

# Supporting a competitive EU banking sector

## Non-performing loans, leveraged lending, and responsible risk-taking

October 2026

### Overview

The European Commission has placed the competitiveness of the EU banking sector firmly on the policy agenda. Its July 2026 Communication on the competitiveness of the EU banking sector (**Communication**) recognises that banks will remain central to financing Europe's investment needs and that resilience must be balanced with responsible risk-taking.

For the loan markets, two existing EU measures are particularly relevant:

- i. the permanent Pillar 1 prudential backstop for non-performing exposures (**NPE Backstop**)
- ii. the European Central Bank (ECB)'s Guidance on leveraged transactions (**Leveraged Lending Guidance**).

Both were introduced in response to legitimate prudential concerns, but experience suggests that they can constrain lending, restructuring, and balance-sheet flexibility in ways that do not always reflect the underlying credit risk.

This paper draws on LMA members' experience and calls for both measures to be made more risk sensitive. For the NPE Backstop, this means considering whether it remains necessary and, if retained, linking its application more closely to material non-performing loan (NPL) accumulation while giving greater weight to recovery prospects. For the Leveraged Lending Guidance, the definition of leveraged transactions and underlying methodology should focus more closely on transactions that present genuinely elevated leverage-related risk. These changes would give banks greater flexibility to support viable borrowers and finance the real economy without weakening bank resilience.

### At a glance

| NPE Backstop                                                                                              | Leveraged Lending Guidance                                                                                    |
|-----------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|
| Automatic capital consequences can be driven by the age of an exposure rather than its recovery prospects | The leveraged transaction definition can capture borrowers that do not present elevated leverage-related risk |
| This can discourage viable restructurings, new financing, and longer-term workout strategies              | Non-binding guidance can operate as a binding constraint in practice                                          |
| <b>LMA view:</b> remove or recalibrate the NPE Backstop to better reflect the underlying risk             | <b>LMA view:</b> make the definition and methodology more risk-sensitive                                      |

# Why this matters for the loan markets

The Communication sets the direction for a broader package of banking reforms expected in the first quarter of 2027. The aim is to create a more integrated, efficient, and competitive banking sector that can better finance growth, innovation, and Europe's strategic priorities, while preserving resilience.

The Commission has identified three main areas for action: reducing fragmentation in the Single Market, ensuring that international standards are applied in a way that reflects the characteristics of the EU banking sector, and simplifying parts of the regulatory framework that have become unnecessarily complex or burdensome. The accompanying staff working document (**Staff Working Document**) provides supporting analysis, including areas where the existing regulatory framework may be unnecessarily complex or insufficiently proportionate.

For the loan markets, these measures can have a direct impact on lending to viable firms, the management of deteriorating credits, the price and availability of financing, and banks' ability to recycle capital into new lending.

Both measures were introduced in very different market conditions and should now be reviewed in light of how they operate in practice. EU banks are better capitalised, aggregate asset quality has improved, and credit-risk management, accounting, restructuring, insolvency, and supervisory frameworks have developed materially.

