European Economic and Social Committee

**ECO/540**
**Tackling non-performing loans in the aftermath of the COVID-19 pandemic**

# OPINION

European Economic and Social Committee

**Communication from the Commission to the European Parliament, the Council and the European Central Bank**
**Tackling non-performing loans in the aftermath of the COVID-19 pandemic**
[COM(2020) 822 final]

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## 1. Conclusions and recommendations

1.1 The EESC welcomes the presentation of the new Commission Action Plan (communication) on non-performing loans (NPLs), but regrets that it essentially lacks new proposals fit for COVID-19 times, leaving Europe to face an extraordinary time with rules written for ordinary times. As such, the EESC recommends tackling first and foremost the root causes of NPLs in order to prevent their build-up in the future, and also proposes a careful review and temporary adaptation of the definition of default, ensuring a "soft landing" for European households and businesses. The EESC notes that in the present COVID-19 crisis, there is a need for monetary and fiscal policy and financial sector regulation to be coherent with the times we live in.

1.2 Tackling the root causes of NPLs is paramount. The EESC stresses that the most effective ways to avert the build-up of high volumes of NPLs by households and SMEs alike are: ensuring that we strive constantly to improve competitiveness, focusing on business continuity and economic recovery, building solid social security systems, combating poverty, over-indebtedness and unemployment, guaranteeing adequate wages and implementing countercyclical economic policy measures in times of crises. Through these steps, we can maintain and strengthen financial market stability and economic resilience, whilst tackling poverty and massive inequality at the same time.

1.3 The EESC argues that "pre-COVID-19" NPLs should be dealt with in a very different manner to "post-COVID-19" (COVID-19-induced) NPLs due to the completely different circumstances before and after March 2020. The EESC accordingly suggests a careful, targeted and strictly temporary review of the EBA guidelines on the definition of default. The EESC also recommends that the EBA Guidelines on credit moratoria stay in place as long as needed.

1.4 The EESC calls for relief measures for credit institutions to go hand in hand with governmental aid measures for borrowers who have only become distressed as a result of the pandemic. Among the measures that should be used in this situation are deferrals with maturities of one to three years, interest rate rebates, restructuring of debt to less expensive forms of credit and moratoria on loan repayments, where possible. The EESC is in favour of this internal workout process.

1.5 The EESC notes that the need for a pan-EU, cross-border NPL market is overstated. Therefore, the Committee is concerned with plans to provide an EU-wide operating "passport" to debt collectors without proper supervision from both their "home" and "host" countries. This move could only be justified if there is a counterbalancing set of measures helping protect distressed borrowers – an EU-wide consumer protection standard for debt collectors.

1.6 Another pillar of the Action Plan is related to – the proposal for AECE – accelerated extra-judicial collateral enforcement, which is strictly limited to corporate loans and applicable only if a prior voluntary agreement between the parties has been achieved when concluding the loan contract. The EESC notes that AECE could provide a balanced solution for debtors but demands that extra-judicial enforcement does not becomes a default option in the loan contracts.

1.7 The EESC strongly urges against fusing the NPL issue, reflecting a widespread phenomenon in the economy, with issues related to preserving financial stability. To maintain the moral and operational integrity of the banking sector, these two issues should be addressed separately.

1.8 The EESC calls for the option of selling NPLs to asset management companies (AMCs, which are also colloquially referred to as "bad banks") to remain an exceptional case and for preference to be given to bilateral workout agreements between the credit institution and the borrower, in which case the solution should be focused on business continuity and economic recovery. The EESC highlights that any use of "precautionary recapitalisation", if funded with public money, is likely to divert public funds away from other more socially and economically useful aims. The EESC also underlines the need for any "precautionary" measures to be used in a highly responsible manner, in order to avoid moral hazards and bank bailouts at society's expense by using public money.

1.9 In light of the current situation, where potentially viable businesses might run into payment difficulties in spite of their "pre-COVID-19" creditworthiness, the EESC suggests a careful review of EBA guidelines on the definition of default, which could give COVID-19-induced distressed debtors a chance to recover before their loans are considered non-performing. However, the EESC stresses that any such changes must be **strictly temporary**, they should not interfere with detailed and accurate identification and reporting of credit risk by banks and they should be done in accordance with the fundamental need to ensure the stability and solvency of the banking sector.

