eba European Banking Authority

BANKING STAKEHOLDER GROUP

15 October 2025

Banking Stakeholder Group's response to Consultation on Draft guidelines amending Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013

Introduction

These notes have been prepared by the Banking Stakeholder Group to contribute to the ongoing revision of the EBA Guidelines on the definition of default (henceforth, the "EBA GL 2016/07") and in response to the EBA Consultation on Draft guidelines amending Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 and (henceforth, the "EBA GL 2016/07"). In line with the mandate given to the EBA under Article 178(7) of CRR3 — which enjoins the EBA to promote proactive, preventive and meaningful debt restructuring — the aim of this document is to support dialogue among stakeholders and offer constructive input for this consultation.

Some BSG members consider that this document should mainly address the rationale behind the current DFO definition. They would like to take the opportunity to highlight pros and cons of having a quantitative criterion as a trigger of the defaulted status, discuss limitations of the current criterion and what they consider to be potential unintended consequences. These stakeholders would like to put forward concrete proposals which they believe are necessary to ensure that the default classification framework remains risk-sensitive, coherent and does not disincentivize the use of legitimate and prudent forbearance strategies.

Other BSG members consider that these proposals significantly underestimate the risks to financial stability, consumer protection, and market integrity that could arise from applying

the proposed modifications to the current definition of default. These members are of the view that a robust and harmonised definition of default is a cornerstone of a transparent, resilient, and trustworthy financial system. They are concerned that the proposals from some BSG members within this response to modify the current definition could, if adopted, dilute the post-financial crisis regulatory architecture designed to protect the public from excessive risk-taking and a resutant deterioration of credit quality. They welcome the proposal by the EBA to update GL 2016/07 in line with the revised wording of Art. 178 CRR3 while preserving the prudential soundness of the current framework.

Background and Definition of "Diminished Financial Obligation" under GL 2016/07

Article 178 of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR) specifies the definition of default of an obligor that is used for the purpose of the credit risk IRB Approach as well as for the Standardised Approach.

According to the EBA GL 2016/07 "for the purposes of unlikeliness to pay as referred to in point (d) of Article 178(3) of CRR, 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".

The obligor should be considered defaulted where the distressed restructuring is likely to result in a diminished financial obligation, where considering forborne exposures, the obligor should be classified as defaulted only where the relevant forbearance measures are likely to result in a diminished financial obligation. More in detail, the GL specifies that a borrower is considered to have a diminished financial obligation when lender concessions (material forgiveness, or postponement, of principal, interest or, where relevant, fees) reduce the net present value (NPV) of expected cash flow by a percentage set by the lender that could not be higher than 1%.

Article 178.7 of the CRR mandates the EBA to issue guidelines, by 10 July 2025, "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."

General considerations on Forbearance Measures

Forbearance measures are an important tool to support borrowers who face or are about to face temporary financial difficulties. According to Article 47b of CRR3, these measures allow a borrower to benefit from new contract terms that are more favourable than the original ones

and/or more favourable than those typically offered by the institution to obligors with a similar risk profile. Alternatively, the borrower may benefit from a total or partial refinancing of a debt obligation. While these measures may result in a potential loss in value for the institution, they help prevent a more substantial loss that could arise in the event of a default. More importantly, by adjusting loan terms, the institution can enhance the borrower's repayment capacity without immediately triggering adverse credit classification. This approach helps ensure that loans are classified accurately, reflecting the borrower's actual financial situation rather than penalizing temporary setbacks. This approach is also consistent also with the EBA/GL/2018/06 "GLs on management of non-performing and forborne exposures" stating that "Forbearance measures should aim to return the borrower to a sustainable performing repayment status, taking into account the amount due and minimising expected losses. "Such measures are particularly valuable for small and medium-sized enterprises (SMEs) and individual borrowers, who often have more limited financial resources and less diversified income streams compared to larger corporations. This makes them more vulnerable to temporary cash flow disruptions, delays in receivables, or unexpected expenses. For SMEs, access to financing is essential for business continuity and economic resilience. From a broader perspective, forbearance can mitigate the effects of economic downturns by smoothing credit cycles and supporting overall financial stability. During extraordinary events, like economic crises or natural disasters, forbearance helps reduce the risk of widespread insolvencies and sustains economic activity. For banks, granting forbearance supports prudent credit risk management by aligning loan classification with the true risk profile of the borrower. This helps preserve asset quality and regulatory capital, while maintaining long-term client relationships and reducing the likelihood of defaults that could unnecessarily restrict access to credit.

Forbearance might be extended to exposures that are formally classified as performing, reflecting a careful and differentiated approach to credit risk management. Such measures are employed primarily as a preventive strategy, intended to preempt the deterioration of a borrower's financial condition and mitigate the emergence of default risk. By proactively modifying contractual terms, lenders can support borrowers through temporary liquidity constraints or operational disruptions, thereby preserving the credit quality and minimizing future losses. In addition to its preventive role, forbearance may be granted for strategic commercial reasons, aimed at maintaining enduring relationships with obligors who demonstrate fundamentally sound creditworthiness and positive long-term prospects. This approach aligns with prudent portfolio management and supports client retention.

Forbearance also fulfils an important technical and operational function by accommodating extraordinary and often uncontrollable events such as natural disasters, delays in payments from governmental or public entities, or internal corporate restructurings. These situations warrant temporary contractual flexibility without necessarily indicating a substantive deterioration in the borrower's repayment capacity. Finally, forbearance can be the result of systemic policy measures, including regulatory moratoria or industry-wide relief programs implemented in response to economic crises. Such interventions seek to stabilize financial markets and economies by temporarily easing credit conditions, even in cases where individual exposures remain performing.

As stated by the EBA draft GLs, classifying a forborne credit as defaulted may have significant implications for both borrowers and financial institutions, particularly when such classification is automatic or not supported by a material deterioration in the borrower's ability to repay. For borrowers, default classification can lead to immediate and long-term consequences. It restricts access to additional credit, may trigger contractual clauses that limit the use of existing facilities, and increases the cost of future financing due to negative credit history. The reputational impact can further affect relationships with suppliers, partners, or other financial institutions. In some jurisdictions[1], default status may also prevent borrowers from accessing public support schemes, such as government guarantees or relief programmes. When applied to borrowers facing only temporary difficulties, the classification can become self-reinforcing—worsening their financial position and reducing their recovery prospects. For banks, default classification carries operational, financial, and strategic costs. It entails more complex monitoring, increased provisioning, and enhanced reporting requirements. If applied too rigidly, it may overstate the level of credit risk in the portfolio and lead to an inefficient allocation of capital. Moreover, it may discourage banks from offering proactive or preventive restructuring solutions—even when such measures would improve the borrower's repayment capacity and preserve long-term asset quality. This could undermine risk-based credit management and hinder the effectiveness of forbearance as a tool to support financial stability.

