EUROPEAN CENTRAL BANK
BANKING SUPERVISION

PRESS RELEASE

11 July 2018

ECB announces further steps in supervisory approach to stock of NPLs

- ECB to address the stock of NPLs by setting bank-specific supervisory expectations for the provisioning of NPLs
- Aim is to achieve same coverage of NPL stock and flow over the medium term
- Bank-specific expectations are guided by individual banks' current NPL ratio and main financial features in a consistent way across comparable banks

The European Central Bank (ECB) today announced further steps in its supervisory approach for addressing the stock of non-performing loans (NPLs) in the euro area. The approach follows the work that has already been undertaken in this area, namely the banks' NPL reduction strategies, and the addendum for provisioning for new NPLs. It creates a consistent framework to address the stock of NPLs as part of the supervisory dialogue through bank-specific supervisory expectations aimed at achieving adequate provisioning of legacy NPLs thereby contributing to the resilience of the euro area banking system as a whole.

Under this approach ECB Banking Supervision will further engage with each bank to define its supervisory expectations. The bank-specific supervisory expectations are based on a benchmarking of comparable banks and guided by individual banks' current NPL ratio and main financial features. The aim is to ensure continued progress to reduce legacy risks in the euro area and achieve the same coverage of the stock and flow of NPLs over the medium term.

The decision follows a number of steps taken by the ECB to address the high levels of NPLs in the euro area. In March 2017, ECB Banking Supervision published guidance to banks on NPLs, which provided an effective toolkit for banks when tackling NPLs. As part of the guidance, high NPL banks were required to agree strategies to address NPL stocks. In March 2018, ECB Banking Supervision published an addendum to this guidance that set out supervisory expectations for the provisioning of new NPLs.

The work so far has led to significant progress in reducing NPLs with the NPL ratio of significant institutions decreasing from 8 percent in 2014 to 4.9 percent in Q4 2017. Nevertheless, the current aggregate level of NPLs remains far too high compared to international standards and further efforts are necessary to ensure that the NPL issue in the euro area is adequately addressed.

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