1.10 The EESC broadly recommends that capital requirements – including the NPL backstop regulation – be kept firmly in place. This will ensure that banks have full capacity to withstand losses and will decrease the likelihood of future public interventions (such as "precautionary recapitalisation") and bank bailouts at the taxpayer's expense. However, temporary flexibility could be looked into and applied to the definition of default and the provision of the NPL backstop in order to mitigate the effects of the COVID-19 crisis.

## 2. Background

2.1 The European Commission's NPL Action Plan, announced in December 2020[1], is intended to prevent a future build-up of NPLs across the European Union as a result of the COVID-19 crisis. A loan becomes non-performing when it is unlikely to be repaid, or when the borrower is 90 days late on a payment. Due to the pandemic, the European Central Bank estimates that in a severe scenario with a much weaker and protracted recovery, the sum of NPLs held by euro area banks could reach "up to EUR 1.4 trillion"[2].

1 COM(2020) 822 final.

2 1 October 2020 speech by Andrea Enria, chair of the Supervisory Board of the ECB. NPLs amounted to nearly EUR 1 trillion at the end of 2016, equivalent to 5.1% of total bank loans. Using 2019 data for reference, the EUR 1.4 trillion portfolio of NPLs would constitute approx. 12% of Euro area GDP.

2.2 In July 2017, the Action Plan to Tackle Non-Performing Loans in Europe was unveiled[3], and, in the course of a few subsequent years, it helped to address and reverse the build-up of NPLs in banks. A subsequent Communication on completing the Banking Union[4] followed.

2.3 In March 2018, the European Commission introduced a legislative proposal[5] to spur on the development of the secondary market of NPLs in the EU. The draft directive should help banks sell their NPL portfolios easily to third party investors anywhere in the EU. The proposal also introduces an out of court enforcement procedure called "accelerated extra-judicial collateral enforcement". The draft directive is still a work in progress, although the two issues have been detached in separate legislative acts.

2.4 With the outbreak of the COVID-19 pandemic, the Commission reacted swiftly by enacting measures to help the banking sector deal with the expected and upcoming NPL build-up. The Banking Package in April 2020 has already provided substantial short-term support[6] to the banking sector, including rules on how banks assess the risk of a borrower not able to repay the loan, or prudential rules for the classification of non-performing loans, and the accounting treatment of delays in repayments. Banks have also been benefiting from significant liquidity support measures (ECB Pandemic Emergency Purchase Programme[7] and the easing of conditions for targeted longer-term refinancing operations, TLTRO III, in March 2020). Now it is time to think about the solvency levels of European firms.

2.5 The accompanying Capital Markets Recovery Package provided the banking sector with further support by removing regulatory obstacles to the securitisation[8] of NPLs.

2.6 In recent months, the European banking sector has benefited from regulatory relief and liquidity support measures aimed at safeguarding financial and economic stability and supporting European households and companies. Consequently, the banking industry has continued to lend to their clients and no credit crunch has occurred.

2.7 Member States have also taken decisive action, with support schemes to alleviate liquidity difficulties affecting households and businesses. These schemes typically involve public guarantee schemes and/or payment deferrals ('moratoria'). These measures help borrowers with temporary liquidity problems and prevent an immediate surge in non-performing loans (NPLs). The Commission has also adopted a Temporary Framework to enable Member States to use the full flexibility provided for under State aid rules to support the economy during the COVID-19 outbreak.

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3 *Action Plan to Tackle Non-Performing Loans in Europe*, ECOFIN Council, July 2017. https://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/.

4 **Error! Hyperlink reference not valid.**COM(2017) 592 final

5 Directive on credit servicers, credit purchasers and the recovery of collateral, COM/2018/0135 final - 2018/063 (COD).

6 COM/2020/169 final.

7 https://www.ecb.europa.eu/mopo/implement/pepp/html/index.en.html.

