

EU sets marching orders in the form of a definitive NPL "Action Plan" for 2017: *Are these the first steps to a Banking Union Pillar IV and a comprehensive solution for NPLs in the EU-27?*

On 11 July 2017 the Council of the European Union (the **Consilium**)¹, meeting in the ECOFIN set-up, approved the conclusions on the European Commission's (EC) review of the EU's Capital Markets Union Plan (CMU). This included an approval to refocus on certain "priority areas" so as to ensure CMU is implemented by the original deadline of 2019.

The focus on CMU tied in with the discussion on the priorities of the Estonian Consilium Presidency Programme² that started on 1 July and which will run until Bulgaria assumes the Presidency on 1 January 2018 before handing over to Austria which will assume the Consilium Presidency from 1 July 2018 to 31 December 2018.

Finalising both Banking Union and CMU, by pressing ahead with specific workstreams, is central to the Joint Programme of the Estonian, Bulgarian and Austrian Consilium Presidencies³. So too is the need to implement a comprehensive solution to tackling the problem of non-performing loans and exposures in the banking sector (jointly, **NPLs**). The Consilium agreed to revert regularly on the issues of NPL supervision, reforms of insolvency and debt recovery frameworks, development of secondary markets as well restructuring of the sector. In connection with this 11 July meeting, the Consilium published its "Conclusions on an Action Plan to tackle non performing loans in Europe" via a press release⁴ (the **2017 NPL Action Plan**).

The 2017 NPL Action Plan has some important time bound deliverables that will impact EU institutions as well as market participants that are now "invited to act". These "invitations", build upon the conclusions from the 31 May 2017 Report of the FSC Subgroup on Non-Performing Loans⁵ (the **FSC NPL Report**).

This Client Alert assesses the contents of the NPL Action Plan, what it means for market participants and policymakers, how it ties into other EU-27 regulatory reform workstreams, including CMU, and how it ties into Eurozone specific regulatory reforms, including the continuing fine-tuning of the EU-27's Single Rulebook as it is applied within the Banking Union.



¹ A legislative body of the European Union that is comprised of varying representatives of the executive governments of the Member States of the EU. The Consilium develops and coordinates EU Member State's policies in specific fields, negotiates and adopts EU legislative instruments, concludes international agreements and adopts the EU's budget.
² The Estonian Presidency Programme 2017 is available here: https://www.eu2017.ee/sites/default/files/2017-06/EU2017EE%20Programme_0.pdf
³ The 18-month programme of the Consilium prepared by the "trio" of Estonia, Bulgaria and Austria is available here: <http://data.consilium.europa.eu/doc/document/ST-9934-2017-INIT/en/pdf>
⁴ See: <http://www.consilium.europa.eu/en/press/press-releases/2017/07/11-conclusions-non-performing-loans/>
⁵ See: <http://data.consilium.europa.eu/doc/document/ST-9854-2017-INIT/en/pdf>

Viewing the 2017 NPL Action Plan in context

The points proposed in the 2017 NPL Action Plan should also be viewed in conjunction with the European Central Bank's (**ECB**) role in Banking Union, specifically in the actions undertaken as the lead in the Single Supervisory Mechanism (**SSM**). This includes the ECB-SSM's own updated NPL review (**Second NPL Stocktake**) exercise, which it announced on 30 June 2017⁶, and which now extends to include all Eurozone countries as well as providing an update on the eight jurisdictions covered in the original stocktake published in 2016.

It should be noted that the first NPL Stocktake, gave birth to the ECB-SSM's supervisory guide on NPLs (the **NPL Guide**). For further information on the NPL Guide please see our Eurozone Hub's Background Briefing on the NPL Guide and its practical impacts. In short, the SSM's NPL Guide provides a comprehensive set of 'supervisory expectations', which read quite like a rulebook. Whilst the NPL Guide is based on the experiences of Ireland and Spain in relation to their own binding NPL frameworks introduced as a result of the 2008 financial crisis, the NPL Guide applies to those credit institutions operating in the Eurozone that are Banking Union Supervised Institutions (**BUSIs**). In-scope BUSIs are already required to embed the requirements of the NPL Guide into their operating and compliance frameworks.

BUSIs are distinguished, especially for SSM purposes, according to how they are categorised. The relevant level of categorisation determines who supervises BUSIs and how. Certain SSM-specific requirements provide an ability for smaller BUSIs to apply risk-based proportionate approaches to their compliance obligations.

Banking Union supervision distinguishes between those BUSIs that are categorised as "Significant Supervised Institutions" (**SCIs**), which are under the direct prudential oversight of the ECB-SSM. These SCIs are distinguishable from those BUSIs that are "Less Significant Institutions (**LSIs**). LSIs are indirectly supervised by ECB-SSM but directly supervised by national competent authorities (**NCA**s) within the Banking Union.

