



CP on Draft Guidelines on management of non-performing and forborne exposures

Meri Rimmanen, Trevor Fitzpatrick, Anita Szekely

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Outline



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Background: Council conclusions (July 2017)



The EBA mandates

- Issue **Guidelines on NPE/FBE Management**, to apply to all EU banks
- Issue **Guidelines on banks' loan origination**, monitoring and internal governance
- Implement, together with ESMA and CAs, **enhanced disclosure requirements** on asset quality and NPLs
- Issue **Guidance on loan tapes monitoring**, specifying information required on banks' credit exposures / data templates.

The EBA to work with the ECB and the Commission

- Propose initiatives to **strengthen the data infrastructure** with uniform and standardised data for NPLs and consider setting-up platforms

Mandates where the EBA is not in the lead

- **Blueprint of AMCs**
- **Structural reforms of insolvency** and debt recovery frameworks
- Fostering **restructuring of the banking system**

Supervision

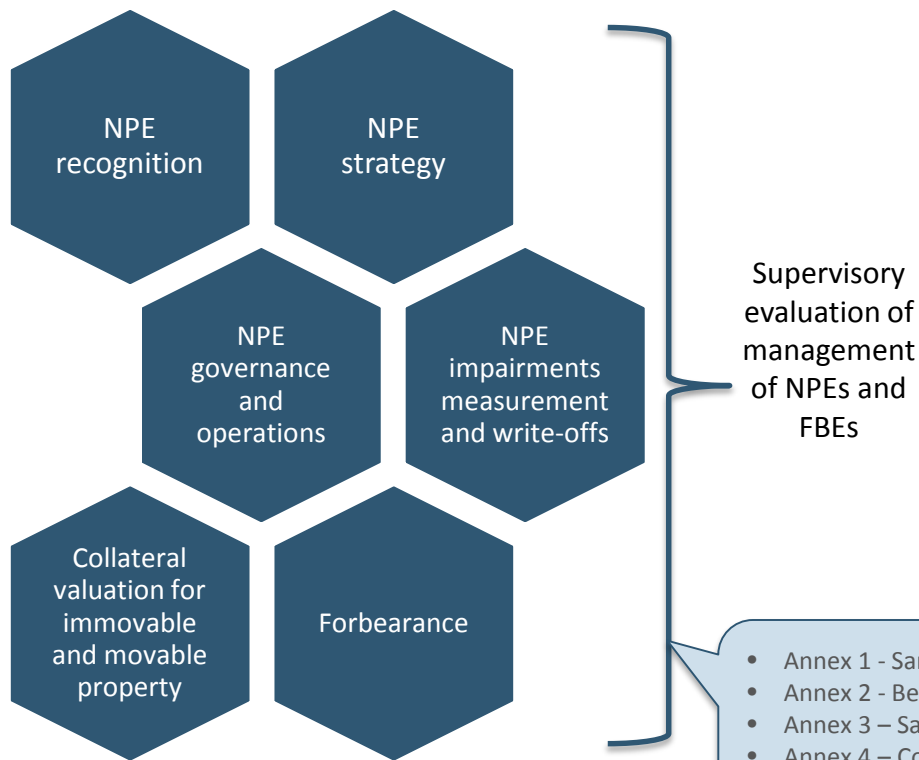
Secondary markets

Background: EBA's work on NPLs



Name of the product	Focus of the product	Current status
The EBA Standardised NPL templates	The main objective of these templates is first to improve consistency and transparency and widen investor base by lower barriers to entry, secondly, to improve data quality and availability , and finally, to support price discovery and facilitate transactions.	Published in December 2017
Consultation Paper on Guidelines on management of non-performing and forborne exposures	Aiming to achieve a sustainable reduction of NPEs in credit institutions' balance sheets.	Consultation will end in June 2018 and the Guidelines should be implemented by January 2019
Enhanced disclosure requirements for non-performing and forborne exposures	Specifying a common content and uniform disclosure formats on information on NPEs, forborne exposures and foreclosed assets that credit institutions should disclose.	Planned finalisation of the product is end of 2018
Guidelines on loan origination, monitoring and internal governance	Addressing in particular issues such as transparency and borrower affordability assessment and where relevant will leverage on existing national experiences.	Planned finalisation of the product is Q1 2019

Draft guidelines: overview



- The Guidelines specify sound risk management practices for credit institutions for managing NPE and FBE, looking at the governance and operations of a NPE workout framework, the internal control framework and NPE monitoring, and warning processes.
- The aim is to achieve a sustainable reduction of NPEs in credit institutions' balance sheets.
- The guidelines focus on prudential aspects, but consumer protection perspective is also important.