8 COM(2020) 822 final and COM(2020) 283 final.

## 3. General comments

3.1 The EESC notes that the current Commission Action Plan (communication) follows and reiterates the same measures already contained in the 2017 plan. It essentially lacks new proposals fit for COVID-19 times, leaving Europe to face an extraordinary time with rules written for ordinary times. The EESC argues that "pre-COVID-19" NPLs should be dealt with in a very different manner to "post-COVID-19" (COVID-19-induced) NPLs due to the completely different circumstances before and after March 2020. The EESC accordingly recommends a careful, targeted and strictly temporary review of the EBA definition of default, to avoid the automatic classification of debtors as defaulted and to mitigate the procyclical effects of the current regulation and ensure a "soft landing" for European households and businesses.

3.2 The pandemic led to a reduction of demand and consumption, which created concerns for SMEs in terms of finding customers. While access to finance is currently not reported by SMEs (in ECB surveys[9]) as the most pressing problem, all the issues that SMEs are facing should be considered when tackling NPLs.

3.3 The EESC consistently advocates[10] for non-performing loans to be reduced in a socially sustainable way while preserving financial stability[11]. During COVID-19 times, this is now more important than ever. In contrast to what happened a decade ago during the 2008-2009 financial crisis, the current expected NPLs surge is not the fault of the financial sector or any other specific category of players within the economic system, but it is not the fault of the "real economy", governments or European citizens either. The intervention of EU-level regulators and Member States' governments with the right tools is critically important.

3.4 While the EESC acknowledges that there are certain advantages to developing secondary markets for NPLs, the Committee would favour bilateral workout agreements between the credit institution and viable borrowers. Although NPL volumes on banks' balance sheets can be reduced via sales to credit purchasers, this does not mean that NPL sales are optimal from a borrower's perspective or for society as a whole. NPL sales should be a last-resort solution.

3.5 Tackling the root causes of NPLs is paramount. The EESC stresses that the most effective ways to avert the build-up of high volumes of NPLs by households and SMEs alike are: ensuring solid social security systems, combating poverty, over-indebtedness and unemployment, guaranteeing adequate wages and implementing countercyclical economic policy measures in times of crises, while enhancing productivity and the competitiveness of the European economy, focusing on business continuity and economic recovery, with a clear and updated regulatory framework that gives visibility to long term investments. Through these steps, we can maintain

9 https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/ecb.safe202011~e3858add29.en.html

10 OJ C 353, 18.10.2019, p. 32

11 Financial institutions are expected to "continue identifying and reporting asset quality deterioration and the build-up of NPLs in accordance with the existing rules, so as to maintain a clear and accurate picture of risks in the banking sector ", as expressed in a letter from the ECB of 4 December 2020. In addition, the ECB warns that "from a prudential perspective, sound staging and provisioning policies and procedures are key to ensure adequate credit risk management and coverage, including the timely identification and management of distressed debtors".

and strengthen financial market stability and economic resilience, whilst tackling poverty and inequality at the same time. In this light, the EESC recommends that the EBA Guidelines on credit moratoria stay in place as long as needed and suggests a careful, targeted and strictly temporary review of the definition of default.

3.6 In the EESC's view, the Action Plan reflects the basic logic that nowadays banks act as an essential infrastructure in the monetary-flow-based economy in Europe, and that the health and stability of the banking sector is a necessary prerequisite for economic recovery. As the Commission puts it in the related communication[12], "making sure that European citizens and businesses continue to receive support from their banks is a top priority for the Commission". In this context, the EESC points to the decisive role of the ECB in safeguarding banks' stability and credit supply, and notes that the European economy is supported by measures that are intended to ensure that lending would be provided to solvent credit demand.

3.7 The EESC notes that reliable data on NPLs are partially missing and that much uncertainty remains as to the future of COVID-19 vaccination, SARS-CoV-2 virus mutations (COVID-19 variants), lockdown measures and economic recovery. The EESC stresses the importance of data quality to properly assess the extent of the problem and the identification of viable firms. The EESC, therefore, calls for caution and for measures that could get the European economy back on its feet quickly, such as measures to support small businesses and to guarantee adequate wages and solid social security systems. The EESC points out that banking sector deposits have increased substantially[13], which means that there is good potential for consumer demand in the months following the lifting of lockdown restrictions.

