

EBA/CP /2025/09

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02 July 2025

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# Consultation paper

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Draft guidelines

amending Guidelines on the application of the definition of default  
under Article 178 of Regulation (EU) No 575/2013

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# 1. Responding to this consultation

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1. The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 5.2.
2. Comments are most helpful if they:
  - respond to the question stated;
  - indicate the specific point to which a comment relates;
  - contain a clear rationale;
  - provide evidence to support the views expressed/ rationale proposed; and
  - describe any alternative regulatory choices the EBA should consider.

## **Submission of responses**

3. To submit your comments, click on the 'send your comments' button on the consultation page by 15 October 2025. Please note that comments submitted after this deadline, or submitted via other means may not be processed.

## **Publication of responses**

4. Please clearly indicate in the consultation form if you wish your comments to be disclosed or to be treated as confidential. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

## **Data protection**

5. The protection of individuals with regard to the processing of personal data by the EBA is based on Regulation (EU) 1725/2018 of the European Parliament and of the Council of 23 October 2018. Further information on data protection can be found under the Legal notice section of the EBA website.

## 2. Executive Summary

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6. Under Article 178(7) of CRR, as amended by Regulation (EU) 2024/1623, the European Banking Authority is mandated to review the Definition of Default guidelines which were drafted by the EBA based on the mandate in Article 178(7) of Regulation (EU) No 575/2013. While the mandate explicitly mentions the treatment of debt restructuring, other parts of the framework have also been assessed.
7. **NPV threshold for debt restructuring:** The consultation paper proposes to maintain the 1% threshold for the net present value (NPV) loss in debt restructuring, based on the following arguments:
  - a. The current framework is already sufficiently flexible and risk sensitive. It is in particular noted that the scope of application of the fixed threshold is limited to obligors experiencing or likely to experience financial difficulties. In addition, the calculation rules of the NPV loss are aligned with accounting principles, and allow institutions to perform restructuring in a way that does not lead to a loss (e.g. extension of maturity). Therefore, the current framework does not lead to wrong default identifications.
  - b. Amending the framework would hinder the effort made following the great financial crisis to reduce the level of non-performing loans. Increasing the threshold would create inconsistencies and potential arbitrage opportunities in the framework as the thresholds on past due amounts are also set at 1%. With that, a sound default identification process is key as the default classification impacts both prudential (IRB) and accounting (IFRS 9) credit risk models, and hence the capitalisation and provisioning of the entire portfolio. Therefore, an increase in the threshold would severely impede the robustness of the framework.
  - c. Any change in the definition of default framework also implies operational costs, as well as a new development and new validation cycle for at least prudential models.
8. **Probation period.** The possibility to shorten the probation period from 1 year to e.g. 3 months for certain forbore exposures is considered. The guidelines text does however not incorporate this change, as it is noted that such change would imply a widening of the gap between the definition of non-performing exposures and the definition of default.
9. **Legislative Moratoria:** The possibility to introduce specific criteria for the recognition of moratoria is considered, both for legislative moratoria and private initiatives, but not introduced in

the guidelines. Similar arguments as the ones provided for the non-increase in the NPV threshold for debt restructuring are used: the framework is already sufficiently flexible to ensure no default misclassification, and recent events observed in the EU are the manifestation of climate risks that should be appropriately measured and capitalised.

**10. Factoring Arrangements:** The consultation paper proposes to increase the exceptional treatment of days past due at invoice level from 30 to 90 for factoring arrangements to better reflect the economic reality of purchased receivables.

**11. Other update in the guidelines:** the application of CRR3 entails some technical updates, such as the removal of the reference to the previous 180 day past due discretion or the reference to distressed restructuring.

## Next steps

**12.** The draft GL are published for a three month consultation period. This consultation paper includes several questions in order to assess the impact of the different options considered. The responses received during the consultation period will be taken into account when specifying the final GL.

## 3. Background and rationale

### 3.1 Background

13. Under Article 178(7) CRR, as amended by Regulation (EU) 2024/1623 (CRR3), the EBA is mandated to review the Definition of Default guidelines (EBA/GL.2017/17, hereinafter “GL DoD”), which were drafted by the EBA based on the mandate in Article 178(7) of Regulation (EU) No 575/2013 (CRR).

<sup>1,2</sup> While the mandate explicitly mentions the treatment of debt restructuring, other parts of the framework could be assessed, in particular the application to factoring as raised in the past by the industry.

### 3.2 Debt restructuring

14. Recital 24 of the CRR3 states that *“institutions should play a key role in contributing to the recovery from the COVID-19 pandemic also by extending proactive debt restructuring measures towards worthy debtors facing or about to face difficulties in meeting their financial commitments. In that regard, institutions should not be discouraged from extending meaningful concessions to obligors where deemed appropriate as a result of a potential and unwarranted classification of counterparties as being in default where such concessions might restore the likelihood of those obligors paying the remainder of their debt obligations. When developing guidelines on the definition of default of an obligor or credit facility, EBA should duly consider the need for providing adequate flexibility to institutions.”*

15. Within the context of debt restructuring, the following components of the GL DoD have therefore been assessed:

- a. The criteria to enter into the defaulted status, i.e. the mechanism to determine whether a diminished financial obligation has resulted from the forbearance measure.
- b. The criteria to return to a non-defaulted status after an exposure has been classified as defaulted due to an unlikelihood to pay indication based on a diminished financial obligation that resulted from a forbearance measure.

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<sup>1</sup> Article 178(7) CRR as amended by Regulation (EU) 2024/1623 (CRR3): “By 10 July 2025, EBA shall issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010, to update the guidelines referred to in the first subparagraph of this paragraph. In particular, that update shall take due account of the necessity to encourage institutions to engage in proactive, preventive and meaningful debt restructuring to support obligors.

In developing those guidelines, EBA shall duly consider the need for granting a sufficient flexibility to institutions when specifying what constitutes a diminished financial obligation for the purposes of paragraph 3, point (d).”

<sup>2</sup> Article 178(7) CRR before the amendment introduced by Regulation (EU) 2024/1623: Article 178(7) of CRR. “EBA shall issue guidelines on the application of this Article.”

### 3.2.1 Current framework in the context of CRR3

16. Article 178(3)(d) CRR was revised by CRR3 replacing the notion of ‘distressed restructuring’ by a direct reference to the forbearance measure, as defined in Article 47b CRR.<sup>3</sup>
17. Article 178(3)(d) CRR, as amended by CRR3, states that *“elements to be taken as indications of unlikelihood to pay shall include the following (...) (d) the institution consents to a forbearance measure as referred to in Article 47b of the credit obligation where that measure is likely to result in a diminished financial obligation due to the material forgiveness, or postponement, of principal, interest or, where relevant, fees;”*
18. The current GL DoD contain a chapter on ‘distressed restructuring’, providing guidance on when to classify an exposure that is subject to such a debt restructuring as defaulted. However, the CRR3 clarifies that there is an indication of unlikelihood to pay (UTP) for an exposure when the institution consents to a forbearance measure as referred to in Article 47b CRR, where that measure is likely to result in a diminished financial obligation. As such, the amended GL DoD need to define when a default has occurred in situations where forbearance measures have been granted by an institution to its obligors. As such, a potential default classification depends on an assessment to be performed by institutions that includes two aspects.
19. First, institutions should assess whether the measure constitutes a forbearance measure. According to Article 47b CRR, a forbearance measure is a concession by an institution towards an obligor that is experiencing or is likely to experience difficulties in meeting its financial commitments (‘financial difficulties’). Therefore, institutions should first assess whether the obligor is or will likely be in financial difficulties, and secondly, whether the concession is given by the institution *due to* these financial difficulties.<sup>4</sup> While a measure may imply a concession by the institution when granted to the obligor in financial difficulties, such concession may not relate to those financial difficulties, and in this case, the institution should consider whether the measure itself constitutes a forbearance measure. Therefore, while the second (quantitative) criteria mentioned below are purely mechanic, the first (qualitative) assessment provides already a great deal of flexibility to prevent default misclassification.
20. Second, institutions should assess whether a forbearance measure is likely to result in a diminished financial obligation. In that context, the GL DoD already provide guidance on how to determine