## 01 Permanent NPE Backstop

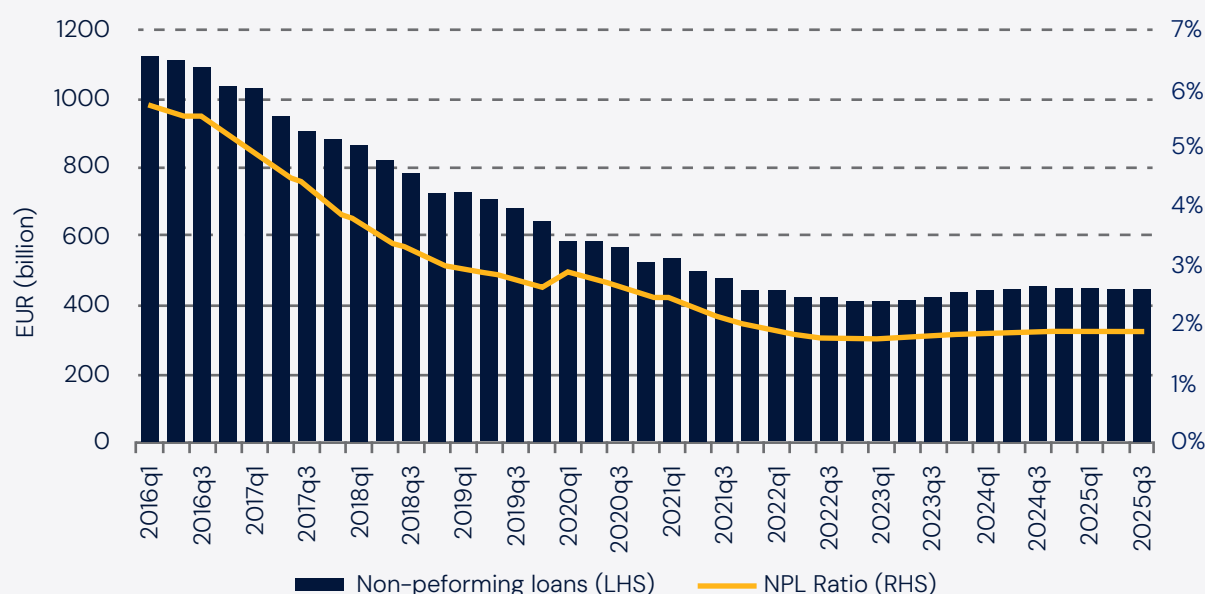
### The policy issue

The NPE Backstop requires banks to maintain minimum levels of coverage for non-performing exposures and is intended to encourage timely recognition of potential credit losses. Its permanent application as an automatic Pillar 1 requirement may, however, be less appropriate in normal market conditions.

The framework for recognising and managing credit deterioration has developed materially since the NPE Backstop was introduced, including through enhanced expectations on loan origination, monitoring, and default management, and more developed bank credit-risk management practices. IFRS 9 expected-loss provisions already affect CET1 capital through profits and retained earnings, while Article 159 of the CRR provides an additional safeguard for banks using the Internal Ratings-Based approach. Restructuring and insolvency frameworks across Member States have also developed, giving lenders and borrowers more options to support viable restructurings and preserve value.

The Staff Working Document notes that EU banks are well capitalised and resilient and that the EU's NPL ratio fell from around 6.5% in 2014 to around 1.8% in the fourth quarter of 2025. The ECB has similarly noted that NPL ratios reached as high as 50% in some countries following the global financial crisis but have now largely converged across countries.

#### Non-performing loans in the EU



Source: ECB.

Note: NPL, domestic and (non-EU) foreign subsidiaries and branches, FINREP reporters in EUR (billion) and NPL ratio, domestic and (non-EU) foreign subsidiaries and branches, FINREP reporters, EU, quarterly data.

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**The reforms implemented after the crisis have clearly paid off. But as the European Commission is currently reviewing the state of the EU banking sector, it is time to assess and secure the progress made.”**

**Claudia Buch,**  
Chair of the Supervisory Board of the ECB, 19 May 2026

## Practical effects identified by members

- The required level of coverage increases as an exposure ages, which can lead to capital consequences that are increasingly disconnected from underlying credit risk and recovery prospects
- Banks may face incentives to sell an exposure early, potentially at a significant discount, rather than pursue a longer workout that could preserve greater value
- For viable borrowers, an early sale can disrupt established lending relationships at a critical point in a restructuring
- Expected future backstop deductions may discourage banks from providing new liquidity to an otherwise viable borrower facing short-term pressure
- Automatic capital consequences may arise before a long-term workout or complex restructuring has had time to work
- Early identification of distress, including through prudent covenants and intervention triggers, may accelerate entry into the NPE framework, even where early intervention improves recovery prospects

## Competitiveness implications

Automatic provisioning timelines can reduce banks' flexibility to manage distressed exposures, support borrowers through periods of financial difficulty, preserve recovery value, and recycle capital into new lending. Common regulatory timelines may also concentrate loan sales, weaken sellers' negotiating positions, and distort secondary-market pricing.

The NPE Backstop was introduced as part of the strengthening of prudential safeguards following the global financial crisis, but other major jurisdictions (including the United States and Japan) have since taken different approaches and do not apply an equivalent permanent Pillar 1 backstop for non-performing exposures. They rely more heavily on accounting standards, supervisory judgement, and institution-specific assessment. In the UK, the Prudential Regulation Authority removed its automatic CET1 deduction for non-performing exposures in November 2023, while retaining supervisory powers to address inadequate provisioning on a firm-specific basis.

ECB research covering 88 banking crises since 1990 found that approximately 81% involved NPL ratios above 7% of total loans. The 7% figure provides a useful reference point for considering whether the NPE Backstop should respond to material NPL accumulation at institution or portfolio level, rather than the ageing of individual exposures.

# Options for a more risk-sensitive approach

- Give greater recognition to credible restructuring plans, borrower viability, and demonstrable recovery prospects
- Introduce targeted carve-outs or supervisory adjustments where expected recovery materially exceeds a distressed-sale outcome
- Review the interaction between the NPE Backstop and the definition of default so that viable restructurings are not unnecessarily discouraged
- Link the NPE Backstop more closely to material NPL accumulation at institution or portfolio level
- Under a threshold model, apply deductions only to NPL amounts above the relevant threshold to reduce cliff effects
- Consider removing the NPE Backstop if accounting requirements, ordinary supervision, and other prudential safeguards provide sufficient protection

## 02 Leveraged Lending Guidance

### The policy issue

The Leveraged Lending Guidance is a matter for the ECB, which is reviewing whether it remains appropriately calibrated. It is nevertheless relevant to the wider work on banking competitiveness, particularly the focus on financing the real economy and the distinction between binding requirements and non-binding supervisory guidance.

