Single Rulebook Q&A

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Legal act	Directive 2013/36/EU (CRD)
Topic	Credit risk
Article	74
Paragraph	-
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	EBA/GL/2018/06 - Guidelines on management of non-performing and forborne exposures
Article/Paragraph	143
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Disclose name of institution / entity	No
Type of submitter	Credit institution
Subject matter	NPE calculations of NPE workout options
Question	Should the NPV calculations that paragraph 143 of the EBA Guidelines on management of non-performing and forborne exposures describes be performed with a risk adjusted discount rate, i.e. the original effective interest rate should not be used for these calculations?
Background on the question	IFRS 9.5.4.3 prescribes that for modifications of contractual cash flows, the entity has to recalculate a present value of the renegotiated or modified contractual cash flows, but that these should still be discounted at the financial asset's original effective interest rate. Similarly for impairment calculations IFRS 9.B5.5.44 states that expected credit losses shall be discounted… using the effective interest rate determined at initial recognition (or an approximation thereof).The NPV calculations that are currently performed are therefore all based on the original effective interest rate. Paragraph 143 of the EBA Guidelines of non-performing and forborne exposures requires that credit institutions should use a net present value approach to determine the most suitable workout option. The parameters in these calculations, such as the assumed liquidation time horizon, discount rate, cost of capital and liquidation costs, should be based on observed empirical data. Because discount rate is also mentioned in the above

	sentence, our question is whether this means that NPV calculations for envisaged forbearance measures, or repossessions, or liquidation options, should be performed with a different discount rate than the original effective interest rate? If a different discount rate should be used, should that then be a risk adjusted (e.g. based on a current (internal) risk rating) discount rate?
EBA answer	The objective of the EBA Guidelines on non-performing and forborne is to ensure that the institutions when making the analysis of various NPE workouts strategies uses fair and comparable assumptions to choose the most suitable workout strategy. To this end, paragraph 143 of the said guidelines expects institutions to perform NPV and compare NPV calculation for different workout strategies to determine the most suitable forbearance measures. Such calculations should be based on realistic assumptions and with reference observed empirical data, which can include original effective interest rates, but also observed market rates as long as the discount rate is used consistently for comparing different workout options, and is not based on unrealistic future assumptions.
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