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Legal Service

Opinion of the Legal Service

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LEGAL OPINION

Subject: **Addendum to the ECB Guidance to banks on non-performing loans – Legal effects – Competence of the ECB to adopt such Addendum**

I. Introduction

1. By letter of 24 October 2017, received at the Legal Service on the following day,[1] Mr. Antonio Tajani, President of the European Parliament, requested the opinion of the Legal Service on the legal effects of the draft document entitled "*Addendum to the ECB Guidance to banks on non-performing loans: Prudential provisioning backstop for non-performing exposures*" (hereinafter: the 'Addendum').[2]

2. In this regard, President Tajani asks whether the Addendum "*amounts to establishing rules of general scope applicable to banks, and in the affirmative whether the European Central Bank has competence to adopt such rules*".

II. Background

A. The relevant elements of the applicable legal framework

a) The ECB's supervisory powers within the Single Supervisory Mechanism

3. For present purposes, it should be recalled from the outset that, as part of the establishment of a EU banking union, Council Regulation (EU) No 1024/2013[3] created a Single Supervisory Mechanism ('SSM') for credit institutions (banks), in the context of which specific supervisory

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1 Attached as Annex 1 to this Opinion.

2 Attached as Annex 2 to this Opinion. The full text of the draft Addendum is available on the ECB's Banking supervision website, at the following address (last accessed on 31 October 2017): https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/npl2/ssm.npl_addendum_draft_201710.en.pdf

3 Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions, OJ L 287 of 29.10.2013, p. 63 (hereinafter: the 'SSM Regulation').

tasks were conferred on the European Central Bank ('ECB') pursuant to Article 127(6) TFEU. In this regard, it is important to note that, while the SSM is composed of the ECB and national competent authorities, the ECB is tasked with supervising directly 'significant entities' i.e. banks meeting certain criteria in terms of size, importance of the economy, or volume of cross-border or that are in receipt of direct public financial assistance (Article 6(1) and (4) of the SSM Regulation).

4. The ECB's supervisory tasks are set out in Article 4(1) of the SSM Regulation and include *inter alia* the tasks to ensure compliance with prudential requirements laid down in EU legislation (and, where applicable, in national legislation transposing or implementing such EU legislation) as regards own funds (Article 4(1)(b)), as well as with requirements relating "*to risk management processes* [...] *and effective internal capital adequacy assessment processes, including Internal Ratings Based models*" (Article 4(1)(e)). In this regard, the ECB is also given the task "*to carry out supervisory reviews in order to determine whether the arrangements, strategies, processes and mechanisms put in place by credit institutions and the own funds held by those institutions ensure a sound management and coverage of their risks*" and, on the basis of that supervisory review "*to impose on credit institutions specific additional own funds requirements* [...] *and other measures*" specifically made available by relevant EU legislation (Article 4(1)(f)).

5. Article 16 of the SSM Regulation provides the ECB with the supervisory powers necessary to carry out the tasks enumerated in Article 4(1). The ECB is entitled to make use of those supervisory powers in any of the circumstances referred to in Article 16(1), namely when a bank does not meet the statutory requirements laid down in relevant EU legislation (and, where applicable, in national legislation transposing or implementing such EU legislation) (Article 16(1)(a)); or when the ECB has evidence that the credit institution concerned is likely to breach such requirements "*within the next 12 months*" (Article 16(1)(b)); or, finally, when the ECB comes to the conclusion "*in the framework of a supervisory review in accordance with point (f) of Article 4(1), that the arrangements, strategies, processes and mechanisms implemented by the credit institution and the own funds and liquidity held by it do not ensure a sound management and coverage of its risks*" (Article 16(1)(c)).

