

## **LMA response to European Commission targeted consultation on the competitiveness of the EU banking sector**

The Loan Market Association (**LMA**)<sup>1</sup> is pleased to respond to the Commission's targeted consultation on the competitiveness of the EU banking sector. We welcome the Commission's decision to launch a broad, evidence-based consultation as part of its work on the Savings and Investment Union (**SIU**), and its openness to input on both structural and regulatory drivers of banking sector competitiveness. The LMA is the voice of the trillion-dollar EMEA loan markets. Our diverse membership includes over 300 EU banks (covering more than 80% of the top 25 EU banks, with a market capitalisation of over €1.6 trillion) as well as non-EU banks, institutional investors, non-bank lenders, issuers, market infrastructure providers, and others. This breadth of membership places us in a strong position to contribute to the debate on how a more competitive EU financing landscape can be supported by both direct bank lending and well-functioning complementary funding channels.

In our view, more diversified sources of credit intermediation can play an important role in supporting banks' balance-sheet capacity, widening financing options for EU borrowers and enabling more effective, scalable, and cross-border funding of the real economy. This is consistent with the Draghi report on European competitiveness, which highlights the need to address fragmentation and strengthen the capacity of Europe's financial system to mobilise private capital at scale in support of investment, growth, and strategic priorities.<sup>2</sup> This interaction is central to the objectives of the SIU, which seeks to mobilise private capital more efficiently in support of growth, innovation and strategic investment across the EU.

Against this backdrop, our response focuses on the role of cross-border lending, securitisation, and institutional capital in supporting banks' ability to finance large-scale investment aligned with EU strategic priorities. It also highlights areas where aspects of regulatory calibration and supervisory practices may be constraining banks' capacity to deploy capital efficiently, including across borders, with potential implications for the competitiveness of the EU banking sector as a whole.

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Yours faithfully,

**Scott McMunn**

Chief Executive Officer, Loan Market Association

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<sup>1</sup> For 30 years, the LMA has supported the loan markets, with a focus on enhancing liquidity, transparency, and sustainability. Today, with 850+ members in 69 jurisdictions, we represent an ever-growing diversity of participants in international capital markets, including institutional investors, private and public sector issuers, banks, non-banks, technology solution platforms and market infrastructure providers, spanning the UK, US, EMEA, and Africa. For more information, please visit our website: [www.lma.eu.com](http://www.lma.eu.com)

<sup>2</sup> European Commission, The future of European competitiveness – Report by Mario Draghi (September 2024).

## Table of Contents

<b>Question 2</b> .....	2
<b>Question 26</b> .....	5
<b>Question 52</b> .....	8
<b>Question 66</b> .....	9

## Question 2

**Is current credit demand adequately met by banks and how is the demand and the capacity to meet it likely to evolve in the medium and long-term? Are you observing barriers affecting bank financing in support of the economy, including in areas identified as political priorities by the EU or Member States? Please elaborate by providing evidence and identifying economic sectors where access to credit could be improved.**

*EU borrowers' access to non-EU lending sources (the response to Question 2 has been driven primarily by impacted non-EU LMA members)*

EU institutional and corporate borrowers currently benefit from access to a diversified set of funding sources, including both EU and non-EU banks. This diversity supports competitive pricing, liquidity, and resilience in lending markets and is an important component of the EU's financing ecosystem. Since 2008, EU bank lending to the real economy has declined relative to GDP and as a proportion of total lending.<sup>3</sup> Meanwhile, credit demand is expected to increase materially in the medium and long term as the EU pursues increasingly capital-intensive policy priorities. Recent European Commission and European Central Bank (**ECB**) analysis suggests that additional annual investment needs linked to the green transition, digitalisation, and defence amount to close to €1 trillion per year (rising to almost €1.2 trillion annually over the period 2025–2031 once updated defence commitments are included).<sup>4</sup> To meet this demand for funding, it is important that the regulatory framework governing the cross-border provision of banking services into the EU preserves reliable access to capital and liquidity for EU borrowers, while meeting prudential objectives.