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<sup>3</sup> Article 178(3)(d) CRR previously stipulated the following indication of a UTP indication: ‘the institution consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or, where relevant fees. This includes, in the case of equity exposures assessed under a PD/LGD Approach, distressed restructuring of the equity itself;’

<sup>4</sup> Article 47b of CRR: “A concession may entail a loss for the lender and shall refer to either of the following actions:

(a) a modification of the terms and conditions of a debt obligation, where such modification would not have been granted had the obligor not experienced difficulties in meeting its financial commitments;

(b) a total or partial refinancing of a debt obligation, where such refinancing would not have been granted had the obligor not experienced difficulties in meeting its financial commitments.”

whether the concession entails a diminished financial obligation. As such, the assessment is based on a comparison between the net present value (NPV) of expected cash flows before the changes in the terms and conditions of the contract and the NPV of expected cash flows based on the new arrangement, both discounted using the effective interest rate of the original contract:

- a. If the difference between the NPV of cash flows before and after restructuring arrangements exceeds a certain threshold the exposure should be classified as defaulted. The threshold should be set by institutions but should not exceed 1 %.
- b. Where this difference is below the specified threshold, institutions should still assess such exposures for possible other indications of unlikelihood to pay.

21. This NPV mechanism was introduced in the GL DoD to align with the accounting framework, where the calculation of an impairment loss involved a comparison between the loan's carrying amount and the future cash flows discounted with the effective interest rate. The maximum threshold of 1% was set to exclude from a default classification mainly those situations where the change in the net present value (NPV) of the contract results from technical discounting aspects and rounding of the amounts.

22. Under IFRS9, which was introduced after the publication of the GL DoD, this alignment is generally still applicable. When an institution modifies a financial asset which does not result in a derecognition, under IFRS9 the institution shall recognise a gain or loss by comparing the gross carrying amount of the financial asset before and after the modification, where the gross carrying amount of the financial asset shall be calculated as the NPV of the cash flows discounted at the financial asset's original effective interest rate.

23. The GL DoD also specify the criteria for reclassifying exposures to a non-defaulted status. In relation to exposures that defaulted due to debt restructuring with a diminished financial obligation, the current GL DoD specify that a one year probation period and additional conditions should apply before such exposures can return to a non-defaulted status. The probation period is defined as at least one year from the latest of: i) the moment of extending the restructuring measures, ii) the moment when the exposure was classified as defaulted or iii) the end of any grace period included in the restructuring arrangements. Additionally, this period should not be shorter than the period during which a material payment has been made by the obligor, which is expected to be a total amount equal to the amount that was past-due (if there were past-due amounts) or that has been written-off (if there were no past-due amounts) under the forbearance measures.

### **3.2.2 Considerations to revise the framework**

- a. The default classification involves additional costs for the institutions and the borrower

24. One of the elements considered in the update of these guidelines is the appropriateness and proportionality of the application of the 1% threshold in relation to the materiality of the NPV loss



described above. The question of proportionality is mostly related to concessions that imply an NPV loss above 1% but below 5%, but where there is no loss on the nominal amount and where no other indications of UTP apply.

25. The considerations below take as the starting point the situation where an obligor is in financial difficulties and a concession has been granted to this obligor which constitutes a forbearance measure, and where no other indications of UTP are present.

26. A first consideration is that the impact on the institution's profit and loss account and capital ratios might be disproportionate to the increase in risk related to the materiality of the NPV change in the contract (less than e.g. 5%). This impact relates to several elements. By placing the obligor in financial difficulties with the restructured debt in default, there is an effect on the profit and loss account in terms of the level of provisioning. In addition, capital ratios are impacted via the risk-weighted exposure amounts (RWEA) for the obligor itself, and for the rest of the portfolio (only IRB institutions). Institutions may therefore be incentivised to liquidate non-performing exposures (NPE) or sell NPE on the secondary market.

#### **Impact on profit and loss account**

27. Classifying an obligor in financial difficulties to default is likely to impact the provisioning of the related exposure. Under IFRS9, a rebuttable assumption is that the exposure would already have experienced a significant increase in credit risk (SICR) and be classified in Stage 2 based on the forbearance measure. Provisioning for the exposure would likely increase if the obligor is classified as defaulted, as this classification will likely translate to a transfer of the exposure to the IFRS9 Stage 3, triggering a corresponding decrease in the profit and loss account of the institution. This is likely to affect the parameters used in the determination of expected lifetime credit losses.

#### **Impact on the risk-weighted exposure amount associated with the defaulted exposure**

28. The risk weighted exposure amount (RWEA) related to the obligor may increase depending on the exposure class and whether the institution uses the Internal Ratings Based (IRB) Approach or the Standardised (SA) approach.

- a. Under the SA, Article 127 CRR groups the unsecured parts of defaulted exposures as a specific exposure class. Within this exposure class the risk weight is assigned according to the ratio between the unsecured part of the exposure value and the specific credit risk adjustments (SCRA) and the amounts deducted in accordance with point (m) Article 36(1) of the CRR. If the SCRA and the deducted amounts together are equal to or greater than 20% of the unsecured part of the exposure value, then the assigned risk weight is 100%. The assigned risk weight is 150% if the SCRA and deductions are less than 20% of the unsecured part of the exposure value. As these are the highest levels of risk weights used in most of the other exposure classes under the SA, it is reasonable to expect an increase in the risk-weight of an obligor as a result of a default classification.

- b. Under the IRB-Approach without the use of own estimates of LGDs and IRB-CCFs (F-IRB Approach), the risk weight of defaulted exposures is zero. However, the calculation of expected loss is based on a PD that is equal to 100%; therefore, the expected loss is much higher than if the exposure was not classified as defaulted (and a PD for non-defaulted obligors or exposures smaller than 100% would be applied). The stricter the default definition, the higher the expected loss. If the expected loss amount is not fully covered by the credit risk adjustments and other value adjustments and deductions related to the exposure as referred to in Article 159(1) CRR then the difference between the expected loss amount and those adjustments and deductions is deducted from own funds.
- c. Under the IRB Approach with the use of own estimates of LGDs and IRB-CCFs (A-IRB Approach), the impact on capital requirements is complex. The risk weight for defaulted exposures is not zero but calculated on the basis of expected loss best estimate (ELBE) and LGD in-default estimates and should represent the unexpected loss within the recovery process. It is not explicit whether the risk weight calculated in this way is higher or lower than the risk weight for non-defaulted exposures. However, the same effect on expected losses applies as for the F-IRB Approach.

29. Both under both the SA and IRB Approach, this effect on RWEA is temporary, and is largely negated as soon as the exposure returns to a non-defaulted status. As such, the materiality of the RWEA impact also depends on the criteria to be met in order to return to a non-defaulted status.

#### **Impact on the risk-weighted exposure amount associated with the non-defaulted portfolio**

30. The default classification of the obligor likely also impacts the RWEA related to the portfolio to which the exposure of the obligor in financial difficulties is assigned (only for IRB portfolios as the weighted risk weight for the portfolio of non-defaulted obligors under SA would not change based on the default classification of other obligors in the portfolio, and with a certain delay).

- a. Under the F-IRB Approach, a stricter default definition results in a higher default rate, leading to higher PD estimates and higher risk weights for non-defaulted exposures – as the LGD is fixed.
- b. Under the A-IRB Approach, a stricter definition of default results in higher PD estimates. In the case of LGD, however, the impact would most likely be the reverse, because a stricter definition of default might result in more defaults that would be cured within a short period of time or with no loss. This effect would decrease LGD estimates and thereby the risk weights for non-defaulted exposures. The overall magnitude of the RWEA impact of defaulted obligors on the non-defaulted portfolio is therefore difficult to estimate under the A-IRB Approach.

