



Reform of the EU Banking Framework: Progress and Challenges

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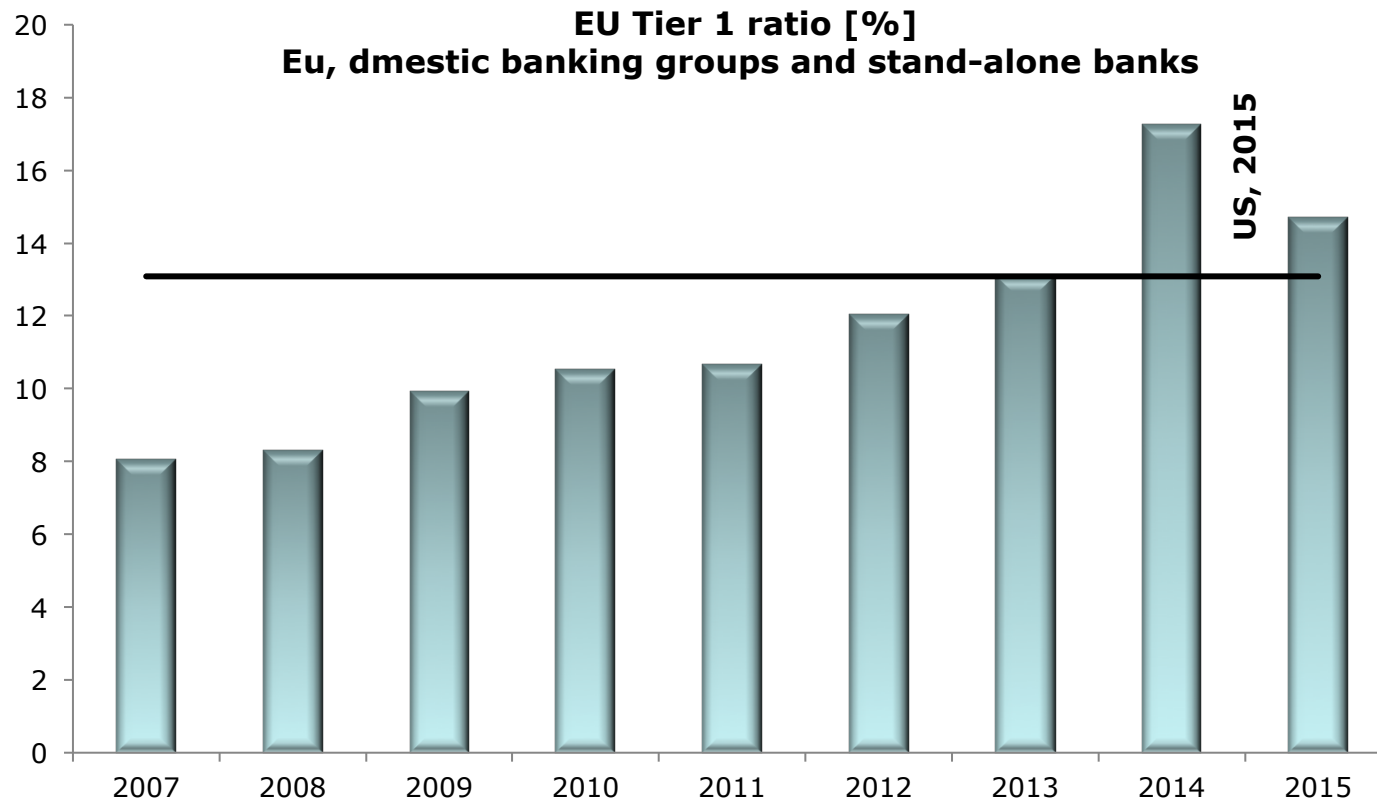
**Zagreb – Croatian National Bank
3rd March 2017**

Challenges of the EU Banking System

- What has been achieved so far
- Completing the Banking Union
 - TLAC/MREL
 - EDIS
- Dealing with NPLs