3.8 It remains to be seen how firms and households which "have come under significant financial pressure due to pandemic"[14], can be assisted by banks ("receive support from their banks"[15]) if the rise in NPLs is addressed. The proposed changes or regulatory easing are currently not conditional on banks' lending to solvent SMEs or households. The EESC regrets that, except for the banking sector, the Commission's Action Plan provides few new measures to help ailing economic actors. In the face of the external economic shock making many workers and companies even more dependent on loans, support and mitigating measures for banks should be aimed at lending more to solvent SMEs and households. At the same time, authorities should establish adequate safeguards to prevent irresponsible lending and subsequent over-indebtedness.

3.9 The EESC recommends acknowledging civil society as a whole as stakeholders in the field of financial market regulation. In particular, with regard to tackling of NPLs in the aftermath of the

12 https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2375. Valdis Dombrovskis, Executive Vice-President for an Economy that Works for People, hopes that the strategy "will help contribute to Europe's … recovery by helping banks to offload these [NPL] loans from their balance sheets and keep credit flowing".

13 Total euro area deposits by non-financial corporations increased from EUR 2.73 trillion (March 2020) to EUR 3.12 trillion (October 2020) despite the pandemic. The same figure for households increased from EUR 7.85 trillion to EUR 8.21 trillion respectively. (https://sdw.ecb.europa.eu).

14 Commissioner responsible for financial services, financial stability and the Capital Markets Union - Mairead McGuinness, https://ec.europa.eu/commission/presscorner/detail/en/ip_20_2375.

15 Ibid.

pandemic, NPLs have several impacts, also affecting, for example, workers' interests in their role as debtors, employees in indebted companies, financial sector employees or taxpayers (especially relevant in the case of public funds being used to tackle NPLs).

3.10 The EESC notes that the need for a pan-EU, cross-border NPL market is overstated despite the fact that the banking sector is steadily moving towards an EU-wide Banking Union. It is highly questionable whether the cross-border operations of credit purchasers provide tangible economic benefits for the economic system overall, and not just for banks, credit purchasers and credit servicers (while it is true that the latter may definitely gain from economies of scale).

3.11 In that context, the EESC also underlines that distributing the risk may not lead to a reduction of it. On the contrary, the 2008-2009 financial market crisis taught us that this may result in a non-transparent accumulation of risk in the economy. The EESC urges that the objective of all measures dealing with incentives for the financial sector should be to discourage market players from taking too much risk.

3.12 At the same time, the EESC highlights that European businesses, households, workers and civil society require resources and full support to withstand the crisis and thus such support measures should be put forward by the EU. Such assistance should be available over a period of up to three years (as per the Next Generation EU stimulus package) to support businesses and borrowers that were deemed healthy and creditworthy prior to the pandemic. Virtually the entire population of Europe is affected by the rising socio-economic insecurity. Businesses experience disruption due to forced closures and reduced demand, while households are confronted with unemployment and a fall in income. The EESC believes that European citizens and businesses would need an entirely different kind of measures and obviously not the fast enforcement of the NPL framework as the Commission proposes.

## 4. Specific comments

4.1 The Commission is convinced that the agreement on the proposal for a directive on credit services and credit purchasers, in essence creating a common secondary market for NPLs, is a top priority. The EESC is concerned with plans to provide an **EU-wide operating "passport"** to debt collectors without proper supervision from both their "home" and "host countries. This move could only be justified if there is a counterbalancing set of measures helping protect distressed borrowers – an EU-wide consumer protection standard for debt collectors. The EESC is also concerned that the proposal for a directive on credit servicers and purchasers[16] would prevent states from enacting any other or further requirements for credit servicers and purchasers, even if such requirements were deemed to protect debtors. If "home" and "host" supervision is ensured, consumer protection rules are observed, "best practice" guidelines are provided via the EBA and a uniform approach to such activities is envisaged, most of the issues raised here would be addressed. Considering such arguments, in order to make the EU-wide operating passport functional, borrower protection rules have to be stepped up to avoid the above-mentioned risks.

