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COMMENTS ON THE EBA CONSULTATION PAPER PROPOSING DRAFT ITS ON SUPERVISORY REPORTING ON FORBEARANCE AND NON-PERFORMING EXPOSURES (CP/2013/06)

GENERAL COMMENTS

Global approach and level playing field

One of the main lessons from the financial crisis is that the global financial system needs global approaches to regulation and supervision. Achieving international consistency is of particular importance in the area of supervisory reporting – not merely because it is likely to result in reducing the reporting burden of cross-border banks but also, and probably more importantly, because it contributes to improving banking supervision at a global level considering that global definitions allow for making comparisons across international banks and, moreover, increase the common understanding that banking supervisors may achieve.

We would, therefore, like to suggest that the European supervisory community should bring this issue up at the level of the Financial Stability Board and/or the Basel Committee for Banking Supervision.

Also, the consultation paper suggests that the EBA '*may consider future liaisons with ESMA on the issues of forbearance and non-performing'* (page 8). It would have been more appropriate for the EBA to indicate that it would liaise with the IASB as a global standard setter on this in the future considering that the IFRS Interpretations Committee is the only body which is authorised to decide about the interpretation of IFRS concepts.

We would like to encourage such close co-operation in view of a possible alignment to take place before the EBA paper reaches conclusion and, strongly urge the EBA to include the industry in the co-operation process as well.

Due process

The consultation provides a typical example of data requirements which would benefit from broad discussion involving all stakeholders. Given the complexity of the issue and its possible far-reaching consequences the EBF has suggested the dialogue ahead of the consultation[1]. We would still like to suggest that an expert meeting be organised as soon as possible to discuss possible solutions to satisfy the supervisory information needs in the area of forbearance in a most efficient way.

[1] EBF letter to EBA and ESRB of 6 December 2012

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Alignment with IFRS

It is essential that the definition of forbearance which the consultation paper proposes be reviewed to be fully aligned with IFRS. While IFRS does not define forbearance as such, its concept is described in IFRS in IAS 39 paragraph 59c as indicator of impairment based on two elements being i) the entry into concession as ii) a result of the financial difficulty of a customer.

While forbearance relates to both defaulted and non-defaulted assets, from an operational perspective many banks only keep track of the defaulted ones. Requesting reporting of non-default related forborne assets might prove operationally difficult, requiring significant IT system changes that cannot be done within the envisaged implementation timeline. We suggest that the EBA and the industry would jointly seek for an approach that would support supervisory needs in a feasible manner whilst reducing the banks' administrative burden in an optimal way.

Concerns with the EBA definitions

We have concerns with several aspects of the proposals that would lead to reporting at odds with banks' credit risk managements.

30 days past due

The 30 days past due threshold that is to be met at least once in the past 3 months prior to the modification of refinancing, would not, in most cases, be reflective of the financial difficulties. We believe that the threshold should be more aligned with entities credit risk management practices to avoid volatility in the reporting figures. We believe that 90 days as a safety net criterion would be more representative and meaningful, taking into account the existing national discretions as provided for in CRR, when applied.

Materiality threshold

A materiality threshold should be introduced concerning a minimum overdue amount to avoid that any immaterial credit obligations to drive the classification of the whole contract as forborne.

Concession

We do not believe that modifications leading to more favourable terms compared to market conditions should be considered as concessions in distressed markets. In markets with strong credit restrictions, the criterion would no longer be appropriate given that it is unlikely that debtors would be in the position to obtain more favorable conditions that those given by their own financial institution.

Use of embedded clauses

The use of clauses embedded in the contract that enable the debtor to change the terms and conditions of its contracts without additional assent of the financial institution should not be

considered as forbearance unless their use leads to a significant relief of the financial burden of the debtor.

Scope of the proposal

We strongly disagree with the proposal to include trading book instruments in the category of forborne and non-performing exposures. If a financial instrument is classified as "trading" it is held to be actively managed. Such instruments are measured at fair value, which integrates possible deteriorations, so no additional information is necessary.

Consolidation scope

In order to align the consolidation scope to the scope of consolidation under which the rest of the FINREP data is reported, we believe that the definitions should be applied on prudential scope of consolidation.

Implementation

Preparing banks' IT-systems to allow them to manage the definitions inherent ambiguity which the consultation seeks to introduce will be a tremendous challenge. We strongly suggest adopting a phased approach for introducing those items which we have highlighted as being particularly burdensome.