On the other hand, a significant risk associated with forbearance is "evergreening," whereby loans that lack fundamental viability are (repeatedly) restructured without a meaningful improvement in the borrower's capacity to repay. This creates "zombie loans" that obscure true credit risk and delay loss recognition and credit resolution, harming the financial system's health. For borrowers, forbearance may reduce incentives to repay, encouraging moral hazard and worsening default risk. Without proper classification, this distorts the banking sector's risk profile, leading to inaccurate risk assessment and loan mispricing. For banks, failing to timely classify deteriorated loans as non-performing results in underestimated credit losses, insufficient provisions, and impaired asset quality. It also complicates the balance between supporting borrowers and meeting regulatory risk recognition requirements. Beyond banks, inconsistent forbearance and classification practices can erode market confidence, increase funding costs, and harm reputations, affecting stability and competitiveness.

These concerns are also addressed by other pieces of the regulatory framework, and notably the GLs on management of non-performing and forborne exposures (2018/06), which urge banks to assess the viability of forbearance measures. To this end the GLs provide a list of factors that institutions should carefully consider. That said, the key challenge is to develop a classification framework of forbearance measures that flexibly accommodate temporary distress while preventing the masking of true credit deterioration. This requires periodic

[1] For instance, several COVID-19 public support schemes across Europe explicitly excluded borrowers already in default or classified as "undertakings in difficulty": Germany (KfW coronavirus aid loans), Italy (SACE "Garanzia Italia" and the SME Guarantee Fund under the Decreto Liquidità), and Spain (ICO guarantee lines).

reassessment, qualitatively subjective analysis, and alignment with projected repayment capacity to balance financial stability and borrower support.

As recalled by the draft amended GLs under consultation, “the CRR3 clarifies that there is an indication of unlikeliness 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.” Accordingly, the GLs, clarify that the classification of default applies only when two criteria are fulfilled. The first one is a qualitative criterion pertaining to the definition of forbearance measures and reiterating that only concessions granted to an obligor who is experiencing or is likely to experience difficulties and only concessions that are given by the institution *due to* these financial difficulties can be classify as forbearance measures. The second criterion is a quantitative criterion specifying when forbearance measures result in a diminished financial obligation and to this end the reduction in the Net present Value of the loan is considered.

The draft Guidelines under consultation specify that the presence of the qualitative criterion allows for considerable flexibility, thereby helping to prevent the misclassification of credit exposures. Some BSG members consider that this flexibility does not appear to fully reflect the intent of recital 24 of CRR3, which requires that banks “not be discouraged from extending meaningful concessions to obligors where deemed appropriate,” emphasizing their “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.”

These BSG members note that, in line with the qualitative criterion, it seems unlikely that a bank would grant concessions to a client in financial difficulties without such measures being, to any extent, linked to the debtor’s willingness or ability to overcome these difficulties. Therefore, when considering obligors experiencing financial difficulties, they consider the qualitative criterion to become inapplicable, and the only viable basis for classifying such measures would remain the quantitative criterion defining the DFO.

Other BSG members, by contrast, emphasise the need to differentiate between the prudential treatment of defaulted exposures, which is governed by CRR3 and the GLs, and legislative frameworks which sets out specific rules for relevant product categories and customer segments, both at the EU and member-state level, such as Directives 2023/2225 (CCD II) and 2014/17/EU (MCD). It is important, in their view, to preserve the integrity of the prudential framework by ensuring that financial institutions are adequately capitalised at all times. They point to a body of research, e.g. by the BIS, which demonstrates that well-capitalised banks lend more, and are therefore more likely to support growth in the real economy. At the same time, they agree that borrowers must be provided with options to overcome financial difficulties, including forbearance and refinancing of loans. These members are of the view that provisions governing the forbearance of loans, in particular mortgage loans to households and small enterprises, are not sufficiently harmonised across EU member states and should

therefore be reviewed in line with the recently updated framework for consumer loans, especially Article 35 of the CCD II.

Advantages and Limitations of the quantitative Criterion of DFO

Advantages

While forbearance can offer meaningful support to borrowers and avoid the consequences associated with default classification, it also carries the risk of concealing underlying credit deterioration and enabling evergreening. It is therefore essential that the criteria used to distinguish between performing and non-performing forborne exposures are effective, reliable, and robust, ensuring that genuine restructuring efforts are appropriately recognised without masking financial weakness.

The Diminished Financial Obligation (DFO) criterion spelled out in the EBA Guidelines, whereby any concession or forbearance granted to clients facing, or about to face, financial difficulties that results in a reduction of the net present value (NPV) by more than 1% is considered indicative of material forgiveness — and thus leads to the classification of the obligor as defaulted — serves as a clear and measurable indicator of financial concessions granted to borrowers under forbearance arrangements. By quantifying the reduction in the net present value of expected cash flows, the criterion seeks to identify cases where the lender has effectively granted material relief to the obligor, which may signal a heightened credit risk. This objective measure supports consistent and transparent default classification across institutions, helping to harmonize supervisory practices and improve the accuracy of credit risk reporting. Using a quantitative criterion to identify defaulted forborne exposures offers key benefits. It may promote supervisory consistency and comparability by providing a harmonized benchmark across institutions and jurisdictions. It may also prevent over-classification, preserving the accuracy and relevance of default indicators by excluding cases that don't reflect real credit deterioration. Besides, the clear numerical threshold may enhance operational clarity, enabling consistent application and reducing subjectivity.

As mentioned in paragraph 21 of the CP, this approach is consistent with a specific provision of IFRS 9, which states that when a financial contract undergoes a modification—such as a deferral of payments or an adjustment to the residual maturity—that is not deemed substantial, institutions must recalculate the asset's gross carrying amount. This recalculation should be based on the modified cash flows, discounted using the original effective interest rate. If the resulting amount differs from the original net present value (NPV), the institution must recognise a modification gain or loss in the profit or loss statement.

The accounting framework does not establish a threshold of 1%. This requirement is, therefore, unrelated to the classification of the loan. Under IFRS 9, 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. In this sense, it is expected that a significant increase in credit risk has already occurred. In fact, the granting of forbearance

measures is one of the indicators that may trigger a SICR assessment, potentially leading to the reclassification of the loan from Stage 1 to Stage 2. As a result, the institution must switch from calculating the 12-month expected credit loss (ECL)—applicable to Stage 1 exposures—to the lifetime ECL, which is required for Stage 2 exposures. However, if there are concessions of the lender due to financial difficulties of the issuer or borrower, that would be one of the cases that are mentioned in Appendix A of IFRS 9 as objective evidence of a credit-impaired asset, with the consequence of transferring the loan to Stage 3. In comparison to Stage 3, the assessment of the loan loss to be booked has to be based on the individual loan and not on a portfolio basis. Once the loan loss according to the 3-Stage-Model is booked as an expense in the p/l-statement, the amount of a modification loss can be expected to be very low.

In summary, although the criterion of NPV variation following the granting of forbearance measures is relevant from an accounting perspective in practice, it does not provide sufficient justification for applying the 1% NPV reduction threshold as a standalone indicator of Diminished Financial Obligation (DFO) under the regulatory definition of default. Instead, IFRS 9 follows the idea of significant deterioration in credit quality regarding Stage 2 and several objective evidence issues leading to an impairment, which are explicitly mentioned in the Appendix of the Standard regarding Stage 3.

Limitations

Despite the definite advantages of having a quantitative criterion to identify a Diminished Financial Obligation, some BSG members consider that its automatic and isolated application as a legal backstop may lead to potential distortions and in some cases, even prove to be ineffective or inappropriate. This could result in the identification of defaults even in some cases where, based on wider and more thorough analyses, the client would not be deemed to be in a situation of Unlikeliness to Pay.

