Brussels, 24th September 2021

EACB Comments on EBA CP on Draft Regulatory Technical Standards (RTS) on the specification of the calculation of specific credit risk adjustments (EBA/CP/2021/25)

General comments

The members of the EACB welcome the opportunity to comment on the EBA's Consultative Paper (CP) on amendments to its RTS on credit risk adjustments in the context of the calculation of the risk weight (RW) of defaulted exposures under the Standardised Approach (SA). The EACB appreciates the initiative undertaken by the EBA to revise and clarify the prudential treatment of defaulted exposures following the sale of a non-performing asset, especially in light of the European Commission's Action Plan on *Tackling NPLs in the aftermath of the COVID-19 pandemic*.

In principle, we support the initiative to amend the RTS as it is intended to eliminate an unequal treatment between the IRB and SA.

Indeed, it would be appropriate to include in the credit risk adjustment for a NPL buyer to determine the RW, the write-downs accounted for in the transaction price of the exposure which are retained by the seller as realised loss.

Concerning the example provided by the EBA in the CP, it could be stated more explicitly that its aim is to describe the effect whatever could be the accounting treatment by distinguishing re-evaluation and ECL revision.

Q1 *Do you agree with the proposed amendment to Commission Delegated Regulation (EU) No 183/2014?*

As illustrated above, we believe that the aim of the amendment is appropriate although the example provided does not seem to be consistent with accounting rules.

At the same time, we consider another adjustment to the RTS to be rather urgent in order to avoid unnecessary administrative expenses (thus increasing the cost of compliance) and a double burden on CET1 capital due to newly formed risk provisions.

Article 1(1), second paragraph, of the Commission Delegated Regulation (EU) No 183/2014 stipulates that the stock of loan loss provisions existing at the reporting date may only be taken into account in the own funds report as general or specific risk adjustments if:

a) there is an (interim) loss that is deducted from CET1 capital, or
b) there is an interim or year-end profit for which the institution has the supervisory approval to be included in CET1 in accordance with Article 26(2) CRR.

The result of this rule is that institutions with profits or interim profits that voluntarily waive the recognition of profits (at the same reporting date) are not allowed to take into account the existing level of risk provisioning in the financial accounts. In our opinion, however, only the consideration of the current risk provisioning (and all other current balance sheet items) gives a realistic picture of the solvency of institutions. In practice, this leads to the fact that newly formed credit loss provisions either have to be deducted from CET1 capital again or an application for the attribution of "zero" interim profits has to be submitted to the supervisory authority (see also EBA Q&As 2014/1087, 2016/2629, 2017/3330).

For example, with a marginal interim loss of -1, infinite new credit loss provisions, e.g., +1000, may be taken into account. However, with a marginal interim profit of +1, this would not be possible and 1000 would have to be additionally deducted from CET1. In order to avoid the additional capital deduction, the only alternative is to submit to the supervisory authority an application for the attribution of "zero" interim profit.

While we understand that supervisors need some evidence from institutions that loan loss provisions have been accounted for, the unequal treatment of institutions with interim losses vs. profits is incomprehensible.

For the proof, the accounting figures reviewed by the responsible auditor (analogous to the requirement for interim profit recognition according to Article 26(2) CRR) should be sufficient.

We therefore request that the second paragraph of Article 1(1) of the Commission Delegated Regulation (EU) No 183/2014 be amended:

"Any amounts resulting pursuant to the first subparagraph which have been recognised during the financial year, may only be included in the calculation of general and specific credit risk adjustments if the respective amounts have been deducted from an institution's Common Equity Tier 1 capital, either in accordance with Article 36(1) of Regulation (EU) No 575/2013, or, in the event of interim profits or year-end profits that have ~~not been approved in accordance with Article 26(2) of that Regulation, by way of a corresponding immediate reduction in Common Equity Tier 1 capital for the determination of own funds.~~ requirements laid down in Article 26(2)(a) of Regulation (EU) No 575/2013 are met."

Contacts:

For further information or questions on this paper, please contact:

- Mr. Volker Heegemann, Head of Department (volker.heegemann@eacb.coop)

- Mr. Marco Mancino, Deputy Head of Department (m.mancino@eacb.coop)

- Ms. Maryia Sulik, Adviser (maryia.sulik@eacb.coop)