The proposals made in the Consultation Paper will take at least eighteen months to implement from the point the rules are final.

QUESTIONS FOR CONSULTATION

6.2.1 Questions on the Definitions

1) *Do you agree that building definitions of forbearance and non-performing by taking into consideration existing credit risk related concepts enables to mitigate the implementation costs? If not, please state why.*

   We agree that building on the existing credit risk related concepts is essential in order to maintain the link to the risk management. However, it is important that the definitions are fully aligned with IFRS.

2) Do you agree with the proposed definitions? Especially, do you agree with the inclusion of trading book exposures under the scope of the non-performing and forbearance definitions? If you believe alternative definitions could lead to similar results in terms of identification and assessment of asset quality issues, please explain them.

   No, we do not agree. We have concerns with several aspects of the proposals that would result in reporting becoming at odds with the way in which banks manage credit risk.

- The 30 days past due threshold that is to be met at least once in the past 3 months prior to the modification of refinancing, would not, in most cases, be reflective of the financial difficulties. We believe that he threshold should be more aligned with entities credit risk management practices to avoid volatility in the reporting figures. We believe 90 days as a safety net criterion would be more representative and meaningful, taking into account the existing national discretions as provided for in CRR, when applied.

  We also believe that a materiality threshold should be introduced to avoid that any immaterial credit obligations to drive the classification of the whole contract as forborne.

- We do not believe that modifications leading to more favourable terms compared to market conditions should be considered as concession in distressed markets. In markets with strong credit restrictions, the criterion would no longer be appropriate given that it is unlikely that debtors would be in the position to obtain more favorable conditions that those given by their own financial institution.

- The use of clauses embedded in the contract that enable the debtor to change the terms and conditions of its contracts without additional assent of the financial institution should not be considered as forbearance unless their use leads to a significant relief of the financial burden of the debtor.

- We strongly disagree with the proposal to include trading book instruments in the category of forborne and non-performing exposures. If a financial instrument is classified as "trading" it is held to be actively managed. Such instruments are measured at fair value, which integrates possible deteriorations, so no additional information is necessary.

3) *How long will it take you to implement, and collect data on, the definitions of forbearance and non-performing?*

   The proposals made in the consultation paper will take at least eighteen months to implement from the point the rules are final. Preparing banks' IT-systems to allow them to manage the definitions which the consultation seeks to introduce will be a tremendous challenge. This is particularly true as to the templates requesting granular data breakdowns that will be operationally challenging to implement.

   It should also be taken into account that banks will be developing their IT systems in order to comply with the requirements of IFRS9 as well as implementing the requirements stemming from the new supervisory framework. It would be more efficient to adapt banks IT systems at the same time in order to create the appropriate data model to fit all the requirements.

4) *What definitions of forbearance and non-performing are you currently using respectively for accounting and prudential purposes?*

   As we presume that this question aims at collecting information on individual banks' practices, it does not appears to be addressed to banking associations.

6.2.2 Specific Questions on some Aspects of the Forbearance Definition

5) Do you agree with the types of forbearance measures covered by the forbearance definition? If not, what other measure(s) would you like to be considered as forbearance?

As explained above in our "General Comments" (under the heading "Concerns with the EBA Definitions"), we do not agree.

6) Do you agree with the following elements of the forbearance definition?

a. the criteria used to distinguish between forbearance and commercial renegotiation?

We do not.

The proposal made in the Consultation Paper that the contract is presumed to include concessions when the modified contract includes more favourable terms than those the debtor could have obtained in the market, only makes sense in a non-stress financial market. When strong credit restrictions exist, this criterion is not valid to be able to identify concessions ("all measures would be concessions"). In addition, in these situations the evidence of similar terms would be impossible to provide.

b. the criteria used to qualify refinancing as forbearance measures?

We do not, as explained above in our "General Comments" (under the heading "Concerns with the EBA Definitions").

c. a 30 days past-due threshold met at least once in the three months prior to modification or refinancing, as a safety net criterion to always consider modification or refinancing as forbearance measures?

There may be various reasons explaining a 30 days past due amount. Therefore, the proposed threshold is much too strict to be really meaningful. A 30 past due amount is, more particularly, not a proper indicator when no doubt exists about the ability of the debtor to meet the existing terms of the contract.

As we explained above, a materiality threshold should apply as there may be insignificant overdue amounts.

d. the proposed treatment for exposures with embedded forbearance clauses?

