HELLENIC BANK ASSOCIATION

Response from the Hellenic Bank Association to the EBA consultation paper: *Guidelines on the application of the definition of default under Article 178 of Regulation (EU) 575/2013*

General comments

The Hellenic Bank Association (HBA) was established in 1928 and is a non-profit legal entity, representing the vast majority of Greek and foreign credit institutions that operate in Greece, which hold more than 95% of assets of the Greek banking system.

The HBA appreciates the opportunity to respond to the European Banking Authority's (EBA) draft Guidelines on the application of the definition of default, which seek to reduce significant variance in practices concerning definition of default identified across Member States and to enhance convergence of supervisory practices and comparability among institutions.

In general, we agree with the majority of the proposed provisions provided for in the consultation paper (CP), since they meet industry's expectations in respect of their consistency and effectiveness. However, we deem necessary to raise certain issues which we consider appropriate to be clarified or amended in order to ensure that the Guidelines fulfill the objectives set by co-legislators without causing negative implications for credit institutions.

The definition of default, which is a crucial element in the context of credit risk management and capital adequacy framework, is closely related to the materiality threshold of credit obligations past due. Although this was the subject of a separate consultation held by the EBA last year, we consider necessary to reiterate our proposals on this issue, since in the QIS carried out by the EBA in the context of the consultation for the definition of default there was a scenario on materiality threshold.

In particular, the HBA considers that the combination of the relative and absolute component is necessary for the purposes of identifying defaulted exposures and will reflect in a better way the credit quality of the credit institutions' loan portfolios. The appropriate level of the relative component should be at 5% of the exposure amount.

Response to the consultation questions

1. Do you agree with the proposed definition of technical defaults? Do you believe that other situations should be included in this definition? If yes, please provide detailed proposals on how to address further possible situations.

The EBA CP provides for a strict interpretation of technical defaults aiming to ensure clarity and consistency in credit risk management procedures applied by credit institutions established in different EU jurisdictions. In particular, pursuant to the EBA CP, technical defaults are considered only those derived from data or system errors attributable to credit institutions. The HBA considers that it is appropriate for the EBA to leave room for expert judgment, given that in the past many defaults have arisen from non-credit related reasons owing to internal disputes in the counterparties or due to technical problems for which institutions were not responsible. Furthermore, it is likely an institution's exposure to be

classified as defaulted as a result of long-lasting negotiations between the institution and the obligor concerned.

In addition, another striking example of technical defaults which is worth mentioning, regards the inability of counterparties to service their obligations due to capital controls imposed on Greek banking system last year. Restrictions on the free movement of capital caused significant problems for obligors (corporates and individuals) to repay their loans, albeit they could afford them. For instance, shipping companies whose deposits accounts were held by Greek credit institutions came up with significant difficulties in transferring funds to credit institutions located in other EU Member States for the purpose of repaying their credit obligations. Those defaults, though were of temporary nature and not credit related, would not be included in the scope of technical defaults definition proposed by the EBA in the CP.

Therefore, the HBA considers appropriate for the EBA to adopt the OPTION B referred to in p. 51 of the CP, i.e. technical defaults referring to various non-credit related reasons for the delays in payments. This option provides institutions with the appropriated degree of flexibility in order to distinguish between defaults owed to credit reasons and technical defaults. Expert judgment is essential for the purposes of credit risk management and we urge the EBA not to adopt such a restrictive approach for the definition of technical defaults.

2. Do you consider the requirements on the treatment of factoring arrangements as appropriate and sufficiently clear? If not, please provide proposals for additional clarifications.

N/A

3. Do you agree with the approach proposed for the treatment of specific credit risk adjustments?

In the CP (par. 25) it is mentioned that in general, Specific Credit Risk Adjustments (SCRA) should be treated as an indication of unlikeliness to pay if they concern "losses as a result of current or past events affecting a significant individual exposure or exposures that are not individually significant which are individually or collectively assessed". This point seems to be in contradiction with recital 12 of the Commission Delegated Regulation 183/2014, which clearly states that "for the purpose of the determination of default under point (b) of Article 178(3) of Regulation (EU) No 575/2013, it is necessary to include only Specific Credit Risk Adjustments which are made individually for a single exposure or a single obligor, and not to include Specific Credit Risk Adjustments made for whole groups of exposures. Specific Credit Risk Adjustments made for whole groups of exposures do not identify obligors of exposures belonging to such groups for which a default event is considered to have occurred. In particular, the existence of Specific Credit Risk Adjustments for a group of exposures is not sufficient reason to conclude that default events have occurred for each of the obligor or exposures belonging to this group".