Article 21c of CRD VI (**Article 21c**) establishes a general prohibition on the direct provision of "core banking services" (including lending) to EU clients from outside of the EU, unless specific exemptions or carve-outs apply. These exemptions are crucial for the efficient functioning of financial markets, for competition that benefits EU borrowers, and for broader financial stability. They are intended to ensure that non-EU banks can continue to provide banking services lawfully into EU Member States where those services fall within scope of the exemptions.

As mandated by CRD VI, the European Banking Authority (**EBA**) attempted to assess the impact and the effect of Article 21c on the competitiveness of EU financial sector entities

<sup>3</sup> Commission, Mid-term review of the Capital Markets Union Action Plan (June 2017).

<sup>4</sup> ECB, Time to be strategic: how public money could power Europe's green, digital and defence transitions, ECB Blog (July 2025).

(FSEs) and the potential costs they may face. The EBA's resulting report noted that several factors make it difficult to reach a comprehensive EU-wide view on Article 21c's likely impact on FSEs.<sup>5</sup> The report highlights that the available quantitative data relates primarily to deposits by FSEs and that there is scant quantitative information available related to lending to FSEs from outside of the EU.<sup>6</sup>

Based on what the EBA terms as "limited and anecdotal" evidence, the EBA concludes that Article 21c's impact on lending to FSEs is "potentially limited" at this stage and that Article 21c exemptions and carve outs "may provide an adequate solution to meet the demand" of FSEs. The report did not recommend expansion of the inter-bank exemption to include FSEs (but noted that the situation may need to be further monitored). In this context, the absence of comprehensive lending data should not be interpreted as evidence of negligible impact on FSEs, but rather as reinforcing the need for careful and proportionate implementation of Article 21c.

Moreover, the status of Member State transposition of CRD VI currently calls into question the EBA's core assumption about the harmonised and predictable availability of Article 21c exemptions across the EU. Only three Member States adopted final legislation implementing CRD VI by the 10 January 2026 deadline – and the Commission's own CRD VI monitoring page (updated 30 March 2026) indicates that only five Member States had communicated full transposition measures at that point, and that infringement proceedings were pending against 22 Member States due to the lack or delay of notification (or incompleteness) of national transposition measures.<sup>7</sup> This risks disrupting local banking markets and cross-border lending activity, to the detriment of EU borrowers – especially where non-EU banks reduce or withdraw financing because of regulatory uncertainty.<sup>8</sup> In practice, non-EU banks must make jurisdiction-by-jurisdiction risk assessments, meaning that lack of clarity in even a subset of Member States can have disproportionate effects on EU-wide lending decisions. Additionally, should national transposition ultimately omit, narrow, or gold-plate these exemptions, this could adversely affect the liquidity and competitiveness of lending markets, increase costs for EU borrowers, and restrict access to financing.

From the perspective of EU borrowers, possible consequences include:

- interruption or reduction in lending to EU borrowers by non-EU banks, resulting in fewer financing options overall;
- higher costs for EU borrowers from non-EU banks, due to increased compliance burdens passed on by lenders;
- reduced access to capital and liquidity for EU borrowers in wholesale, project-related, and cross-border financing (and a loss of competitiveness relative to other Member States where implementation is more proportionate);

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<sup>5</sup> EBA, Report on the provision of services from third countries (July 2025).

<sup>6</sup> As a predominantly private, bilateral, and institution-to-institution market, cross-border loan activity is not centrally reported, which inherently limits the availability of aggregated EU-wide quantitative data on lending volumes, particularly for non-EU bank participation.

<sup>7</sup> European Commission, Monitoring the implementation and enforcement of the Capital Requirements Directive VI (March 2026).

<sup>8</sup> This fragmentation is compounded by the fact that Article 21c does not harmonise existing national restrictions on lending activity (like bank monopoly laws), which will continue to apply at Member State level alongside CRD VI and may further affect the availability of cross-border lending in practice.