If the contract includes forbearance clauses, the use that is being made of such clauses cannot, in general, result in forbearance when enforced by the debtor. The bank identifies and classifies the customers. The good knowledge of the financial situation of the customers must result in a correct analysis of the reason why a customer uses the embedded forbearance contractual clauses.

Only in some rare situations, the use of embedded forbearance clauses might lead to situations which are similar to the outcome of a forbearance measure, i.e. whenever the use of such clauses implies a significant relief of the financial burden of the client.

7) *Do you agree with the proposed scope of on- and off-balance sheet exposures to be covered by the definition of forbearance?*

This issue may require closer examination.

8) *Do you agree not all forbearance transactions should be considered as defaulted or impaired?*

Yes. See general comments (under the heading "Concerns with the EBA Definitions").

9) *What types of forbearance transactions are likely, according to you, not to lead to the recognition of default or impairment?*

We do not agree with the statement made in the Consultation Paper that forbearance will normally lead to the recognition of impairment on forborne assets.

Renegotiated loans of which the terms are (still) based on current market rates and contractual agreed cash flows are expected to be collected in full during the life of the loan. Modifications to loan agreements which do not impact payment streams themselves cannot, therefore, be considered as sufficient indicators of impairment as such. An extension of repayments (whether or not granted against additional fees) implies, in general, that the bank has confidence in the business model of his client and his cash generating capacity on the longer term.

We would like to suggest that the EBA would distinguish between (i) short term debt service relief with little or no impact on cash flows and (ii) (partial) debt forgiveness with material impact on cash flow streams.

10) *Do you agree with the proposed definitions of debtors and lenders and the scope of application of the forbearance definition (i.e. accounting scope of consolidation)?*

Given that the current scope of consolidation is the prudential scope of consolidation, we believe it is necessary to align the proposed definitions of debtors and lenders and the scope of application of the forbearance definition to that of the rest of FINREP.

11) *Do you agree with the proposed mixed approach (debtor and transaction approaches) for forbearance classification?*

We agree that a debtor approach needs to be used to assess his situation. We also agree that all the debtor's contracts do not have forbearance measures and that the ones with such measure are the only ones to be specifically reported.

It needs to be highlighted nevertheless that examining if items meet all those criteria (existence of past due before forbearance; identification of the type of counterparty) will involve a complex process. Adopting a debtor approach will, moreover, produce a significantly greater reporting volume considering the extremely strict exit criteria and

extremely long exit terms (up to 24 months). As a result, a single large client with difficulties related to only one exposure would result in a 2-year tainting of all products.

12) *Do you agree with the exit criteria for the forbearance classification? In particular:*

We agree with the exit criteria for the forbearance classification. The analysis of the financial condition of the debtor is key.

a. what would be your policy to assess whether the debtor has repaid more than an insignificant amount of principal or interests?

As we presume that this question aims at collecting information on individual banks' practices, it does not appears to be addressed to banking associations.

b. do you support having a probation period mechanism ?

As a matter of principle, we support having a probation period mechanism. We wonder, however, if the 2-year probation period proposed by the EBA is based on experience and back-testing confirming that it is appropriate.

We do not believe that it would be appropriate introducing a two-year probation period before a loan can exit the forbearance classification. Credit risk will not be adequately reflected if, for instance, a loan to a property company is classified as forborne following a tenant default and subsequently continues to be so classified even after a solvent, long-term replacement tenant has been found.

The timing of the probation period should in any event be different depending on the type of counterparty and the existence or not of past due amount before the forbearance measures. Retail and non retail counterparty are not managed in the same way and the time to recover financial health is different.

13) *Do you agree with the proposed approach regarding the inclusion of forborne exposures within the non-performing category?*

See our General Comments (under the heading "Concerns with the EBA Definitions").

a. do you agree the generic non-performing criteria allow for proper identification for neither defaulted nor impaired non-performing forborne exposures? Would you prefer to have the stricter approach (all forborne exposures identified as non-performing) implemented instead?

See our General Comments (under the heading "Concerns with the EBA Definitions").

b. do you agree with the proposed consequences of forbearance measures extended to an already non-performing exposure? Especially, are the proposed exit criteria strict enough to prevent any misuse of forbearance measures or would stricter criteria be needed?

We agree that the forbearances measures extended to already impaired exposures might lead to additional impairment. However, forbearance does not automatically imply that there would be impairment.

Any forbearance measures should be followed by an update of the impairment assessment.

