EACB Comments

BCBS Consultative document

Prudential treatment of problem assets – definitions of non-performing exposures and forbearance

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INTRODUCTORY REMARKS

The members of the EACB welcome the opportunity to comment on the Committee guidance on the prudential treatment of problem assets – definitions of non-performing exposures and forbearance.

In the current regulatory context the terms "non-performing exposures" (NPEs) and "forbearance" are defined differently in various jurisdictions, however regulators are trying to harmonise such definitions, in particular the EBA is conducting in depth work. We believe that these workstreams should be as aligned as possible to avoid uncertainty for institutions and inconsistencies that would make implementation extremely difficult.

GENERAL COMMENTS

In the area of supervisory reporting, the EU has its set of requirements as specified by the EBA ITS on supervisory reporting (EU 680/2014) on forbearance and non-performing exposures in conjunction with amending Commission Implementing Regulation (EU) 2015/227. The terminology used in the BCBS consultative document should be consistent with the requirements already set by EBA, as this framework has proved successful.

Different wording for the same issue could cause problems when it comes to ensuring a uniform understanding for supervisory purposes. For instance, in para. 28 when classifying a borrower as non-performing, both BCBS and EBA stipulate that it must be examined whether the entire group would have to be classified as non-performing. For this "group", which is the term used in the EBA ITS, the BCBS consultative document uses the term "group of connected counterparties" instead. We would suggest to use the term "group" also in the BCBS guidelines.

According to para. 19, all exposures to a debtor have to be considered as non-performing when any of the exposures is past due. To take into account materiality, we consider this definition to be inappropriate. We rather believe that an aggregated exposure should only be regarded as non-performing if a certain threshold is breached (e.g. more than 20% of the aggregated exposure (cf. paragraph 155 of Implementing Regulation (EU) 2015/227 of 9 January 2015 amending Implementing Regulation (EU) 680/2014)).

SPECIFIC ISSUES

- **Definition of non-performing – para 24**

Para. 24(iii) defines all exposures as non-performing where there is evidence that full repayment of principal and interest without realisation of collateral is unlikely, regardless of the number of days past due.

In order to have a common understanding of this definition it is crucial to clarify the meaning of "realisation of collateral". We consider it necessary to differentiate in an explicit manner exposures where the repayment of the exposure is intended to occur

without a realisation of collateral from exposures and where the repayment is originally intended to be made through a realisation of collateral.

Additionally, payments made by other parties, e.g. parent companies, should not be considered as a realisation of collateral if they are made voluntarily (e.g. comfort letter). Such clarifications would also be consistent with what indicated later in the Guidelines as para. 28 – unlikely full repayment, 2. subparagraph stipulates that an unlikeliness to pay is indicated by a forced sale of collateral.

In this regard it should be clarified that if the counterparty sells the collateral itself with the agreement of the bank to fulfil its obligations this is not seen as "realisation of collateral" because the bank is not directly realising the collateral (this would also include sales proceeds of financed commodities or financed assets like project finance, e.g. development of apartments for sale).

- **Interaction of non-performing exposures with forbearance**

According to para. 30 a forborne exposure should be recognised as non-performing when it meets the conditions for such categorisation or when the original exposure would have been considered as non-performing had the forbearance measure not been granted to the original exposure.

We agree that a forborne exposure should be recognised as non-performing when it meets the conditions for such categorisation but we strongly disagree with the following criteria. On the one hand we believe that it is not necessary to consider exposures as non-performing when the original exposure would have been recognised as non-performing had the forbearance measure not been granted. This would be excessive since it would not complement the category of "defaulted" in the Basel framework (para. 452 Basel II framework) but rather extend the current definition and therefore diverge from the aim of these Guidelines which is to complement the current categories (para. 10).

- **Reclassification of non-performing exposures as performing**

Para. 33 defines which situations do not lead to a reclassification of a non-performing exposure as performing and explicitly mentions a partial write-off of a non-performing exposure.

We believe that the current wording of para. 33(i) is too wide and should be amended. The extent of this provision is unclear since it may cover situation which occur due to court compensation proceedings or court insolvency proceedings resulting in an undermining of the legal effects of (national) legal acts which result in a restructured borrower. Furthermore, it has to be clarified when a non-perfoming exposure can be reclassified if the partial-write off was part of an out of court settlement that resulted in a significant improvement of the counterparty's creditworthiness and financial standing.

Additionally, the proposed provision does not differentiate if the write-off concerns material amounts in relation to the exposure or just insignificant parts. A possible

solution could be the setting of a double materiality threshold, e.g. 2,5% and 250 Euro of all committed lines (both conditions to be simultaneously fulfilled). If the write-off of the non-performing exposure goes beyond the materiality threshold a reclassification of the exposure as performing would not occur. Furthermore, it has to be distinguished between revenue out of credit related interests and non-credit related revenues out of fee income (e.g. maintenance fees for accounts). In this regard, the write off (booking out) of fees is a correction of too high income expectations. As only income expectations get corrected, no economic loss is resulting out of the procedure and therefore no Individual Loan Loss Provision (ILLP) can be allocated to this exposure type.

- **Identification of Forbearance – Explanation of terms**

According to the proposed definition within the Guidelines (Financial difficulty lit. c) a delisting of securities should be considered as financial difficulty of the counterparty.

In some jurisdictions a delisting of securities from an exchange is subject to the fulfilment of formal requirements, e.g. if the distribution falls below 725.000 Euro or 10.000 shares (Austria). None of the reasons for a delisting would depend on the financial situation of the issuer and therefore there is neither reason or justification for qualifying a delisting as financial difficulty. To the contrary, issuers may even aim at a delisting of their securities for several non-financial reasons, e.g. reducing the disclosure requirements resulting from the listing to an exchange.

In the light of the above, believe that a delisting from an exchange (lit. c) should not be considered as a financial difficulty of the counterparty.