



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Feedback statement

Responses to the public consultation
on the draft ECB guidance to banks
on non-performing loans

BANKENTOEZICHT

March 2017

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Contents

This document is divided into three parts:

A	Overview and analysis of responses	2
A.1	Context	2
A.2	Structure of the feedback statement	2
A.3	Statistics on the responses	2
A.4	Adoption of the guidance	3
B	Explanation of the proposal and policy rationale	4
C	Comments and amendments to the draft ECB guidance to banks on non-performing loans	5
C.1	Chapter 1: Introduction	5
C.2	Chapter 2: NPL Strategy	6
C.3	Chapter 3: NPL governance and operations	6
C.4	Chapter 4: Forbearance	7
C.5	Chapter 5: NPL recognition	7
C.6	Chapter 6: NPL measurement	8
C.7	Chapter 7: Collateral valuations	8

The aim of this document is to provide an overview and assessment of the comments received during the public consultation on the draft ECB guidance to banks on non-performing loans. It also explains the amendments made to the draft guidance as a result of the consultation.

A Overview and analysis of responses

A.1 Context

On 12 September 2016 the European Central Bank (ECB) launched a public consultation on the ECB draft guidance to banks on non-performing loans (“the guidance”). This consultation was conducted in accordance with Article 4(3) of Council Regulation (EU) No 1024/2013¹ (“the Single Supervisory Mechanism (SSM) Regulation”). The public consultation ended on 15 November 2016. In addition to soliciting written comments, the ECB also gave industry participants and interested parties the opportunity to provide additional input at a public hearing with senior representatives of the ECB. This event was held in Frankfurt on 7 November 2016. While the comments provided during the public hearing are not reflected in the figures of the table and chart below, they have nonetheless been taken into account. Moreover, most (if not all) of the comments submitted at the public hearing have also been reiterated through written submissions. Thus, the ECB has given due consideration to all of the comments received during the consultation period.

A.2 Structure of the feedback statement

This feedback statement presents an overall assessment of the comments received in the public consultation and aims to address the most relevant issues raised by them. Amendments to the draft guidance have been made as a result of the comments received.

Part 2 of this document summarises the key comments and the resulting amendments to the guidance, by chapter. However, it only lists the most relevant comments and amendments. A tracked changes version of the guidance, which includes all the amendments made, is available.

A.3 Statistics on the responses

In total, 44 responses were received, mostly in English. Contributions were submitted by credit institutions and by market and banking associations, showing a broad participation by the relevant stakeholders. Table 1 shows the breakdown of the responses to the public consultation by category of respondent. Table 2 shows the number of individual comments received by type of comment.

¹ Council Regulation (EU) No 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

Table 1
Responses to the public consultation

(Breakdown of the responses by category of respondent)

Category	Numbers	Percentage
Private individuals	4	9%
Credit and financial institutions	11	25%
Market and banking associations	29	66%

Figure 1
Respondents to the public consultation

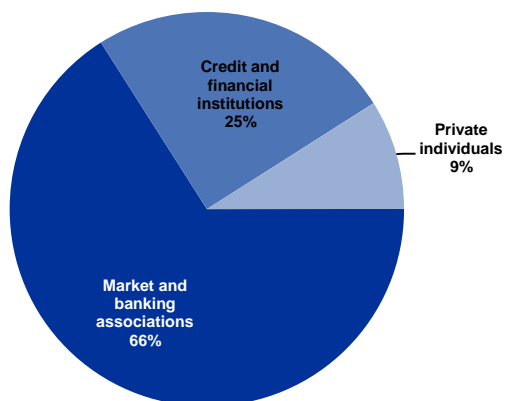
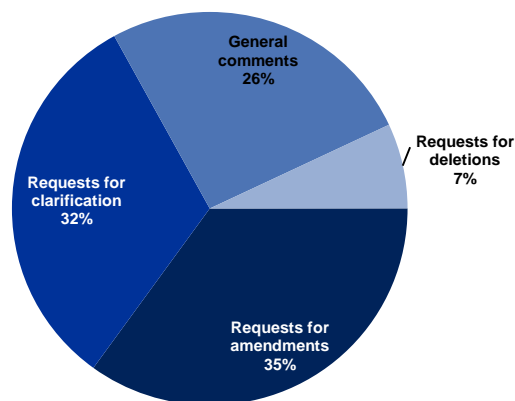


Table 2
Individual comments received

Category	Numbers	Percentage
General comments	187	27%
Requests for amendments	250	35%
Requests for clarification	229	32%
Requests for deletions	45	6%

Figure 2
Individual comments received



A.4 Adoption of the guidance

A complete draft proposal for the adoption of the draft ECB guidance to banks on non-performing loans was sent by the Supervisory Board to the Governing Council of the ECB on 1 March 2017. The guidance, as adopted by the Governing Council on 8 March 2017, was published on the ECB website on 20 March 2017, together with this feedback statement.