6. In accordance with Article 16(2)(b), the ECB's supervisory powers include, in particular, the power "*to require* [credit] *institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements*".

b) The EU rules on the supervisory framework and prudential requirements for the banking sector

7. Prudential requirements are, in substance, the rules concerning the amount of capital and liquidity that banks and other financial institutions must hold in order to withstand economic shocks. The legal framework currently in force at the EU level governing, inter alia, the access to the activity, the supervisory and prudential requirements for banks is composed of two main legislative instruments, which taken together are commonly known as the 'CRD IV package': Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 (the 'Capital Requirements Regulation' or 'CRR')[4] and Directive 2013/36/EU of the European Parliament and of the Council, also of 26 June 2013 (the 'Capital Requirements Directive' or

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4 Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ L 176, 27.6.2013, p. 1.

'CRD').[5] In essence, the CRD lays down rules on access to the activity of banks, their corporate governance, internal risk management as well as on the powers and responsibilities of national competent authorities as regards the supervisory review of banks. In turn, the CRR lays down general prudential requirements which must be complied with by banks and are meant to ensure the financial stability of banks, as well as a high level of protection of investors and depositors.

8. For present purposes, it should be recalled in particular that, pursuant to its Article 1, point (a), the CRR lays down "*own funds* [prudential] *requirements relating to entirely quantifiable, uniform and standardised elements of credit risk, market risk, operational risk and settlement risk*".

9. In this regard, Article 3 of the CRR specifies that "[t]*his Regulation shall not prevent institutions from holding own funds and their components in excess of, or applying measures that are stricter than those required by this Regulation*". In other words, Article 3 makes it clear that the CRR does not prevent banks from choosing, on a purely optional basis, to hold own funds in excess of, or to apply measures stricter than, the statutory prudential requirements.

10. As far as the CRD is concerned, the following provisions should be recalled.

11. Article 74 of the CRD lays down rules on internal governance and recovery and resolution plans of banks. In this context, Article 74(1) requires banks to have "*adequate internal control mechanisms, including sound administration and accounting procedures,* [...] *that are consistent with and promote sound and effective risk management*".

12. As part of the technical criteria that must be taken into account for establishing the above mechanisms, Article 79 of the CRD lays down rules on credit and counterparty risk. In this regard, Article 79 requires competent authorities to ensure that "*institutions have internal methodologies that enable them to assess the credit risk of exposures to individual obligors* [...] *and credit risk at the portfolio level*" (point (b)) and that "*the ongoing administration and monitoring of the various credit risk-bearing portfolios and exposures of institutions, including for identifying and managing problem credits and for making adequate value adjustments and provisions, is operated through effective systems*" (point (c)).

13. As regards governance, Article 88(1)(b) of the CRD provides that "[t]*he management body must ensure the integrity of the accounting and financial reporting systems, including financial and operational controls and compliance with the law and relevant standards*".

14. Articles 102 to 107 of the CRD deal with supervisory powers and measures. For present purposes, it is important to recall that Article 102 mirrors Article 16(1) of the SSM Regulation in identifying the circumstances in which competent authorities are entitled to make use of their supervisory powers in respect of individual banks.[6] Article 104(1), in turn, sets out the minimum powers that must be available to competent authorities. Those powers include the power "*to require the reinforcement of the arrangements, processes, mechanisms and strategies implemented in accordance with Articles 73 and 74*" (Article 104(1)(b)), as well as the power "*to require* [credit] *institutions to apply a specific provisioning policy or treatment of assets in*

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5 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, OJ L 176, 27.6.2013, p. 338.

6 See paragraph 5 above.

terms of own funds requirements" (Article 104(1)(d), which has exactly the same wording of Article 16(2)(b) of the SSM Regulation).

15. It is clear from the chapeau of Article 104(1) that the above supervisory powers are designed to ensure compliance with the statutory requirements laid down in the CRR as well as to allow the competent authorities to perform the tasks described in various other provisions of the CRD, among which the so-called 'supervisory review and evaluation process' ('SREP'), which is essentially intended to ascertain whether the arrangements, strategies, processes and mechanisms implemented by a bank in order to comply with the CRD and the CRR, as well as well as the own funds and liquidity that it holds, ensure a sound management and coverage of the risks (Articles 97 and 98(4) of the CRD).

