European banks

Brussels seeks to help banks offload rising tide of bad loans

Paper will set out ideas for how to tackle forecast increase in corporate distress

European banks are facing a surge in pandemic-related corporate insolvencies © Yves Herman/Reuters

Sam Fleming in Brussels and **Martin Arnold** in Frankfurt NOVEMBER 29 2020

Brussels is planning to lay out a raft of proposals in a bid to make it easier for EU banks to offload soured loans as it anticipates the risk of a pandemic-related wave of corporate distress.

A European Commission paper due to be published in December will discuss ideas including boosting secondary markets for buying and selling non-performing loans (NPLs) and creating a network of national bad banks across the EU. It will also seek to tackle anomalies in the bank capital regime for distressed assets.

Europe is braced for a surge in insolvencies once national business support programmes lapse next year. Brussels officials told the Financial Times that the commission wanted to avoid the mistakes made in the last financial crisis more than a decade ago, when a failure to quickly tackle NPLs impaired banks' ability to bolster lending once the recovery gathered strength.

"Drawing lessons from the last severe economic crisis, it is imperative to address a renewed build-up of NPLs on banks' balance sheets — as early as possible — in order to combat the implications of the pandemic," the commission said.

"Further structural measures" might be needed to "prevent the accumulation of NPLs over the medium term", the commission said.

The report has not yet been completed and is expected to be released in the middle of the month. It is being spearheaded by new financial services commissioner Mairead McGuinness.

A key focus is on the private market for the sale and purchase of bad loans, as officials seek to ensure banks can offload NPLs and keep their books in order.

The European Banking Authority has put forward data templates to help investors analyse NPLs, but these are not heavily used, and officials want to boost uptake and further enhance information available to investors — something the European Central Bank has long advocated.

Among the ideas in play are making the templates mandatory or creating a central data hub for the region. Brussels also wants to tackle discrepancies in the risk weights attached to NPLs in standard bank models, which can vary depending on whether the assets are being bought and sold. It will discuss best practices in national insolvency and debt recovery regimes.

Although it will float the idea of a network of national asset management companies, a proposal for a Europe-wide bad bank set out by Andrea Enria, chair of the ECB's supervisory arm, has not won traction in Brussels.

Bad banks were used to clean up Spanish and Irish banks after the 2008 financial crisis, but lawyers have questioned whether they could in some situations trigger more recent rules requiring bondholders to be wiped out before public money is used to rescue a bank.

Mr Enria warned in October that "in a severe but plausible scenario non-performing loans at euro area banks could reach €1.4tn, well above the levels of the 2008 financial and 2011 EU sovereign debt crises".

Nicolas Véron, a senior fellow at the Peterson Institute for International Economics, said that while there was a plausible scenario under which there would be a jump in NPLs next year, it was hard to make a confident assessment in advance.

"There are certainly concerns at this stage that the secondary market for distressed assets is not functioning as well as it could, that there are not enough buyers out there," he said. "The market is by no means frozen, or dead, but if you take steps like creating an optional public platform it can only help."

The eurogroup of finance ministers will on Monday attempt to strike a deal aimed at bolstering the single currency area's banking sector by agreeing on the early implementation of a long-awaited backstop to its bank resolution fund.

One of the key questions remaining to be resolved is whether banks in southern Europe are deemed by northern capitals to have made sufficient progress in paring back risks on their balance sheets, including by reducing NPLs.

Total NPLs in the biggest 121 eurozone banks more than halved in six years to €506bn, or 3.2 per cent of their loan books, by the end of last year. But Greek banks still have NPL ratios of more than 30 per cent.

The ECB warned in its twice-yearly financial stability review last week that “the economic fallout from the pandemic will likely continue to weigh on banks’ asset quality in the latter part of 2020 and into 2021”.