- increased fragmentation of global capital and liquidity pools, with potential financial stability implications; and
- the relocation of EU borrowers to jurisdictions offering greater regulatory certainty and flexibility.

To mitigate these risks and avoid unnecessary disruption during the transition period, the Commission should consider requesting the EBA to issue a no-action letter advising national competent authorities to de-prioritise the supervision and enforcement of Article 21c until 12 months after *all* Member States have transposed the relevant provisions into national law.<sup>9</sup> This would support the original policy intention that the market have a full year to implement any necessary changes based on final legislation. Such an approach would support orderly and consistent implementation across Member States, without weakening prudential oversight.

At the same time, the Commission should use this implementation period to undertake an assessment of national transposition measures to ensure that the exemptions and carve outs to Article 21c are implemented consistently and in line with the Directive across all Member States. Ensuring faithful and uniform transposition would help safeguard a level playing field for EU borrowers, reduce regulatory uncertainty for non-EU banks operating on a cross-border basis, and mitigate the risk of fragmentation arising from divergent, restrictive, or gold-plated national approaches.

In addition, further consideration should be given to extending Article 21c's inter-bank exemption to FSEs, such as eligible counterparties, and professional clients (including large corporates that opt up to professional status) as defined under MiFID. This would be consistent with existing EU financial services legislation, which already recognises such counterparties as possessing the expertise, experience, and organisational capacity to participate in international capital markets and to assess and manage the risks associated with complex financial services. This approach would apply only to wholesale, non-retail activity and would not affect consumer protections. Extending the inter-bank exemption on this basis would represent a proportionate and risk-based calibration of Article 21c, aligned with its underlying policy objectives and without undermining prudential safeguards for retail clients. In the context of the EU's growth, competitiveness, and strategic objectives, a proportionate baseline approach would be to avoid restricting FSEs' access to established sources of credit in the absence of clear evidence of prudential risk or market failure.

Finally, the Commission should undertake a cost-benefit analysis of Article 21c to assess its likely impact on lending to EU institutional and corporate borrowers and to ensure that it supports, rather than constrains, access to credit in the EU economy. Such an assessment would provide an evidence-based foundation for any targeted future recalibration, informed by observed market impacts once implementation is complete.

Ensuring Article 21c is implemented in a transparent, predictable, and proportionate way would directly support the EU's objectives of legal certainty, market integration, and the smooth functioning of cross-border financing markets, which are essential to meeting future credit demand across the EU economy.

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<sup>9</sup> See EBA/Op/2025/08, Opinion on the interplay between PSD2 and MiCA (No-Action Letter) (June 2025), providing a time-limited instruction to de-prioritise supervision and enforcement of specified provisions of the Payment Services Directive and Markets during a transitional period.

## Question 26

**What factors are constraining the ability of EU banks to finance large-scale projects, including in the areas of digitalisation, climate transition and defence, compared to their international peers? In particular, to what extent do differences in profitability, cost structures, balance-sheet capacity, risk-appetite, scale or regulatory and market conditions explain any identified gaps?**

### Securitisation

A key constraint on EU banks' ability to finance large-scale, long-dated projects is the limited ability to recycle balance-sheet capacity, reflecting regulatory and market frictions relative to US and other international peers. This constraint interacts with other structural factors – including lower profitability, higher capital intensity, and a balance-sheet-centric intermediation model – but is particularly acute in relation to capital-intensive investment needs in areas such as climate transition, digitalisation, and defence.<sup>10</sup>

The Draghi report on the future of European competitiveness identifies a structural gap between abundant private savings in the EU and persistently insufficient productive investment, particularly in long-dated, capital-intensive sectors.<sup>11</sup> The report links this gap to the limited ability of EU banks to recycle balance-sheet capacity, in contrast to their US peers that rely more heavily on securitisation and capital markets intermediation. Securitisation is highlighted by Draghi as a mechanism to bridge the savings–investment gap by transferring risk from banks to long-term investors, thereby enabling additional lending without requiring commensurate increases in regulatory capital.