16. It is thus apparent from the very wording of Article 104(1) that the exercise of the minimum supervisory powers granted to competent authorities depends on the specific situation of each supervised bank and only allows the adoption of measures addressed to the individual bank concerned.[7]

B. The Addendum

17. The Addendum was prepared by the High Level Group on non-performing loans ('NPL')[8], which was established within the SSM in 2015 and is composed of representatives of the national competent authorities and the ECB. The Addendum is currently only a draft, which was published on 4 October 2017 and at the same time submitted to a public consultation that will run until 8 December 2017. In light of the elements arising from that public consultation, the ECB will publish the comments received, together with a feedback statement.[9] As is apparent from its wording, the Addendum is designed to apply as from January 2018 to all significant banks directly supervised by the ECB.[10]

18. The aim of the draft Addendum is to reinforce and supplement the already existing ECB Guidance on non-performing loans (NPL) published in March 2017 "*by specifying quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures*".[11]

19. In essence, those 'quantitative supervisory expectations' consist in minimum provisioning requirements which apply to exposures which are classified as non-performing since a certain time (2 years for unsecured exposures, and 7 years for secured exposures).[12] Those requirements entail 100% coverage of the corresponding exposure after the prescribed period

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7 Obviously, this holds true *mutatis mutandis* also as regards groups, in cases where supervision is exercised at group level.

8 'Non-performing' loans are those in which a specific amount of time (usually, 90 days) has passed without the borrower paying back the agreed instalments or the interest.

9 See in this regard the press release accompanying the addendum and announcing the public consultation.

10 See the Addendum, section 2.1 (p. 3).

11 See the Addendum, section 1 (p. 2). In line with the Addendum, the expressions "*non-performing loans*" and "*non-performing exposures*" are used interchangeably in this Opinion.

12 The eligible credit protection to secure exposures (i.e. assets, such as immovable property, pledged to the bank in return for the loan) is specified in section 3.2 (p. 7) of the Addendum.

of time, which means that, at the end of the 2 (or 7) year-period, the exposure must be written down in full.

20. It is apparent from the Addendum that the above 'expectations' (i.e. requirements) are set at a level that goes beyond statutory requirements under the applicable legal framework (as set out in the CRR). In order to comply with those 'expectations', banks are thus encouraged to close the gap between statutory requirements in force and those laid down in the Addendum by applying voluntarily stricter measures, as is permitted by Article 3 of the CRR.[13]

21. Banks are asked to report periodically to the supervisory authority (the ECB) on the compliance with the above 'expectations' (i.e. requirements). Deviations are only possible in well-specified circumstances outlined in the Addendum, which must be justified on the basis of "*acceptable evidence*". Beyond those exceptions, potential non-compliance is taken into account by the supervisory authority in the framework of the SREP, and may trigger supervisory measures.[14]

22. The Addendum purports to set out its "*regulatory basis*" by referring to the supervisors' responsibility "*to make decisions as to whether banks' provisions are adequate and timely*". In this regard, the Addendum also refers to Articles 74, 79 (b) and (c), 88 and 104(1) of the CRD as "*relevant*" provisions "*in the existing regulatory framework applicable for significant institutions*".[15]

III. Facts

23. As explained above, the Addendum was published on the ECB's website on 4 October 2017.

24. On 9 October, President Tajani wrote to the President of the ECB expressing his concern about the quantitative supervisory expectations outlined in the Addendum, inasmuch as they "*would, in essence, amount to requiring supervised entities to book additional provisioning and/or adjust Common Equity Tier 1 capital at levels going beyond the existing regulatory framework*". In this regard, President Tajani wondered "*whether specific additional obligations, which may conflict with legislative provisions currently in force and alter the existing regulatory balance set by the present legislation, can be imposed on supervised entities without appropriately involving the co-legislators in the decision-making process*".

25. The President of the ECB replied by a letter dated 11 October 2017, in which he pointed out that, on 28 September, the ECB's Governing Council had approved the start of the public consultation on a draft prepared by the SSM Supervisory Board concerning guidance on non-performing loans. He also added that, since the matter related to the ECB's supervisory tasks, he had asked the Chair of the Supervisory Board, which had prepared the draft Addendum, to revert to President Tajani regarding the issues raised in his letter of 9 October.