In this regard, it should be noted that the criterion under Article 178(3)(d) is not the only basis for identifying a situation of Unlikely to Pay (UTP); nevertheless, this criterion alone is sufficient to trigger a default classification. Indeed, the other criteria referring to the status of the facility/obligor prior to the forbearance and to the characteristics of the new conditions should be sufficient to discriminate forbearance at the time of concession between the status of performing and non-performing.

Other BSG members consider that the 1% threshold is a critical prudential backstop, not an accounting exercise. Its primary purpose is to provide a clear, objective, and harmonised trigger to identify a material concession indicative of heightened credit risk. The argument that it is "mechanistic" is its strength; it reduces the scope for subjective interpretation and "evergreening" -- the practice of extending credit to effectively insolvent borrowers to avoid recognising losses.

1. Below are arguments by some BSG members illustrating that: (i) the “1% NPV reduction” criterion yields heterogeneous outcomes due to several technical factors, suggesting that a threshold may be inadequate (argument 1), **and** (ii) the automatic application of this criterion

may not consistently support the appropriate classification of the obligor as defaulted (argument 2). The Annex provides a few examples that illustrate and support the statements set out below.

They are of the opinion that the impact of the NPV threshold varies depending on technical characteristics of the loan itself. For example:

a. Residual Maturity: Longer remaining maturities amplify the effect of cash flow changes on the NPV, suggesting that a uniform threshold may unfairly penalize long-term loans. For instance, a restructuring on a 10-year loan that reduces by the same amount the interest rate or delays payments by one year will affect the NPV more significantly than the same concession on a 2-year loan, all else being equal. This may discriminate against debtors with longer-maturity loans and undermine the objective of providing flexibility to these obligors, particularly in cases of temporary financial distress.

   Credit risk does depend on loan maturity—although this affects RWAs only under the IRB approach and not under the Standardized approach—but this factor should already be priced in at origination. When two loans are granted the same concessions, all else being equal, the differing impact of maturity on NPV arises primarily from the mechanical effect of the time value of money, rather than from any change in the underlying risk level. Treating it as risk-driven would otherwise result in double-counting.

   Some BSG members claim fact that the delta NPV criterion —intended as a proxy for the materiality of the concession— is maturity-sensitive rather than risk-sensitive. By way of illustrating this point they propose the following example: Suppose the maturity of two loans with significantly different original terms—say, 5 years and 15 years—is extended by 2 years. The percentage increase in RWAs due to the longer maturity is higher for the 5-year loan than for the 15-year loan. This demonstrates that the same concession would increase the risk profile of a 5-year loan more than that of a 15-year loan. However, because the 15-year loan originally carries higher overall risk, its RWAs remains higher even after the extension. This illustrates that extending maturity does not produce a proportionally greater increase in risk for longer-term loans, and therefore, the larger reduction in NPV observed for the longer-term loan is not justified by a corresponding increase in risk. Thus, these BSG members argue that calibration of the threshold should consider maturity to ensure proportionality.

   Other BSG members note, however, that the example provided (e.g., longer maturities amplifying NPV impact) does not demonstrate a flaw in the use of a threshold but rather confirm its correct application. According to these BSG members, a concession on a long-term loan has a greater economic impact and hence impact on the risk profile of the loan book, than on a short-term one. In their view, the threshold accurately captures the materiality of the economic concession provided by the bank, and is consistent with a “risk-sensitive” prudential approach.

b. Effective Interest Rate at Origination: Some BSG members think that loans issued during periods of higher interest rates face a stricter implicit threshold. For example, regardless of the spread applied by the bank to reflect the borrower's risk, a loan originated when market rates were 8% will see a larger NPV reduction from a given concession than one issued when at 2%, even if the concessions are economically similar. Accounting for shifts in market interest rates between origination and forbearance when assessing the status of the forborne loan could improve accuracy and increase the risk-sensitivity of the NPV criterion. Besides, in some high-interest-rate markets, particularly emerging markets, the level of interest rates is so high compared to Europe that while a concession may lead to a substantial absolute reduction in the interest rate, such a modification does not reflect a commensurate increase in credit risk and, therefore, cannot be considered sufficient to justify a breach of the NPV criterion. Finally, it is to be noted that the criterion -based on the effective interest rate at origination - may have pro-cyclical effects, with a negative impact banks' willingness to restructure loans especially during economic downturn when rates are usually lower.

Other BSG members disagree with the core premise of this reasoning, i.e. that a concession in a high-rate environment is economically similar but mathematically harsher. They argue that the 1% NPV test is not designed to measure the "generosity of the concession" but to identify a "material economic loss" to the bank. A larger absolute reduction in the interest rate on a high-yielding loan directly translates to a larger absolute loss in expected cash flows. The NPV calculation therefore accurately reflects this larger economic loss. If the original high interest rate properly compensated for the borrower's risk, any concession that breaches the threshold indicates the bank is no longer being adequately compensated, signalling a clear deterioration in the credit's quality. Adjusting the threshold for market rates would render the test meaningless As it would create a system where a larger economic loss is treated more leniently simply because it occurred in a different macroeconomic context, which does not sit well with the principle of consistency and comparability across institutions and over time. The test's strength lies in its objectivity; introducing subjective "adjustments" for origination rates would make it more subjective and even open to manipulation. These BSG members note that if an EU bank is operating in a high-rate, high-risk jurisdiction, e.g. an emerging market, its risk management and pricing models should already account for that volatility. In their view, a "substantial absolute reduction" in interest income should be considered precisely as the signal of distress the test is designed to catch. If the credit risk hasn't increased commensurately, as argued, then the bank's original pricing was flawed, and the concession merely corrects it to a prudent level—which itself is a credit event indicating a potential flaw in the original risk assessment . They note that weakening a core prudential standard in the EU to accommodate the operations of some EU banks abroad could create a dangerous double standard and may prove counter-productive in the pursuit of a robust single rulebook. It could incentivise banks to take on higher risks in certain foreign markets knowing the criteria for default are softer, potentially exporting risk back to the EU financial system. These BSG members point out that regulation must be applied consistently to ensure a level playing field and prevent regulatory arbitrage. They also observe that banks' reluctance to restructure loans during downturns should not be seen as an unintended side-effect of the NPV test. They note that the main

obstacle to restructuring in these circumstances is the need for banks to recognize losses and hold capital against deteriorated assets—which is, in their view, the main purpose of prudential regulation. They believe that the NPV test is a crucial diagnostic tool to prevent ”evergreening” and avoid capital depletion during a crisis. This test ensures that banks remain solvent and acknowledge their true financial position. Increasing the threshold of this accurate diagnostic tool would be pro-cyclical. It would allow banks to delay loss recognition, creating a false sense of health during a downturn and ultimately amplifying an incipient crisis. These members believe that the solution to banks' reluctance to restructure loans is not to blindfold them to their losses but to ensure they are always well-capitalized enough to absorb those losses and continue lending.