This constraint is increasingly relevant given the scale of Europe's strategic investment needs. Recent Commission and ECB analysis suggests that additional investment requirements linked to the green transition, digitalisation, and defence now amount to close to €1 trillion per year (with estimates rising to around €1.2 trillion annually over 2025–2031 once updated defence commitments are included).<sup>12</sup> While banks are expected to remain central to project origination and construction financing, these needs cannot be met sustainably without mechanisms that allow banks to recycle balance sheets at scale.

Additionally, the contraction in Europe's securitisation market is structural: it is now only around 17% of the size of the US market (down from approximately 85% prior to the global financial crisis) and annual issuance remains significantly lower relative to GDP than in the US or UK.<sup>13</sup> This underdevelopment has direct implications for balance sheet capacity and the competitive pricing of long-dated credit by EU banks. Industry analysis indicates that a more proportionate regulatory and supervisory framework could, over time, unlock hundreds of billions of euros in additional bank lending.<sup>14</sup>

We share Draghi's assessment and view a well-functioning securitisation framework as essential to boosting EU productivity and economic growth, and to strengthening EU banks' ability to finance large-scale projects such as digitalisation, the climate transition, and

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<sup>10</sup> See Bruegel, EU securitisation needs a more market-based approach (December 2025), which documents the persistent underdevelopment of EU securitisation markets and the resulting constraints on EU banks' ability to support long-dated investment.

<sup>11</sup> Commission (note 2)

<sup>12</sup> ECB (note 4).

<sup>13</sup> See Christian Noyer (Chair), Developing European capital markets to finance the future – Proposals for a Savings and Investments Union, Report of the Expert Committee (April 2024), pp. 46–49; and AFME, Securitisation Data Report Q4 2023 & 2023 Full Year (March 2024).

<sup>14</sup> AFME, EU Securitisation back on track – A 5-point plan (June 2024).

defence. An underdeveloped EU securitisation market materially constrains EU banks' balance-sheet capacity, capital velocity, and return on equity relative to international peers, limiting their ability to support such investment at scale. With appropriate reforms to the applicable regulatory framework, securitisation can and should play a meaningful role in closing this competitiveness gap.

A vibrant EU securitisation market is also a key pillar of the SIU, enabling capital to flow efficiently to corporates, particularly small- and medium-sized enterprises (**SMEs**). In a context where public balance sheets are constrained and EU banks face higher capital charges on long-dated exposures than many international peers, increasing institutional investor participation is essential to revitalising the EU securitisation market – both as a source of long-term funding for EU corporates and as a means of enabling banks to expand lending. A deeper and more functional securitisation market would also help attract international and domestic institutional capital into EU credit markets, strengthening non-bank funding channels for EU borrowers while supporting banks' role as primary originators.

Against this objective, the current regulatory framework for securitisation is not fully reflective of the risk profile of certain structures, in particular collateralised loan obligations (**CLOs**). CLOs already account for a significant proportion of loan market financing in the EU for both large- and mid-cap corporates and play an important role in diversifying credit risk across the institutional investor base. However, aspects of the regulatory framework continue to limit their effectiveness as a funding tool.

While the current reform proposals contain encouraging elements, concerns remain that they may not fully unlock the potential of securitisation (and CLOs in particular). Key issues include:

- Bank and insurance capital rules – Capital requirements for senior CLO tranches in particular fail to reflect historical loss experience, structural simplification and protections, and alignment of interests within CLO structures. This risks disincentivising bank and insurance company investment in securitisations, impairing banks' ability to recycle balance-sheet capacity and reducing lending capacity for large-scale projects, with limited systemic benefit.
- Disclosure templates – Although the proposals aim to scale back existing requirements, CLO investors already receive the information necessary for due diligence through contractual disclosure frameworks. Additional prescriptive disclosure requirements risks increasing compliance costs for sponsors and issuers without delivering commensurate transparency benefits.
- Extension of sell-side sanctions to investors – Extending the existing sell-side sanctions regime to investors (for breaches of their due-diligence requirements) is not necessary and risks deterring buy-side participation in the EU securitisation market. Investors are already subject to robust sectoral regulatory regimes with appropriate enforcement and remediation tools.
- Applicability of disclosure requirements to non-EU transactions – Prescriptive disclosure requirements applied to non-EU issuers indirectly via EU investor due-diligence obligations risk limiting EU investors' access to global securitisation markets, reducing diversification and potential returns, and ultimately weakening the development of the EU securitisation market itself. EU investors should instead simply be required to ensure that sufficient disclosures are made by sell-side parties (wherever located) to enable them to make an adequate risk assessment (both before investing and on an ongoing basis).