26. The Chair of the Supervisory Board did so by a letter dated 13 October 2017, in which she sought to provide "*some background on the process as well as on the rationale of the ECB for putting forward the draft addendum*". In this regard, the Chair of the Supervisory Board pointed out, in particular, that "[t]*he rationale of the draft addendum is to foster a more timely provisioning practice for new NPLs from 2018 onwards in order to avoid a renewed increase*

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13 See the Addendum, section 2.3 (p. 5).

14 *Id.* (p. 6).

15 See the Addendum, section 2.2 (p. 3-4).

of NPLs in the future. It sets out the ECB's supervisory policy for addressing NPLs and provides credit institutions with the ECB's supervisory expectations, aiming to provide clarity and a level playing field." She furthermore explained that "[a]*s part of a periodic comply-or-explain process, credit institutions are asked to demonstrate, on the basis of acceptable evidence, if the supervisory expectations are not justified in a specific case. If, after this process, the ECB still considers on a case by case basis provisioning levels to be inadequate for prudential purposes, it may adopt supervisory measures (so-called Pillar 2 measures) to ensure that credit institutions reassess and increase respective risk coverage in order to meet prudential expectations*". In light of this, she took the view that "[t]*here is therefore no automaticity*".

27. After recalling the regulatory context as outlined in the Addendum, the Chair of the Supervisory Board also pointed out that, in her view, "[t]*he draft Addendum does not establish additional obligations on banks and therefore does not go beyond the existing regulatory framework. It clarifies, in the interest of transparency at all levels and for level playing field reasons, what the ECB expects from the banks when complying with existing provisions*". She then concluded that "*the draft Addendum falls within the supervisory mandate and powers of the ECB. In fact, it is an obligation of the ECB, in line with its supervisory mandate, to address the key vulnerability in the European banking system*".

IV. Analysis

28. As explained above, the Legal Service is asked to analyse in this Opinion the legal effects of the Addendum, in particular whether it amounts to establishing rules of general scope applicable to banks, and in the affirmative whether the ECB has competence to adopt such rules.

29. The Legal Service will accordingly focus in the first place on the question whether the Addendum has legal effects, before addressing briefly the question of the ECB's competence to adopt the Addendum in its current form. The Legal Service wishes to recall from the outset that the Addendum is currently only a draft text, which is undergoing public consultation with a view to its subsequent adoption in time for applying as from January 2018. For this reason alone, it is thus clear that – at this stage – the Addendum is not (yet) capable to have legal effects. Therefore, the Legal Service will carry out its analysis on the basis of the text of the Addendum as it currently stands, on the assumption that it will be eventually adopted without changes further to the public consultation. It is understood that the conclusions reached in this Opinion will have to be reconsidered should any significant amendment be made to the Addendum ahead of its adoption.

A. The legal effects of the draft Addendum

30. According to settled case-law, in order to determine whether an act has legal effects, a number of elements should be examined, among which the wording and context of the act in question[16] as well as, more importantly, its content.[17] In contrast, the designation of the act by its author

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16 See e.g. judgment of the Court of 20 March 1997, *France* v *Commission*, C-57/95, EU:C:1997:64, paragraph 18.

17 See e.g. judgments of the Court of 9 October 1990, *France* v *Commission*, C-366/88, EU:C:1990:348, paragraph 11; of 13 November 1991, *France* v *Commission*, C-303/90, EU:C:1991:424, paragraph 10; and of 20 March 1997, *France* v *Commission*, C-57/95, cited above, paragraph 9.

is not decisive for that purpose, and hence even acts presented as non-binding may be found to be capable to have legal force.[18]

31. It also follows from case-law that the key element in examining the wording and context of the act is the way in which the parties concerned may reasonably perceive that act. Accordingly, an act may be found to be capable to have legal effects if such examination reveals that the parties concerned will perceive the act as an act which they must comply with, despite its form or designation.[19]

32. A first, albeit not conclusive, indication in that regard is provided by the publicity given to the act. Case-law suggests that absence of publication should in principle point to absence of legal effects of the act concerned, inasmuch as the act in question remains internal to the institution or body which is its author.[20] In this case, however, it is clear that the Addendum has indeed been publicised, since it was submitted to public consultation, and that it will be published once adopted by the ECB with a view to its application.

