ASSILEA
Associazione Italiana Leasing

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Assilea's Positon Paper on EBA's Consultation Paper: "Guidelines on the application of the definition of default under Article 178 of Regulation (EU) 575/2013" (EBA/CP/2015/15, 22nd September 2015)

Assilea, the Italian Leasing Association, represents the Italian leasing industry. Our members are leasing companies classed into generalist banks, specialist banks, non-banking financial intermediaries, brokers and dealers, long-term rental companies, outsourcers specialised in the leasing market.

The Association's key task is to carry out institutional activities with a view to providing information and assistance to its Members and contributing towards the solution of leasing-related issues at different levels, in different domestic and international venues.

Assilea is member of ***Leaseurope*** *(the European Leasing Federation) and of* ***ABI*** *(the Italian Banking Association) and actively participated to the drafting of the Position Papers released by the above mentioned Federation (joint Eurofinas and Leaseurope Position Paper) and Association (ABI's Position Paper).*

We thank you for the opportunity offered with this consultation. In this paper we reply to some of the main questions of the Consultation Paper (CP) "Guidelines on the application of the definition of default under Article 178 of Regulation (EU) 575/2013" (EBA/CP/2015/15, 22nd September 2015).

Contents

1.Past due criterion in the identification of default

Q1 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.

1.1 Manual errors

According to the CP, technical defaults can also be the result "of manual errors of standardized processes, but excluding wrong credit decisions".

We ask for confirmation that "wrong credit decisions" refer only to data or system errors **including manual errors in the default identification processes, that can lead to an incorrect identification of risk parameters.**

We also ask if in those mentioned "manual errors" we could include the **errors made by the client, when he/she inserts his/her data for payments.** Otherwise, in those cases the exposure could be considered defaulted even if the client had the possibility and the "intention" to pay in time.

1.2 Problems linked to the leased asset

Though we appreciate the need to provide a technical and precise framework for the identification of default, it is also important to explicitly recognise that a judgmental process is sometimes required.

As specifically refers to leasing contract, situations may occur in which suspended payments, even of more than 90 days, are not due to a credit deterioration of the counterparty but to technical issues related to the asset. These technical issues could be related to disputes about the nature of the leased good, its quality, its maintenance, or due to asset accidents not contractually foreseen.

We ask you to allow that, in the mentioned situations, any delay in payment is considered as a technical default.

1.3 Counting of days past due

The counting of days past due on a daily basis proposed in the Consultation Paper (*chapter 4, par. 19*) is a common procedure among banking institutions, whereas financial intermediaries, leasing companies and institutions that operate in the instalment payment sector often use a different time basis for the calculation of default. Extending to these institutions the use of a daily basis for the calculation of past due by means of the prudential standards would have a significant impact in terms of operating costs related to the recalibration of internal IT systems and default identification processes.

This would not take into consideration the fact that for those financial products – e.g. leasing, instalment payment credit in general– which rely on specific repayment schedules, the delay in payments cannot materially be evident and cannot be measured on a daily basis before the first month deadline. **We, therefore, ask you to allow for instalment payments that the counting of days past due begin from the first delay on a monthly basis.**

1.4 Larger and public sector entities

It is also worth stressing that for larger/key accounts such as public sector entities or very large corporations, internal payment processes can often lead to repayment delays which are not due to financial circumstances. As these clients are typically highly unlikely to fail and default on their agreements, it would be useful to clarify whether **an "intention to pay" would be sufficient to effectively re-age the number of days past due for these obligors.**

2. Indication of unlikeliness to pay

2.1 Sale of credit obligation

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

As referred to in point (c) of Article 178(3) of Regulation (EU) No 575/2013, institutions can take as an indication of unlikeliness to pay the case where "the institution sells the credit obligation at a material credit-related economic loss". As stressed in the CP, the economic loss should be identified taking into account also the materiality of the loss related with the sale of credit obligations. The Guidelines suggest that institutions set a 5% materiality threshold for the economic loss related with the sale of credit obligations to be considered material. This threshold should be calculated as the difference between the total outstanding amount of the obligations subject to the sale, including interest and fees, and the price agreed for the sold obligations, measured as a percentage of the total outstanding amount of the obligations itself.