We consider the exit criteria to be sufficient to prevent any misuse of forbearance measures.

6.2.3 Specific Questions on some Aspects of the Non-performing Definition

14) Do you agree with the following elements of the non-performing exposures definition?

a. the use of 90 days past-due threshold to identify exposures as non-performing?

We disagree with the use of 90 days past-due threshold. This was extensively debated during the CRR negotiations. It was finally decided to maintain existing national discretions to take into account longer payment practices which are not evidence of default (such as those due by public administrations and central governments).

b. the proposed guidance for past-due amounts?

There would be a merit in examining possible operational difficulties which the proposed approach might generate within banks.

c. the proposed treatment of collateral and especially the proposed valuation methodology for its reporting?

We agree that collateral should not be taken into account to asses if an exposure is evidence of individual impairment test or defaulted, or not. The collateral is taken into account only to calculate the impairment or the risk exposure.

15) Do you agree with the coverage of the proposed definition and with the possibility to apply the generic non-performing criteria to all fair-valued non-performing exposures? Do you expect challenges when implementing them and collecting data on fair-valued non-performing exposures? Would you suggest other criteria instead?

The concept of “non-performing” is used only within the framework of the banking book today. To extend it to trading book items would create confusion.

We strongly disagree with the proposal to apply the non performing criteria to all non-performing exposures that are measured at fair value considering that the credit risk represented by the issuer is included in the fair value and, moreover, that a trading instrument cannot be classified as non-performing as long as it can be sold or bought. As trading exposures cannot possibly default, it would not make sense to make a reference to “non-performing trading exposures”. It may be, at the very most, be considered to reclassify a trading book item as a banking book item. Therefore, we strongly oppose to report forbearance or non performing exposures on the trading book.

16) *Do you agree with the proposed treatment for derivatives exposures? If not, what criteria would you suggest to enable identification of non-performing derivatives?*

We agree with the proposed treatment for the derivative exposures as they are no more derivatives exposures but receivables once they are past due.

17) *Do you agree with the proposed criteria to identify off-balance sheet exposures as non-performing?*

Yes.

18) *Do you agree not to consider exposures subject to incurred but not reported losses as non-performing?*

Yes.

19) *Do you agree with the proposed approach regarding the materiality threshold?*

Yes.

20) *Do you agree with the proposed definitions of debtors and lenders and the application of the non-performing exposures definition on an accounting scope of consolidation?*

We do not. See our General Comments (under the heading "Concerns with the EBA Definitions").

21) *Do you agree with the proposed approaches (debtor approach for non-retail exposures, and possibility of a transaction approach for retail exposures)? In particular, do you agree with the idea of a threshold for mandatory application of the debtor approach? If so, which ratio methodology would you favour and why?*

We agree with the principle of a debtor approach for non-retail exposures and a transaction approach for retail exposures.

We do not agree with the idea of a threshold for mandatory application of the debtor approach. Instead, the debtor approach should be used by an institution for those exposures it deems to be non-retail.

The ratio methodology is not clearly explained or rationalised – for example, it seems counter-intuitive that the 1 day past-due threshold should be lower than the 90 days past-due threshold (5% vs. 20%).

22) *Do you agree with the exit criteria from the non-performing category?*

Provided that trading book items are not included in the non-performing category, we can agree with the exit criteria that are being proposed.

23) *Do you agree with the separate monitoring in a specific category of exposures ceasing to be non-performing? Do you think this specific category should be integrated within the performing or the non-performing category?*

We do not agree with the separate monitoring of such a specific category – it introduces further complication and will make it more difficult for institutions to implement the EBA requirements. We monitor the forborne exposures when they cease to be defaulted during a probation period.

An exposure should be either performing or non-performing; a specific category for exposures that were non-performing during the last 12 months (itself an arbitrary period) seems to make little sense. The specific category should instead be integrated within the performing category.

24) *Would you favour specific exit or specific separate monitoring criteria for non-performing exposures to which forbearance measures are extended*?

We would favour specific separate monitoring for exposures which had forbearance measures and consequently have been defaulted, when no more defaulted during a probation period.

6.2.4 Impact assessment questions

25) *Could you indicate whether all the main drivers of costs and benefits have been identified in the table above? Are there any other costs or benefits missing? If yes, could you specify which ones?*

The following operational costs are missing:

- Costs of a "pre study" which banks will need to undertake to build up the definitions of forbearance and non-performing in the internal systems.
- Processes adaptation due to the granularity of the data collection and monitoring on retail assets, and the perimeter of the data collection (trading book, accounting scope vs prudential…)
- Processes to produce and control the data quality in order to comply with the requirements.
- Efforts needed to explain the different perspectives adopted by accounting standards and prudential standards.