33. Next, and more importantly from the point of view of the parties concerned, the wording of the act should be examined in order to establish whether it is couched in mandatory terms or, in contrast uses language tending to show that it is purely indicative in nature.[21]

34. As explained above, the ECB presents the Addendum as an additional supervisory tool intended to reinforce and supplement the existing guidance on NPL by specifying "*quantitative supervisory expectations concerning the minimum level of prudential provisions expected for non-performing exposure*".[22] In the ECB's own words, "*while the Addendum is non-binding, banks are expected to explain any deviations*" and "*should report on the compliance with the* [Addendum] *at least annually*".[23]

35. In this regard, it should be noted that the Addendum sets out the 'quantitative supervisory expectations' in an extremely clear and precise fashion: in order to meet those expectations, banks are required to write down in full non-performing exposures within a certain period of time.[24]

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18 See, among many others, judgment of the Court of 31 March 1971, *Commission* v *Council*, 22/70, EU:C:1971:32, paragraph 39. As the General Court recalled in its judgment in *United Kingdom* v *ECB* (judgment of 4 March 2015, T-496/11, EU:T:2015:133, paragraph 30), that case-law is intended to prevent the form or designation given to the act by its author from allowing that act to escape judicial review even though it has in fact legal effects.

19 See judgment of the General Court of 4 March 2015, *United Kingdom* v *ECB*, T-496/11, cited above, paragraph 32 and case-law cited therein.

20 See judgment of the General Court of 20 May 2010, *Germany* v *Commission*, T-258/06, EU:T:2010:214, paragraphs 30-31.

21 See judgment of the General Court of 4 March 2015, *United Kingdom* v *ECB*, T-496/11, cited above, paragraph 35.

22 See the Addendum, section 1 (p. 2) (emphasis added).

23 See the Addendum, section 2.1 (p. 3).

24 See the Addendum, section 4.1 (p. 10).

36. Likewise, the Addendum delimits in an equally clear and precise terms the circumstances in which non-compliance with the 'expectations' is permitted. Pursuant to section 2.3 of the Addendum,

> "*Deviations from the* [expectations] *are possible if a bank can demonstrate, in the course of a periodic comply-or-explain process and on the basis of acceptable evidence, that*
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> *(a) the calibration of the prudential provisioning backstop is not justified for a specific portfolio/exposure (e.g. debtor verifiably makes regular partial payments amounting to a significant portion of the initial contractual payments, or the application of the backstop would result in covering more than 100% of the exposure in combination with Pillar 1 capital requirements for credit risk), or*
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> *(b) the application of the backstop is not reasonable in justified circumstances (e.g. pulling effect on a debtor's performing exposures)*".

37. The Addendum then goes on to specify the consequences of such deviations. The comply-or-explain process is followed by a supervisory assessment of the deviations and the justifications provided by the bank in that respect. The outcome of this assessment is then taken into account in the framework of the supervisory review and evaluation process ('SREP') of the Single Supervisory Mechanism,[25] where "*non-compliance may trigger supervisory measures based on the supervisory powers specified in the European and national regulatory frameworks*".

38. In the Legal Service's opinion, it is clear from the above that the language used in the Addendum is of a prescriptive nature, inasmuch as not only it lays down the amount of write-downs of non-performing exposure required in order to comply with the ECB's 'quantitative supervisory expectations', but also precisely delimits the ambit of permitted exceptions from compliance and finally specifies the consequences of non-compliance that may result in the application of supervisory measures in respect of individual banks.[26] In light of this, the Legal Service takes the view that the parties concerned (i.e. banks) may reasonably perceive the wording of the Addendum as mandatory.