Other BSG members strongly disagree with this position, arguing that EU regulation in no way seeks to prevent institutions from operating in third countries. On the contrary, they emphasize that the BCBS has openly stated that diversification is also an element of strength for banks’ solvency and, consequently, for financial stability. Therefore, it would be appropriate for the regulation to adequately take into account the different macroeconomic conditions of these countries, and in particular the varying levels of interest rates.

c. Credit Consolidation: Some BSG members think that restructuring actions such as converting overdrafts or current account credit into secured loans – which are more common in the case of corporate debtors-may result in a reduction of the expected loss, which in turn may allow for lower interest rates and ultimately can significantly reduce NPV. For example, consolidating a high-interest overdraft into a longer-term collateralized loan at a lower rate may breach the 1% threshold, despite improving the borrower’s repayment capacity and reducing credit risk. It is therefore important to note that while such consolidation may breach the 1% NPV threshold, this does not necessarily indicate a deterioration in credit quality. On the contrary, replacing a high-interest overdraft with a secured instalment loan at more favourable terms often enhances the borrower’s repayment capacity (lowering the PD) and reduces the loss given default. Therefore, the reduction in NPV should not be interpreted in isolation as evidence of default, but rather as part of a broader strategy to strengthen financial sustainability.

Other BSG members agree that converting an unsecured overdraft to a secured loan could indeed improve the loan's risk profile (lowering PD and LGD), but add that this does not obviate the need to recognize an economic loss. They argue that the 1% NPV test is aquantitative measure of whether the “present value” of the modified cash flows is materially less than the original ones. A lower interest rate, even if justified by new collateral, represents a contractual concession that diminishes the bank's financial claim. The test captures the economic reality, irrespective of the bank's intent. In their view, if the restructured loan is significantly de-risked by new collateral, the bank should be able to offer better terms without incurring a material economic loss (a breach of the 1% threshold). If the NPV still breaches the threshold this suggests that the concession (the lower rate) may be larger than what the improved collateral alone would justify. This would indicate that the restructuring is not merely a re-collateralisation but also a concession necessitated by the borrower's financial difficulty—

which is the scenario the default definition aims to capture. They point out that the definition of default has two distinct components: unlikeliness-to-pay (UTP) and the concept of a "diminished financial obligation" (DFO - the NPV test). A loan can be restructured, breach the NPV test (be classified a DFO), and be placed in default. However, if the restructuring genuinely and significantly improves the risk profile, the bank's internal models should quickly reflect this. The positive outcome of a successful restructuring is captured in the "probability of default (PD)" and "loss given default (LGD)" parameters used for capital calculation. A well-collateralized, performing restructured loan will quickly migrate to a lower risk bucket, reducing its capital consumption. This is, in the view of these BSG members, the appropriate place to recognize the improved risk, not by neutering the initial default classification. The initial classification ensures prompt and consistent recognition of the impairment event, while the models capture the subsequent recovery.

2. Impact of national laws that may lead to different effects of forbearance on NPV.

Legal regulations in some countries can affect how loan modifications influence NPV. For instance, laws limiting compound interest accrual may cause simple payment deferrals to breach the threshold without actual forgiveness, due purely to legal constraints rather than lender concessions. Depending on the maturity and the discount rate, the mere postponement of loan instalments (without any write-off of principal) might be sufficient to breach the 1% threshold not due to a forgiveness on the part of the bank but simply as a result of applying binding legal provision. At the same time, in some jurisdictions such as Italy, usury laws prevent lenders from maintaining high interest rates in the context of loan restructurings, which may inadvertently lead to a breach of the 1% NPV reduction threshold.

Some BSG members argue above that a breach caused by legal constraints (e.g., a mandated payment deferral or usury cap) is somehow different from one caused by a voluntary bank concession. Other BSG members are of the opinion, from an economic perspective, that the impact on the bank is identical: the present value of the loan's cash flows has been materially diminished. They argue that the test's purpose is to identify this objective economic reality to ensure the bank's balance sheet accurately reflects the value of its assets. The reason for the diminution—whether voluntary, strategic, or legally mandated—does not change the fact that the loss has occurred. Introducing subjective exemptions based on the cause of the NPV reduction would create a flaw in the design of the test, which may affect the consistency of its application. It would blur the line between voluntary and involuntary restructurings and could cause serious practical issues in the application of the Guidelines across the EU. They do not concur with the assertion that legal actions cause a breach "without actual forgiveness" or a "deterioration in credit quality". Legal interventions, such as laws limiting interest accrual or mandating payment holidays, are typically enacted precisely because of a widespread deterioration in borrower credit quality (e.g., during a systemic economic crisis). These laws are a response to elevated credit risk that has already materialized across a portfolio. They argue, therefore, that an NPV breach triggered by such legal actions is not a false positive but an accurate and timely signal that the economic value of the loan has been impaired by the same macroeconomic distress that prompted the legislation. Recognizing this through a

default classification ensures prompt provisioning and capital holding, which strengthens the banking sector's resilience to the very crisis the laws are addressing.

Some BSG members highlight what they consider to be genuine complexity in the interaction between EU prudential rules and divergent national civil and consumer protection laws.Other BSG members, however, underline that initiatives to resolve ths complexity must not come at the expense of maintaining EU-wide prudential standards. they argue that exemptions for jurisdictions with specific legal frameworks would tilt the Level Playing Field and fragment the Single Rulebook. A loan with identical risk characteristics would be classified differently across member states based solely on national law, making EU-wide risk assessment and comparison impossible. They believe that the integrity of the capital and provisioning requirements for defaulted exposures must be maintained uniformly to ensure financial stability across the Union. BSG members agree on the underlying concern, which is that a mechanical breach triggered by law could lead to a disproportionate supervisory burden, but disagree on the appropriate way to address it. In the view of some members, this concern should be addressed at the level of supervisory response, not the definition of default itself. They argue that supervisors already have the tools and discretion to assess the overall health of an institution: while a legally-mandated modification may technically trigger a default classification, supervisors can and should consider the context when evaluating a bank's overall risk management and capital adequacy. They are concened that weakening the objective metric could remove a critical source of transparency and eliminate a key data point supervisors need to do their job effectively.

3. Forbearance measures granted in the occasion of emergencies.

Some ESG members think that during systemic crises, forbearance often follows broad legislative or regulatory measures that cannot be individually tailored. Such general relief efforts may cause breaches of the NPV threshold without reflecting borrower-specific credit issues and thus should be considered separately from standard diminished financial obligation assessments.

Other BSG members consider that while the unique nature of systemic crises warrants specific consideration, a blanket exemption is a blunt and dangerous instrument. Creating a permanent loophole for "emergencies" invites abuse. Banks and national authorities could be incentivised to declare "emergencies" for non-systemic events (e.g., localized economic downturns, sector-specific issues) to avoid default classifications, thereby masking the build-up of systemic risk. The EBA's proposed criteria for assessing legislative moratoria (e.g., broad scope, government fiscal support, limited changes to payment schedules) represent a more balanced and prudent approach. They allow for flexibility in genuine crises while maintaining the principle that credit risk must still be assessed. A blanket exemption abandons this principle entirely. Automatically excluding large portfolios from default assessment during crises severely degrades the quality of risk data available to supervisors, policymakers, and the banks themselves, precisely when it is needed most to navigate the crisis effectively.