Within the EU-27 and the Eurozone-19 and its Banking Union, it is important to note that (currently) conduct of business supervision, despite being shaped by supervisory culture, convergence or approaches and EU-led rulemaking including by the European Supervisory Authorities (**ESAs**), is still within the mandate of individual national authorities. Consequently, the NPL Action Plan, whilst noting the ECB-SSM's work on the NPL Guide and stating that it should be rolled out to LSIs, provides a comprehensive solution for the whole of the EU-27 and expects "action" by national and European authorities.

Hot Topics

The following table provides a breakdown of the 2017 NPL Action Plan's time-bound "deliverables", who needs to do what... by when. The table briefly highlights areas where issues for policymakers and market participants needing to comply with the rules might arise. These deliverables can be grouped in the following three stages:

2017: Policy preparation and planning.

2018: Expansion of existing compliance obligations or introduction of new requirements on market participants.

2019: Introduction of infrastructural and institutional reforms or frameworks to support the comprehensive NPL framework introduced by the 2017 NPL Action Plan.

"Actions" in the 2017 NPL Action Plan as it applies to the EU-27			
Who is 'invited to act':	by when?	in relation to what workstream/deliverable?	Observations from the Eurozone Hub and implications for BUSIs and other markets participants in the EU-27
EC	"during summer 2017"	<ul style="list-style-type: none"> publish an interpretation of existing supervisory powers in EU legislation, with a view to clarifying usability of credit institutions' provisioning for NPLs for purposes of Art. 104 CRD IV⁶ and under Art. 16 of the SSM Regulation⁷ (the 2017 NPL Interpretation Report); following a review of the NPL Interpretation Report and relative pros and cons analysis, consider an amendment to Art. 104 CRD IV in the context of reviews to CRR/CRD IV⁸ and the policy options set out in the FSC NPL Report; 	<ul style="list-style-type: none"> it is not clear whether DG-FISMA, as gatekeeper for this type of work, possibly working together with the ECB-SSM and the authors of the FSC NPL Report, may have sufficient time and resources to deliver a comprehensive report and policy proposals during a period when most subject matter experts and policymakers may be on annual leave;

⁶ See: <https://www.bankingsupervision.europa.eu/press/pr/date/2017/html/ssm.pr170630.en.html>
⁷ Directive 2013/36/EU, as amended and itself under current review.
⁸ Council Regulation (EU) No. 1024/2013, as supplemented and as amended.
⁹ itself also driven by and partly dependent on the global political agreement relating to Basel IV.

Hot Topics

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EC	presumably concurrent with compilation of 2017 NPL Interpretation Report, may however be driven or impacted by ESMA workstream on creating a common European framework for loan origination by investment funds;	<ul style="list-style-type: none"> consider, within the framework of the CRR/CRD IV review, the introduction of 'prudential backstops' addressing potential under-provisioning which would apply to newly originated loans. This would follow an assessment of the most appropriate calibrations in line with international practice; the level of statutory backstops could take the shape of compulsory prudential deductions from own funds of NPL amounts; 	<ul style="list-style-type: none"> the same considerations as to adequate availability of resources, as voiced above, are likely to apply to this workstream; equally, it is conceivable that any notion of "statutory backstops" whilst added to an already on-going, and in parts difficult, process of the CRR/CRD IV review, may also require equivalent measures to be added into supervisory practice both within the SSM level as it applies to SCIs, but mirrored and rolled-out to LSIs given how the ECB's fine-tuning of CRR/CRD IV (NODE) applies to BUSIs that are either SCIs and LSIs. The same roll-out process starting from SCIs going to LSIs would need to be mirrored for non-Banking Union jurisdictions and national authorities and may protract a timely and harmonised roll-out;
ECB-SSM + SSM- NCAs	end of 2018	<ul style="list-style-type: none"> roll-out and implement the SSM's NPL Guide to LSIs with "targeted adaptations" where necessary. Currently the NPL Guide only applies to SCIs; 	<ul style="list-style-type: none"> the NPL Guide has been a success in drafting but has yet to be implemented by SCIs in a sufficiently wholesale manner, let alone policed by the ECB-SSM; rolling-out the NPL Guide to LSIs, whilst desirable, will not solve situations if BUSIs (both LSIs and SCIs) do not have sufficient staff, supported by counsel, to implement and embed the requirements that supervisors then actually police;