The leasing industry wishes to stress that it is not common that the company considers performing a credit obligation, selling it with a material credit-related economic loss. The more frequent situation is that where a credit obligation is reported by an institution as defaulted before being sold. Secondly, not all the institutions may be in a position to analyse (post-sale) the quality of a credit obligation without taking into account other on-balance exposures towards the same obligor, for the institution can no longer perceive the credit quality of an obligation once it has been sold. The case that can be more easily analysed is that of the sale of a credit obligation when the institution maintains other on-balance exposures towards the same borrower**. We therefore ask for confirmation that it will be possible for the institution to analyse the credit quality of the obligation subject to the sale taking into account the credit quality of the obligation at a obligor level.**

Moreover, CP suggests that institutions should analyse the reasons for the sale of credit obligations and the reasons for any losses recognized thereby. Where the reasons for the sale of credit obligations were not related to credit risk, such as where there is the need to increase the liquidity of the institution or there is a change in business strategy, and the institution does not perceive the credit quality of those obligations as declined, the economic loss related with the sale of those obligations should be considered not credit-related and the sale should not be considered an indication of default, even where the loss is material (*chapter 5, par. 31*). In our opinion, we could consider among these cases that of sales of credit obligations '*en bloc*', where a discount is usually applied compared to one to one evaluation (in order to conclude the deal earlier) with no link to the real risk of the block. **We ask for the confirmation that this kind of transactions should not be considered as defaulted.**

Finally, we would appreciate a clarification by the EBA on whether securitized credits have to be considered within the "sale of credit obligation" category.

2.2 Distressed restructuring

Q 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?

For the purposes of unlikeliness to pay as referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013, a distressed restructuring should be considered to have occurred when concessions have been extended towards a debtor facing or about to face difficulties in meeting its financial commitments. Given that, as referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013, the obligor should be considered defaulted where the relevant forbearance measures are likely to result in a diminished financial obligation (*chapter 5, par. 39*). In the CP, regulator proposes that institutions should set a threshold not higher than 1% for the diminished financial obligation (*chapter 5, par. 40*). The threshold should be calculated as the difference (expressed in percentage points) between the net present value of expected cash flows (including unpaid interest and fees) before the changes in terms and conditions of the contract discounted using the customer's original effective interest rate and the net present value of the expected cash flows based on the new arrangement discounted using the customer's original effective interest rate.

This Association wish to stress that the 1% threshold seems excessively low and is not sufficient to include the effects of commercial renegotiation of the exposure. Given that, there is concern that almost every commercial renegotiation would lead to consider the exposure defaulted. **We think that a higher threshold - between 3 to 5 % - would be more effective in distinguishing between commercial renegotiations and distressed restructurings**.

2.3 Other indications of unlikeliness to pay

In identifying indications of unlikeliness to pay, institutions should also take into account the information available in external databases (including credit registers, macroeconomic indicators and public information sources). The indications that could be considered include events such as significant delays in payments to other creditors, a crisis of the sector in which the counterparty operates, information that a third party, in particular another institution, has filed for bankruptcy or similar protection of the obligor (*chapter 5, par. 48*).

Furthermore, we observe that current asset quality definition of exposures in Italian regulatory framework is more detailed than that adopted at European level according to EBA's "Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under article 99(4) of Regulation (EU) No 575/2013" and includes at least six different categories for the classification of credit quality. Given this complexity, national institutions could not be always able to achieve broad equivalence with the definition of default used in external data, as prescribed in article 178 (4) of Regulation (EU) No 575/2013. To avoid difficulties in using external data that are not

consistent with the internal definition of default, **we ask for the possibility to allow institutions to achieve appropriate equivalence of internal asset quality definition to the three main asset quality related definitions of exposure assessed at European level (i.e. performing exposures, forbearance and non performing exposures).**

Among other indications of unlikeliness to pay, CP includes credit frauds. In particular, if the credit fraud is identified before default has been recognised this should be treated as an additional indication of unlikeliness to pay (*chapter 5, par. 50*). It seems that, among others, identification of credit fraud could stem from the start of legal proceedings against the obligor, for this can be seen as an indication of significant risk of unlawful conduct of the obligor itself. **We ask for confirmation of this interpretation.**

3. The updated definition of materiality threshold

The definition of a materiality threshold of credit obligation past due has a significant impact on the issue discussed in the present consultation.

While materiality threshold was subject to separate consultation, we have noted the inclusion of a scenario related to this specific issue in the "Instructions for EBA data collection exercise on the proposed regulatory changes of the Definition of Default" ("QIS on the GL on definition of default" of the 22nd September 2015). In that document, EBA measures the impact of a different policy option as respect to the proposal for the materiality threshold included in the Consultation Paper for the RTS on the materiality threshold published in October 2014 (cfr. EBA/CP/2014/32 "Draft Regulatory Technical Standards on materiality threshold of credit obligation past due under Article 178 of Regulation (EU) 575/2013" of 31st October 2014).

On this regard, we welcome:

- the introduction of the concept that both an absolute and relative limit should be breached;
- the mechanism for the counting of 90 days, that begins when the threshold is breached.

Nevertheless, we ask for a further consultation of both qualitative and quantitative aspects of the definition of default before the coming into force of the final EBA's Guidelines on default definition and application.