39. The above conclusion cannot be invalidated by the fact that, according to its author, the Addendum is purported to be "*non-binding*". It follows from case-law that the description of the act given by its author does not rule out the possibility that it is perceived as mandatory in nature, if its wording suggests so.[27] In the Legal Service's view, such is the case here.

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25 As outlined in Article 97 of the CRD (see paragraph XX above).

26 In this regard, it is important to remind that under the SREP the supervisory authority may impose on the bank in question additional specific requirements consisting in, inter alia, additional capital provisions (see paragraph XX above).

27 See judgment of the General Court of 4 March 2015, *United Kingdom* v *ECB*, T-496/11, cited above, paragraph 36.

40. Turning now to the content of the Addendum, in accordance with case-law it is necessary to ascertain whether in fact it provides for additional obligations on the parties concerned (banks), as compared with the legal framework currently in force.[28]

41. In this regard, first of all it should be emphasised that the ECB's 'quantitative supervisory expectations' amount in fact to minimum prudential provisioning requirements. According to section 2.2 of the Addendum, "[w]*here provisioning levels are considered to be inadequate for prudential purposes, supervisors are obliged to ensure that banks reassess and increase respective risk coverage in order to meet prudential expectations*". In this regard, banks are expected under the Addendum to write down in full non-performing exposures after a given period of time, which may then require adjustments to the banks' Common Equity Tier 1 capital. In this regard, it is important to highlight that none of the provisions of the CRD which are referred to in the Addendum as the "*regulatory basis*" for the ECB's action (namely Articles 74, 79 (b) and (c), 88 and 104(1))[29] lays down quantitative requirements generally applicable to banks which may provide a basis for the above-mentioned minimum prudential provisioning requirements. It follows that the Addendum may not be considered as merely fleshing out requirements already provided for by the EU legislature in the CRD (or, for that matter, in the CRR).

42. Secondly, it should likewise be noted that, as is apparent from the Addendum itself, those minimum prudential provisioning requirements are set at a level going beyond the statutory requirements applicable in accordance with the legal framework currently in force (as set out in the CRR). In fact, according to section 2.3 of the Addendum,

> "[b]*anks are encouraged to close potential gaps relative to the prudential minimum expectations by booking the maximum level of provisions possible under the applicable accounting standard. If the applicable accounting treatment does not fulfil the prudential provisioning backstop, banks should adjust their Common Equity Tier 1 capital on their own initiative, applying Article 3 of the CRR on the application of stricter requirements*".[30]

43. Thirdly, it should be recalled that the Addendum lays down clear rules designed to ensure compliance with the above minimum prudential provisioning requirements, and delimits precisely the ambit of permitted exceptions from compliance with those requirements. Where a bank deviates from the minimum prudential provisioning requirements laid down in the Addendum, it must demonstrate, to the satisfaction of the supervisory authority, that it does so because one of the exceptions specifically defined in the Addendum applies. Where the supervisory authority considers that the bank has not (or not sufficiently) discharged its burden of proof, it will take into account any deviation from the minimum prudential provisioning requirements within the framework of the SREP, which may lead to supervisory measures in respect of the bank concerned.

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28 See judgment of the General Court of 20 May 2010, *Germany* v *Commission*, T-258/06, cited above, paragraph 28.

29 See the Addendum, section 2.2 (p. 3-4), cited at paragraph 22 above.

30 See the Addendum, section 2.3 (p. 5 *in fine*).

44. In the Legal Service's view, all the above elements concur in indicating that the Addendum does in fact introduce additional obligations on banks going beyond the regulatory framework currently in force (and is expressly designed to do so).