Addressing these issues would strengthen the role of securitisation – and CLOs in particular – as a funding tool for the future, ensuring that productive investments that are central to Europe’s strategic objectives are adequately financed.

A well-functioning securitisation framework is critical to enable EU banks to recycle balance-sheet capacity and sustain lending volumes, particularly for large and long-dated projects. Constraints on securitisation directly weaken EU banks’ competitiveness by limiting their lending capacity, increasing capital intensity, and reducing their ability to finance strategic sectors at scale relative to international peers.

### *Impact of the Leveraged Loan Guidance*

A range of factors constrain the ability of EU banks to finance large-scale projects (in areas such as digitalisation, the climate transition, and defence), including comparatively lower profitability, balance-sheet constraints, and a more conservative regulatory and supervisory environment relative to some international peers. Within this context, the ECB Guidance on Leveraged Transactions (the **Guidance**) represents a particularly relevant regulatory factor affecting banks’ risk appetite and lending capacity.

The Guidance increases supervisory scrutiny, governance requirements, and internal capital and risk-management costs associated with lending to leveraged borrowers, which in practice can constrain the supply of credit to certain segments of the market. Since the introduction of the Guidance (and its subsequent operationalisation through supervisory follow-up) banks have been required to impose quantitative limits within their risk-appetite frameworks, tighten underwriting standards, and apply enhanced stress testing to leveraged portfolios. Where deficiencies are identified, supervisory escalation and additional capital requirements may apply, directly influencing banks’ willingness and capacity to originate and hold leveraged exposures. While the objective of the Guidance – to improve underwriting standards, enhance governance, and reduce systemic risk – is appropriate, the current definition of leveraged transactions is over-inclusive and may inadvertently capture borrowers that are not inherently high-risk.

In particular, the Guidance can disproportionately affect lending to activities aligned with the EU’s strategic objectives, such as fast-growing digital businesses, companies active in the green transition, and capital-intensive defence projects. These borrowers may exhibit higher leverage or negative EBITDA during growth or investment phases or may be backed by financial sponsors such as venture capital or private equity funds, without necessarily presenting elevated credit risk (e.g., where supported by appropriate equity buffers, contractual protections, or long-term revenue visibility).

This calibration challenge is increasingly relevant in a global context. By contrast with the EU approach, the United States has recently moved away from prescriptive leveraged-lending guidance. In December 2025, US banking regulators formally rescinded the 2013 Interagency Guidance on Leveraged Lending, concluding that it had been overly restrictive and overly broad, had impeded banks’ application of general risk-management principles, and had contributed to a significant shift of leveraged lending activity from banks toward non-bank lenders. In place of detailed supervisory expectations and leverage-based classifications, US regulators now rely primarily on general safety-and-soundness principles and institution-specific risk-appetite frameworks.

This divergence in supervisory approach risks placing EU banks at a competitive disadvantage in leveraged and sponsor-backed financing, particularly for globally mobile

borrowers and investment activity, at a time when the EU is seeking to mobilise private capital in support of its strategic priorities. For example, direct lending by private credit funds has expanded rapidly in the EU, with quarterly origination volumes reaching approximately €28 billion in 2025 – an increase of over 80% year-on-year – suggesting that tighter bank-based constraints contribute to the migration of leveraged lending activity toward non-bank lenders.<sup>15</sup>

The Commission and relevant supervisory authorities should consider whether the Guidance would benefit from greater risk-sensitivity and flexibility. Possible options could include revisiting leverage thresholds used for supervisory classification (for example, higher debt-to-EBITDA thresholds), or providing clearer exclusions or differentiated treatment for certain categories of borrowers, such as SMEs or investment-grade counterparties. This could help preserve prudent lending standards while ensuring that EU banks are not unduly constrained in supporting strategically important investment.

