017 (https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf); and European Central Bank, Addendum to the ECB Guidance to Banks on Non-Performing Loans: Supervisory Expectations for Prudential Provisioning of Non-Performing Exposures, 15 March 2018, (https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.npl_addendum_201803.en.pdf)
38. European Banking Authority, Public Hearing on Consultation Paper (CP) on Draft Guidelines on Management of Non-Performing and Forborne Exposures, 25 April 2018 (https://www.eba.europa.eu/documents/10180/2150686/2018+04+25+Public+Hearing+on+GL+on+NPL+management.pdf)
39. The Italian State injected EUR 5.4 bn into Monte dei Paschi di Siena and provided EUR 4.8 bn to support the partial sale of two smaller banks, Banca Popolare di Vicenza and Veneto Banca; European Commission, State Aid: Commission Authorises Precautionary Recapitalisation of Italian Bank Monte dei Paschi di Siena, Press Release, 04 July 2017, (http://europa.eu/rapid/press-release_IP-17-1905_en.htm); European Commission, State Aid: Commission Approves Aid for Market Exit of Banca Popolare di Vicenza and Veneto Banca under Italian Insolvency law, Involving Sale of Some Parts to Intesa Sanpaolo, Press Release, 27 June 2017 (http://europa.eu/rapid/press-release_IP-17-1791_en.htm)
40. 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 ('Banking Communication'), OJ C 216, 30 July 2013, pgs. 1–15
41. Art. 44/5 BRRD requires that investors (shareholders and bondholders) of a failing bank have to make a contribution of no less than 8% of the bank's total assets to cover the capital shortfall before any public funds can be injected.
42. In fact, the financial crisis of 2008 is seen by many as a crisis of the shadow banking system (e.g. Krugman, Paul, The Return of Depression Economics and the Crisis of 2008, Norton, 2nd Edition, Ney York/London, pgs. 170 ff.): it started with the collapse of two hedge funds managed by Bear Stearns, the investment bank, in July 2007 and its single largest casualty was the insurance group AIG, which was undone by its shadow banking activities.
43. ca. EUR 40 trn (38% of all financial sector assets in the EU) as of year-end 2016 (European Systemic Risk Board, EU Shadow Banking Monitor No. 2 (May 2017), 29 May 2017, pg. 4 (https://www.esrb.europa.eu/pub/pdf/reports/20170529_shadow_banking_report.en.pdf)