Adopting a more high-level perspective, it needs to be highlighted that the proposals will contribute to creating an unlevel playing field, at the detriment of EU banks.

26) *For institutions, could you indicate which type of one-costs (A1, A2, A3) and ongoing costs (B1, B2, B3) are you more likely to incur? Could you explain what exactly drives these costs and give us an indication of their expected scale?*

A1 & B1 because of:

- the relevant granularity that needs to be collected to manage the definitions;

- record keeping (in conformity with the need of accumulated indicators restitution);
- ongoing processes to make sure that those transactions are tagged in an appropriate way (relevance, data quality…)

Furthermore, as forbearance is a category in itself that needs to be identified in systems there will be cost in IT infrastructure and staff training to comply.

Ongoing compliance with the concept will be an additional task when undertaking internal audits.

Future IT developments testing will also need to include impact on forbearance reporting.

27) *Do you agree with our analysis of the impact of the proposals in this Consultation Paper? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?*

See our comments above.

6.2.5 Appendix I questions

28) *Do the instructions provide a clear description of the reporting framework? If not, which parts should be clarified?*

- In the Table "Information forborne exposures", we do not understand the use to be made of the columns 030, 040, 050 and 150, 160 and 170. These columns may create very significant costs and implementation difficulties.
- FBE columns 040 and 050: 'Debt refinanced by the institution' and 'Refinancing debt granted by the institution' would benefit from greater clarify around definition and the difference between them.
- FBE and NBE: the requirement to determine the component of Fair Value changes 'due to credit risk' is excessive and is not required by IFRS disclosures.
- NPE: How are banks to comply with the requirement to 'separately report for one year' exposures exiting the non-performing category? It does not seem to be requested in the templates.
- NPE columns 080 and 170: It would be preferable to keep these components separate, i.e. 'unlikely to pay that are not past due' and 'past due <90 days'.
- NPE column 030: It would be preferable to keep these components separate, i.e. 'not past due' and 'past due <30 days'.
- The explanations of 'non-performing', 'defaulted' and 'impaired' would benefit from greater clarity. For FBE, column 100 ('defaulted') and column 110 ('impaired') should be clearly defined and presented in such a manner that the distinction between them (and 'non-performing') is easily understood.
- What will be the rule when the forbearance measures are a mix of modifications and of refinancing?
- How to report the original debt? What if several debts are re-packaged into another one or several ones? How to report the forborne debt granted by a pool of banks?

29) Are there specific aspects of forbearance and non-performing loans that are not covered or addressed properly in the templates?

We have no specific comment to make.

30) *Do the reporting requirements include items which would be disproportionately costly to implement? If yes, how the templates could be modified to cover the necessary supervisory information? Institutions are especially encouraged to provide their views on which break-downs are easier to fill in, or whether they believe there are redundancies with information reported in other supervisory reporting templates, or if they believe alternative definitions could achieve similar results as those in this Consultation Paper but at lesser costs.*

As mentioned above, we take the view that:

- Trading book items should not be reported as forborne exposure or as non-performing.
- The Table "Information on performing and non-performing exposures" is identical to what already needs to be reported under FIN4 and is, therefore, superfluous.
- Including the split between performing and non-performing - with or without forborne measures - by class , category, type of counterparty, country of residence of the counterparty, NACE code and residence of the counterparty and, by type of instruments in some instances (see line 230 and 240 of FIN14.4) will be very costly.
- Too much detail will harm the analysis of the data both for the banks and the supervisor. We do not believe that so many details are necessary to assess the assets quality.
- There is considerable overlap between NPE and FINREP Table 4 – this should be addressed.
- The requirement to present forborne and non-performing exposures by country of residence of the counterparty is not aligned to how banks' capture and monitor these positions. Presentation by country of booking is more aligned with how the positions are managed and consistent with the majority of the other FINREP requirements.
- The requirement to track the accumulated changes in fair value due to credit risk for debt instruments measured at fair value through profit and loss in order to arrive at a proxy of their 'gross amount' is not used to manage the risks associated with exposures measured at fair value and therefore is not captured in banks' underlying systems. We suggest that the gross amount should align to the balance sheet presentation.