- Annex 1 - Sample criteria for grouping NPE in retail
- Annex 2 - Benchmark for NPE monitoring metrics
- Annex 3 – Sample of early warning indicators
- Annex 4 – Common NPE-related policies
- Annex 5 - Possible forbearance measures

Proportionality



A balance between the policy requirements and the characteristics of the institutions, i.e. whether the policy instruments for the institutions are appropriate and fair given a set of criteria

Avoid disproportionately large (e.g. administrative and operational) costs for the institutions with respect to their risk profile but also size, internal organisation, and nature, scope and complexity of their activities

- A **NPL ratio of 5%** which indicates that credit institutions should establish a **strategy** (Ch.4) and the related **operational and governance arrangements** (Ch.5)
 - This is **not an automatic target** and competent authorities can request institutions below the threshold to implement NPE strategies if they identify evidence for deteriorating asset quality
- Reference to **EBA/2017/11 Guidelines on internal governance under Directive 2013/36/EU**, in particular for the implementation of **NPE Strategy** (Ch. 4) and **Governance and Operations** (Ch. 5)
- Alignment with **EBA/GL/2014/13 Guidelines on SREP** for **supervisory evaluation** (Ch. 10)

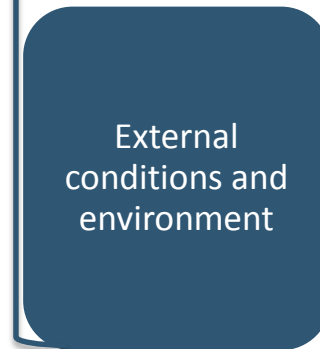
Focus on: NPE strategy (Chapter 4)

- The development and operationalisation of an NPE strategy is the core building block of the guidelines for banks' NPE management
- The NPE strategy:
 - should be built on an assessment of the operating environment (internal capabilities, external conditions, capital implications)
 - should set out time-bound realistic, yet ambitious reduction targets and consider all available strategic options to reduce NPEs (covering short, medium and long-term time horizons)
 - should be fully embedded management processes of the institution, including regular review and independent monitoring (covering integration to ICAAP, RAF recovery planning)