## Operational costs and reputational effects

31. Next to a capital cost, institutions might suffer from additional operational costs and reputational effects due to the classification of an obligor as defaulted. The default classification might trigger some risk management measures from the institution that may not match the level of risk of the obligor. Actions, in particular those described in the EBA Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06), might be required as well. For example, depending on the type of exposure, collateral that is subject to individual valuations and revaluations on a regular basis may need to be updated at the time when the exposure is classified as defaulted. Next to the operational burden on the institution, such risk management measures, if considered disproportionate by the obligor, might cause reputational damage on the institution. An institution may therefore want to refrain from providing the forbearance measures to the obligor, even if there are viability concerns in relation to the original payment schedule.
32. Another consideration, which interacts with the previous point, is that the impact on the obligor due to the default classification because of the NPV threshold breach may be disproportionate to the forbearance measure received.
33. Institutions may not be incentivised to provide viable forbearance measures to the obligor due to higher capital or operational costs, such that there is a chance that the obligor's financial situation worsens. In case the institution decides not to grant the forbearance measure (due to capital and operational costs for the institution), there might be a higher chance that the obligor in financial difficulties defaults on the original payment schedule, being worse off than if the obligor had received the forbearance measure.
34. In the case the forbearance measure is granted, there might be implications for the obligor if this measure triggers a default classification. The obligor might be subject to some of the institution's risk management costs (such as collateral revaluation) related to the default classification. Additional credit granting by the institution providing the forbearance measure may also be automatically restricted due to the default status (e.g. the tightening of revolving working capital). Furthermore, the default classification might translate into a negative notation in a public credit registry, with the consequence that the obligor loses access to viable private funding solutions for a sustained period. In some jurisdictions, a default status may also impose restrictions on available public funding schemes (e.g. public guarantees, legislative moratoria). As such, with a lack of available funding, temporary financial difficulties might translate into more permanent solvency issues.
- b. However, the default identification framework already incorporates flexibility when specifying what constitutes financial difficulties, a concession and a diminished financial obligation
35. The above considerations are relevant only in the context where an obligor is in financial difficulties and a concession has been made to this obligor, which constitutes a forbearance measure, and where no other indications of UTP are present. Any potential additional flexibility to be incorpo-

rated into the guidelines on the treatment of a diminished financial obligation and the NPV threshold should therefore be considered in relation to the flexibility already integrated in the framework, especially with regards to the concepts of financial difficulties and concessions.

36. First, the CRR framework already allows for flexibility in determining when an obligor is experiencing or is likely to experience difficulties in meeting its financial commitments. Article 47b(4) stipulates the difficulties experienced by an obligor in meeting its financial commitments shall be assessed at obligor level, and Article 47b(3) provides indicators where a forbearance measure may have been adopted.

37. Second, any concession made by the institution for other reasons than these financial difficulties, e.g. due to commercial or reputational reasons, does not constitute a forbearance measure.

38. Finally, institutions can already provide leeway to an obligor that is in temporary financial difficulties without triggering a concession and/or a diminished financial obligation. This includes:

- a. A temporary payment holiday could be granted if the unpaid amounts are paid back in full within three months (such that no effective restructuring has taken place).
- b. A grace period, either non-limited in time where the obligor pays only the interest payments and pause the principal payments (as long as there are no viability concerns vis-à-vis the eventual principal payments), or limited in time and where compensated by additional payments (e.g. via an extension of the maturity, or slightly higher interest rate after the temporary grace period) to compensate the NPV loss for the institution.
- c. Provide restructurings with a limited loss (NPV loss below 1 %), i.e., a grace period of principal and interest during a limited period of time, or a measure where the obligor does not have to (or is not allowed to) pay compounded interest.

39. The restructuring solutions described above would most likely be viable for obligors in temporary financial difficulties, also because a combination of these solutions is possible (for instance, a full grace period can be provided for a limited period of time to cope with a severe liquidity issue, followed by a grace period only on the repayment of the principal). Those obligors for which the NPV neutral measures would not imply a viable solution, i.e., those that cannot compensate (after an initial period of liquidity shortage) for the loss in NPV stemming from the forbearance measure, are likely to be in more structural financial difficulties.<sup>5</sup> It is noted that granted forbearance measures in general are expected to be viable payment solutions for obligors, such that the viability of a forbearance measure itself should not be the sole reason for not classifying an obligor to default.

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<sup>5</sup> Based on figures received by the EBA, the incidence of obligors with temporary financial difficulties that default solely due to the diminished financial obligation (i.e. no other UTP indications apply to the exposure) is understood to be low.

40. Therefore, an UTP indication and default treatment for obligors with structural financial difficulties with an NPV loss above 1 % is overall deemed to be proportional. The default identification framework already has already provided sufficient flexibility to institutions when specifying what constitutes a diminished financial obligation, such that they can engage in proactive, preventive and meaningful debt restructuring to support obligors. An increase of the NPV threshold from 1 % to 5 % is deemed not appropriate for providing additional flexibility to institutions to find viable forbearance measures.

**c. An increase in the NPV threshold would create inconsistencies with other parts of the default identification framework**

41. An increase in the NPV threshold (to e.g., 5 %) used to determine whether a forbearance measure implies a diminished financial obligation may be incompatible with other parts of the definition of default. The intention of the 1 % is to capture mainly those situations where the change in the net present value of the contract results from technical discounting aspects, rounding amounts, and where the diminished obligation by forgiveness, or postponement of principal, interest or, where relevant fees, should consequently not be considered material. With that, an increase to 5 % creates inconsistencies with the implementation of the materiality threshold for credit obligations past due, which is in most jurisdictions set at 1 %. An increase to 5 % would thus create possible ways to postpone the material past due default indicator by postponing payments for a sustained period. Finally, credit institutions are highly leveraged entities, with regulatory leverage ratios typically around 5 %. Hence a loss between 1 % and 5 % on a significant portion of the portfolio can amount to a material loss in comparison to the absolute common equity Tier 1 capital from an institution.

42. In conclusion, an increase from 1 % to 5 % is not deemed sufficient to provide flexible restructuring solutions to obligors in structural financial difficulties, and would create inconsistencies and potential arbitrage possibilities in the framework. The threshold should therefore be maintained at 1% and the amending guidelines propose no change in this regard.

**Consultation box: considered alternative approach for the diminished financial obligation for exposures subject to a forbearance measure**

**Rationale**

Additional flexibility in terms of debt restructuring to alleviate the impact on obligors and institutions of a default classification can instead be introduced by allowing for more risk sensitivity in the criteria for a return to the non-defaulted status.

Many of the issues described above in relation to the current framework, e.g. higher capital requirements and obligors losing access to funding, relate largely to the obligor being in default, rather than to the default classification event itself. As such, shortening the period in which the obligor is in default, in particular the probation period, would alleviate the impact on both institutions and obligors, allowing for more risk sensitive and flexible debt restructuring.

Two changes are therefore considered to be made to the criteria for a return to non-defaulted status for defaults that are triggered because the institution consents to a forbearance measure of the credit obligation as referred to in Article 47b of the CRR where that measure is likely to result in a diminished financial obligation.

- First, the probation period is shortened from one year to a period between three to six months for those debt restructurings where the diminished financial obligation, following the NPV calculation methodology described in the GL DoD, is below 5%, and changes relate solely to the schedule of payments, namely by suspending, postponing or reducing the payments of principal amounts, interest or of full instalments, for a predefined limited period of time; no other terms and conditions of the loans, such as the interest rate, should be changed, unless such change only serves for compensation to avoid losses which an institution otherwise would have due to the delayed payment schedule under the measure, which would allow the impact on the net present value to be minimised (in other words, there should be no loss in terms of the nominal amount of agreed payments under the original credit contract);.
- Second, the required material payment should in total be equal to the amount that has been written-off (if there were no past-due amounts) under the forbearance measures, capped at 20% of the principal outstanding amount of the exposure prior to the forbearance measure.