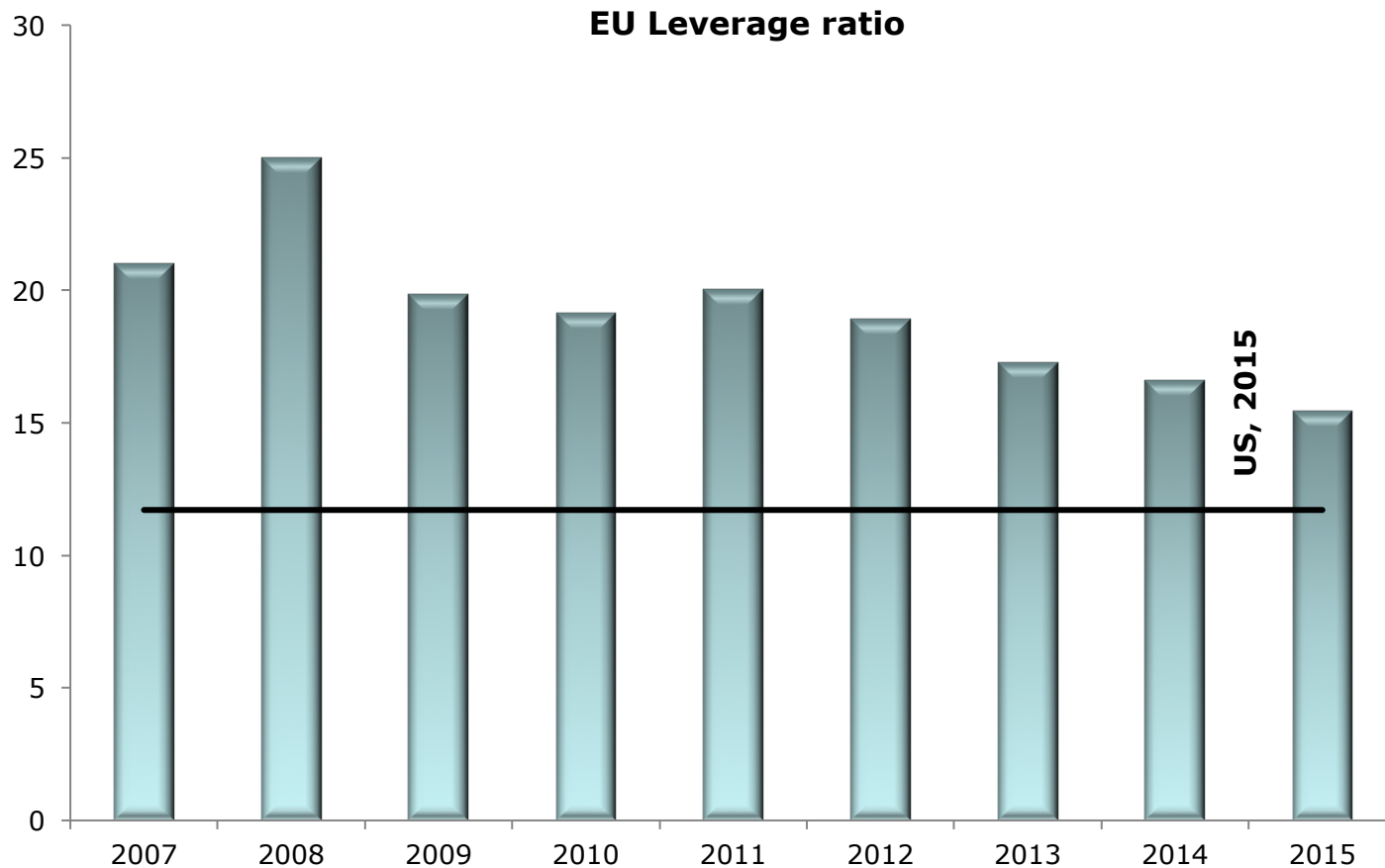
What has been achieved so far

European banks' capital levels



Source: ECB, IMF (for US)

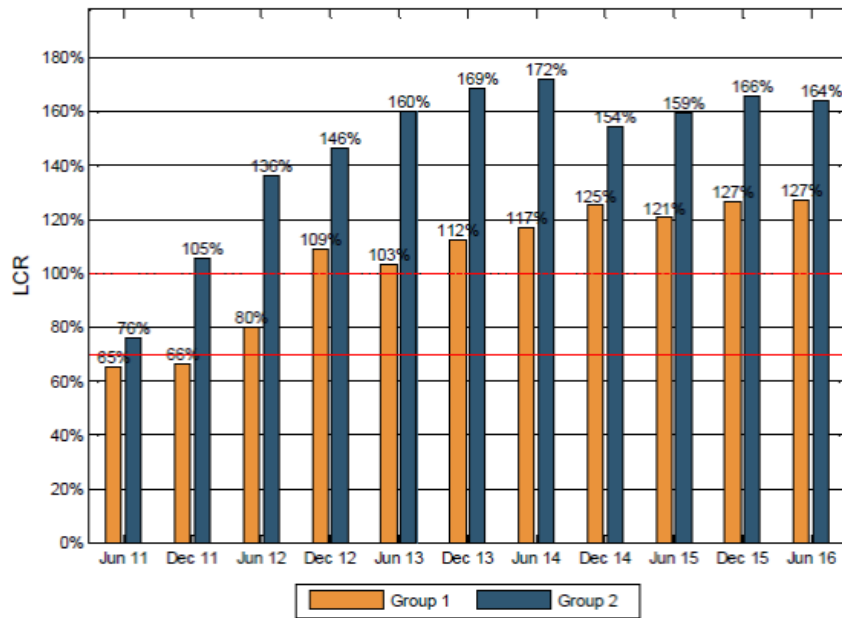
European banks' leverage ratio



Source: ECB, IMF (for US)

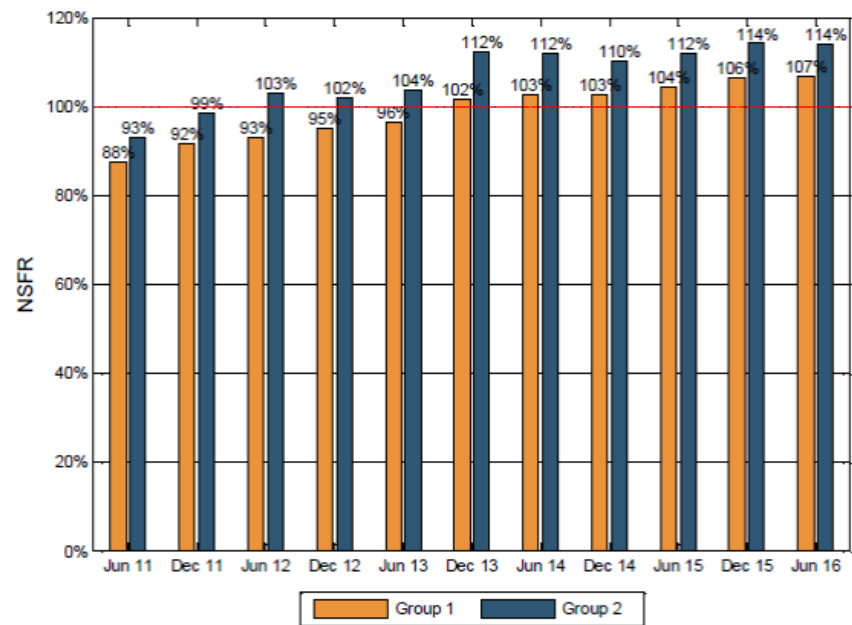
European banks' funding: more stable

Liquidity Coverage Ratio



Source: EBA QIS data (June 2016)

Net Stable Funding Ratio



Source: EBA QIS data (June 2016)

⁵ Group 1 banks are banks with Tier 1 capital in excess of EUR 3 billion and which are internationally active. All other banks are categorised as Group 2 banks. This report has classified Group 2 banks into sub-groups: large Group 2 banks

Source: EBA

A Croatian perspective

- Croatian economy in slow recovery from a long recession
- Croatian banks remain highly capitalized
- NPLs slowly beginning to decline, but still among highest in EU
- Economy is highly euroized
- Economic vs. prudential considerations