4. Do you consider the proposed treatment of the sale of credit obligations appropriate for the purpose of identification of default?

N/A

5. Do you agree that expected cash flows before and after distressed restructuring should be discounted with the customer's original effective interest rate or would you prefer to use the effective interest rate applicable at the moment before signing the restructuring arrangement? Do you consider the specification of the interest rate used for discounting of cash flows sufficiently clear?

According to the EBA CP, distressed restructuring should be considered as an indication of unlikeliness to pay, where concessions extended to obligors with financial difficulties result in a diminished financial obligation calculated in accordance with an NPV formula. Although we have to assume that the adoption of the aforementioned approach has certain drawbacks and it is quite difficult to be applied consistently, we consider appropriate the net present value of the expected cash flows to be discounted with the effective interest rate at the moment before signing the restructuring arrangements.

6. Do you agree that the purchase or origination of a financial asset at a material discount should be treated as an indication of unlikeliness to pay?

The HBA supports that a financial asset purchased or originated at a material discount should not be considered as an indication of unlikeliness to pay and should not imply its automatic classification to defaulted exposures. It is necessary credit institutions to make a case-by-case assessment of the reasons that caused the discount of the asset. In particular, where that discount is related to any reason but the credit quality of the obligations concerned, that exposure should not be considered as a defaulted one.

7. What probation periods before the return from default to non-defaulted status would you consider appropriate for different exposure classes and for distressed restructuring and all other indications of default?

Determining criteria concerning return to non-defaulted status provided for in the CP are strict and restrictive aiming to mitigate risk of excessive number of multiple defaults. The minimum probation period of three and twelve months in respect of defaulted exposures and distressed restructuring respectively are not in line with Article 178(5) of the CRR, which clearly allows institutions to reclassify exposures to non-defaulted status pursuant to their own assessment criteria. In particular, Article 178(5) CRR states that "if the institution considers that a previously defaulted exposure is such that no trigger of default continues to apply, the institution shall rate the obligor or facility as they would for a non-defaulted exposure. Where the definition of default is subsequently triggered, another default would be deemed to have occurred."

Setting three months' probation period is unreasonably stringent and penalizing for exposures, mainly in wholesale portfolio, that are past due for more than 90 days for reasons not reflecting deterioration in the credit quality of the obligor. Taking the aforementioned into account, the HBA suggests the elimination of the minimum probation period of three and twelve months as a determining criterion for the reclassification to non-defaulted exposures. Consistent application of the remaining criteria set in par. 58-60 of the CP

combined with expert judgment is expected to establish an effective framework for the reclassification to an non-default status limiting the risk of multiple defaults.

With regard to the criterion provided for in par. 60, point a) of the CP, we deem necessary its amendment in order to ensure alignment with the Commission Delegated Regulation 2015/227 on forborne and non-performing exposures. In particular, the abovementioned point should be replaced by the wording of point c, par. 157 of the Commission Delegated Regulation 2015/227, which states that "there is not, following the forbearance measures, any past-due amount or concern regarding the full repayment of the exposure according to the post-forbearance conditions. The absence of concerns shall be determined after an analysis of the debtor's financial situation by the institution. Concerns may be considered as no longer existing where the debtor has paid, via its regular payments in accordance with the post-forbearance conditions, a total equal to the amount that was previously past-due (where there were past-due amounts) or that has been written-off (where there were no past-due amounts) under the forbearance measures or the debtor has otherwise demonstrated its ability to comply with the post-forbearance conditions."

8. Do you agree with the proposed approach as regards the level of application of the definition of default for retail exposures?

N/A

9. Do you consider that where the obligor is defaulted on a significant part of its exposures this indicates the unlikeliness to pay of the remaining credit obligations of this obligor?

Where institutions apply the definition of default at the level of an individual credit facility with regard to retail exposures, they should not consider automatically as defaulted the total amount of exposures of an obligor, if a significant part of its exposures is classified as defaulted. Although the EBA proposal seeks to ensure an harmonised approach across Member States, it is rather preferable for purposes of risk sensitiveness to adopt an alternative approach based on which, where an obligor is defaulted on a significant part of its exposures, institutions must further assess its creditworthiness in respect of the remaining credit obligations based on their own behavioural scorecards with customer characteristics.

10. Do you agree with the approach proposed for the application of materiality threshold to joint credit obligations?

N/A

11. Do you agree with the requirements on internal governance for banks that use the IRB Approach?

Requirements on internal governance for IRB-institutions laid down in the CP are suitable for the purposes of capital requirements calculation and internal risk management processes. In addition, the proposed arrangements and not more stringent than those with

which Greek credit institutions have to comply in accordance with legal acts adopted by the Bank of Greece.