These changes to the current GL DoD could potentially enable institutions to extend to obligors meaningful concessions which might restore the likelihood of those obligors paying the remainder of their debt obligations, without classifying obligors as being in default for a disproportional period.

However, a change in minimum conditions for reclassification to a non-defaulted status proposed in these amending guidelines for some defaulted exposures subject to a forbearance measure resulting in a diminished financial obligation (from the current minimum one-year probation period to a minimum three-month period) contradicts a similar existing requirement for the definition of non-performing exposures (NPE) as defined in Article 47a CRR. According to Article 47a(6)(b) CRR, to reclassify a NPE subject to a forbearance measure, at least one year shall have passed since the date on which the forbearance measure was granted and the date on which the exposure was classified as NPE, whichever is later.

Therefore, the considered change in the GL DoD implies that whereas these exposures would no longer be considered defaulted according to Article 178 CRR, they would still be treated as NPE in accordance with Article 47a CRR.

It means that the considered changes would involve increasing the gap between the NPE definition and the default definition, which would go against supervisory efforts to align the two definitions within institutions. It is noted that at EU level, institutions have largely aligned their definitions of NPE and default.

**Considered amendments to the Guidelines under the alternative treatment for determining the diminished financial obligation for exposures subject to a forbearance measure**

(1) A new paragraph 72a is inserted as follows:

‘72a. By way of derogation from paragraph 72, the minimum one-year period is reduced to three months for those exposures satisfying all of the following conditions:

- (a) The forbearance measure results in a diminished financial obligation, the net present value of which calculated according to paragraph 51 is below 5%;
- (b) The forbearance measure relates solely to the schedule of payments, namely by suspending, postponing or reducing the payments of principal amounts, interest or of full instalments, for a predefined limited period of time; no other terms and conditions of the loans, such as the interest rate, should be changed, unless such change only serves for compensation to avoid losses which an institution otherwise would have due to the delayed payment schedule under the measure, which would allow the impact on the net present value to be minimised.’

(2) Paragraph 73(a) is replaced by the following:

‘73(a) during that period a material payment has been made by the obligor; material payment may be considered to be made where the debtor has paid, via its regular payments in accordance with the restructuring arrangements, a total equal to the amount that was previously past-due (if there were past-due amounts) or that has been written-off subject to a maximum of 20% of the principal outstanding amount of the exposure prior to the forbearance measure (if there were no past-due amounts) under the restructuring measures’

**Consultation questions**

**Question 1:** Do you believe the current guidelines result in some exposures under forbearance measures to be incorrectly classified as defaults, thus hindering proactive, preventive and meaningful restructurings given the detrimental effects that defaulted status has for the affected obligors? If so, please further specify the characteristics of the exposures, which you deem as being subject to an incorrect classification of default.

**Question 2:** Do you think that relaxing the criteria for the minimum period before returning to the non-defaulted status for defaulted forborne exposures could be an appropriate measure to alleviate a higher burden on your institution and clients? How material would the difference be in your case between the amounts of forborne exposures classified as NPE and as defaulted if the minimum one-year probation period in the definition of default were reduced to three-months for certain forborne exposures (with change in NPV below 5% and no loss on the nominal



amount)? Would that proposal create additional operational burden or practical impediments? Do you see support such proposal, and if so, for which reasons?

**Question 3:** Do you see any alternatives other than those referred to in this section that the EBA should consider under Article 178(7) CRR to update the Guidelines and encourage institutions to engage in proactive, preventive and meaningful debt restructuring to support obligors?

**Question 4:** Do you use internal definitions of default and NPE that are different from each other? Which differences are these and how material are those differences? Do you have any reasons or observed practical impediment that warrants a different definition of NPE and default? If so, please provide examples where a different definition of NPE and default is appropriate?

**Question 5:** Would a potential lack of alignment between the default and NPE definition lead to issues in accounting in your case?

### 3.3 Considerations on moratoria

43. In the context of natural disasters that affected some EU countries in the last quarter of 2024, legislative and non-legislative moratoria ('general payment moratoria') on loan repayments were introduced in several jurisdictions. Since dedicated guidelines on moratoria were issued by the EBA to deal with the COVID-19 crisis<sup>6</sup> (EBA/GL/2020/02 – the GLs on moratoria), the current review of the GL DoD could be considered an opportunity to include an explicit treatment of general payment moratoria, to prevent having to issue dedicated guidelines whenever a crisis occurs in an EU jurisdiction. While in the context of COVID-19 crisis these moratoria were seen as exceptional, the issue is now considered from a more "business as usual" perspective, for example related to the materialisation of climate risk that is likely to occur on a more regular basis.
44. The key issue for the application of the definition of default to exposures within the scope of a general payment moratorium is whether the application of a general payment moratorium would not in itself lead to a classification of an exposure as forbearance under the definition as defined in Article 47b CRR.
45. Introducing a dedicated derogation from the forbearance status and therefore to the forbearance unlikely-to-pay default criteria under Article 178(3)(d) CRR for general payment moratoria or only for legislative moratoria would depart from the objective of harmonisation of the definition of the default to reduce RWA variability that lies at the root of the development of the EBA guidelines on the definition of default in 2016. Under this revised treatment, a Member State could for instance issue a legislative moratorium in case of any crisis affecting its territory allowing the institutions from the jurisdiction to no longer apply the harmonised definition of default prescribed in the guidelines (temporarily).

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<sup>6</sup> The [GLs](#) on moratoria were applicable until 31 March 2021.



46. In addition, the current framework already allows for flexibility since the NPV test should only be performed for forbore exposures, and the definition of forbearance involves judgement as regards the assessment of whether the obligor is experiencing or is likely to experience difficulties in meeting its financial commitment.
47. Furthermore, in case an exposure is classified as being subject to a forbearance measure, the NPV test prescribed in paragraph 51 of the GL DoD is to be performed to assess if the forbearance measure results in a diminished financial obligation – an UTP criterion triggering the default in case the NPV loss is higher than 1%. The flexibility in the current framework ensures that the application of a moratorium does not automatically result in a classification of such exposure as defaulted. The amending guidelines therefore propose no change in relation to moratoria.

#### **Consultation box: considered alternative approach for legislative moratoria**

##### **Rationale**

The main argument justifying exempting from a forbearance classification those exposures subject to legislative or non-legislative moratoria (and as such from a classification as defaulted) is related to the risk of default misclassification. Exposures identified as defaulted based on a forbearance measure with an NPV loss higher than 1%, may not be true defaults where this measure stems from a general payment moratoria, because these measures will typically not be associated with any loss on the nominal amount, since the recourse to the moratorium is explained mainly by short term liquidity shortages and not by solvency issues. Indeed, moratoria usually go hand in hand with support measures taken by the respective government to help business and citizens affected by the crisis or with insurance payouts to customers impacted by the damage.

In addition, from an operational perspective, carrying out an individual assessment of forbearance and then performing the NPV test of paragraph 51 of the GL DoD for each exposure in the scope of a general payment moratorium can be overly burdensome for institutions in case a material share of the credit risk exposures is subject to moratoria.

It can be argued that in a period of crisis, the banking prudential framework for credit risk should avoid being too procyclical when at the same time public measures are taken by governments to dampen the effect of the crisis, so that exposures subject to general payment moratoria could be exempted from the forbearance status. Other parts of the banking prudential framework already embed options to mitigate the procyclicality of the framework in “extraordinary circumstances” such as in market risk (Article 325az(5) CRR) or in prudent valuation (Article 34(2) CRR).

In the specific case of legislative moratoria, institutions could be considered to be forced by law to grant moratoria to every obligor applying for it meaning that institutions are not voluntarily *consenting* to forbearance measures and as such are not truly meeting the criteria for default

referred to in Article 178(3)(d)<sup>7</sup> CRR. Besides, in this case as the modification has been granted to all obligors asking for it without discrimination, the modification could have also been granted if the obligor had not experienced difficulties in meeting its financial commitments, and therefore the conditions under Article 47b CRR would not be met to be considered as forborene. From this perspective, non-legislative moratoria could be considered to be different as institutions are not forced by law to grant those moratoria. Institutions are also usually directly involved in setting up the conditions of non-legislative moratoria which may raise concerns in term of risk of arbitrage of framework on the definition of default, in the specific case of non-legislative moratoria.