16 See Article 5, Article 11, in particular Article 11(5) and Article 15(2) of the proposal for a directive.

4.2 The EESC notes that certain credit purchasers and debt collectors have a bad reputation – hence why some credit purchasers are called "vulture funds" – and underlines that providing the EU-wide operating "passport" to debt collectors without proper supervision from both their "home" and "host" countries, and without proper "best practice" guidelines being implemented in a timely and effective manner throughout EU, might lead to improper business conduct by such credit purchasers or credit servicers, to the detriment of distressed borrowers. The EESC also highlights the need to ensure that the proposal for a directive on credit servicers and purchasers does not prevent states from enacting additional legal requirements for credit servicers and purchasers, thus guaranteeing that the "gold-plating" principle is observed properly in this case.

4.3 In addition, some credit purchasers are known to have tax avoidance issues. For example, in Ireland, some of them are registered as charities and pay almost no taxes. The EESC calls on the European Commission to step up its efforts in tackling the issue of tax avoidance.

4.4 Another pillar of the Action Plan is related to the proposal for AECE – **accelerated extra-judicial collateral enforcement** –, which is strictly limited to corporate loans and applicable only if a prior voluntary agreement between the parties has been achieved when concluding the loan contract. The EESC acknowledges that households (private consumers) are excluded from this procedure and notes the need to achieve a balance between AECE tool and Directive (EU) 2019/1023 and insolvency procedures. The EESC notes that he AECE could provide a balanced solution for debtors but demands that extra-judicial enforcement does not becomes the default option in the loan contract. It should be ensured that distressed businesses are not left helpless and do not lose access to the standard judicial system with its checks and balances, developed on the basis of age-long tradition. In the EESC's view, systematic collateral recovery delay issues should be dealt with on a country-by-country basis, by carrying out well-prepared reforms and with targeted interventions by Member States where bottlenecks persist.

4.5 The EESC agrees with Commission's statement that "[...] banks should be incentivised as much as possible to apply a proactive approach to engage with their debtors early and constructively", as this will avoid harming viable firms and ensure business continuity. However, the Committee calls on the Commission to put forward tangible measures to deliver on this vital objective.

4.6 The EESC welcomes the initiative to further converge the various insolvency frameworks across the EU and notes that such convergence is beneficial not only for the banking business but for the whole entrepreneurial landscape in Europe overall. Such a convergence should not necessarily be tied to the NPL issue. It should be noted, however, that this measure will not help in the short term and will not provide much help in the aftermath of the COVID-19 crisis. Certainty over rules regarding creditor and debtor rights and greater harmonisation of collateral removal procedures across Member States will reduce risks and provide further impetus for cross-border investments and internal trade. The EESC stresses that when reforming insolvency frameworks, due consideration should be given to borrowers.

4.7 The EESC points out that the secondary market for NPLs in no way helps businesses flourish, nor does it sustain jobs or allow closed undertakings to reopen. For businesses to re-start, targeted state-funded measures are fundamentally important. The EESC believes that lending to an economy suffering from an unprecedented loss of output due to COVID-19-induced lockdowns is crucial, yet such lending should not turn into on excessive one, which may not prove sustainable.

4.8 However, the proposal the Commission is pushing for – the pan-EU secondary market and, to a lesser extent, AECE – raises fears that a single secondary market for NPLs in Europe will open up room for abuse and leave bank customers vulnerable to "vulture funds", the majority of which are not of EU origin. The EESC recommends more transparency and proper rules so as to ensure that consumers are protected from abuses by credit servicers, credit purchasers or "vulture funds".

4.9 The EESC advocates that credit investors and debt collectors should not be given an EU-wide operating "passport" if they buy consumers' (private customers) NPLs. It could be examined whether the debt of micro-enterprises should be exempted too.

4.10 The emphasis on **NPL data standardisation** across the EU is welcome, but it is not sufficient given the task and, in principle, it is not very relevant. The EESC also notes that EU institutions and taxpayers should not bear the costs of creating efficient markets and improving the standardisation of NPLs with a view to easing their trading; these costs should be borne by market participants themselves as the main beneficiaries of NPL trading. Data transparency is required to ensure that both external and internal (within banking groups) sales of NPLs follows all International Financial Reporting Standards (IFRS) rules and are carried out in a proper manner.