The calibration of the Leveraged Loan Guidance directly affects banks' ability to originate and hold higher-yielding, growth-oriented financings, which are key to supporting investment and maintaining profitability. An overly restrictive or broad application risks weakening EU banks' competitiveness by constraining risk appetite and reducing deal flow.

## Question 52

***Do you have concrete examples of gold-plating of EU rules via transposition of EU directives, national options and discretions? If so, please list them here.***

### UCITS eligible assets

The UCITS Eligible Assets Directive (2007/16/EC) (the **EAD**) defines and clarifies the categories of assets in which a UCITS fund may invest. Since its introduction in 2007, however, there has been divergence among Member States in their interpretation of the UCITS eligibility of both direct and indirect exposures to loans. This divergence reflects, in part, gold-plating through overly restrictive national interpretations of EU-level rules and guidance, rather than requirements flowing from the UCITS framework itself. For example, a 2020 update to the Commission de Surveillance du Secteur Financier (**CSSF**)'s UCITS guidance required Luxembourg-domiciled UCITS to divest any loan exposures by year-end and amend their prospectuses accordingly.<sup>16</sup>

In 2023, the Commission mandated ESMA to review the EAD and make proposals to modernise the rules and address inconsistencies in application across Member States. In its resulting report, ESMA did not propose to add loans as a standalone eligible asset class for UCITS, but instead proposed retaining and clarifying that the existing "flexible bucket" of up to 10% for exposures to alternative assets could be used for certain indirect exposures to loans, where all relevant requirements are met (including liquidity and valuation).<sup>17</sup> This clarification confirms that such indirect exposures are not prohibited by the UCITS framework itself.

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<sup>15</sup> European Commission, Climate Risk and Bank Capital Structure (February 2023).

<sup>16</sup> CSSF, FAQ Law of 17 December 2010 (February 2026).

<sup>17</sup> ESMA, Technical advice to the European Commission on the review of the UCITS Eligible Assets Directive (June 2025).

However, the CSSF's UCITS guidance continues to prohibit UCITS from investing in any loans, including within the 10% bucket for alternative assets. This approach goes beyond what is required by the UCITS framework and ESMA's report and results in a materially more restrictive regime than that applied in other Member States, undermining supervisory convergence and the level playing field within the internal market.

This form of gold-plating also has broader implications for the competitiveness of the EU banking sector, which is directly relevant to the Commission's consultation. Divergent national restrictions on UCITS investment capabilities limit the ability of EU-based institutional investors to participate consistently in loan markets, which in turn affects banks' capacity to originate, syndicate, and distribute loans efficiently within the EU. By narrowing the domestic investor base for loan assets in certain Member States, such gold-plating can increase funding costs, reduce market depth and liquidity, and contribute to the migration of financing activity to non-EU jurisdictions or to non-bank lenders. This risks disadvantaging EU banks relative to global peers and exacerbating market fragmentation, contrary to the objectives of the Capital Markets Union and the SIU.

We therefore recommend that the Commission provide clarification to ensure consistent interpretation across Member States, including that UCITS may include broadly-syndicated loans within the 10% bucket for alternative assets where all relevant requirements are met (e.g., liquidity and valuation).

In our view, loans are a well-understood asset class that could be accommodated within UCITS without undermining investor protection. Any such exposure would, in any event, remain subject to the UCITS liquidity risk management framework, including ESMA's liquidity management tools and valuation requirements.

In addition, permitting UCITS to invest in broadly-syndicated loans would support the wider EU economy by facilitating additional non-bank financing and contributing to economic growth and innovation, while also strengthening the interaction between EU banks and EU capital markets in a manner supportive of banking-sector competitiveness.