As such, it could be argued that the application of a legislative moratorium that meets the requirements of these guidelines would not in itself lead to a reclassification under the definition of forbearance. Even where the legislative moratoria are not classified as forbearance measures, this does not remove the obligations for institutions to carefully assess the credit quality of exposures benefiting from these measures and identify any situations in which borrowers are unlikely to pay within the meaning of the definition of default under Article 178(1)(a) CRR.

A potential introduction of a derogation for legislative moratoria such that they do not lead to a reclassification under the forbearance status would need to be subject to stringent criteria. The EBA has identified the following four criteria:

- The moratorium changes only the schedule of payments. This condition is consistent with the objective of the moratorium to address short-term liquidity issues. In order to achieve this objective, the moratoria suspend, postpone or reduce the payments (principal, interest or both) within a limited period of time. This clearly affects the full payment schedule and may lead to increased payments after the period of the moratorium or an extended duration of the loan. However, the moratorium should not affect other conditions of the loan, in particular the interest rate, unless such change only serves for compensation to avoid losses which an institution otherwise would have due to the delayed payment schedule under the moratorium, which would allow the impact on the NPV to be minimised. Measures not meeting this condition would be a specific solution for individual loans and could lead to a significant change in the NPV of the credit obligation, such that a forbearance classification would have to be considered. In this context, in the case of contracts based on variable interest rate, the usual adaptation of the interest rate based on the changes of the benchmark rate is not considered a change to the terms and conditions of the respective loan.
- The moratorium has to apply to a broad range of obligors. This condition is necessary to ensure that the change of the schedule of payment does not address specific financial difficulties of individual obligors, as this would meet the definition of forbearance. Therefore, in

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<sup>7</sup> Art. 178(3)(d) CRR: ‘the institution consents to a forbearance measure as referred to in Article 47b of the credit obligation where that measure is likely to result in a diminished financial obligation due to the material forgiveness, or postponement, of principal, interest or, where relevant, fees’

order to benefit from this alternative treatment specified in this consultation box, the moratorium must be available to a large, predefined group of obligors, regardless of the assessment of their individual creditworthiness. As the moratorium is supposed to address short-term liquidity shortages, the selection criteria must be sufficiently broad. Examples of such broad criteria include, but are not limited to, a specific exposure class or sub-exposure class (e.g., retail, private individuals, SMEs or corporates), a specific product range (e.g., mortgage loans) or obligors from specific regions or certain industry sectors that are most affected by the crisis. Second, this condition also ensures that the derogation is only granted in cases where it would be arguably too burdensome for institutions to perform an individual assessment of forbearance and an individual NPV test as per paragraph 51 of the GL DoD since a material share of the credit risk exposures is subject to the moratorium.

- The government of the Member State in which the legislative moratorium is implemented, has itself taken specific fiscal measures to help households and/or businesses affected by the emergency situation so as to ensure that obligors are mainly facing liquidity issues and not solvency issues, thanks to the government spending dampening the effect of the crisis.
- The moratorium does not apply to new loans granted after the launch of the moratorium. It has to be ensured that the moratorium addresses a specific issue arising as a result of the respective crisis situation and is not used for new lending granted after the start of this situation. In this context, the use of existing credit lines or renewal of revolving loans is not considered a new loan. Institutions are allowed and encouraged to grant new lending to both new and existing clients during the application of the moratorium. However, it is expected that this new lending will follow the normal credit policies and will be based on the assessment of the creditworthiness of the clients and will take into account any possible associated public guarantees. These new loans should be adequately structured taking into account the current payment capacities and hence the application of the moratorium should not be necessary. While granting a new loan to an obligor already subject to a legislative the moratorium does not automatically lead to a forbearance classification of the exposures to that obligor, for such cases the individual conditions should be assessed on a case-by-case basis.

**Considered amendments to the Guidelines under the alternative treatment of legislative moratoria**

- (1) The following section is added to the Guidelines EBA/GL/2016/07:

‘Section 11 - Treatment of legislative payment moratoria’

- (2) A new paragraph 115 is added to the Guidelines EBA/GL/2016/07:

‘115. Where a legislative moratorium meets the conditions referred to in paragraph 117 and applies to all of the exposures of an institution within the scope of the moratorium, such measures should not change the classification of exposures under the definition of forbearance in accordance with Article 47b of Regulation (EU) No 575/2013 or change

whether they are treated as defaulted in accordance with Article 178(3)(d) of that Regulation. Consequently, for the purpose of these guidelines the application of the legislative moratorium in itself should not lead to reclassification of the exposure as forborne unless an exposure has already been classified as forborne at the moment of the application of the moratorium.'

(3) A new paragraph 116 is added to the Guidelines EBA/GL/2016/07:

'116. Where institutions grant new loans to obligors subject to a legislative moratorium, this does not automatically lead to a reclassification of exposures as forborne. In such cases, the classification should be considered on a case-by-case basis in accordance with Article 47b of Regulation (EU) No 575/2013.'

(4) A new paragraph 117 is added to the Guidelines EBA/GL/2016/07:

'117. A moratorium should be considered eligible for the treatment set out in paragraph 115, where all of the following conditions are met:

- (a) the moratorium is based on the applicable national law of the respective Member State ('legislative moratorium');
- (b) the moratorium applies to a large group of obligors predefined on the basis of broad criteria, where any criteria for determining the scope of application of the moratorium should allow an obligor to take advantage of the moratorium without the assessment of its creditworthiness; examples of such criteria could correspond to an exposure class or a subsegment thereof, an industry sector, a product range or a geographical location. The scope of application of the moratorium may be limited only to performing obligors, who did not experience any payment difficulties before the application of the moratorium, but it should not be limited only to those obligors who experienced financial difficulties before the outbreak of the crisis;
- (c) the moratorium only relates to changes to the schedule of payments, namely by suspending, postponing or reducing the payments of principal amounts, interest or of full instalments, for a predefined limited period of time; no other terms and conditions of the loans, such as the interest rate, should be changed, unless such a change exclusively serves the purpose of minimising the negative impact of a moratorium on the net present value of the cash flows as calculated in accordance with paragraph 51;
- (d) the moratorium does not apply to new loan contracts granted after the date when the moratorium was announced;

- (e) the government of the Member State having issued the moratorium has taken specific fiscal measures to financially support households or businesses affected by the crisis.'

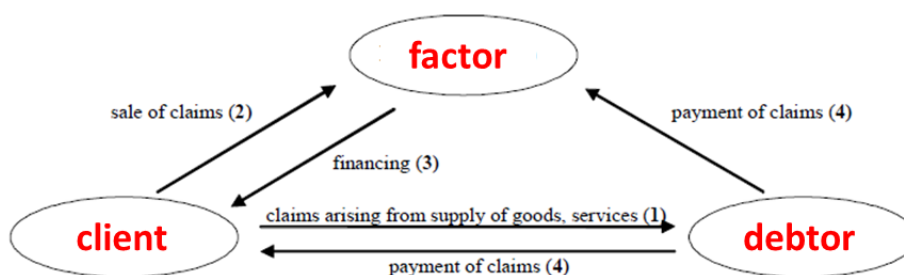
#### **Consultation question**

**Question 6:** Do you agree that no specific provisions should be introduced for moratoria on the grounds of the sufficient flexibility of the revised framework? In case you think the proposed alternative treatment for legislative moratoria should be included in these guidelines, do you have any evidence of the definition of default framework being too procyclical in the context of moratoria? Do you agree with the four conditions that need to be satisfied?

### 3.4 Technical past due for factoring

48. The factoring business, which is a particular form of purchased receivables business, involves three different parties, as described in the CEBS guidelines 10 (GL 10).<sup>8</sup> To exemplify the picture below, one may think of the 'client' as some business-to-business service provider (e.g. a caterer), the debtor as a corporate using the catering services and the factor as a credit institution offering immediate liquidity to the client against a share of the receivables (i.e. payables from the debtor to the client).