4.11 National **asset management companies** (AMCs), widely advertised by the Commission's document, and which are also colloquially referred to as "bad banks", may and most likely will require public money. The EESC consequently urges each Member State to carry out an in-depth analysis of the use of public money for the creation of such AMCs, depending on the situation at hand in each Member State while respecting the state aid rules.

4.12 The EESC strongly urges against fusing the NPLs issue, reflecting a widespread phenomenon in the economy, with issues related to preserving financial stability. To maintain the ethical and operational integrity of the banking sector, those two issues should be addressed separately. The EESC believes that even though specific financial institutions' problems may be due to an overload of NPLs on their balance sheet, no justification should be given for rescuing non-viable banks with public money, using the AMCs model under the guise of "off-loading" bad NPLs, and believes that the issue of banks' crises management should be addressed as a whole. The EESC calls for the sale of NPLs to AMCs to remain an exception and for preference to be given to working out such loans on banks' balance sheets.

4.13 Moreover, it is essential that the Commission should prevent public money from being used to bail out private banking interests time and time again. Saving a bank should not be perceived as having a value in itself; it is not the ultimate goal of economic policies. In the long run, repeated bank-saving campaigns, involving huge amounts of public money, could create a moral hazard and disturb the system of incentives embedded in the banking business. Hence, the EESC warns against any policy that results in the "privatisation of profits and socialisation of losses". Instead, banks should be incentivised to address their NPL issues internally and to better manage their loan portfolios; any kind of implicit or explicit government support will not help to tackle underlying balance sheet problems. The EESC acknowledges the existence of the Single Resolution Fund, which is funded by contributions from credit institutions. The sizing of the Single Resolution Fund to the right capacity would prevent public money from being used to bail out private banking interests, hence addressing the concerns of "privatisation of profits and socialisation of losses".

4.14 The EESC strongly calls for efforts to be directed at completing the Banking Union, which would boast a resilient, adequately capitalised and, most importantly, self-sustaining banking sector. A balance has to be struck between risk sharing and risk reduction. Significant impact on public budgets and on taxpayers in the event of a crisis, whether at national or EU level, should be prevented. Thus robust minimum requirements for own funds and eligible liabilities (MREL) and effective anti-money laundering measures need to be implemented. Moreover, greater attention should be paid to the regulation of the shadow banking sector. It has to be ensured that risk is not transferred from well- regulated to less regulated financial market players. Moreover, attention should be paid to the regulation of any financial activity not conducted by a regulated entity, following the principle of "same risks, same activity, same regulation and same supervision".

4.15 From the point of view of consumer protection, the aim of AMCs is clearly to maximise returns and efficiency by selling off loans to third party investors or realising the collateral, and this does not seem compatible with ensuring the right protection for household borrowers and ensuring viable repayment plans and a minimum living standard. The EESC recommends that the AMCs incorporate socially-oriented objectives into their policies.

4.16 The EESC is worried that any use of **"precautionary recapitalisation"** is likely to divert public money away from more socially and economically useful aims. As such, the use of "precautionary recapitalisation" should remain absolutely exceptional in the context of COVID-19. The EESC underlines the need for any **"precautionary measures"** to be used in a highly responsible manner, in order to avoid moral hazards and bank bailouts at society's expense by using public money. It is worth mentioning that financial stability is also a public good and therefore, financial regulators and supervisors should ensure that strong prudential rules are in place to avoid endangering the public good that is financial stability.

4.17 The EESC notes the communication's assertion that the Recovery and Resilience Facility (RRF) can provide support "to reforms aimed at improving insolvency, judicial and administrative frameworks and underpinning efficient NPL resolution". RRF funds, as claimed by the European Council, should be used to "boost growth potential, job creation and economic and social resilience"[17]. Further explanation is needed to clarify the Commission's intentions in linking the RRF to NPLs, and to ensure that the RRF is not derailed from its original goal of fostering green and digital transition.

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17 https://www.consilium.europa.eu/fr/infographics/20201006-recovery-resilience-rrf/. Moreover, the RRF may be spent "in line with European Semester country-specific recommendations", plus at least 37% of resources should be contributed to climate action and environmental sustainability – and at least 20% to the EU's digital transition.

