EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Danièle NOUY
Chair of the Supervisory Board

Mr Matt Carthy
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 18 May 2018

Re: Your letter (QZ039-43)

Honourable Member of the European Parliament, dear Mr Carthy,

Thank you for your letter on the ECB's Guidance to banks on non-performing loans[1], which was passed on to me by Mr Roberto Gualtieri, Chairman of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 24 April 2018.

As explained in my recent letter to you dated 23 April,[2] a senior loan resulting from a split mortgage restructuring can return to being classified as performing and can be considered a sustainable long-term method of restructuring retail mortgage debt provided that the restructuring complies with all conditions established under the relevant EU law, as further explained by the key supervisory expectations outlined in the same letter. The approach described is intended to be applied only to retail residential mortgage loans for which the definition of default is applied at the level of the individual credit facility rather than in relation to the total obligations of a borrower[3]. This approach does not represent a change in existing regulations and/or practices but rather reflects our supervisory expectations in terms of the curing of split mortgage restructuring and will be applied on a case-by-case basis, taking the bank-specific circumstances into account.

The definition of a non-performing exposure for supervisory reporting purposes is laid down in Commission Implementing Regulation (EU) No 680/2014 (the "Regulation"). The Regulation establishes conditions under which non-performing exposures with forbearance measures can be considered to have ceased being non-performing. Regarding your specific query concerning "full repayment" of the various components of the split mortgage, this information is also outlined in my previous letter. In order for the senior part of the split mortgage to return to performing classification, it is essential that the retail split-loan restructuring has resulted in two separate and independent payment obligations with substantially different terms and

1 https://www.bankingsupervision.europa.eu/ecb/pub/pdf/guidance_on_npl.en.pdf

2 https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.mepletter180426_Carthy.en.pdf

3 Last sub-paragraph of Article 178(1) CRR.

European Central Bank
60640 Frankfurt am Main
Tel.: +49 69 1344 0
E-mail: info@ecb.europa.eu
Website: www.bankingsupervision.europa.eu

conditions, i.e. two separate exposures. As such, an obligor should not be subject to any contractual repayment obligations in respect of the junior until the senior has been repaid in full or if the obligor defaults on the senior.

In addition, in order to permit a return to performing classification, the senior part of the split mortgage should be deemed fully sustainable. Furthermore, one year must have passed since the most recent of either the moment forbearance measures were applied or the moment an exposure was classified as non-performing. This implies that the borrower should be making principal and interest payments on the senior part of the split mortgage for at least a 12-month period and the senior should be set at a level that is considered fully affordable for the borrower before it can be considered as cured[4]. Moreover, the repayments of the senior loan should be sufficient to repay the capital amount in full over its agreed term. Section 4.4 of the Guidance to banks on non-performing loans also sets out supervisory expectations of how the assessment of affordability should be carried out for forbearance arrangements. These expectations are relevant to all forbearance products including split mortgages as outlined above.

Regarding your question on paragraph 157 (now paragraph 231) of Annex V, Part 2 of the Regulation and the reference to the borrower being required to settle by regular repayments a total amount equal to the amount written off as part of its forbearance measures, please note that the wording in the Regulation is drafted in an **either/or** manner[5]. Thus, it is not necessarily the case that the borrower has repaid an amount equal to what was written off. The Regulation focuses on the need for a bank to satisfy itself that the borrower has the capacity to fully repay the post-forbearance exposure and that this post-forbearance exposure is sustainable. This is to be read together with the other sustainability expectations, namely that the borrower should make regular principal and interest payments and the revised repayment obligations must be sustainable, affordable and sufficient to fully clear the senior part over the agreed term.

Yours sincerely,

Danièle Nouy

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4 Paragraph 231(b) of Annex V, Part 2 of Commission Implementing Regulation (EU) No 680/2014 requires that: *"one year has passed since the latest between the moment where forbearance measures were applied and the moment where exposures have been classified as non-performing."*

5 *"Concerns may be considered as no longer existing when the debtor has paid, via its regular payments in accordance with the post-forbearance conditions, a total equal to the amount that was previously past-due (if there were past-due amounts) or that has been written-off (if there were no past-due amounts) under the forbearance measures or the debtor has otherwise demonstrated its ability to comply with the post forbearance conditions."*