44. e.g. Dombret, Andreas, Systemic Risk of Shadow Banking, 20 August 2013 (https://www.bis.org/review/r130821a.pdf); European Central Bank, Financial Stability Review: May 2017, pgs. 100-102 (https://www.ecb.europa.eu/pub/pdf/other/ecb.financialstabilityreview201705.en.pdf); Constancio, Vitor, Macroprudential Policy In A Changing Financial System: Speech delivered at the Second ECB Macroprudential Policy and Research Conference, Frankfurt, 11 May 2017 (https://www.ecb.europa.eu/press/key/date/2017/html/ecb.sp170511.en.html); Financial Stability Board, Assessment of Shadow Banking Activities, Risks and the Adequacy of Post-Crisis Policy Tools to Address Financial Stability Concerns, 03 July 2017 (http://www.fsb.org/wp-content/uploads/P300617-1.pdf); Financial Stability Board, Global Shadow Banking Monitoring Report 2017, 05 March 2018, (http://www.fsb.org/wp-content/uploads/P050318-1.pdf); Ehlers, Torsten/Kong, Steven/Zhu, Feng, Mapping Shadow Banking in China: Structure and Dynamics, Bank for International Settlements (BIS) Working Papers No. 701, February 2018 (https://www.bis.org/publ/work701.pdf)
45. European Mortgage Federation, Hypostat 2017 (as of 31 December 2016)
46. European Banking Authority, Risk Assessment of the European Banking Sector, November 2017, pg. 25; (https://www.eba.europa.eu/documents/10180/2037825/Risk+Assessment+Report+-+November+2017.pdf)
47. As of June 2017, ca. 4.5% of all loans were considered non-performing. They included 13.8% of SME loans, 6.2% of corporate loans and 4.3% of loans to private households. (European Banking Authority, Risk Assessment of the European Banking Sector, November 2017, pg. 27-28)
48. European Parliament, Opinion of the European Economic and Social Committee on 'Consumer protection and appropriate treatment of over-indebtedness to prevent social exclusion', OJ C 311, 12 September 2014
49. Consumer Financial Protection Bureau, Consumer Experiences with Debt Collection: Findings from the CFPB's Survey of Consumer Views on Debt, 12 January 2017; (https://www.consumerfinance.gov/data-research/research-reports/consumer-experiences-debt-collection-findings-cfpbs-survey-consumer-views-debt/)
50. European Court of Justice, Judgment of 20 July 2017, Gelvora, C-357/16, ECLI:EU:C:2017:573
51. Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market, OJ L 149, 11 June 2005, pgs. 22–39
52. Stiefmueller, Christian, Failing or Likely to Fail, 13 January 2017, (http://www.finance-watch.org/hot-topics/blog/1316); Przewoska, Paulina, Should Precautionary Recapitalisations Make Taxpayers Nervous?, Finance Watch Policy Brief, 08 October 2014; (http://www.finance-watch.org/our-work/publications/942-fw-policy-brief-october-2014)
53. 'Precautionary recapitalisation' was granted in respect of Italian bank Monte dei Paschi di Siena in 2016 despite widespread doubts about the bank's solvency at the time, which was a precondition for the rescue (e.g. Silver, Vernon / Sirletti, Sonia / di Pasquale, Sergio, Bank of Italy Knew for Years Paschi Masked Losses Report Shows, Bloomberg, 02 November 2017; https://www.bloomberg.com/news/articles/2017-11-02/bank-of-italy-knew-for-years-paschi-masked-losses-report-shows); Weber, Alexander, Monte Paschi Bailout Plan Has Some ECB Supervisors Grumbling, Bloomberg, 27 March 2017, https://www.bloomberg.com/news/articles/2017-03-27/italy-s-monte-paschi-bailout-has-some-ecb-supervisors-grumbling); de Groen, Willem-Pieter, Precautionary Recapitalisations: Time for a Review?, European Parliament In-Depth-Analysis provided to the ECON Committee, IPOL IDA(2017)602091, 05 July 2017 (http://www.europarl.europa.eu/RegData/etudes/IDAN/2017/602091/IPOL_IDA(2017)602091_EN.pdf). 'Precautionary recapitalisations' were also suggested, but not approved, for two smaller Italian banks, Veneto Banca and Banca Popolare di Vicenza.
54. Two smaller Italian banks, Veneto Banca and Banca Popolare di Vicenza were liquidated in June 2017 under Italian bankruptcy laws after the Single Resolution board (SRB) decided that there was no public interest in placing them into resolution. The banks' viable operations and assets were subsequently transferred to Banca Intesa Sanpaolo, a competitor, supported by EUR 4.8 bn of cash injections from public funds and State guarantees totalling up to EUR 12 bn, all approved under the Banking Communication.
55. Hache, Frédéric, A Missed Opportunity to Revive Boring Finance?, Finance Watch Position Paper on Long term Financing, Securitisation and Securities Financing, 15 December 2014, pgs. 29 ff. (http://www.finance-watch.org/our-work/publications/998-position-paper-on-ltf); Hache, Frédéric, Finance Watch Webinar on Securitisation, 27 July 2015 (http://www.finance-watch.org/our-work/events/1120-webinar-securitisation)

About Finance Watch

Finance Watch is an independently funded public interest association dedicated to making finance work for the good of society. Its mission is to strengthen the voice of society in the reform of financial regulation by conducting advocacy and presenting public interest arguments to lawmakers and the public. Finance Watch's members include consumer groups, housing associations, trade unions, NGOs, financial experts, academics and other civil society groups that collectively represent a large number of European citizens. Finance Watch's founding principles state that finance is essential for society in bringing capital to productive use in a transparent and sustainable manner, but that the legitimate pursuit of private interests by the financial industry should not be conducted to the detriment of society. For further information, see www.finance-watch.org

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