EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Andrea ENRIA
Chair of the Supervisory Board

COURTESY TRANSLATION

Mr Frank Schäffler, MdB
Member of the German Bundestag
Platz der Republik 1
11011 Berlin

Frankfurt am Main, 14 January 2021

Re: Your letter of 24 November 2020

Honourable Member of the Bundestag, dear Mr Schäffler,

Thank you for your letter, which was passed on to me by the President of the Bundestag, the honourable Dr Schäuble, accompanied by a cover letter dated 26 November 2020. First of all, please allow me to refer you to my recent letter to Mr Zanni MEP, Mr Grant MEP, Mr Rinaldi MEP and Ms Donato MEP, which addressed some of the questions raised in your letter.[1]

As regards developments in respect of non-performing loans (NPLs) following the onset of the coronavirus (COVID-19) pandemic, I would like to point out that the crisis has not, thus far, resulted in a material increase in NPLs. In the third quarter of 2020 the total NPL ratio for all significant institutions stood at 2.82%, compared with 3.22% in the fourth quarter of 2019. Statistics with a detailed breakdown by countries are published by the European Banking Authority.[2]

However, we do expect NPLs to rise. As I indicated in the “Financial Times” article to which you refer[3], the ECB estimates that in a severe scenario with a very weak and protracted recovery[4], the total NPLs of euro area banks could reach €1.4 trillion. Although the probability of that severe scenario has lowered according to more recent forecasts, please note that it is still difficult to give a precise figure, mainly because of the current uncertainties in the macroeconomic outlook and the persistently high COVID-19 caseload in the euro area.

1 The letter to the MEPs can be found on the ECB Banking Supervision website: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.mepletter201204_Zanni_Donato_Grant_Rinaldi~37e7a4bd25.en.pdf?10a3f84d59483c0c4f5fda01df41a5cd

2 European Banking Authority, Risk assessment of the European banking system (December 2020), Figure 28: https://www.eba.europa.eu/risk-analysis-and-data/risk-assessment-reports

3 “ECB: the EU needs a regional ‘bad bank’”, *Financial Times*, 26 October 2020: https://www.ft.com/content/cc3a9a51-4d9a-4c73-9ff0-9f623ecf4065

4 The vulnerability analysis performed by the ECB in July 2020 focused on two scenarios set out in the June 2020 Eurosystem staff macroeconomic projections for the euro area: the central scenario (i.e. the one that is most likely to materialise according to Eurosystem staff) and a severe scenario. The figure of €1.4 trillion relates to the severe scenario.

Consequently, the ECB is monitoring the evolution of NPL ratios very closely and encouraging banks to develop reliable and prudent projections of their asset quality under different scenarios.

As regards the question of how the ECB assesses the financial stability of the euro area in the context of NPLs totalling €1.4 trillion, I would refer you to the results of the ECB's COVID-19 vulnerability analysis[5] (which also provide details of the main assumptions behind the various scenarios and the methodology used).

As regards your question on the ECB's views concerning the creation of a European asset management company, I would like to clarify that – as indicated in my letter to you of 25 May 2020[6] – ECB Banking Supervision has not developed any official proposal on this issue. I can also confirm, therefore, that the ECB has not submitted any plans for the creation of a European asset management company to the European Commission, the Single Resolution Board or representatives of the German government.

I personally have supported the idea of a European asset management company in the past, and I still think it has the potential to be a useful tool in the event of a significant system-wide deterioration in asset quality. Alternatively, I argued that a network of national asset management companies could also prove helpful in supporting a swifter economic recovery, if designed appropriately. I think that an integrated European response to such a problem would be preferable to a plethora of uncoordinated national initiatives. This was and remains a personal contribution to the policy debate, as the establishment of asset management companies, and the conditions for their compatibility with the EU legal environment, are outside the competences of the ECB. As you are probably aware, the European Commission has subsequently published a Communication[7] detailing an action plan to tackle non-performing loans, which amongst other things supports the establishment of a EU network of asset management companies.

As regards your question on the measures planned by the ECB with a view to reducing NPLs in the euro area, I would like to emphasise that addressing NPLs has always been one of the key priorities for ECB Banking Supervision. Indeed, its overall objective in developing its supervisory approach was to avoid "wait and see" approaches, which lead to an excessive build-up of NPLs and impair banks' ability to support the economic recovery. This was a key lesson from the last crisis, as delaying the recognition and resolution of NPLs increases problems in the longer term and makes them harder to tackle. One very important element of our framework, which facilitates the timely resolution of NPLs, is the ECB's "Guidance to banks on non-performing loans"[8], which was published in March 2017. As part of that guidance, banks with high levels of NPLs[9] are expected to develop their own strategies with a view to reducing NPL stocks and putting adequate governance arrangements in place. Such NPL strategies, which are reviewed and updated by banks on an annual basis,

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5 ECB, COVID-19 Vulnerability Analysis: Results Overview, 28 July 2020: https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200728_annex~d36d893ca2.en.pdf?731039993a2a10392e3b7679d1669fb5

6 https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.mepletter200525_Schaffler~4b5ffb68c8.en.pdf

7 https://ec.europa.eu/finance/docs/law/201216-communication-non-performing-loans_en.pdf

8 https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf

9 The guidelines on the management of non-performing and forborne exposures are as follows: credit institutions with gross NPL ratios of 5% or above have to establish a non-performing exposure strategy as part of their overall strategy, as well as putting relevant governance and operational arrangements in place. In addition, the European Banking Authority's guidelines also give supervisors discretion to request details of NPL strategies and associated governance and operational arrangements from other banks on the basis of their specific risk profiles and/or bank-specific circumstances.

are assessed and challenged by Joint Supervisory Teams (JSTs). The JSTs also monitor their implementation on an ongoing basis.

In addition, in response to the COVID-19 pandemic, the ECB has sent letters to banks communicating its expectations in this respect. The ECB has emphasised the need for banks to ensure that they adequately assess, classify and measure credit risk. Banks also need to ensure that they have sufficient operational capacity to deal with distressed debtors in the context of the pandemic. This should enable banks to provide appropriate solutions to distressed debtors in a timely manner, helping to contain the build-up of problem assets at banks, and thus minimising and mitigating any cliff effects where possible. The JSTs are engaging with banks on a case-by-case basis in this regard.

Yours sincerely,

[signed]

Andrea Enria