45. In fact, once the Addendum enters into force, banks whose provisioning levels are in line with the statutory requirements under the CRR but do not meet the ECB's quantitative supervisory expectations (i.e. minimum prudential provisioning requirements) as laid down in the Addendum will be in practice forced to make use of the possibility, available under Article 3 of the CRR, to apply stricter measures going beyond the applicable legal framework in order to comply with those expectations, failing which they will bear the burden of proving that they can avail themselves of one of the exceptions outlined in section 2.3 of the Addendum. A bank that does not apply such stricter measures, and does not discharge its burden of proving that it falls within the scope of one of the exceptions, will be in a situation of non-compliance which may prompt the application of supervisory measures within the SREP. In other words, banks will be obliged to meet requirements going beyond the applicable legal framework (and hence to make use of Article 3 of the CRR) or, alternatively, to prove that one of the exceptions laid down in the Addendum applies to them, not to face the threat of supervisory measures.

46. Hence, the Addendum introduces a direct link between the eventual non-compliance by banks with the newly introduced minimum prudential provisioning requirements, and the outcome of the SREP, in the framework of which the supervisory authority will take into account unjustified deviations from those requirements in its assessment of the need to impose supervisory measures on individual banks.

47. In doing so, the Addendum *de facto* changes supervisory expectations into additional general rules applicable to banks, the observance of which is ensured through the threat of supervisory measures within the SREP.

48. It is admittedly true that, from a purely formal point of view, there is no automaticity between non-compliance with the minimum prudential provisioning requirements and the application of supervisory measures within the SREP, since such measures may only be imposed following the assessment of the specific situation of each individual bank. However, the fact remains that, under the Addendum, deviations from the above requirements are only permitted in specific and well-defined circumstances. This makes it reasonable to assume that any case of non-compliance not justified on the basis of those circumstances will be considered as a negative element within the SREP and will indeed lead to the application of supervisory measures.[31]

49. In conclusion, the Legal Service is of the view that, from the point of view of its content too, the Addendum is capable of altering the legal position of banks directly supervised by the ECB to a significant extent, inasmuch as those banks will be under the obligation to apply the (more stringent) minimum prudential provisioning requirements laid down in the Addendum and, to that end, to make use of the possibility afforded to them under Article 3 of the CRR (which is, under the current legal framework, only optional).

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31 It may be interesting to recall the statements made in this regard by the Chair of the ECB's High Level Group on NPLs: "*Even though the guidance is currently non-binding in nature, we expect the institutions to apply it in full, in line with the scale and severity of the NPL challenges they face. We want banks to manage this issue much more proactively. Banks will need to explain any deviations from the guidance and non-compliance may trigger supervisory measures.*" The full text is available on the ECB's Banking supervision website at: https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/npl2/ssm.npl_addendum_draft_201710.en.pdf (last accessed on 31 October 2017).

50. Indeed, from that perspective, the Addendum appears to be effectively aimed at achieving the same result as a formal modification of the statutory capital requirements as currently laid down in the CRR.[32]

51. Hence, in the Legal Service's opinion, albeit being described as a mere guidance document the Addendum does indeed produce legal effects.

B. The ECB's competence to adopt the Addendum in its current form

52. Turning to the question whether the ECB has competence to adopt the Addendum (in its current form), the Legal Service wishes to recall in the first place that the Addendum itself refers to various provisions of the CRD as a "*regulatory basis*" for the ECB's initiative, namely Articles 74, 79 (b) and (c), 88 and 104(1).[33] However, the Legal Service notes that is not entirely clear from the Addendum what the ECB means by 'regulatory basis', i.e. whether the ECB considers the above provisions as the legal rules enabling the ECB to adopt the Addendum, or whether those provisions are simply recalled as relevant to the subject-matter of the Addendum, in order to show that the measures included in the addendum are consistent with the general aims pursued by existing legislation.[34]

53. Be it as it may, the Legal Service observes that, in any event, Articles 74, 79 (b) and (c) and 88 of the CRD IV lay down no empowerment which would enable the ECB to take measures in respect of banks. In fact, as explained above, those provisions lay down qualitative prudential requirements, mainly relating to corporate governance and internal risk management. Therefore, they are not relevant for the purpose of determining whether the ECB has competence (i.e. the necessary powers) to adopt the measures included in the Addendum.