B Explanation of the proposal and policy rationale

The ECB guidance to banks on non-performing loans contains supervisory expectations for significant institutions (SIs). It addresses the key aspects of strategy, governance and operations which are important for successfully resolving NPLs. The guidance sets out expectations which banks should meet and a number of best practices identified by ECB Banking Supervision.

The guidance also sets out that banks with a high level of NPLs are expected to establish a clear strategy aligned with their business plan and risk control framework to effectively manage and ultimately reduce their NPL stock in a credible, feasible and timely manner. The bank's strategy should include the setting of quantitative targets by portfolio and a detailed implementation plan. The guidance makes it clear that banks should put in place appropriate governance and operational structures to deliver effective NPL workouts. This should be done by closely involving the bank's management, setting up dedicated NPL workout units (WUs) and establishing clear policies linked to NPL workouts.

In addition, the guidance provides details of short-term and long-term options for viable forbearance solutions with the aim of returning exposures to a situation of sustainable repayment. It guides banks on how to measure impairment and write-offs in line with international accounting standards. The guidance also outlines the policies, procedures and disclosures banks should adopt when valuing immovable property held as collateral for NPLs.

The guidance will serve supervisors as a basis for evaluating banks' handling of NPLs, as part of the regular supervisory dialogue. Addressing the high level of NPLs in some banks and euro area countries is a process that started with the 2014 comprehensive assessment. That exercise was the first time that banks' assets were evaluated using the same yardstick. It resulted in a more adequate level of provisions and provided supervisors with a sound basis to further address the issue. The guidance follows up on this process to reduce the level of NPLs, recognising that it will take some time for NPLs to be reduced to reasonable levels but also gradually placing a stronger focus on the timeliness of provisions and write-offs.

Banks will be expected to apply the NPL guidance proportionately and with appropriate urgency, in line with the scale and severity of the challenges they face.

The ECB, together with national supervisory authorities, has also conducted a stocktake of national supervisory practices and legal frameworks concerning NPLs. While a number of countries have taken proactive and coordinated prudential, judicial and other measures to tackle the issue, some countries could further improve their legal and judicial framework to better facilitate the timely workout of NPLs.

C Comments and amendments to the draft ECB guidance to banks on non-performing loans