Completing the Banking Union

Key elements of the Banking Union

**Single
Supervisory
Mechanism**

**Single
Resolution
Mechanism**

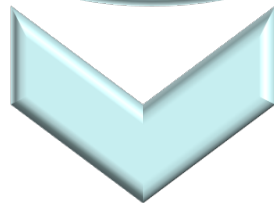
**European
Deposit
Insurance
Scheme**

**Single
Rule Book
(CRR/CRD IV, BRRD, DGSD)**

Roadmap for completing Banking Union

Risk Reduction

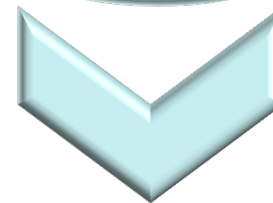
**CRR/CRD
IV, BRRD,
DGSD,
SSM, SRM**



**COM
Banking
Package**

Risk Sharing

SRF



**EDIS
SRF
Backstop**

Completing the Banking Union

TLAC/MREL

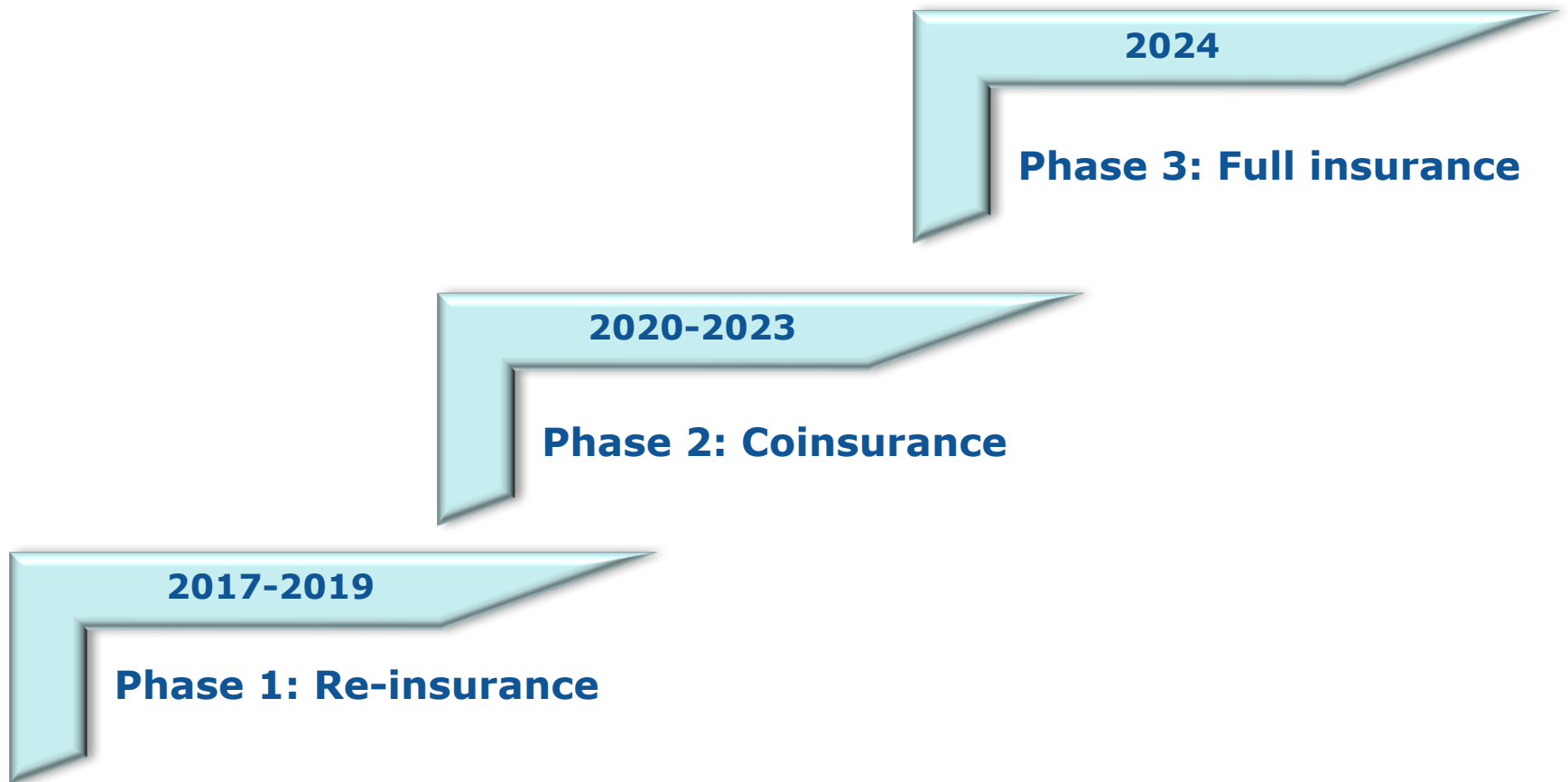
TLAC/MREL

- MREL already introduced by EU under BRRD on a firm-specific basis
- TLAC agreed at G20 level for G-SIBs, will come into force in 2019
- Commission proposes to integrate TLAC minimum requirement into existing MREL rules
- Minimum TLAC requirement (Pillar 1) through amendments to CRR
- Firm-specific add-ons for G-SIBs/non-G-SIBs through targeted amendment to BRRD