**Figure 1: Description of the factoring business**



49. Two types of factoring can be distinguished, which are both subject to a specific (but different) preferential treatment according to the GL DoD:

- a. factoring where the institution has full recourse to the client: In the case of a default of the debtor, the bank can ultimately claim the money from the client. This case is to

<sup>8</sup> [Guidelines on the implementation, validation and assessment of Advanced Measurement \(AMA\) and Internal Ratings Based \(IRB\) Approaches.](#)

be treated by the factor as an exposure toward the client, with the receivables treated as collateral;<sup>9</sup>

- b. factoring where the institution has no recourse to the client: In this case, the institution is directly exposed to the debtor / obligor / buyer, without the possibility of recourse to the client (except in cases of dispute regarding goods and/or services supplied) and these transactions are typically unsecured.

50. A second distinction relates to whether the obligor is classified in the CRR as *retail* (e.g. a private individual or small SME) or non-retail (e.g. a big corporate, or a public sector entity).

- a. For retail obligors, a default may be assessed either at facility level or at obligor level.<sup>10</sup> In the case of purchase receivables, this means that the default can be triggered at the invoice level;
- b. For non-retail obligors, a default may generally only be assessed at obligor level.<sup>11</sup> However, Article 153(6) of the CRR opens the possibility for institutions using the IRBA approach to use “*the risk quantification standards for retail exposures as set out in Section 6*” also for their purchased corporate receivables.<sup>12</sup> This Article hence allows a default assessment at facility level (under strict conditions).<sup>13</sup>

51. In relation to non-recourse factoring, the EBA understands that institutions with big corporate-loan portfolios are hesitant to provide factoring facilities to clients (often SMEs) who wish to sell the receivables of a company for immediate liquidity, where this company is also a non-retail obligor of the institution (i.e., the institution has a direct exposure to this company). A typical example would be the one where an SME (client) has sold the receivables of a large company (debtor / obligor) to the institution (factor). The credit risk and therefore the definition of default is assessed toward this large company. Furthermore, if the credit institution also has other direct exposures to the debtor (on which the debtor is timely paying according to the payment schedule), these direct exposures would also have to be placed in default if the large company is consistently paying late on the factoring receivables.

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<sup>9</sup> See Article 151(2) CRR.

<sup>10</sup> Article 178(1), subparagraph 2 CRR.

<sup>11</sup> Article 178(1), subparagraph 1 CRR.

<sup>12</sup> For purchased corporate receivables that comply in addition with the conditions set out in Article 154(5) of the CRR., and where it would be unduly burdensome for an institution to use the risk quantification standards for corporate exposures as set out in Section 6 for these receivables, the risk quantification standards for retail exposures as set out in Section 6 may be used.

<sup>13</sup> To qualify for this treatment purchased corporate receivables must comply with the conditions set out in Article 154(5) of the CRR, and the use of the regular risk quantification standards for corporate exposures as set out in Section 6 for these receivables must be overly burdensome.

52. The current ‘days past due’ (DPD) counting convention applicable under Article 178(1)(b) CRR has limited impact on ‘regular’ products, while it does not reflect the economic reality of purchased receivables where repayments are made invoice by invoice. The industry argues that the combination of the following elements is the source of non-credit related past due amounts in case of non-recourse factoring.

- a. The DPD counter may keep increasing due to a consecutive overlap in non-payments of these invoices. If there is a high number of receivables, the DPD counter keeps on increasing with payment delays on each invoice.
- b. There are observed lengthy administrative processes with a natural long validation lifecycle of the receivables on invoices.
- c. A factoring institution may not have control over the payment receivable, where the claims due are between the debtor and the client. The debtor might not know its receivable has been sold to a factoring institution, as contracts and corresponding invoices are established between client and debtor and the servicing of the receivables may be performed by the client unless a default of the debtor of a receivable occurs. It is likely that any interaction between factor and debtor may only start when the invoice is past due. Pursuing the debtor to request payment of past due amounts (‘dunning’) may even be performed by the client and not by the factor. Moreover, delays in payment may arise in relation to disputes on services provided by the client.

53. The GL DoD already foresee a specific treatment for purchase receivables because of the specificities of this type of product. Paragraph 23(d) includes an exception to the general 90DPD treatment, explaining that *‘a technical past due situation should only be considered to have occurred [...] in the specific case of factoring arrangements where the purchased receivables are recorded on the balance sheet of the institution and the materiality threshold set by the competent authority in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013 is breached but none of the receivables to the obligor is past due more than 30 days.’*

54. The DPD criteria and the materiality threshold should not have a function to go beyond the identification of obligors that are not paying or are unlikely to pay their credit obligations due. Stricter criteria on past due may not have the effect of reducing past-due payments but rather of institutions denying credit to businesses (often SMEs).

55. However, the industry has argued that the current exception in paragraph 23(d) of the GL DoD does not sufficiently consider the specificities of the factoring product and its natural delays in the payment process, such that the current default definition produces incorrect default classifications. They indicate that many corporates in several jurisdictions have at least one invoice on which they pay later than 30 days after the due date, whilst being rated at investment grade. Furthermore, the cure rate in non-recourse factoring, i.e. the rate of obligors returning from a default to a non-default status or from default to full repayment, ranges from 93% to 100% with an average of 98%, measured across several EU jurisdictions over a period between 2021 and 2023.

56. For the reasons referred to in the previous paragraphs, it is therefore proposed to amend in these guidelines the existing specific treatment for factoring in paragraph 23(d) by increasing the number of days referred to in that treatment from 30 days past due to 90 days past due on the level of an individual invoice.

57. An important additional clarification also made is that for the purpose of paragraph 23(d), factoring is understood to be related to the financing and insuring of invoices related to goods and services. Specifically, purchased receivables related to debt/credit/loan products, i.e. where those receivables relate to principal and interest payments, should be excluded from the treatment described in paragraph 23(d), as the reasons provided in paragraph 40 above do not apply.

58. Two other updates are also introduced that clarify the current interpretation of the application of the requirements with respect to factoring and purchased receivables arrangements.

- a. The first sentence of paragraph 31 is moved to the technical past due section, relating to the situation where the obligor has not been adequately informed about the cession of the receivable by the factor's client, given that the situation described is a technical misclassification of default.
- b. Paragraph 32 is also considered to describe a situation where a technical past due misclassification could have occurred. It is now clarified that this situation describes a difference in date regarding the invoice due date and the date the payments are transferred from the client to the factor, where this difference relates only to administrative delays related to the transfer of a payment from the client to the factor, but should not be based on delayed payment agreements between the client and the factor as this implies an exposure from the factor towards the client.

**Consultation box: on factoring technical past due situations**

**Question 7.** Do you agree with the revised treatment of technical past due situations in relation to non-recourse factoring arrangements? And if you do not agree, what are the reasons? Do you have any comments on the clarifications of paragraphs 31 and 32 in the current GL DoD?

59. It was also considered to extend the exception for factoring to leasing arrangements. However, whereas the factor operates within a tripartite agreement between factor, client and obligor as described in Figure 1 above, there is a direct contractual relationship between the leasing institution and the lessee. As such, the dunning process is under full control of the leasing institution such that late payments should be addressed (pre-emptively) by the leasing institution in order to prevent default classifications.



### 3.5 Other updates to the GL DoD

60. The GL DoD have also been updated to reflect updates in the CRR3 in relation to the default definition. Primarily, references to the use of a 180 DPD counting instead of a 90 DPD counting on the basis of the discretion formerly provided in Article 178(1)(b) CRR have been removed as this discretion has been removed in the CRR with the implementation of the CRR3 as well.