4. Potential Misclassification of Default Status Due to Restructuring

Some BSG members are of the opinion that the application of the threshold could lead to incoherent situations. For instance, an exposure where the client accumulates a deterioration over 1% of the NPV of the exposure may not be classified as default in specific circumstances. Whereas exposures where the bank has decided to apply some forbearance measures, but where the client does not accumulate until that moment a deterioration over 1%, can be flagged as forbearance, and thus, classified as default, because of the measure itself.

Finally, these members point out that there is also a bias regarding the threshold of 5% which is considered as a material economic loss in the case of sale of credit obligations and therefore should be considered as an indication of default (paragraphs 43 and 44 of the EBA 2016 guidelines). They believe that there is an inconsistency because a situation of default can be triggered with two different levels of threshold. Beyond the apparent inconsistency, it might lead a creditor to sell its credit obligations rather than restructuring them, which could be detrimental to the obligor in the sense that the bank has less incentive to accompany its client in the difficulties it might face, and might feed the growth of non-banking financial sector, which is less regulated than banking sector.

These drawbacks may disincentive the concession of forbearance measures by banks, thus contradicting the mandate of the CRR3 aimed at ensuring “the guidelines do not hinder preventive restructuring”.

Other BSG members think that there is no inconsistency between the 1% NPV threshold for forbearance and the 5% material economic loss threshold for debt sales. They argue that these are two distinct triggers for two different scenarios, each with its own purpose. The “1% DFO threshold” is a forward-looking, probabilistic indicator. It identifies a concession made due to or anticipating borrower difficulty. Its low threshold is designed for early warning, ensuring a loan is classified as default at the point of impairment, prompting immediate provisioning and heightened monitoring to protect the bank. The “5% material economic loss” threshold (e.g., in a debt sale) is a backward-looking indicator, which confirms a concrete, crystallized loss has already occurred. Its higher threshold reflects the fact that a market transaction provides undeniable proof of a severe devaluation. They believe that that it would be illogical, from an economic point of view, for a bank to sell a loan (at a 4.9% loss) rather than restructure it (and risk a 1.1% loss triggering default) as it presumes a bank would willingly crystallize a larger, certain economic loss to avoid an accounting classification that leads to provisioning. The rule should encourage sustainable restructurings, not prevent the accurate labeling of unsustainable ones. These BSG members also disagree with the claim the threshold contradicts the CRR3 mandate by disincentivizing forbearance. In their view, the framework is designed to distinguish between two scenarios: (1) Preventive Restructuring: Measures for a borrower facing potential future difficulties, where concessions are minor and do not breach the 1% threshold. These are not classified as forborne or defaulted. 2/ Remedial Restructuring: Measures for a borrower who is already in financial difficulty, where concessions are material

(breaching the 1% threshold). This is a classic "forbearance" measure and correctly triggers a default classification.

5. Prudential vs. Accounting framework

It is noted in several sections of the CP that the prudential framework was amended with the stated objective of achieving greater alignment with the accounting framework. While it is true that recent amendments affecting prudential exposures have reduced the gap between both regimes—thereby lowering operational costs for institutions and simplifying certain aspects of implementation—some BSG members consider it unlikely that the two frameworks could ever be fully harmonised. They observe that, from both a theoretical and a practical standpoint, such an objective may even be subject to criticism, given the intrinsic differences in their purposes and the distinct sets of entities to which each framework applies.

In this context, these BSG members consider that the EBA's repeated comparison of the accounting and prudential frameworks within the CP adds an additional layer of complexity to the interpretation of the text and appears to rest on the assumption that changes in the prudential regime directly affect institutions' accounting treatment.

In the view of these BSG members the following arguments highlight the divergences between the two frameworks, which may ultimately be justified by the fundamentally different regulatory objectives pursued by each. They observe that there is no regulatory obligation to fully align default, IFRS 9 Stage 3, and NPE definitions. Many banks align them voluntarily for operational simplicity, but divergence is legitimate and acknowledged by regulators (e.g., EBA IFRS 9 monitoring).

Purpose and entities subject to the framework*:* One seeks banking solvency, the other a true and fair view of the financial statements.

- IFRS, issued by the IASB, seek to standardize and increase the transparency of financial reporting worldwide, ensuring comparability, accountability, and efficiency in global markets. IFRS9 was a result of the accusations made to the previous standard (IAS 39) of recognizing impairment losses too late. Hence IFRS 9 replaces the incurred loss model under IAS 39 with a forward-looking expected credit loss model. It requires entities (particularly, but not exclusively, banks) to recognize credit risk losses at an earlier stage.
- European prudential regulation aims to protect the stability of the financial system through capital, liquidity, and risk management requirements. This regulation is exclusive for the banking sector, and not applicable to all financial institutions (i.e. non-regulated financial institutions).

Different PD and LGD estimations*:* IFRS9 applies a point-in-time PD in order to present a true and fair view. The prudential PD applied is not the point-in-time measure, but a through-the-cycle average for borrowers within the same rating grade. Thus, the accounting PD may be high during periods of recession and low when the economic situation is more favorable. The prudential through-the-cycle PD aims to mitigate potential cyclicality of the accounting PD in

order to stabilize capital requirements. Additionally, the time horizon also differs. Thus, the accounting PD is measured over 12 months or on a lifetime basis depending on the stage, whereas the prudential PD is based on a 12-month horizon. A similar comparison can be made regarding the LGD. Finally, the prudential framework also establishes floors to the mentioned parameters.

Collective or individual estimations of expected loss***:*** Under the IRB approach, expected loss estimates are performed collectively by borrower grade, whereas under the accounting framework, individual estimates may also be carried out in cases permitted by the standard.

In the EU, the prudential classification of a restructured loan — including its potential marking as *default* under CRR Art. 178 and the EBA DoD Guidelines — does not determine the timing or amount of accounting losses, which are governed by IFRS 9 (ECL). Related prudential concepts (NPE/forbearance under FINREP/ITS 2021/451) are not the same as default, and there is no obligation to align them with IFRS 9 Stage 3; alignment is often adopted for efficiency, but differences (cures, thresholds) are legitimate. Thus, prudential default marking does not delay losses: IFRS 9 enforces their recognition, while prudential rules ensure discipline, transparency, and capital adequacy.

They argue, accordingly, that the prudential threshold of 1% of the NPV—or any other level at which it may ultimately be determined (as further analysed in a separate section of this document)—ought not to be construed as influencing the recognition of accounting losses. Such recognition falls exclusively within the scope of a distinct regulatory framework, which operates independently from prudential considerations. Put differently, while the prudential framework may, to a certain extent, draw upon accounting principles as a reference point, the accounting framework remains entirely autonomous and unaffected by prudential requirements.

On the basis of the foregoing, these BSG members note that references contained in the CP to the accounting framework appear conceptually unclear and, as such, are difficult to reconcile with the underlying regulatory rationale. Find below some examples that lead to such an impression:

- Paragraph 7 of the background, when it states that "*the calculation rules of the NPV loss are aligned with accounting principle*s". As mentioned in another section of this document, the calculation might be aligned, but is used for another purpose (See section of this document "Advantages and Limitations of the quantitative Criterion of DFO "). Additionally, when it is mentioned 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*".
- Paragraph 21 and 22: It ought to be mentioned that the accounting framework does not apply a 1% threshold, and note that, even if eliminating the threshold from the prudential framework, the accounting NPV calculation would not be affected.
- Paragraph 41: "*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". An increase in the prudential threshold would not affect the accounting recognition of losses.