Completing the Banking Union

EDIS

Commission proposal for EDIS

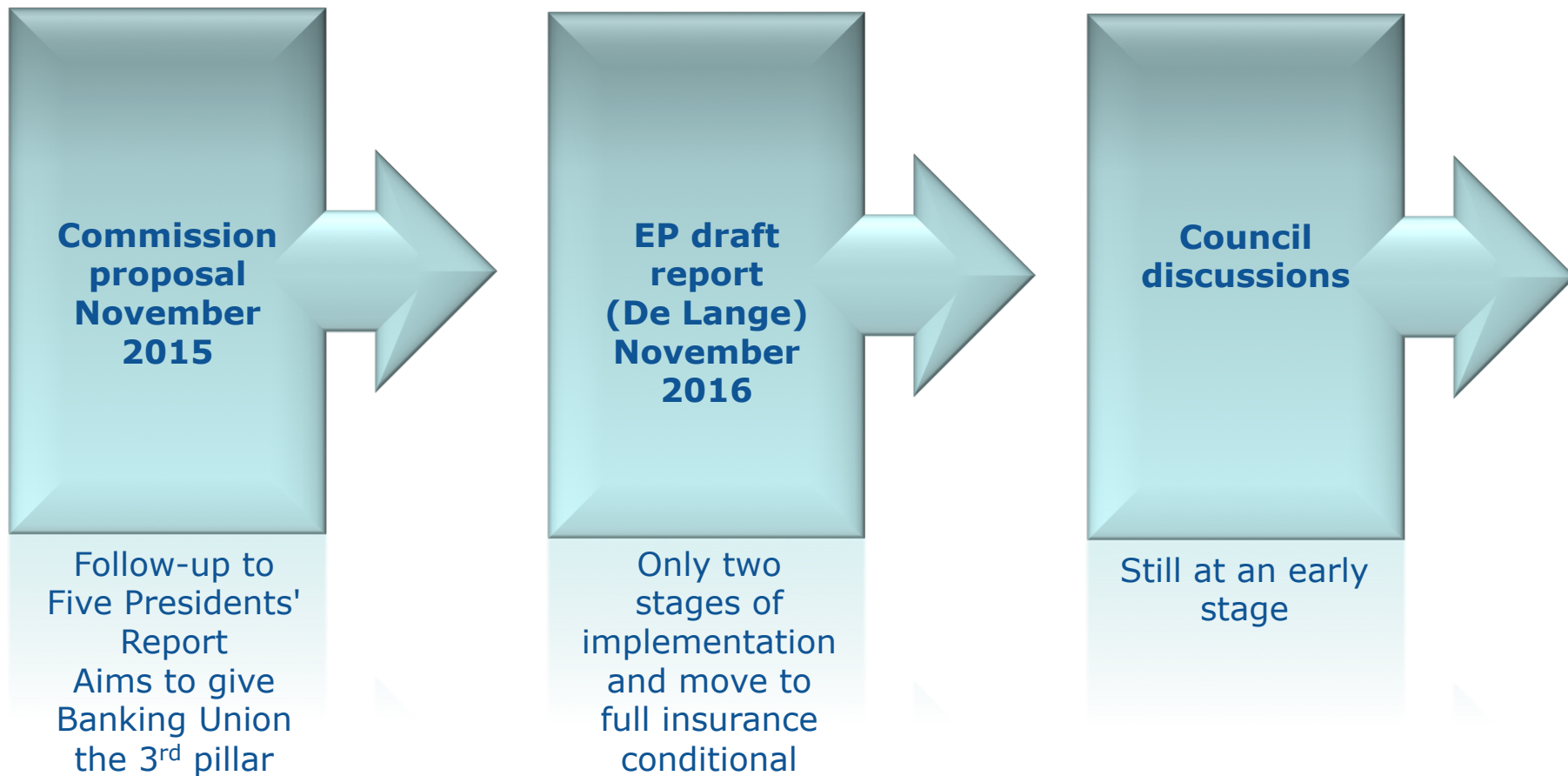


Why we need EDIS

National deposit guarantee schemes remain vulnerable to large, national shocks. By contrast, EDIS will

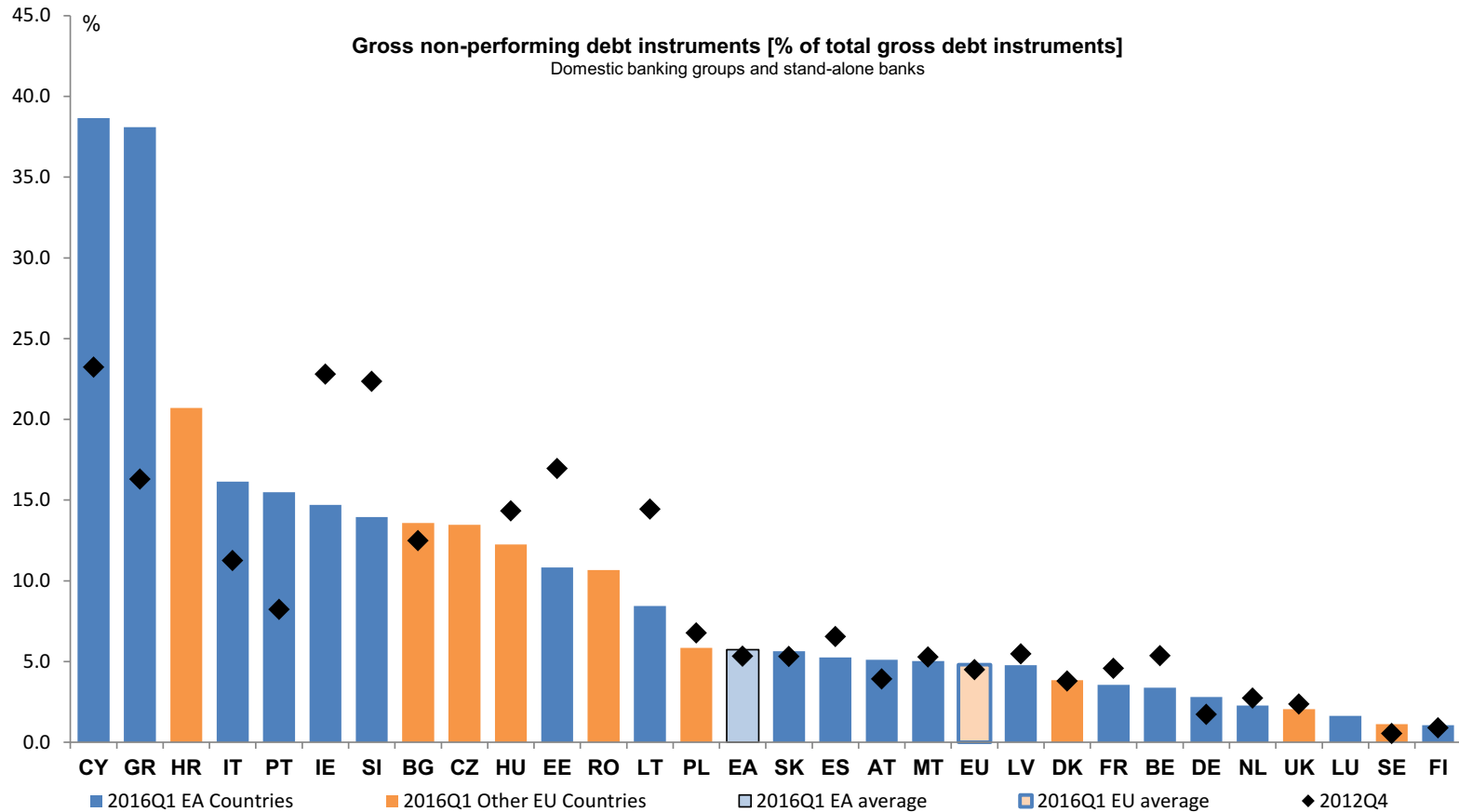
- Enhance resilience against future crises
- Align incentives across all pillars of the Banking Union
- Reinforce depositor confidence and promote financial stability
- Enhance free movement of capital – due to equal treatment of deposits across countries
- Reduce moral hazard by adding European dimension