Assessment of the operating environment



- Magnitude and drivers of NPE
- Past NPE actions
- Operational capabilities

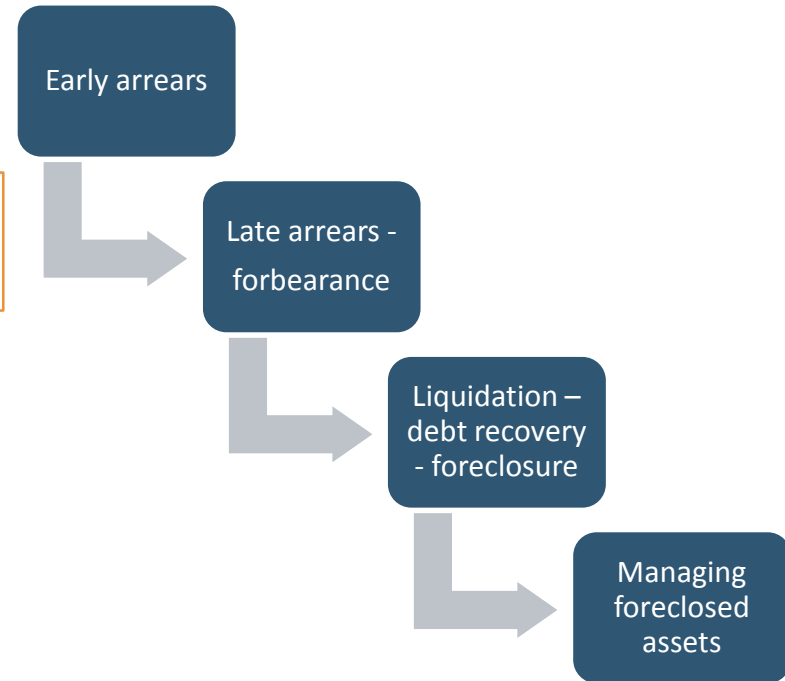


- Macro environment
- Market expectations
- Secondary market for NPEs
- Regulatory/legal/judicial framework

Focus on: NPE governance and operations (Chapter 5)

- The draft guidelines outline the key elements of the governance and operations of a NPE workout framework with key aspects related to:
 - steering and decision making (covering all aspects of policies, strategy and monitoring of their implementation)
 - the NPE operating model (focus on NPE workout units and their operations aligned to the NPE life cycle)
 - internal control framework (application of general internal control requirements to NPE management and monitoring covering all three lines of defense)
 - NPE monitoring (defining and following metrics, engagement with borrowers, forbearance and liquidation activities)
 - early warning processes (designing and following EWS metrics, escalation procedures)

NPE workout - Alignment with NPE life cycle



Focus on: Forbearance (Chapter 6)



- Forbearance measures should be granted only when they aim to restore sustainable repayment by the borrower and are thus in the borrowers' interests
- Institutions should distinguish between viable forbearance measures contributing to reducing the borrower's exposure and non-viable forbearance measures
- Institutions should develop a policy for their forbearance activities
- Institutions should monitor the quality of forbearance activities for both performing and non-performing exposures → to make sure that it is not used for delaying of the assessment that the exposure is uncollectable
- Granting forbearance should be based on borrower creditworthiness assessment
- Forbearance activities should be compared with other workout options → NPV as a basis for comparisons

Focus on: Collateral valuations (Chapter 9)



The draft guidelines provide key elements for collateral valuation for immovable and movable property pledged for NPE:

- General governance and control requirements → policies and procedures for valuation, monitoring, control and back-testing of valuations
- Specific appraisals vs indexed valuations of immovable property → threshold of 300,000 EUR for the indexed valuation
- General requirements for the use of independent appraisers
- Frequency of valuation and their monitoring → at a minimum on annual basis for moveable property and commercial immovable property, and every three years for residential immovable property → more frequent valuations where the market is subject to significant negative changes and/or where there are signs of significant decline in the value of the individual collateral
- Valuation methodologies: expected future cashflow, gone concern approach

Next steps



- Public consultation ends on 8 June 2018
- The guidelines will be then finalised following the standard procedure and issued in H2 2018
- The guidelines are expected to be implemented by 1 January 2019
- The EBA will be monitoring the actual implementation of the guidelines through its ongoing work in the colleges of supervisors
- The guidelines will work together with the Guidelines on loan origination, monitoring and internal governance, which EBA is developing (consultation planned for H1 2019)

Questions for consultation / discussion



1. What are the respondents' views on the scope of application of the guidelines?
2. What are the respondents view of the proposed threshold of 5 % NPL ratio?
3. Do you see any significant obstacles to the implementation date and if so, what are they?
4. Does section 4.3.2 capture all relevant options available for credit institutions to implement their NPE strategy?
5. Do you see any significant obstacles to the operationalisation of the NPE strategy as described in chapter 5?
6. Does the viability assessment of forbearance measures capture all relevant aspects?
7. What are the respondents view on the proposed requirements for recognition of non-performing and performing/non-performing forborne exposures?
8. What are respondents view on the requirements on timeliness of impairments and write-offs of NPEs?
9. Do you have any significant objection against the proposed threshold for property-specific valuation (EUR 300,000)?
10. Do the requirements for valuation of movable property collateral capture all relevant aspects?



EUROPEAN BANKING AUTHORITY

Floor 46, One Canada Square, London E14 5AA

Tel: +44 207 382 1776

Fax: +44 207 382 1771

E-mail: info@eba.europa.eu

<http://www.eba.europa.eu>