As a conclusion, these members of the BSG suggest that both frameworks are governed by different purposes, objectives, and underlying criteria. As highlighted above, their main differences are:

- Accounting framework (IFRS 9)
  - Recognizes Expected Credit Losses (ECL) in 3 stages (Stage 1, 2, 3).
  - IFRS 9 governs the *timing* and *amount* of impairment recognition.
  - Restructuring → if credit-impaired → Stage 3 (lifetime ECL).
- Prudential framework (CRR + EBA/ECB)
  - CRR Art. 178 + EBA DoD define when an exposure is in *default*.
  - Includes "distressed restructuring" as an *unlikeliness-to-pay* trigger.
  - Purpose: reporting, capital and supervisory discipline, not accounting.

They conclude that the prudential default marking does not defer losses, as it is the IFRS 9 which requires timely recognition. Thus, a timely provisioning would not be affected by amendments to the prudential framework (i.e. an increase or elimination of the NPV 1 % threshold).

While divergences persist, many institutions opt to align their internal practices across both frameworks. Such differences, however, are legitimate and stem from structural features such as cure periods and materiality thresholds. Importantly, there is no regulatory obligation to harmonise the concepts of Default, Non-Performing Exposure (NPE), and Stage 3 classification.

Other members of the BSG do not concur with this understanding of the interaction between the accounting and prudential frameworks. They note that the case of a contractual amendment to a financial asset that results in, or could result in, a change in the investor's cash flows immediately or over the course of the remaining term of the contract is barely addressed in IFRS 9. A contract modification occurs when a contract for a financial instrument is modified after the contract has been concluded. Contract modifications occur through renegotiations. Credit-induced contract modifications are intended to give the debtor the opportunity to partially or late-pay their payment obligations. Before a total loss occurs, the creditor agrees to changes in the payment terms. It is also common practice for a partial payment waiver to be issued under civil law for non-performing loans. Therefore, with credit-induced contract modifications, it is expected that the asset is at least in impairment Stage 2, meaning that a significant deterioration in creditworthiness has occurred.

In their understanding, a more likely scenario is a classification in Stage 3, which means that there is objective evidence of impairment for the asset. According to IFRS 9, Appendix A, these

include significant financial difficulties of the issuer or borrower, a breach of contract (such as default or past due date), concessions made by the lender to the borrower for economic or legal reasons related to the borrower's financial difficulties, the disappearance of an active market for the financial asset due to financial difficulties, or a high discount at issuance reflecting incurred credit losses. The second indicator, namely concessions made to the borrower due to economic difficulties, is likely to be frequently relevant.

They maintain, therefore, that it is necessary to first decide on the appropriate level of the impairment category, which is typically Stage 3, and to record the necessary impairment before the effects of a contract modification are recognized in the balance sheet. The assessment of a significant modification is based on a comparison of present values without considering expected losses but including incurred losses. Therefore, after an individual impairment has been recognised, a contractual amendment may ultimately be no longer substantial – if it merely replicates what was already reflected in an impairment. If the cash flows of the modified instrument have also been significantly modified qualitatively, the adjustment would still be substantial and the asset would have to be derecognised.

Other BSG members argue that the IFRS 9 accounting standard governs the “timing and amount” of loss recognition, while the prudential framework (CRR) governs the “definition of default” for capital and reporting purposes. In their understanding, the two frameworks, while legally distinct, are philosophically and operationally intertwined. They argue that the prudential definition of default acts as a critical backstop and a hard trigger for the accounting model. While IFRS 9 requires judgment, the prudential rules provide a clear, objective standard to prevent “evergreening”. They believe that weakening this prudential backstop (by raising the 1% threshold) could remove an important plank of the current credit risk management framework. A loan could be subject to a material economic concession (e.g., a 0.9% NPV reduction) yet avoid classification as a defaulted exposure for capital purposes. This could send conflicting signals to bank management and supervisors, and may delay the necessary monitoring and scrutiny that the default flag triggers. As the Joint Committee Report of the ESAs (Autumn 2025) emphasizes, in a high-risk environment of "geopolitical uncertainties and the potential for rapid changes in global trade policies," "capital buffers remain essential for the robustness of the financial system, as they provide the capacity to absorb shocks and maintain confidence in times of heightened uncertainty." These members believe that any dilution of the trigger for determining a defaulted exposure for prudential purposes undermines this core objective.

These BSG members also note that maintaining parallel systems for identifying impaired exposures—one for accounting and another one for capital—is operationally complex, costly, creates significant model risk, and, could encourage “internal arbitrage”. Bank management could be incentivized to structure concessions to stay just below the prudential threshold, knowing it avoids the significant capital implications of a default classification, even if the economic substance suggests impairment. These BSG members argue that the EBA's push for alignment is a deliberate, and legitimate -- policy to ensure that the risk identification driving capital allocation is consistent with the economic reality driving provisioning. In their view, the

through-the-cycle PD is designed to smooth capital requirements over a cycle, not to delay the recognition of a clear credit event. The 1% DFO threshold is therefore meant to be a sensitive, early-warning indicator that a credit event has occurred. This early warning is especially vital in the current environment, with the previously mentioned Joint Committee Report of the ESAs explicitly warning of "deteriorating economic outlook," "signs of asset quality deterioration" in Stage 2 loans, and an "observed uptick in cost of risk." In this context, "forward-looking provisioning policies" and "stress testing and scenario analysis are powerful tools to support such risk assessments". These BSG stakeholders note that banking solvency is not an academic exercise; it is the foundation of financial stability, And the definition of default is a cornerstone of this foundation. A weakened definition would lead to a systematic undercapitalization of the banking sector against known risks. This has direct systemic implications. Furthermore, the aforementioned Joint Committee Report highlights deep cross-sectoral interlinkages, noting dependencies on non-EU infrastructures and the growth of interconnections between traditional finance and crypto assets. In such a system, undercapitalization in one area (e.g. the banking sector) can amplify shocks that spread to insurers, pension funds, and the broader economy. The prudential framework's purpose is to prevent this, and a robust, sensitive default definition is essential to that goal.

Rationale for revising the quantitative criterion of the DFO

The mandate in Art. 178(7) of the CRR3 enjoins the EBA to “take due account of the necessity to encourage institutions to engage in proactive, preventive and meaningful debt restructuring to support obligors” and to “consider the need for granting a sufficient flexibility to institutions when specifying what constitutes a diminished financial obligation” in the context of a “distressed restructuring”.

In this regard, some BSG members consider that it is also worth noting that many things have changed after the drafting of the EBA Guidelines introducing the 1% threshold. Reference is made not to changes in macroeconomic conditions (which may revert and would therefore not be sufficient alone), but to the major developments in the prudential framework, supervisory practices and credit risk management by banks.