EDIS: the roadmap



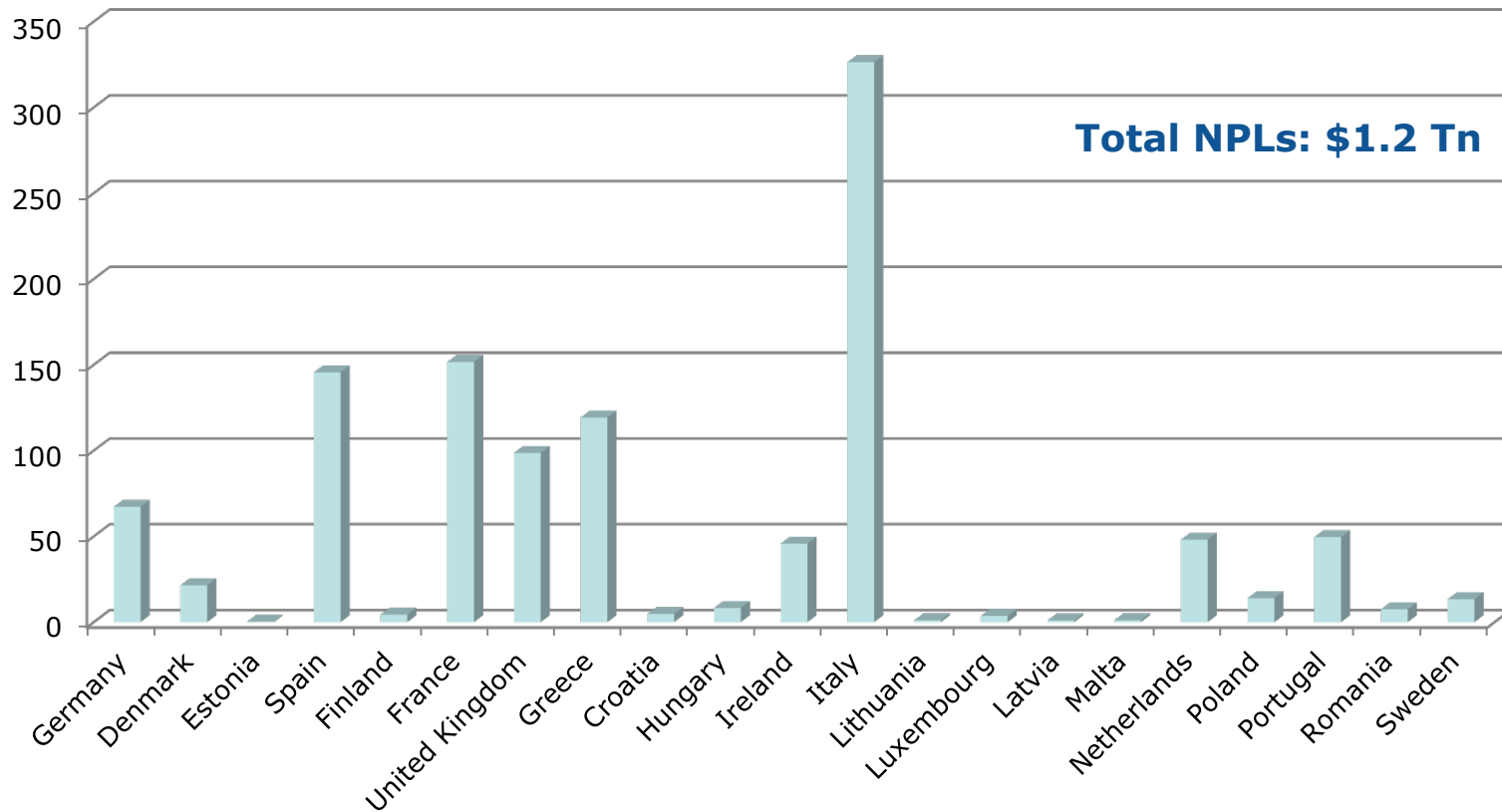
Dealing with NPLs

NPL ratio by Member State



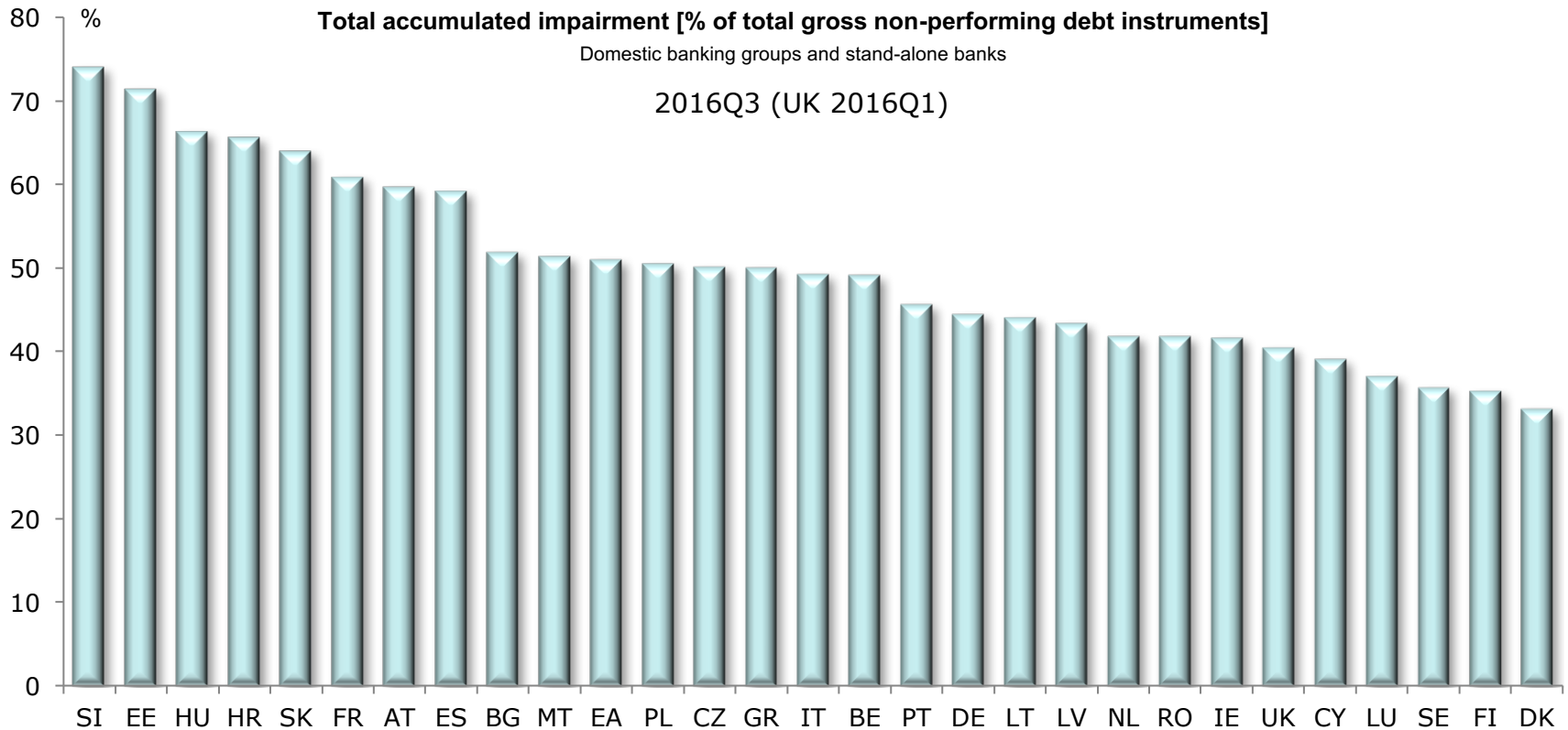
NPL level by Member State

EUR Bn



Source: ECB

NPL coverage ratio by Member State



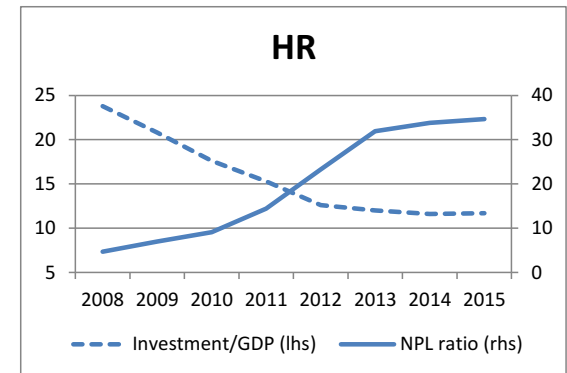
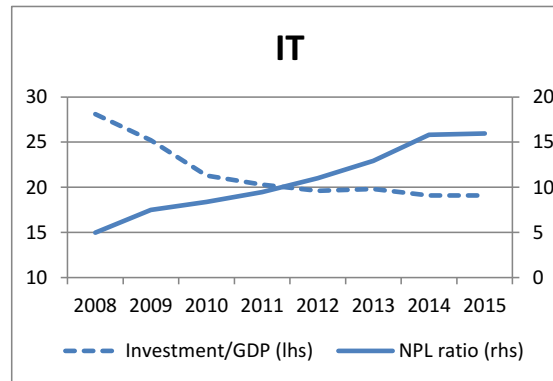
Source: ECB

Croatia: Financial CSRs and NPLs

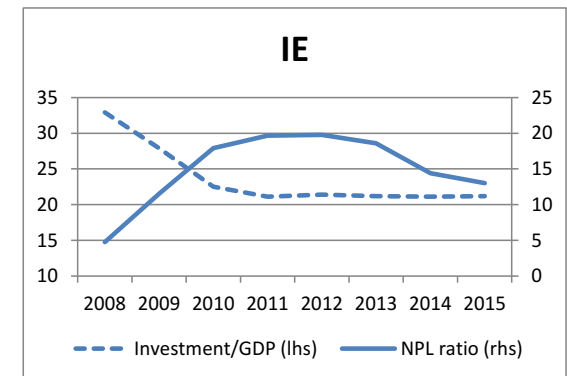
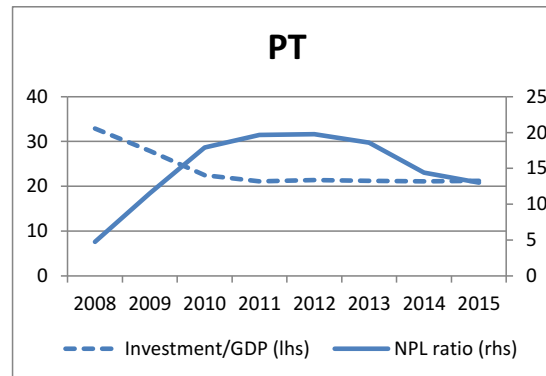
- **2016:** *Facilitate the resolution of non-performing loans, in particular by improving the tax treatment of the resolution of non-performing loans*
- **2015:** *Reinforce the pre-insolvency and insolvency frameworks for businesses in order to facilitate debt restructuring and put in place a personal insolvency procedure. Strengthen the capacity of the financial sector to support the recovery in view of challenges from high non-performing loans . . .*
- **2014:** *Complement the 2014 European Central Bank's asset quality reviews and stress test exercises, undertake a comprehensive portfolio screening exercise designed specifically for the Croatian financial sector*