Chapter 1: Introduction

#	Topic	Details	Response	Change
1	Specification of potential supervisory measures (section 1.1)	Comment(s) suggested that it would be useful to specify the envisaged potential supervisory measures that could be triggered by non-compliance with the guidance.	<ul style="list-style-type: none"> It should be noted that in the near future the guidance will be integrated into the SSM supervisory manual and thus become an integral part of the Supervisory Review and Evaluation Process (SREP). Supervisory follow-up actions and measures will be defined on an institution-specific basis driven by the respective JST following the normal supervisory approaches and escalation mechanisms. 	Yes
2	Proportionality of the application of the guidance (section 1.2)	Comment(s) requested clarification of the proportionality approach to implementing the guidance, including the role of cost-benefit analyses, especially those linked to enhanced disclosures. The applicability/scope of section 3.6 also seemed unclear.	<ul style="list-style-type: none"> Regarding the size of the institution, the guidance aims to create a consistent supervisory approach and is therefore applicable to significant institutions (SIs). However, the institution-specific implementation of the guidance will be subject to supervisory dialogue with the relevant JST. Regarding the size of the NPL issue, Chapters 2 and 3 (and respective annexes) are expected to be more relevant for high NPL banks. For all other banks, these chapters could be applicable to certain parts of the business (e.g. sectoral/regional portfolios or subsidiaries with higher NPL levels) if deemed appropriate by the bank or the Joint Supervisory Team (JST). Chapters 4-7 (and respective annexes) are applicable in the same way to all SIs. Furthermore, all SIs are expected to implement effective early warning mechanisms as covered in section 3.6. The guidance is based on best practices from SIs throughout the Member States covered by the SSM, including banks of a smaller size and with lower levels of NPLs. The elements included in the guidance have thus proved to result in effective and efficient NPL management, including recognition and measurement in a number of SIs. 	No
3	Definition of high NPL banks (section 1.2)	Comment(s) related to the definition of high NPL banks. This was questioned as being too simple and as not sufficiently taking into account the particularities of different markets, banks and portfolios.	<ul style="list-style-type: none"> It is acknowledged that the definition provided, which uses the EU average as a benchmark, is broad and leaves some room for interpretation. However, this will also enable JSTs to take into account institution-specific situations when defining high NPL banks. In this respect, even banks having a consolidated gross NPL ratio below 7% (roughly corresponding to a net NPL ratio of 4%) could be treated as high NPL banks under specific circumstances such as significant NPL inflows, high levels of forbearance or foreclosed assets, low provision coverage or an elevated Texas ratio. 	No
4	Implementation timeline (section 1.2)	Comment(s) suggested that it would be useful to clarify the implementation date to provide banks with sufficient time to comply with this guidance.	<ul style="list-style-type: none"> The guidance will be applicable as of the date of publication. Suitable time-bound action plans should be agreed between SIs and the respective JSTs for any gaps identified. These plans should be ambitious and realistic. Regarding enhanced disclosures on NPLs, to ensure consistency and comparability the guidance should be implemented from the 2018 reference dates onwards. 	Yes
5	NPL definition and scope of the guidance (section 1.3)	Comment(s) highlighted that while the title of the document refers to NPLs, it also covers other types of exposures, e.g. foreclosed assets. The title might therefore be misleading.	<ul style="list-style-type: none"> The guidance uses NPLs as a shorthand term, as indicated in section 1.3, but it clearly refers to related exposures such as foreclosed assets or watch list where needed. For example, high levels of foreclosed assets (FAs) could be a trigger for defining a bank as "high NPL" and would also require the implementation of a dedicated FA reduction strategy and operational plan. 	No
6	Supervisory powers for ECB to issue this guidance	Comment(s) asked for clarification of the ECB's mandate for implementing this guidance, which in part might exceed CRR requirements.	<ul style="list-style-type: none"> The tasks conferred on the ECB include that of ensuring compliance with the relevant Union law, which imposes requirements on credit institutions to have in place robust governance arrangements, risk management processes and internal control mechanisms (Article 4(1)(e) of the SSM Regulation). In this respect, the relevant Union law as implemented under national legislation requires credit institutions to have: <ul style="list-style-type: none"> robust governance arrangements, which include a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to, adequate internal control mechanisms, including sound administration and accounting procedures, and remuneration policies and practices that are consistent with and promote sound and effective risk management (Article 74 of Directive 2013/36/EU); effective systems for the ongoing administration and monitoring of the various risk-bearing portfolios and exposures of institutions, including for identifying and managing problem credits and for making adequate value adjustments and provisions (Article 79 of Directive 2013/36/EU). In this context, the ECB decided to include in this guidance supervisory expectations which credit institutions should meet in managing risks related to non-performing loans. By doing so, the ECB intends to provide the maximum transparency and safeguard the level playing field across all supervised institutions. 	No
7	Supervisory powers for ECB to include NPL disclosure	Comment(s) asked for clarification of the ECB's mandate, with specific reference to NPL disclosure recommendations going beyond	<ul style="list-style-type: none"> Specific disclosures on relevant aspects of the identification, impairment and payment of NPLs should improve stakeholders' confidence in banks' balance sheets and ultimately increase the willingness of markets to play a role in the management of NPLs for which high quality information will have become available. Therefore, in order for banks to convey their risk profiles comprehensively to 	No

recommendations	those required under Part Eight of the CRR (Article 431).	market participants, the ECB recommends that they disclose NPL-related information in addition to that required under Part Eight of the CRR (Article 431).	
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Chapter 2: NPL Strategy

#	Topic	Details	Response	Change
1	Role of market conduct and consumer protection (section 2.2.2)	Comment(s) suggested that the guidance does not sufficiently reflect the role of market conduct and consumer protection rules.	<ul style="list-style-type: none"> The legal environment for consumer protection plays a role in enforcement but also in consumer interaction and communication. A more explicit reference has been added to section 2.2.2 (Regulatory, legal and judicial framework). 	Yes
2	Role of NPL sales and risk transfers more generally (section 2.3.1/2)	Comment(s) raised concerns regarding a potential over-emphasis or under-emphasis in the guidance document on NPL sales. Furthermore, it was mentioned that NPL securitisations were not included as a potential strategic option.	<ul style="list-style-type: none"> The selling of NPLs is only one potential element of a bank's NPL strategy. According to the guidance, it is up to the institution itself to define a suitable strategy for its different NPL portfolios. However, it is acknowledged that there are other ways to transfer NPL risk, including for instance securitisation. An additional paragraph relating to this topic has been added to section 2.3.1, with further details provided in Annex 8. 	No Yes
3	Suitability of high-level targets (section 2.3.2)	Comment(s) suggested that it could be clarified that NPL reduction targets need to be linked to and built up from operational targets.	<ul style="list-style-type: none"> The described high-level targets should be aligned with more granular operational targets. This clarification has been added to section 2.3.2. 	Yes