Hot Topics

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EBA	by summer 2018	<ul style="list-style-type: none"> ▪ issue guidelines on NPL management, applicable to all EU-27 domiciled credit institutions, that are consistent with the NPL Guide as applied to all BUSIs; 	<ul style="list-style-type: none"> ▪ subject to the EBA having sufficient staffing, possibly with the support from Irish and Spanish colleagues, including those (formerly) at the ECB that supported the creation of the NPL Guide, this seems to be a quick win in replicating and rolling-out a consistent set of rules and thus a common menu of options for credit institutions to apply and embed in their NPL management; ▪ EBA's move ahead of BREXIT in 2019 may affect this timeline as well as the host of other workstreams it is engaged on;
EBA	by summer 2018	<ul style="list-style-type: none"> ▪ issue detailed guidelines on EU-27 credit institutions loan origination, monitoring and internal governance, which could in particular address issues such as transparency and borrower affordability assessment (the EBA Origination & Monitoring Guide); ▪ these items conceptually interlink with the NPL Guide replication process described above; 	<ul style="list-style-type: none"> ▪ the same comments as on support and BREXIT in respect of the EBA replicating and rolling-out the NPL Guide apply here to the EBA Origination & Monitoring Guide; ▪ the interlink with the NPL Guide could also conceivably extend to interlinking the EBA Origination & Monitoring Guide with on-going workstreams on the Mortgage Credit Directive as well as work of the European Data Warehouse in relation to strengthening the European Reporting Framework. Firms may want to start positioning themselves in response to these changes;

Hot Topics

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ESRB	by end of 2018	<ul style="list-style-type: none"> develop macro-prudential approaches to prevent systemic risk propagation caused by NPLs. Such approach will account for procyclical measures; 	<ul style="list-style-type: none"> we would imagine that the ESRB, housed within the ECB, will be closely involved in the dialogue between ECB-SSM and EBA in relation to their workstreams but would imagine that, in the absence of a central and cross-authority project management team other than the ECB's SSM Task Force, communication might be protracted;
EBA, in consultation with ESMA	by end of 2018	<ul style="list-style-type: none"> implement enhanced disclosure requirements on asset quality and NPLs applicable to all EU-27 credit institutions; 	<ul style="list-style-type: none"> we would assume that this will be closely coordinated with other data governance and disclosure workstreams that are already in the pipeline but would imagine that, in the absence of a central and cross-authority project management team other than the ECB's SSM Task Force, communication might be protracted;
EBA	by end of 2017	<ul style="list-style-type: none"> issue guidelines to EU-27 credit institutions on loan tapes monitoring, specifying minimal detailed information required on credit exposures in their banking book; 	
EBA, ECB and EC	by end of 2017	<ul style="list-style-type: none"> to propose initiatives to strengthen data infrastructure with uniform and standardised data for NPLs, consideration of setting up of NPL transaction platforms to create and support a development of the secondary market in NPLs; 	

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EC plus "cooperation with all relevant institutions and bodies"	by end of 2017	<ul style="list-style-type: none"> prepare a "blueprint" for the potential set-up of national asset management companies (AMCs), based upon common principles for the relevant asset and participation perimeters, asset-size thresholds, asset valuation, appropriate capital structures, the governance and operational features, etc.; 	<ul style="list-style-type: none"> see in particular our Thought Leadership of our Eurozone Hub lawyers on this proposal, in particular whether Banking Union might need a Pillar IV in the form of a Single Asset Management Agency (SAMA); we would imagine that given the success of Ireland and Spain in their AMCs assisting in containing and then curing the NPL situation whilst concurrently combatting the cause with common rules that irrespective of the national rules inspiring ECB-SSM's NPL Guide headwind on some of the proposals may require know-how and leadership from Ireland and Spain; reforms in this area will also require the pro-active involvement of EC's COMP as responsible for rules on State Aid;
EC	by summer 2018	<ul style="list-style-type: none"> develop an EU approach to secondary markets for NPLs in particular removing impediments for transferring of NPLs from credit institutions to non-credit institutions; as part of this development of secondary markets for NPLs, the safeguarding of consumer's rights as well as the simplification and harmonisation of licensing rights of third-party loan services will be considered; 	<ul style="list-style-type: none"> it is questionable why this workstream on divestment should not run on the same timeline as the AMC workstream above; it is conceivable that the ECB-SSM NPL Guide, the EBA version of it as well as the EBA Origination & Monitoring Guide may find some form of replication and application to non-credit institution buyers of NPLs and/or servicers. This may prompt some firms to secure first mover advantages in terms of compliance of processes and retention of suitable staff;