- a. Paragraph 39(a) of the GL on DoD has been deleted (the competent authorities have replaced the 90 days past due with 180 days past due in accordance with point (b) of Article 178(1) of Regulation EU (No) 575/2013 and this longer period is not used for the purpose of recognition of credit-impairment.
- b. Paragraph 59(h) of the GL on DoD has been amended as follow: (h) the reporting of an exposure as non-performing in accordance with Annex V of Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 as amended by Commission Implementing Regulation (EU) 2015/227, except where competent authorities have replaced the 90 days past due with 180 days past due in accordance with point (b) of Article 178(1) of Regulation EU (No) 575/2013. the classification of an exposure as non-performing in accordance with Article 47a(3) of Regulation (EU) No 575/2013.
- c. Paragraph 83(b) of the GL DoD is deleted (the use of 180 days instead of 90 days past due for certain types of exposures to which the IRB Approach is applied in some jurisdictions in accordance with point (b) of Article 178(1) of Regulation (EU) No 575/2013.

61. However, the reference in paragraph 25 of the GL on DoD has not been removed. This is because, while the use of 180 days was inspired by the previous discretion in CRR, it was not directly connected to it. This is directly observable through the wording of the paragraph that is different from the other three paragraphs mentioned above (there is no reference to “*the competent authorities have replaced*”). In fact, the provision in paragraph 25 of the GL DoD is useful in the case where the discretion was not exercised: in the case where the 90 days were replaced by 180 days, no days past due threshold would be breached anyway. Instead, the 180 days was put as a compromise solution, as a constraining factor to the additional flexibilities provided for these exposures.

62. In addition, the reference in the GL on DoD to the notion of ‘distressed restructuring’ has been replaced by referring to ‘diminished financial obligation due to a forbearance measure’ since Article 178(3)(d) CRR was revised by CRR3 replacing the notion of ‘distressed restructuring’ by a direct reference to the forbearance measure, as defined in Article 47b CRR.

63. Finally, the reference to the definition of NPE has been updated (from EBA/ITS/2013/03 to the CRR). In particular, Paragraph 59(h) of the GL on DoD has been amended as follows: ~~(h) the reporting of an exposure as non-performing in accordance with Annex V of Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 as amended by Commission Implementing Regulation (EU) 2015/227, except where competent authorities have replaced the 90 days past due with 180 days~~

~~past due in accordance with point (b) of Article 178(1) of Regulation EU (No) 575/2013.~~ the classification of an exposure as non-performing in accordance with Article 47a(3) of Regulation (EU) No 575/2013.

- a. The definition of NPE was originally introduced by the EBA for reporting purposes in EBA/ITS/2013/03. At that time, the GL DoD had not yet been developed by the EBA and the definition of default for credit risk was only defined in Article 178 CRR, leading to some variability in the definition of default applied in practice by institutions and controlled by competent authorities. The objective of the definition of NPE in the EBA/ITS/2013/03 then adopted as Commission Implementing Regulation (EU) No 680/2014 was therefore to provide a more harmonised definition of non-performing exposures than the existing concept of default.
- b. Regulation (EU) 2019/630 (NPL Backstop Regulation) introduced in Article 47a CRR a definition of NPE building on the definition existing for reporting in Implementing Regulation (EU) No 680/2014. This definition has not been amended ever since so that it is still the definition applicable according to the CRR as amended by CRR3. The definition encompasses both the i) NPE triggers and ii) the conditions for returning to a non-NPE status.

**Consultation box: on other updates reflecting CRR3 updates**

**Question 8.** Do you agree with the other changes to the guidelines to reflect updates from Regulation (EU) 2024/1623?

## 4. Draft guidelines amending Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013

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EBA/GL-REC/20XX/XX

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## Draft guidelines

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amending Guidelines on the application  
of the definition of default under Article  
178 of Regulation (EU) No 575/2013

# 1. Compliance and reporting obligations

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## 1.1 Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010<sup>14</sup>. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## 1.2 Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by [dd.mm.yyyy]. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website with the reference 'EBA/GL/202x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

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<sup>14</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p.12).

## 2. Addresses

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5. These guidelines are addressed to competent authorities as defined in point 40 of Article 4(1) of Regulation (EU) No 575/2013<sup>23</sup>, including the European Central Bank with regards to matters relating to the tasks conferred on it by Regulation (EU) No 1024/2013<sup>24</sup>, and to institutions as defined in point 3 of Article 4(1) of Regulation (EU) No 575/2013.

## 3. Implementation

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### 3.1 Date of application

6. These guidelines apply from **xxx**. Institutions should incorporate the requirements of these guidelines in their rating systems by that time, but competent authorities may accelerate the timeline of this transition at their discretion.

### 3.2 First and ongoing application of the guidelines

7. The internal validation function should verify the changes which are applied to the rating systems as a result of the application of these guidelines and the regulatory technical standards developed in accordance with Article 144(2) of Regulation (EU) No 575/2013, and the classification of the changes in accordance with Commission Delegated Regulation (EU) No 529/2014.
8. Institutions that need to obtain prior permission from competent authorities in accordance with Article 143(3) of Regulation (EU) No 575/2013 and Regulation (EU) No 529/2014 for the changes in the rating systems required to incorporate these guidelines for the first time by the deadline referred to in paragraph 6 should agree with their competent authorities the final deadline for submitting the application for such prior permission.

## 4. Amendments

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10.Guidelines EBA/GL/2016/07 is amended as follows:

11.Point d in paragraph 23 is replaced by the following:

‘(d) in the specific case of factoring arrangements where the purchased receivables are recorded on the balance sheet of the institution and the materiality threshold set by the competent authority in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013 is breached but none of the receivables to the obligor is past due more than 90 days’

12.In paragraph 23, point e and f are added as follows:

‘(e) Where the obligor has not been adequately informed about the cession of the receivable by the factor’s client and the institution has evidence that the payment for the receivable has been made to the client.

(f) In the specific case of undisclosed factoring arrangements, where the payment was made by the obligor to the client before the payment was 90 days past due and the transfer of this payment from the client to the factor occurred after the 90 days.’

13.Paragraph 31 is replaced by the following:

‘31. Where the obligor has been adequately informed about the cession of the receivable but has nevertheless made the payment to the client, the institution should continue counting the days past due according to the conditions of the receivable.’

14.Paragraph 32 is deleted.

15.Point a in paragraph 39 is deleted.

16.The title after paragraph 48 is replaced by the following:

‘Diminished financial obligation due to a forbearance measure’

17.Paragraph 49 is deleted.

18.Paragraph 50 is deleted.

19.Paragraph 52 is replaced by the following:



'52. For the purposes of unlikeliness to pay as referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013, for each forbearance measure, institutions should calculate the diminished financial obligation and compare it with the threshold referred to in paragraph 51. Where the diminished financial obligation is higher than this threshold, the exposures should be considered defaulted.'

20.Paragraph 53 is replaced by the following:

'53. If however the diminished financial obligation is below the specified threshold, and in particular when the net present value of expected cash flows based on the forbearance measure arrangement is higher than the net present value of expected cash flows before the changes in terms and conditions, institutions should assess such exposures for other possible indications of unlikeliness to pay. Where the institution has reasonable doubts with regard to the likeliness of repayment in full of the credit obligation according to the new arrangement in a timely manner, the obligor should be considered defaulted. The indicators that may suggest unlikeliness to pay include the following:

- (a) a large lumpsum payment envisaged at the end of the repayment schedule;
- (b) an irregular repayment schedule where significantly lower payments are envisaged at the beginning of the repayment schedule;
- (c) a significant grace period at the beginning of the repayment schedule;
- (d) the exposures to the obligor have been subject to a forbearance measure more than once.'

21.Paragraph 54 is replaced by the following:

'54. All exposures classified as forborne non-performing in accordance Article 47a of Regulation (EU) No 575/2013 should be classified as defaulted.'

22.Paragraph 55 is replaced by the following:

'55. Where any of the modifications of the schedule of credit obligations referred to in point (e) of Article 178(2) of Regulation (EU) No 575/2013 is the result of financial difficulties of an obligor, institutions should also assess whether a forbearance measure has been consented and whether an indication of unlikeliness to pay has occurred.'