Chapter 3: NPL governance and operations

#	Topic	Details	Response	Change
1	Role of the management body (section 3.2)	Comment(s) questioned whether the content of the guidance would result in the management body being unduly involved in the ordinary management of the business.	<ul style="list-style-type: none"> A strong governance structure is deemed appropriate for more effective NPL management within the bank. In the case of high NPL banks, the NPL strategy and operational plan should incorporate all the critical decisions that the bank must implement. These decisions go beyond senior management's decision-making capacity. 	No
2	Internal monitoring of NPL information (section 3.2)	Comment(s) remarked that the quarterly internal NPL monitoring requirement could be too burdensome.	<ul style="list-style-type: none"> The quarterly monitoring requirement contained in section 3.2 and specified further in section 3.5 and in the annex mainly applies to high NPL banks. At least quarterly frequency for reporting to the management body, and the degree of granularity described, are deemed appropriate for high NPL banks. 	No
3	Feedback loop between credit and NPL units (section 3.3.1)	Comment(s) suggested that it should be clarified that credit and NPL units cannot work in isolation.	<ul style="list-style-type: none"> It is agreed that there needs to be a regular feedback loop between credit and NPL workout units, i.e. for NPL workout units to plan inflow and for credit units to understand lessons learnt from NPL workout. The guidance was revised to clarify this. 	Yes
4	Handing back exposures to relationship managers (section 3.3.1)	Comment(s) requested clarification of whether the minimum suggested period to monitor forborne exposures by the NPL workout unit (WU) is the probation (as in the draft guidance) or the cure period.	<ul style="list-style-type: none"> After completion of an NPL restructuring/forbearance arrangement, and given their increased risk, borrowers should be constantly monitored for a clearly defined minimum period. Only after this period can they be transferred out of the NPL WU if no further NPL triggers are observed. It is recommended that the minimum monitoring period be aligned with the probation cure period set out in the EBA definition, i.e. at least 1 year. The guidance was revised to clarify this. 	Yes
5	Centrally stored IT data (section 3.3.4)	Comment(s) suggested that the central storage of NPL-related data on a consolidated level might not be adequate in all cases.	<ul style="list-style-type: none"> Central storage of NPL-related IT data as listed in section 3.3.4 should at a minimum comprise banking business within each respective country operation of an SI. Central cross-country storage is, however, useful for large corporate clients. 	No
6	Overlaps with BCBS 239 (section 3.3.4)	Comment(s) requested clarification regarding potential overlap between the NPL data requirements listed in the guidance and BCBS 239.	<ul style="list-style-type: none"> There are natural overlaps but no contradictions with BCBS 239, which sets out general principles for effective risk data aggregation and risk reporting. For example, principle 12 suggests regular reviews by the supervisor. With regard to NPLs, banks should use the criteria outlined in the NPL guidance as benchmarks for supervisory expectations in this respect. 	No
7	Veto right for risk control function (section 3.4.2)	Comment(s) raised concerns that an explicit veto right for risk control functions might weaken control processes.	<ul style="list-style-type: none"> Risk control functions need to ensure independence while at the same time having sufficient power to intervene ex ante in risk-related decision-making when required, e.g. on the implementation of workout solutions and provisions. The wording has been amended to clarify this. 	Yes