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EC	by end of 2017	<ul style="list-style-type: none"> publish results of benchmarking exercise on the efficiency of national loan enforcement (including insolvency) regimes from a credit institution creditor perspective, providing comparable metrics, as precise as possible, for recovery rates, times and costs across EU Member States; 	<ul style="list-style-type: none"> given that this interacts with a number of other workstreams, some of which may not complete before 2017, there is potential for some delay; and
Member States	by end of 2018	<ul style="list-style-type: none"> consider and/or actually carry out dedicated peer-reviews on insolvency regimes across the EU; and 	<ul style="list-style-type: none"> it is conceivable that this will require input, coordination and steering by EC, EBA and possibly ECB-SSM and/or ESRB;
EC	undefined	<ul style="list-style-type: none"> further analyse the possibility of enhancing the protection of secured creditors. 	

Outlook for 2017 and 2018

The 2017 NPL Action Plan sets an ambitious tone from the Consilium with a lot of work to be carried out by a number of European Supervisory Authorities, the ECB and the Commission. Despite the impressive work of the ECB-SSM in creating and implementing the NPL Guide, like with other ambitious EU projects, including that of CMU, it is regrettable that progress is dictated often by resources and timing as opposed to necessary a lack of will.

These problems are not just limited to those EU, Eurozone and respective national policymakers that are required to drive forward solutions, including here tackling NPLs, but also within those market participants that are required to comply with NPL-specific rules or those looking to buy exposures. Assuming that the 2017 NPL Action Plan's timeline remains on course, this summer will canter through to a full autumn and with MiFID II/MiFIR coming online in 2018 as well as progress on the CRR/CRD IV review, 2018 and 2019 will be busy years ahead.

Our **Eurozone Hub** in Frankfurt supports our wider **Eurozone Group** by combining and leveraging our specialist EU-regulatory and institutional know-how with the local market expertise of our regulatory and transactional lawyers. We assist clients in taking a holistic and strategic view that does not lose sight of local requirements. Our multidisciplinary and multijurisdictional Eurozone Hub and Eurozone Group helps clients navigate the complex, fast-paced and multi-tiered regulatory and supervisory environment across the Eurozone. We believe this is key to us assisting in providing tailored and pragmatic counsel on how the EU's Single Rulebook is applied within the EU, the Eurozone and its Banking Union as well as the impact of BREXIT upon those frameworks, market participants and transactions.

Our Eurozone Hub provides clients with a single consistent point of contact to coordinate and steer through issues affecting firms and their "run the business", "change the business" or "business as usual" workstreams and strategic priorities. We have specific experiences, gained both in-house and in an institutional and policymaking setting in creating, implementing and running both NPL compliance programmes but also trading platforms and standalone portfolio divestment transactions.

In relation to the items discussed in this specific Client Alert, and building upon our existing analysis, we will continue to assess and publish updates as these workstreams develop given that they will define as well as reshape how business is structured, executed and supervised in the Eurozone and its Banking Union and/or across the wider EU-27. Specifically we will be looking at workstreams on the:

1. Banking Union's NPL Guide¹⁰ - both in terms of the planned roll-out of the rules to LSIs and the mirroring of those rules by the EBA, the new EBA Origination & Monitoring Guide and the application of these requirements to all credit institutions across the EU-27;
2. Banking Union's NODE Guide - both in terms of how the national options and discretions elimination exercise (**NODE**)¹¹ has been applied by the ECB-SSM to SCIs first, then rolled-out to LSIs and, going forward, how this, in the context of the CRR/CRD IV review will be treated within Banking Union, but also for the wider EU-27; and
3. Banking Union and wider EU-27 priorities to improve data governance and disclosure mechanisms both in order to improve the data capture of NPL stocks but also to improve information dissemination to facilitate more timely and efficient divestments that are backed by more harmonised infrastructure solutions and tools, such as the use of AMCs¹² built around common EU rules.

¹⁰ Please refer to our existing *Background Briefings* on this development in terms of what it means for SCIs, LSIs and as well as buyers of NPLs.

¹¹ See a series of thought leadership pieces authored or co-authored by *Huertas* in the *Journal of International Banking Law & Regulation* for a practical article by article breakdown of how NODE applies to SCIs, how it applies to LSIs and what the impact of CRR/CRD IV review might mean going forward.

¹² See also thought leadership by *Huertas* in "*Tackling non-performance: does the banking Union need a Pillar IV in the form of a single asset management company for the management of illiquid, non-performing assets and exposures?*" which first appeared in Volume 32 - Issue 3 of the *Journal of International Banking Law & Regulation*.

If you would like to receive more analysis from our wider Eurozone Group or in relation to the topics discussed above then please do get in touch with any of our Eurozone Hub key contacts below.

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