As a non-binding supervisory instrument, the Leveraged Lending Guidance is intended to promote sound underwriting, governance, and risk management. Its definition and methodology can, however, capture transactions that do not present elevated leverage-related risk, while supervisory expectations can make the Leveraged Lending Guidance operate as a binding constraint in practice.

ECB-supervised banks are expected to reflect the Leveraged Lending Guidance in their internal frameworks. Classification as a leveraged transaction can affect risk appetite, governance, stress testing, reporting, approval processes, hold levels, syndication strategy, and capital allocation. Members have reported formal remediation expectations following supervisory reviews of policies, procedures, and risk-appetite frameworks, despite the Leveraged Lending Guidance's non-binding status.

The ECB's review, expected to conclude by the end of 2026, should test the definition of leveraged transactions and the underlying methodology against market evidence.

### Practical effects identified by members

Members have identified borrowers with moderate net leverage and meaningful contractual protections that were nevertheless classified as leveraged because of technical features in the methodology. Examples include debt at subsidiary level, undrawn revolving facilities, debt-incurrence baskets, accordion capacity, and non-recourse project finance debt.

#### Illustrative member examples

| Sector              | Gross leverage | Net leverage | ECB expanded metric | Classification driver                                     | Financial protections                                  |
|---------------------|----------------|--------------|---------------------|-----------------------------------------------------------|--------------------------------------------------------|
| Steel manufacturing | 1.67x          | 0.99x        | Infinite            | Debt at subsidiary rather than holding-company level      | Net leverage <3.0x; minimum equity                     |
| Machinery           | 2.99x          | 2.74x        | 9.50x               | Debt-capacity baskets and an uncommitted accordion option | Net leverage <3.5x; step-down to 3.25x; minimum equity |
| Consumer goods      | 3.30x          | 2.70x        | 8.30x               | Undrawn revolving facilities and free baskets             | Net leverage <3.75x                                    |

In each example, lenders benefited from leverage covenants or minimum-equity protections. Despite these protections and relatively modest net leverage, the transactions were still classified as leveraged.

Members have questioned whether leverage calculations should give the same weight to undrawn facilities or theoretical future debt capacity as to actual indebtedness. They have identified cases where leverage metrics may not fully reflect the ring-fenced nature of non-recourse project debt or other structural protections.

## Competitiveness implications

An over-broad definition of leveraged transactions may constrain financing for borrowers whose underlying risk does not justify that treatment. Differences in supervisory approaches across jurisdictions may also put EU banks at a competitive disadvantage and limit their ability to finance digitalisation, clean technologies, defence, infrastructure, and other strategic priorities.

In December 2025, the Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation withdrew from the US Interagency Guidance on Leveraged Lending, while retaining wider safety-and-soundness supervision. In doing so, they cited concerns that the previous guidance was overly restrictive and impeded banks' application of risk-management principles.

## Options for a more risk-sensitive approach

- Focus the definition of leveraged transactions on genuinely highly leveraged transactions and sponsor-driven leveraged buyouts
- Exclude or differentiate borrowers where contractual protections, equity support, recurring revenues, or investment-grade characteristics mitigate the risk
- Revisit the treatment of undrawn facilities, acquisition and capital-expenditure facilities, debt-incurrence baskets, accordions, and theoretical future debt capacity
- Allow differentiated treatment for structurally protected or self-liquidating financings, including trade, commodity, and borrowing-base structures, where leverage metrics do not reflect the underlying risk
- Clarify the distinction between non-binding supervisory guidance and requirements that banks are expected to treat as mandatory

## Conclusion

The NPE Backstop and Leveraged Lending Guidance should respond more closely to the risks they are intended to address. The forthcoming package on the competitiveness of the EU banking sector and the ECB's review of the Leveraged Lending Guidance provide an opportunity to make targeted changes that give banks greater flexibility to support viable borrowers and finance the real economy without weakening bank resilience.

# Appendix

## Sources and further reading

- ➔ European Commission, [\*Competitiveness of the Banking Sector and the Single Market in Banking, COM\(2026\) 615 final\*](#), 17 July 2026.
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- ➔ European Central Bank, Claudia Buch, [\*The bank-sovereign nexus: securing progress by completing the banking union\*](#), 19 May 2026.
- ➔ Regulation (EU) 2019/630, [\*minimum loss coverage for non-performing exposures\*](#), 17 April 2019.
- ➔ Prudential Regulation Authority, [\*PS14/23: The non-performing exposures capital deduction\*](#), 13 November 2023.
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- ➔ Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, [\*Interagency Statement on OCC and FDIC Withdrawal from the Interagency Leveraged Lending Guidance Issuances\*](#), 5 December 2025.

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### Disclaimer

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