Chapter 4: Forbearance

#	Topic	Details	Response	Change
1	Annual review of contractual terms (section 4.2)	Comment(s) indicated that the request for an annual review of the contractual terms of forbearance measures could be misunderstood.	<ul style="list-style-type: none"> The aim of this part of the guidance is to ensure that the bank has the right to review agreed forbearance measures if the situation of the borrower improves and more favourable conditions for the bank (up to the original contractual conditions) could be enforced as a result. The guidance has been revised to clarify this. 	Yes
2	Controls and approval for multiple forbearance (section 4.2)	Comment(s) requested clarification of whether the risk control function or a senior decision-making body, or both, should approve multiple forbearance measures.	<ul style="list-style-type: none"> Control mechanisms should include, at a minimum, that such cases are explicitly brought to the attention of the risk control function ex ante and that the explicit approval of the relevant senior decision-making body should be sought. The guidance has been revised to clarify this. 	Yes
3	Multiple short-term measures (section 4.2)	Comment(s) remarked that the requirement for no other short-term forbearance measure to have been applied in the past seems too strict. This would apply especially in cases where forbearance measures had been granted long ago and resulted in a cure.	<ul style="list-style-type: none"> The aim of this restriction is to avoid situations where a short-term measure results in multiple consecutive forbearance measures being granted. 	Yes
4	Distinction between short-term and long-term forbearance measures (section 4.2)	Comment(s) remarked that a clear distinction between short-term and long-term measures does not exist at all times.	<ul style="list-style-type: none"> It is noted that packages of long-term measures might include short-term measures such as interest only, reduced payments, grace period or arrears capitalisation for a limited timeframe, as indicated in the guidance. The guidance has been revised to clarify this. 	Yes
5	Additional security link to forbearance classification (section 4.2/table)	Comment(s) suggested that it should be clarified that additional security does not automatically result in a "forborne" status.	<ul style="list-style-type: none"> It is noted that taking additional security does not automatically result in a classification of the respective exposure as "forborne". However, in most cases it coincides with forbearance measures being taken. The guidance has been revised to clarify this. 	Yes
6	Affordability assessment (section 4.4)	Comment(s) remarked that the list of elements to analyse borrower affordability seems to focus mainly on retail exposures.	<ul style="list-style-type: none"> It is noted that for non-retail exposures, at least an analysis of cash flows and business plans should be added to the list, as also specified in Annex 6. The guidance has been revised to clarify this. 	Yes

Chapter 5: NPL recognition

#	Topic	Details	Response	Change
1	Cure definition (section 5.3.3)	Comment(s) remarked that the cure criteria seem to be stricter than the EBA guidelines.	<ul style="list-style-type: none"> It is the aim of the guidance to clarify potential ambiguity in the existing EBA cure definition and criteria. The intention is to prevent interpretation of the cure criteria that may result in "window dressing", whereby NPLs are prematurely classified as cured on the basis of a bank's favourable interpretation of any areas of ambiguity. At the same time, however, the guidance should not discourage good forbearance practices. The guidance has been revised to clarify this. 	Yes
2	Applicability of the guidance under IFRS 9 (section 5.5.2)	Comment(s) requested a clarification of the applicability of the guidance with regard to the IFRS 9 definitions.	<ul style="list-style-type: none"> It is expected that as of the date IFRS 9 comes into force, at least all Stage 3 exposures will fall into the scope of this NPL guidance. The guidance has been revised to clarify this. 	Yes

Chapter 6: NPL measurement

#	Topic	Details	Response	Change
1	Use of the word "conservative" or "prudent" in the context of accounting (chapter 6/7)	Comment(s) remarked that several statements in the report seem to suggest a notion of "conservatism" and "prudence" which do not seem compatible with accounting standards.	<ul style="list-style-type: none"> The guidance is not intended to contradict or supersede relevant accounting standards but is intended to provide clarity where ambiguity currently exists. Based on supervisory experience further clarity around these matters is required. The guidance refers in a number of instances to a conservative approach, with commentators expressing concern as to how this interacts with the IFRS Framework's requirement for neutrality. Supervisors are firmly of the view that in areas of uncertainty requiring management judgement a management bias exists and, therefore, a level of conservatism is required to ensure that a neutral view is attained. This view is supported by experience throughout the crisis, particularly in relation to banks and provisioning. 	No
2	Period for cash flow projection (section 6.2.4)	Comment(s) suggested that for estimating operating cash flows, a time horizon of up to 10 years should only be admissible in exceptional circumstances.	<ul style="list-style-type: none"> Following review of the guidance it was agreed that a 5-year projection period is more appropriate, given the inherent difficulty of estimating future cash flows beyond this time period. However, the guidance retains the expression "exceptional circumstances", thereby allowing use of a period of more than 5 years if it is appropriate for specific individual cases. The guidance has been revised to clarify this. 	Yes