4.18 In spite of the aims of the RRF agreed by co-legislators, not a single measure in the Commission's Action Plan is directed at ailing businesses in Europe – small and large, corporations and family businesses. In addition, the EESC notes that in the present communication, the Commission provides no tools to address how consumers struggling to pay their bills and make ends meet can survive the pandemic's effects and avoid sliding into a poverty trap. The EESC also points out other aspects that need dedicated action plans such as small and large corporations and family businesses suffering from the impact of the pandemic.

4.19 The EESC recommends reviewing the following specific regulations:

4.19.1 In light of the current situation, where many potentially viable business might run into payment difficulties in spite of their "pre-COVID-19" creditworthiness, the EESC proposes that a careful review of EBA guidelines on the definition of default (e.g. the number of days past the due date before a loan is considered non-performing; the Net Present Value threshold at which a restructured debt is considered "unlikely to pay" (UTP), etc.) might give such businesses a chance to recover before being considered non-performing. However, the EESC stresses that any such changes must be **strictly temporary** and related to the COVID-19 pandemic only, they should not interfere with detailed and accurate identification and reporting of credit risk by banks, and regulators and supervisors must balance any temporary change with the fundamental need to ensure the stability and solvency of the banking sector.

4.19.2 The EESC recommends that the EBA Guidelines on credit moratoria stay in place as long as needed.

4.19.3 In view of the fact that non-performing loans are non-performing no matter the reasons behind payment difficulties, and given that it is extremely difficult to ascertain which, out of the distressed borrowers, will in fact recover quickly once the pandemic is under control, -the EESC recommends that capital requirements – including the NPL backstop regulation, whose provisioning calendar already provides for very gradual increments in capital – should be kept firmly in place. This will allow banks to be able to withstand losses, be they linked to the pandemic or to other factors, and would be a key factor in decreasing the likelihood of public interventions and bank bailouts at the taxpayer's expense. However, temporary flexibility could be looked into and applied to the definition of default and the provision of the NPL backstop in order to mitigate the effects of the COVID-19 crisis. Furthermore, this could help to avoid firesales on NPLs by banks. In this context, the EESC notes and suggests to take into account the halt in Civil Courts and other delays in civil proceedings experienced throughout Europe.

4.19.4 For banks able to provide evidence of a strong link to the real economy (a significant share of their assets relating to non-financial businesses and households), the EESC envisages that further flexibility could be granted. On the other hand, the utmost care must be taken in relation to globally systemic financial institutions that are highly interconnected with other financial market players.

4.20 The EESC advocates that the Commission should propose reliable methods to ensure strict rules to protect distressed borrowers from unfair treatment:

4.20.1 The EESC calls for relief measures for credit institutions to go hand in hand with aid measures for borrowers who have only become distressed as a result of the pandemic. Among the measures that should be used in this situation are deferrals with maturities of one to three years, interest rate rebates, restructuring of debt to less expensive forms of credit and moratoria on loan repayments, where possible.

4.20.2 Concerning the internal sales of NPLs, in some cases special purpose vehicles (SPVs) might make a profit from a client's debt in a debt collection process but the client is still left in debt. The EESC recommends that the European Commission further considers regulating to ensure that borrowers' rights are protected and they are not additionally indebted after such transaction.

4.21 The EESC maintains the view that comprehensive measures to sustain a just and safe business climate should be provided, with particular emphasis on ensuring that the needs of the most vulnerable are met. The competitiveness of European businesses is built, first and foremost on a strong internal market, constant innovation and a predictable and socially responsible set of rules based on trust between economic stakeholders. The EESC warns against any legislative move that would treat non-performing loans as any other commodity. The EESC notes that such a move would not improve the environment of trust, but would, on the contrary, do more harm. It is imperative that a proper balance between borrowers' and creditors' rights is safeguarded.

4.22 The COVID-19 pandemic is just one of many outside shocks. There are many more to come. Policy measures aimed at containing the extensive damage of such massive shocks should be based on principles that are universal and withstand the test of time. The EU strives to maintain its social market economy orientation and reiterates its promise to leave no one behind, while enhancing the competitiveness of the European economy. The EESC strongly urges that the Commission's action plans and legislative initiatives should take good care of these underlying principles.

Brussels, 24 March 2021

Christa SCHWENG
The president of the European Economic and Social Committee