Divergent national interpretations of UCITS eligibility constrain the ability of institutional investors to participate consistently in loan markets, reducing depth and liquidity in the investor base. This fragmentation weakens EU banks' competitiveness by limiting efficient loan distribution, increasing funding costs, and reducing their ability to originate and syndicate credit at scale across the internal market.

## Question 66

**Are, in your view, the various elements of the framework aimed at reducing NPLs working as intended?**

### Non-performing loans (NPLs)

The objective of the NPL backstop is to strengthen EU bank resilience and financial stability by ensuring timely provisioning against credit losses, incentivising banks to address non-performing exposures at an early stage and supporting the efficient reallocation of capital and resources to lending to the real economy. In principle, these objectives remain valid.

However, certain features of the backstop could be better calibrated to ensure it operates as designed and avoids unintended consequences. While the backstop is meant to encourage early engagement on NPLs, in practice it can also create pressure for

accelerated provisioning driven primarily by regulatory timelines rather than by the underlying recovery prospects of the exposure. This may reduce banks' flexibility to pursue value-maximising workout strategies and can increase incentives to dispose of NPLs at an early stage (including at significant discounts) rather than working them out over time.

These dynamics can have broader implications for bank balance-sheet management, profitability, and credit supply (which are directly relevant to the competitiveness of the EU banking sector), and may also affect the functioning of secondary markets for NPLs by distorting the timing and pricing of transactions. In particular, rigid backstop timelines may contribute to lower recovery values, constraining EU banks' ability to compete effectively with non-EU peers that operate under more flexible loss-recognition and workout regimes.

More generally, the backstop does not always sufficiently reflect the fact that not all payment defaults are driven by the same underlying dynamics. Some defaults may arise from temporary liquidity pressures, short-term market disruptions, or repayment structures that prove overly tight, rather than from a fundamental deterioration in a borrower's business model or earning capacity. In such cases, banks should retain the ability to differentiate among exposures and to support viable companies through appropriate restructuring or workouts, without being disincentivised by automatic provisioning requirements that may be misaligned with the economic reality of the exposure.

In this context, the Commission should consider ending the application of the permanent Pillar 1 NPL backstop, aligning the EU framework more closely with the approaches taken in other major jurisdictions such as the UK and the United States, which do not apply an equivalent permanent, rule-based provisioning backstop. Removing the permanent backstop would help restore greater proportionality and flexibility in the management of distressed exposures, better align provisioning requirements with underlying credit risk and recovery prospects, and support banks' ability to engage in value-maximising workouts rather than premature loan disposals. This would strengthen EU banks' balance-sheet flexibility and lending capacity, while remaining consistent with financial stability objectives.

If the permanent backstop is retained, the Commission could, as an alternative option, consider a review to assess whether its application should be limited to situations where an institution's gross NPL ratio exceeds a 7% threshold. This would better target the backstop to circumstances of systemic stress, where elevated NPL levels pose a genuine risk to bank resilience, while avoiding disproportionate effects in periods where NPL ratios remain low and manageable. Empirical evidence supports such an approach: ECB analysis of historical banking crises finds that a large majority of crises (around 81%) are characterised by NPL ratios exceeding 7% of total loans, suggesting that this level represents a meaningful risk threshold rather than normal cyclical variation.<sup>18</sup> A threshold-based approach would therefore preserve the backstop as a crisis-management tool, rather than a binding, structural constraint on lending in normal conditions, and would contribute to a more competitive, resilient and economically effective EU banking

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<sup>18</sup> European Central Bank, The dynamics of non-performing loans during banking crises: a new database (April 2020).

sector.

The calibration of the NPL backstop directly affects banks' ability to manage distressed exposures and recycle capital into new lending. If provisions are driven more by fixed regulatory timelines than by underlying credit fundamentals, this can weaken EU banks' competitiveness by reducing recovery values, constraining balance-sheet flexibility, and limiting capacity to support new credit to the real economy.