NFC NPLs and investment

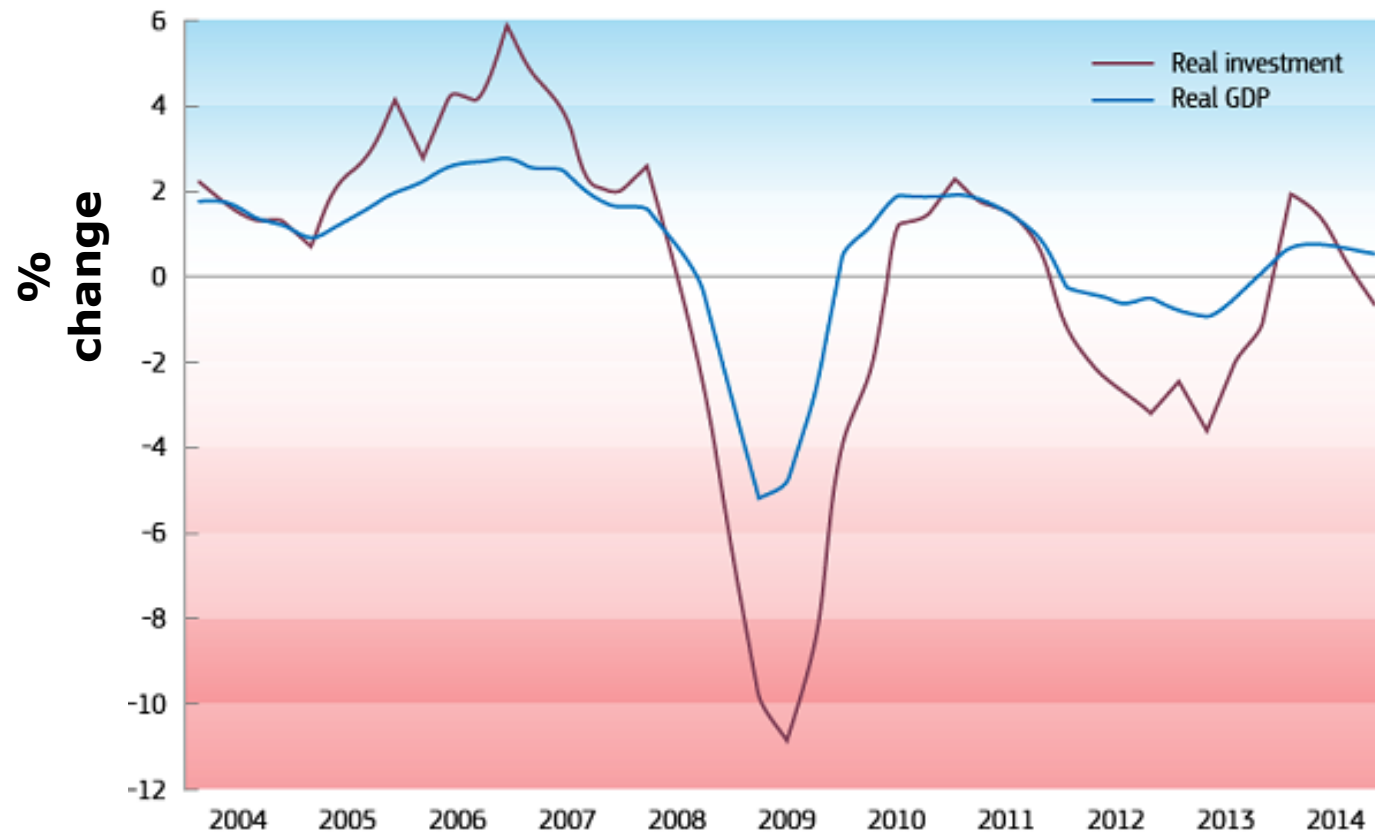
NPL build-up



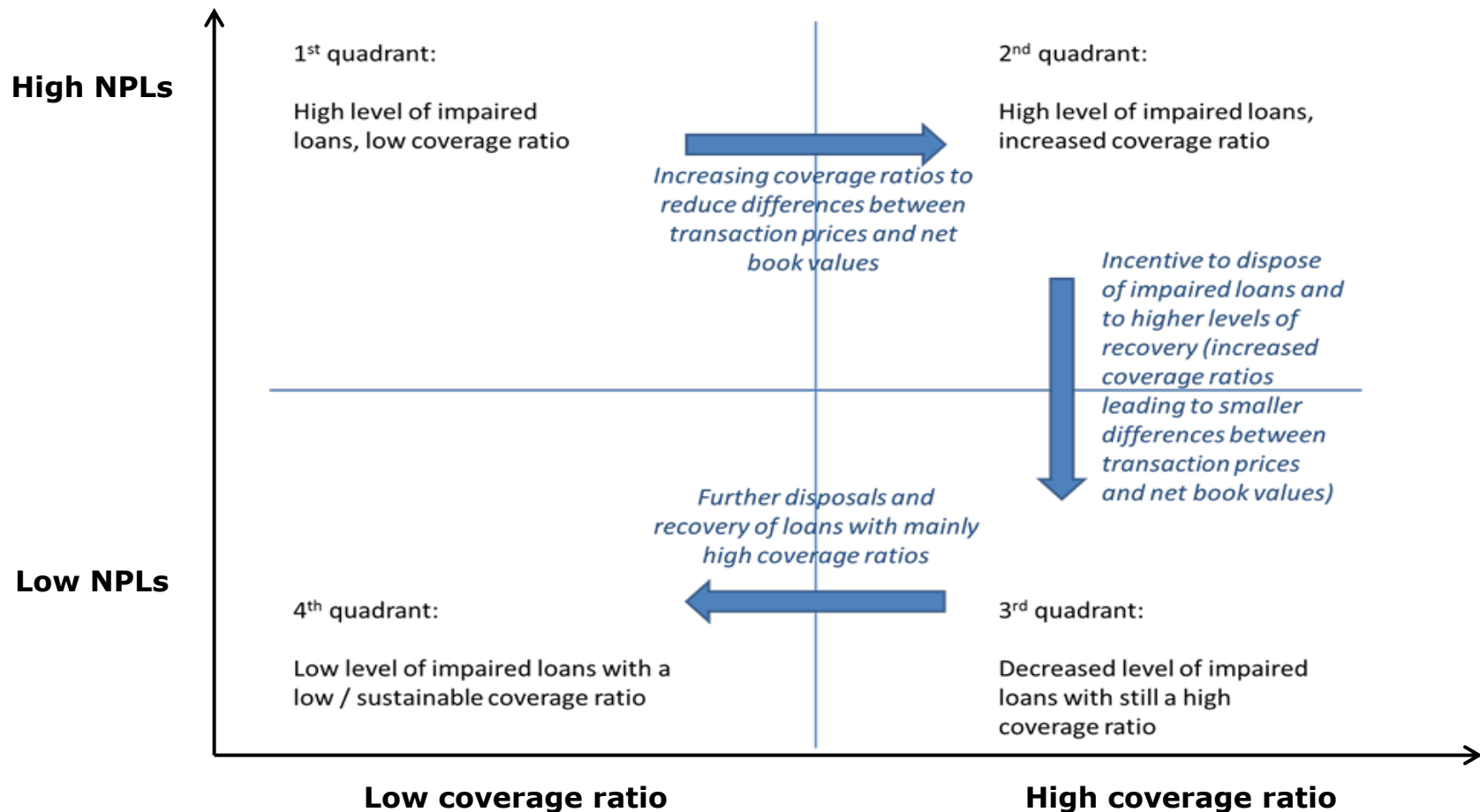
NPL work-out



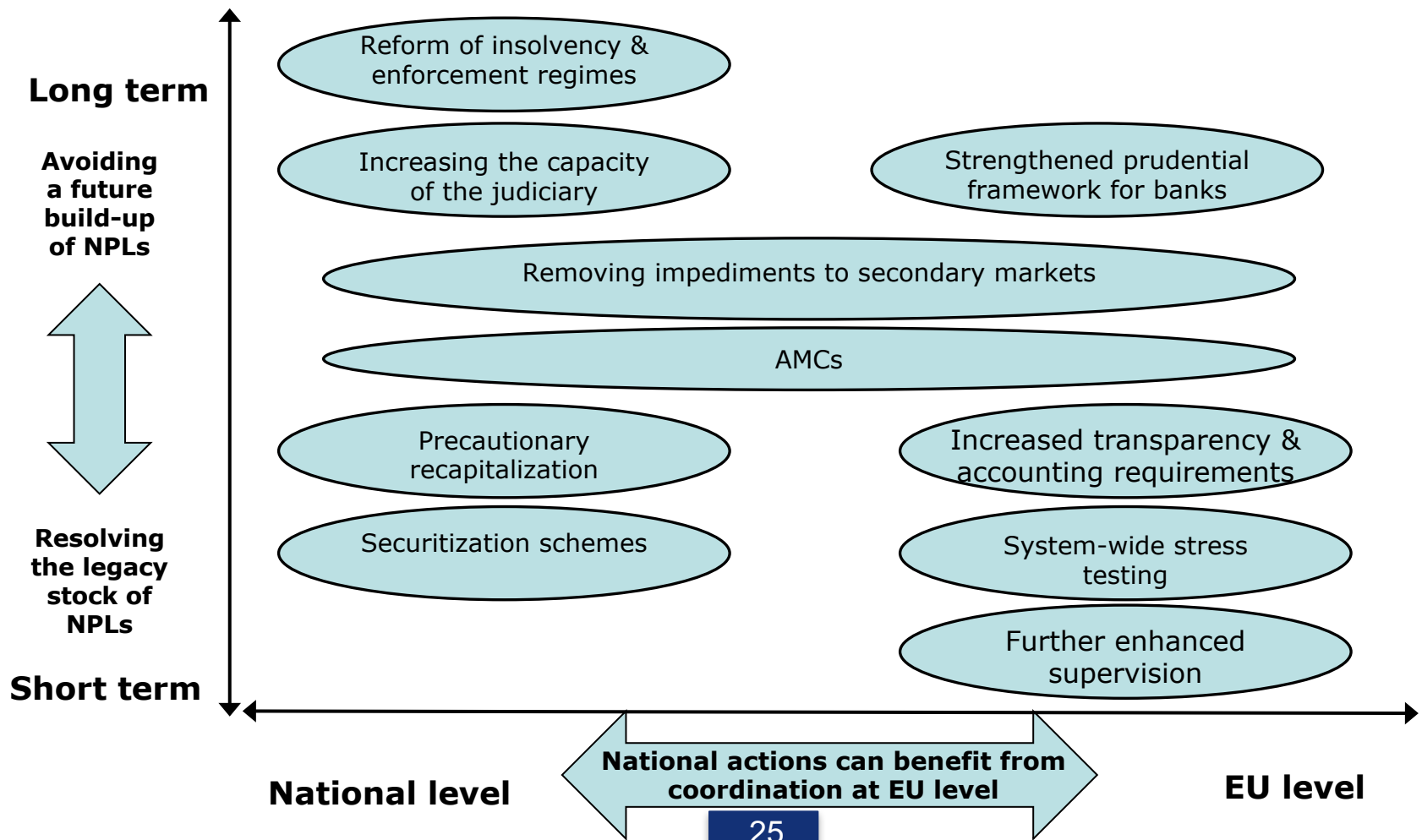
Investment and GDP growth



Towards a virtuous cycle of NPLs



NPL disposal: what strategy?



AMCs as precautionary recap

- It seems conceivable to provide a bank with aid in the form of precautionary recap to finance an AMC
- All the conditions in Article 32 BRRD/18 SRMR as well as in the State Aid framework must be complied with

Making it possible

- **Supervisory Guidance on NPL management (SSM-NCAs)**
- **(Internal/External) NPL Capacity Management (Banks)**
- **Transparency on asset quality (SSM-NCAs)**
- **Insolvency, foreclosure and judicial frameworks (MS)**
- **Secondary markets and AMC**
- **State-aid: viability, burden sharing*, competition**
- **Precautionary Recap: state-aid in BRRD without resolution**

(*) To address already incurred losses and losses to be incurred in the near future

Making it possible

Table 1 – Number of closed and open bad loan positions
(annual data; number of positions and per cent)

Year	Num. of closed positions	Num. of new positions	Num. of positions outstanding in each year	Num. of closed/ outstanding positions at the start of the year (%)
2006	198,588	158,713	547,175	36.3
2007	161,209	189,720	575,686	28.0
2008	123,615	176,769	628,840	19.7
2009	133,976	183,033	677,897	19.8
2010	128,168	233,966	783,695	16.4
2011	145,538	199,196	837,353	17.4
2012	128,653	230,694	939,394	13.7
2013	112,331	228,153	1,055,216	10.6
2014	287,685	341,271	1,108,802	25.9
2015	257,965	325,488	1,176,325	21.9
TOTAL	1,677,728	2,267,003		
Media	167,773	226,700	833,038	21.0

SSM AQR 

Conclusions

- We are much better off than we were before
- But we still need to work on remaining challenges:
 - *system-wide*: complete the Banking Union
 - *idiosyncratic* (bank-by-bank): deal with NPLs