These members note that since the EBA/GL/2016/07 were issued, the prudential framework regarding credit risk management and non-performing exposures has developed significantly incorporating specific level-3 legislation. The EBA Guidelines on loan origination and monitoring (EBA/GL/2020/06) and the Guidelines on management of non-performing and forborne exposures (EBA/GL/2018/06) are particularly relevant. Moreover, credit risk management has continuously been a supervisory priority (and banks’ asset quality review has been carried out), and detailed and thorough reporting has been introduced, to allow for careful monitoring of banks’ asset quality by supervisors. On banks’ side, the credit practices greatly progressed, with improved expertise in the management of performing, forborne and

non-performing loan. Single supervision in the Eurozone has contributed to harmonised practices following to the abovementioned regulations.

These BSG members note, against this backdrop, that the assessment of the trade-off between the prudence of the regulatory framework and the consequences on real economy should be different. The NPL reduction in the last decade, the wide range of prudential measures implemented and the enhancement and harmonisation of supervisory monitoring, have put the EU banking system in a safer environment.

Other BSG members point out that the EU has not experienced another substantial crisis yet, which the banking sector would have had to withstand without fiscal and central bank-support., drawing only on its new, more resilient foundations. They note that, the impact of the Covid-19 crisis, for instance, was cushioned by the €1,850bn Pandemic Emergency Purchase Program (PEPP) of the European Central Bank and by the €2,000bn fiscal and budgetary supports of EU Member States. They point out that there has not been proof positive yet how the EU banking sector, under the new prudential framework, will perform throughout a full economic and credit cycle. They believe, therefore, that it would seem premature to conclude that “many things have changed” since September 2016. The collapse of Credit Suisse in March 2023 – not an EU bank but also subject to the Basel III framework – suggests that the resilience of the banking sector may still not have improved enough.

As previously noted, some BSG members have focused their analysis and comments on the quantitative criterion of the DFO. Indeed, considering that the mandate set out in Article 178.7 aims at not discouraging banks from extending “meaningful concessions to obligors,” and taking into account Recital 24 of CRR3, which refers “to restructuring measures for worthy debtors facing or about to face difficulties in meeting their financial commitments”, they conclude it is clear that the qualitative criterion proposed by the EBA draft GLs is effectively inapplicable for obligors experiencing financial difficulties, and consequently, that the only viable basis for classifying such measures remains the quantitative criterion defining the DFO.

The same BSG members also note that the Economic Governance and EMU Scrutiny Unit of the European Parliament (EGOV) published a report[2] on 15 July 2025 , which states that, in its view, the EBA default framework fails to reflect to co-legislators’ intent. In particular, the EGOV report opines that *the rigidity of the framework and the narrow space for renegotiation discourage institutions from granting forbearance, even in situations where doing so would be economically and socially desirable*. It concludes that *by refusing to revise the 1% NPV threshold or to embed more qualitative assessments into default classification (e.g., the individual circumstances of the borrower or the viability of restructuring), the EBA preserves a rigid framework that risks continuing to discourage debt renegotiation, hinder economic recovery, and contradict recent EU legislative efforts, including the new rules under the Consumer Credit Directive and the Mortgage Credit Directive*.

[2] Report of the Economic Governance and EMU Scrutiny Unit (EGOV) of the European Parliament

Other members of the BSG observe that this statement reflects the opinion of the EGOV, which does not claim to represent the opinion of the European Parliament itself or an authentic interpretation of the relevant legislative (Level 1) text. They note that the objective of the EBA, under the terms of Regulation No 1093/2010 (rec. 5) is to "protect the public interest by contributing to the short-, medium- and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses."

Options

The amended EBA Guidelines reiterate what the approach set by the previous GLs (EBA/GL/2016/07) and confirm that such diminished financial obligation should be identified based on a quantitative threshold not exceeding 1%, calculated through a prescribed formula (para. 51). However, CRR 3 explicitly mandates that the EBA shall grant institutions sufficient flexibility in defining diminished financial obligation and must ensure the guidelines do not hinder preventive restructuring.

While there may be potential benefits in combining a quantitative criterion with qualitative factors, the mechanistic and exclusive application of the current NPV-based threshold to identify diminished financial obligation (DFO) may limit the flexibility encouraged by the regulator and hinder the granting of measures aimed at supporting borrowers facing, or about to face, temporary financial difficulties. Taken together, the limitations described above seem to outweigh the benefits of the current criterion. Given the robustness of the existing regulatory framework, some BSG members believe a delta NPV threshold may, in principle, be unnecessary. Other BSG members do not share this opinion.

Financial institutions are subject to a variety of qualitative risk control and measurement rules - including monitoring of forborne exposures - ensuring that exposures will be classified as defaulted where appropriate. In fact, EU prudential and accounting frameworks require institutions to identify and report forbearance measures applied to distressed exposures. These forbearance cases may be classified as performing or non-performing based on a defined set of criteria outlined in the EBA Guidelines on the management of non-performing and forborne exposures (EBA/GL/2018/06).

In this context, some BSG members are of the view that the removal of the delta- NPV threshold would allow for alignment between the prudential definition of default – as set out in Article 178(3)(d) of CRR3 - and the existing classification of non-performing forbearance (NPF), as defined in EBA/GL/2018/06[3].

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[3] According to EBA/GL/2018/06, an exposure subject to forbearance measures is classified as non-performing when:

They note that the EBA/GL/2018/06 criteria already embed a risk-sensitive assessment of material concessions, borrower viability, and long-term payment capacity, in line with the prudential default framework under CRR. Furthermore, non-performing forborne exposures are subject to additional monitoring, probation periods, and qualitative disclosures, ensuring transparency and supervisory scrutiny.

Alignment between the prudential definition of default and the existing classification of non-performing forbearance (NPF), would, according to some BSG members:

1) **Ensuring consistency to avoid misclassification** Consistency with a) Article 178 CRR default criteria, b) EBA/GL/2016/07 (definition of default), c) EBA/GL/2018/06 (NPE and forbearance classification), d) IFRS 9 staging, and e) Supervisory expectations under FINREP/COREP reporting;

2) **Support Preventive Restructuring**, as emphasized in CRR3's mandate[4]

3) **Allow for operational Simplification and Transparency**: A unified framework for classifying exposures post-forbearance enhances data consistency, simplifies internal systems, and improves communication with supervisors and auditors. It also aligns internal credit risk policies with prudential and financial reporting.

Moreover, it is the view of these BSG members that the current 1% threshold for diminished financial obligation is not anchored in the underlying credit risk of the obligor and may lead to default classifications that are mechanical rather than risk-based. By contrast, the NPF

1. The borrower is assessed as unlikely to pay its credit obligations without the realization of collateral, regardless of the existence of any past-due amount (Unlikeliness to Pay, Article 178 CRR), or

2. The exposure has been in arrears for more than 90 days on any material credit obligation, or

3. The exposure has been subject to distressed restructuring, which implies:

    - A concession has been granted due to financial difficulty,

    - The exposure has been classified as non-performing at the moment of forbearance or within 3 months thereafter,

    - There has been a partial or total cancellation of debt, or conversion to equity, or extension of maturity at below-market conditions.

[4] Regulatory framework must enable institutions to engage in proactive, meaningful, and borrower-centric restructuring, without being discouraged by overly rigid default triggers.

classification captures both quantitative and qualitative aspects of credit deterioration. This view is not shared by other members of the BSG.