Chapter 7: Collateral valuations

#	Topic	Details	Response	Change
1	Scope of application (chapter 7)	Comment(s) questioned the applicability of Chapter 7 for performing exposures.	<ul style="list-style-type: none"> The draft guidance stated "but the guidance can also be used where appropriate in the loan processing, monitoring and underwriting process". The intention was to highlight international best practice which could be adopted where it relates to this process. It is noted that some aspects of Chapter 7 may not be appropriate to performing exposures, e.g. the frequency of reviewing valuations. The guidance has been revised to clarify this. 	Yes
2	Compatibility with accounting standards	Comment(s) queried the compatibility of the guidance with the relevant accounting standards (IFRS Framework/IFRS 9/IFRS 5).	<ul style="list-style-type: none"> The guidance is not intended to contradict or supersede the relevant accounting standards but to provide clarity where ambiguity currently exists. Based on supervisory experience further clarity around these matters is required. Supervisors are confident that this guidance is fully compliant with the relevant accounting standards referred to throughout the document. 	No
3	Rotation of appraisers (section 7.2.2)	Comment(s) questioned the value and rationale for requiring the regular rotation of appraisers, as well as whether this should be done on a firm-level or individual basis.	<ul style="list-style-type: none"> The requirement for rotation is based on a consideration of international best practice and is essential to mitigate the risks associated with conflicts of interest. Further clarity has been provided in the guidance: the requirement applies to individual appraisers when the valuation is completed internally but at firm level when completed by an external appraiser. 	Yes
4	Threshold of indexation and frequency of valuation (section 7.2.3)	Comment(s) questioned the maximum threshold of €300,000 for the use of indexation and the requirement for an annual review of collateral values.	<ul style="list-style-type: none"> This chapter of the guidance is addressed to all significant institutions. The selection of the €300,000 threshold is based on the NCA/ECB experience, including regular supervisory engagement and on-site inspections. Given the importance of collateral valuation in the provision calculation it is imperative that the valuations used are recent and of the highest standard. The requirement for an annual review is based on international best practice observed across a number of institutions. Given the risks associated with banks carrying a high stock of NPLs, supervisors would expect more robust and frequent monitoring. 	No
5	Event-driven valuations (section 7.3)	Comment(s) remarked that the draft guidance does not address situations where the collateral valuation would be made only if an event would modify the collateral value itself.	<ul style="list-style-type: none"> The guidance states that "Banks should carry out more frequent valuations where the market is subject to significant negative changes and/or where there are signs of significant decline in the value of the individual collateral"; this reflects the need for event-driven revaluation of collateral. 	No
6	Requirement for a market value only (section 7.4.1)	Comment(s) requested clarification regarding the use of market value versus mortgage lending value.	<ul style="list-style-type: none"> In order to ensure consistency with the CRR it is deemed appropriate to include mortgage lending value as an option. With respect to "discounted replacement cost", the guidance states that banks should not rely solely on a discounted replacement cost valuation. This requirement is based on observed best practice in a number of jurisdictions. 	Yes
7	Removal of back-testing requirement (section 7.4.3)	Comment(s) questioned the added value produced by the back-testing requirement.	<ul style="list-style-type: none"> Supervisors expect that actual sales prices achieved will be compared to the bank's last valuation to highlight any variance that has occurred and ensure that it is addressed for similar collateral remaining on the balance sheet. This is of particular relevance when a bank relies on indexation. The guidance was revised to clarify this. The need for back-testing is aligned with IFRS 9. 	Yes
8	Minimum discount on liquidation (section 7.4.3)	Comment(s) queried the setting of a minimum 10% discount on liquidation activity through auction.	<ul style="list-style-type: none"> The supervisory expectation is that realising collateral via liquidation will entail significant costs and the potential negative impact on the sales price of any stigma involved. Supervisors believe that in many cases the minimum 10% discount will not be sufficient and would expect larger discounts to be applied. The minimum 10% requirement relates solely to liquidation activity through auction and is based on observed best practice across a number of jurisdictions. 	No
9	Prohibiting uplift (section 7.4)	Comment(s) questioned why the draft guidance does not allow for increases in collateral value when	<ul style="list-style-type: none"> The guidance defines market value as "the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm's length transaction after proper marketing and where the parties had each acted knowledgeably, prudently 	No

estimating the future sales price.

and without compulsion.”

- Therefore, any potential future change in the value of the collateral is generally already reflected in the current market value, taking account of the risks or rewards associated with ownership of the asset.
- In this context it would be inappropriate to then assume any additional future uplift in value beyond the market value when estimating the future sales price.
- Any future uplift factored into the estimated future sales price may result in banks holding on to real estate-backed NPLs on the basis of expected future gains or an unwillingness to incur losses associated with inaccurate estimates around future sale prices.

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