23.Point h in paragraph 59 is replaced by the following:

'59. the classification of an exposure as non-performing in accordance with Article 47a(3) of Regulation (EU) No 575/2013 '

24.Paragraph 72 is replaced by the following:

'72. For the purposes of the application of Article 178(5) of Regulation (EU) 575/2013, regardless of whether the forbearance measure was granted before or after the identification of default, institutions should consider that no trigger of default continues to apply to a previously defaulted exposure, where at least 1 year has passed from the latest between one of the following events:

- (a) the moment of extending the forbearance measure;
- (b) the moment when the exposure has been classified as defaulted;
- (c) the end of the grace period included in the forbearance arrangements.'

25.Paragraph 73(f) is replaced by the following:

'(f) the conditions referred to in points (a) to (e) should be met also with regard to new exposures to the obligor, in particular where the previous defaulted exposures to this obligor that were subject to a forbearance measure were sold or written off.'

26.Point b in paragraph 83 is deleted.

27.Paragraph 107 is replaced by the following:

'107. Institutions should verify on a regular basis that all forborne non-performing exposures are classified as default. Institutions should also analyse on a regular basis the forborne performing exposures in order to determine whether any of them fulfils the indication of unlikeliness to pay as specified in Article 178(3)(d) Regulation (EU) No 575/2013 and in paragraphs 51 to 55.

## 5. Accompanying documents

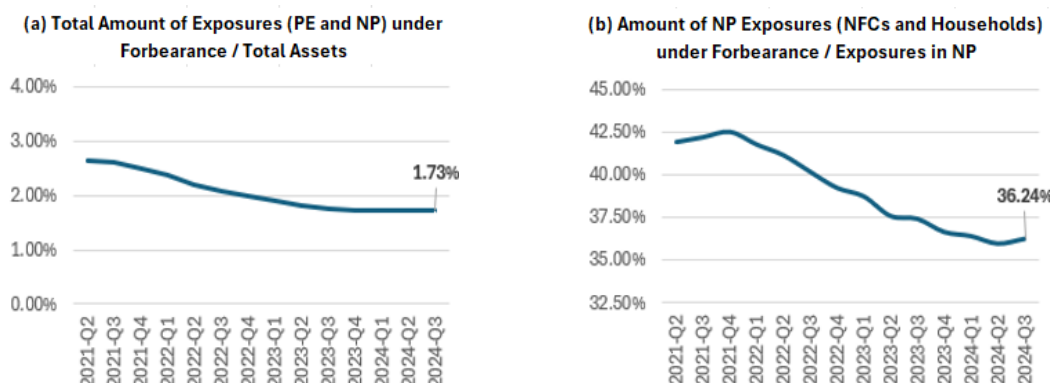
### 5.1 Draft impact assessment

1. The impact assessment of the policy choices put forward in this consultation paper has already been qualitatively described in the background and rationale. In this section, only additional quantitative analysis complementing the background and rationale are presented.
2. This section is based on data extracted from the regulatory reporting (Finrep templates F.18 and F.19 and Corep templates C.01, C.02 and C.47). A stable sample of institutions that reported to the EBA Corep and Finrep figures over the considered period (2021Q2 2024Q3) was used.<sup>15</sup>

#### 5.1.1 Evolution of the use of forbearance measures

3. Figure 1 provides an overview of the use of forbearance measures and its evolution over time. Figure 1(a) shows the ratio between the total exposures subject to forbearance measures (both performing and non-performing) and total assets. It can be seen how this ratio has decreased over time, falling below 2% since 2023.
4. A more interesting measure of the importance of forbearance is presented in figure (2) where, for exposures to Non-financial corporates (NFC) and households only, the amount of NPE subject to forbearance measures is compared to the stock of NPE. Also in this case, a downward trend can be noted. At the end of 2024, approximately one third of the exposures to households and NFCs classified as NPE were subject to some forbearance measures.

**Figure 1: use of the forbearance**



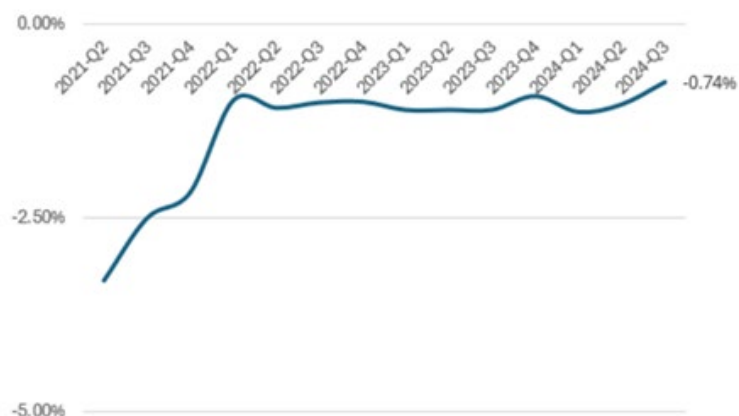
Source: Finrep and Corep, stable sample of banks (Cf. Table 1)

<sup>15</sup> 216 institutions out of the total 2795 institutions reporting Corep figures to the EBA, representing 80.8% of the total assets of EU institutions.

### 5.1.2 NPE vs default

5. Regarding the option to reduce the probation period from 12 months to 3 months, a drawback is that it would only apply to the definition of default and not to the definition of non-performing exposures, leading to a non-intuitive increase of the gap between the two definitions.
6. The figure below shows the relative difference between the amount of NPE subject to forbearance measures **and classified as defaulted** vs the total amount of NPE subject to forbearance measures. As can be noticed, the difference is quite limited since 2022, **less than 1% in relative terms**.

**Figure 2: relative difference between NPE subject to forbearance and defaulted vs the total amount of NPE forborne**



Source: Finrep and Corep, stable sample of banks (Cfr Table 1)

## 5.2 Overview of questions for consultation

1. **Question 1:** Do you believe the current guidelines result in some exposures under forbearance measures to be incorrectly classified as defaults, thus hindering proactive, preventive and meaningful restructurings given the detrimental effects that defaulted status has for the affected obligors? If so, please further specify the characteristics of the exposures, which you deem as being subject to an incorrect classification of default.
2. **Question 2:** Do you think that relaxing the criteria for the minimum period before returning to the non-defaulted status for defaulted forborne exposures could be an appropriate measure to alleviate a higher burden on your institution and clients? How material would the difference be in your case between the amounts of forborne exposures classified as NPE and as defaulted if the minimum one-year probation period in the definition of default were reduced to three-months for certain forborne exposures (with change in NPV below 5% and no loss on the nominal amount)? Would that proposal create additional operational burden or practical impediments? Do you see support such proposal, and if so, for which reasons?
3. **Question 3:** Do you see any alternatives other than those referred to in this section that the EBA should consider under Article 178(7) CRR to update the Guidelines and encourage institutions to engage in proactive, preventive and meaningful debt restructuring to support obligors?
4. **Question 4:** Do you use internal definitions of default and NPE that are different from each other? Which differences are these and how material are those differences? Do you have any reasons or observed practical impediment that warrants a different definition of NPE and default? If so, please provide examples where a different definition of NPE and default is appropriate.
5. **Question 5:** Would a potential lack of alignment between the default and NPE definition lead to issues in accounting in your case?
6. **Question 6:** Do you agree that no specific provisions should be introduced for moratoria on the grounds of the sufficient flexibility of the revised framework? In case you think the proposed alternative treatment for legislative moratoria should be included in these guidelines, do you have any evidence of the definition of default framework being too procyclical in the context of moratoria? Do you agree with the four conditions that need to be satisfied?
7. **Question 7:** Do you agree with the revised treatment of technical past due situations in relation to non-recourse factoring arrangements? And if you do not agree, what are the reasons? Do you have any comments on the clarifications of paragraphs 31 and 32 in the current GL DoD?
8. **Question 8:** Do you agree with the other changes to the guidelines to reflect updates from Regulation (EU) 2024/1623?