54. As regards Article 104(1) of the CRD, it does indeed provide for (minimum) supervisory powers that must be available to supervisory authorities. Those powers include the power "*to require* [credit] *institutions to apply a specific provisioning policy or treatment of assets in terms of own funds requirements*" (Article 104(1)(d)). As explained above, pursuant to Article 16(2)(b) of the SSM Regulation, the same power is granted to the ECB in respect of banks subject to its direct supervision.

55. However, it must be emphasised that the supervisory powers vested on the supervisory authorities by Article 104(1) of the CRD IV (and, for that matter, Article 16 of the SSM Regulation) are by nature bank-specific. Indeed, it is clear from the very wording of both those provisions that the possibility to adopt binding measures in respect of banks depends on the assessment of each bank's specific situation, and that such measures must be addressed to

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32 In this regard, it may be noted that, in its Conclusions of 11 July 2017 on an Action plan to tackle non-performing loans in Europe, the Council envisaged precisely a legislative initiative in this regard, and invited the Commission "*to consider, within the framework of the ongoing review of the CRR/CRD IV, prudential backstops addressing potential under-provisioning which would apply to newly originated loans; these statutory backstops could take the shape of compulsory prudential deductions from own funds of NPL, following an assessment of the most appropriate calibrations in line with international practice*" (see doc. 9854/17 of 11.7.2017, section 8; emphasis added).

33 See the Addendum, section 2.2 (p. 3).

34 As the letter of the Chair of the Supervisory Board of 13 October 2017 would seem to suggest (see paragraph 27 above).

individual banks (and hence, are of individual scope).[35] Besides, such powers are designed to ensure compliance with statutory requirements, not to replace them.

56. It follows, in the Legal Service's view, that those supervisory powers can provide no legal foundation for the adoption of measures such as those included in the Addendum. In fact, as explained above, the Addendum introduces minimum prudential provisioning requirements, which have legal effects and are designed to apply to all (significant) banks directly supervised by the ECB, regardless to the specific situation of each individual bank. Neither the CRD IV nor the SSM Regulation confer on the ECB regulatory powers which would be needed for that purpose. Nor, for that matter, any such power is provided for in the Treaties or in other pieces of secondary EU law.

57. It must therefore be concluded that the ECB has no competence to adopt the measures included in the Addendum (in its current form).

58. As discussed in section A of this Opinion, those measures effectively consist in laying down binding prudential capital requirements of the same kind of those provided for at the legislative level in the CRR. For this reason, the Addendum appears to interfere with the prerogatives of the European Parliament as holder, together with the Council, of the legislative function under the Treaties.

59. In this regard, it may be recalled for the sake of completeness that Parliament has, already in the past, warned against the (improper) use of atypical acts, such as interpretative communications or guidance documents, as rulemaking tools. In this regard, Parliament highlighted that those acts may "*serve the legitimate purpose of providing legal certainty but that their role should not extend beyond that point;* [...] *when they serve to impose new obligations,* [those documents] *constitute an inadmissible extension of lawmaking by soft law;*".[36]

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35 See paragraph 16 above.

36 See European Parliament resolution of 4 September 2007 on institutional and legal implications of the use of "soft law" instruments (2007/2028(INI), P6_TA(2007)0366, paragraph 10.

V. Conclusions

60. The Legal Service reaches the following conclusions:

(a) *If adopted in its current form, the ECB's 'Addendum to the ECB Guidance to banks on non-performing loans: Prudential provisioning backstop for non-performing exposures' will have legally binding character inasmuch as it sets out quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures.*

(b) *The ECB has no competence to adopt the Addendum inasmuch as it lays down legally binding rules of general scope applicable to all banks directly supervised by the ECB pursuant to Council Regulation (EU) No 1024/2013.*

Luca VISAGGIO
Head of Unit

Matteo MENEGATTI

Visa:

Freddy DREXLER
The Jurisconsult

Annexes: Request for a legal opinion dated 24 October 2017.
Addendum to the ECB Guidance to banks on non-performing loans: Prudential provisioning backstop for non-performing exposures