Even though the above is considered the most desirable approach by some members of the BSG, in case the EBA decides to discard such option, because it is the EBA's interpretation that the EBA's mandate necessarily requires the retention of a quantitative criterion, such as the one based on Net Present Value (NPV), another possible approach, in their view, could involve a material revision of the current threshold. They argue that this would leave banks flexibility to treat differently those cases where a client facing temporary difficulties is likely to remain performing with some support in the form of a forbearance measure (with a limited loss for the bank), from those cases where the concession actually address a deterioration in the financial conditions of the client (and a default classification is warranted, even if the delta NPV negligible).

Some BSG members also note that the definition of the 1% threshold is intended to "exclude from default classification those cases in which the change in the net present value (NPV) of the contract arises primarily from technical discounting effects or rounding of amounts" (para.21), and to "allow institutions to perform restructuring in a way that does not lead to a loss (e.g. extension of maturity) (para. 7).". In their view this approach does not take into account the guidance provided by CRR3, which aims to encourage meaningful restructuring.

According to some BSG members, the choice of the 1% threshold does not appear to be supported by robust modelling or analytical evidence. Accordingly, it would be advisable for the threshold to be defined on the basis of analyses that validate its appropriateness, ensuring a balance between prudential standards and institutional stability on one hand, and the objective of supporting borrowers experiencing temporary financial hardship on the other. Some other BSG members disagree with that claim.

Based on the available data, it is difficult to assess whether there have been actual cases of misclassification—namely, forborne exposures erroneously classified as defaulted, or vice versa. Thus, some BSG members contend that the proposal of increasing the 1% NPV by other members is a «solution seeking its problem». Empirical analyses attempting to evaluate this issue are inherently biased due to potential endogeneity. Since the publishing of the rule in 2016, banks have been aware that any forbearance measure resulting in an NPV reduction greater than 1% would automatically trigger a default classification. This in some cases might have discouraged the extension of forbearance measures to less risky debtors facing temporary difficulties. As a result, such concessions might have been granted mainly to borrowers already experiencing severe financial distress. This creates a selection bias, according to some BSG members. Unless this endogeneity is properly addressed, any analysis may risk overstating the effectiveness of the 1% threshold as a reliable indicator of actual credit risk. Other BSG members underline that this qualification does not by itself strengthen the case in favour of increasing the 1% NPV threshold.

As previously noted, some BSG members are of the view that any increase in the threshold is not expected to create inconsistencies with accounting standards—which, in their view, do not prescribe any specific provision regarding the materiality of forbearance measures. They suggest, moreover, that any potential misalignment with the materiality threshold applied to past due credit obligations should be carefully evaluated, especially considering the differences in calculation methodology. Specifically, the 1% threshold used for the past due criterion—defined as 1% of the total amount of credit obligations of the obligor to the institution—may not coincide with the 1% net present value (NPV) reduction applied in the context of forbearance measures

These BSG members note that, given the current text of the GL, where the 1% actually represents a cap to the applicable threshold, a general limit set at a higher level could also allow institutions to define their own internal thresholds within the prescribed regulatory range, allowing room for adjusting the internal thresholds based on one or more of the variables that, as previously illustrated , affect the delta NPV (for example, setting higher threshold for longer maturities, or higher interest rates), or to account for different geographies with different practices and interest rate levels. Other BSG members remind that allowing self-regulation by institutions on their own internal threshold is highly dangerous for financial stability.

In short, in the view of some BSG members, this solution would maintain compliance with the quantitative nature of the criterion, while introducing a greater degree of flexibility. By enabling institutions to calibrate the threshold in accordance with their specific risk profiles, business models, and operational capacities, and to apply some judgment for the concessions within the threshold limit, the framework would become more proportionate and risk-sensitive. Other BSG members, to the contrary, consider that it would not be more risk-sensitive and, in fact, increase systemic risk by postponing the recognition of deteriorating credit-risk. Furthermore, it would enhance alignment with banks' internal credit risk management practices and help prevent the default classification of concessions that are economically immaterial or merely technical in nature.

Finally, the same BSG members argue that increasing the threshold for the diminished financial obligation would also reduce the inconsistency with the threshold applied for the sale of credit obligations and the potential incentives for banks to sell their credit obligations rather than restructuring them.

In the view of these BSG members, given certain highly specific situations, it would also be appropriate to allow institutions—while ensuring a proper assessment of the viability of the forbearance measures and full compliance with the rules on the classification of forborne exposures—to classify as performing certain exposures which have been granted concessions that exceed the established threshold. This exception would imply that under specific qualitative criteria and only if an entity could demonstrate to the supervisor that the concessions does not constitute a significant deterioration, a forborne exposure could be

classified as performing even if surpassing the NPV threshold. Other BSG members are of the opinion that this would render "evergreening" the rule at the discretion of these institutions.

Some BSG members note that the application of the 1% prudential threshold has no impact on loss registration from an accounting perspective. Therefore, setting the DFO prudential threshold at 1% or at other level does not imply evading the registration of any losses at the accounting level. Accounting has its own set of rules for registering losses in forbearance cases, which are not related to the prudential classification of default. The proposal to modify the DFO threshold does not entail any change in the registration of accounting losses. Such losses are always recorded under accounting standards and not under capital regulations like this RTS, a contention that is not universally supported by other BSG members.

Finally, some BSG members argue that a special consideration should be paid to general forbearance measures, intended to tackle emergencies or extraordinary situations, which should be excluded from the scope of the delta NPV assessment (as it occurred for the Covid-19). In these events, on the one hand, the concession shall be granted in a very short time, and a case-by-case assessment of the clients is often not feasible. It has to be noted that, in case a financial relief in the form of a forbearance measure (e.g. suspension of payments) is offered, clients might apply for the concession even if they don't strictly need it to meet their financial obligations, but prefer having liquidity available (for example, to accelerate the recovery or to support relatives - which would in turn reduce the credit risk for the bank connected to their exposures). Classification as defaulted of all the obligors benefiting of the relief would therefore be overly penalising for the clients and detrimental to the economic recovery of the interested area. As already explained earlier in this response, other BSG members disagree with this assertion.

Some BSG members wish to highlight that, given the abovementioned sensitivity of the delta NPV to the contractual features of the exposure, the same forbearance measure can result in different outcomes (classification as defaulted or not) for clients with similar credit risk profiles. This would be hardly justifiable in terms of credit risk, but above all, it entails reputational risk for a bank in face of its clients. Notably, especially in case of legislative measures, it is usually not possible to adapt the terms of the concession to idiosyncratic situation of each obligor (to remain below the delta NPV threshold). Other BSG members contend that the reputational risk of a specific institution is not a trade-off with financial stability.

Therefore, in any case general forbearance measures (adopted to face emergencies or extraordinary situations) should not be subject to the mechanic application of a delta NPV threshold. It is worth clarifying that this does not mean that the exposures involved cannot be classified as defaulted, but simply that the delta NPV rule does not trigger their classification as defaulted, provided that in due course they will be assessed against all the other criteria and classified as defaulted if appropriate.

In the Consultation Paper, although not proposing actual changes, the EBA shows openness to the possible introduction of a derogation for public moratoria, provided that certain conditions

are met, ensuring – among other things - that the forbearance is targeted to a wide scope of clients, and that the moratoria is accompanied by public support measures intended to alleviate the impact of the emergency justifying the moratoria itself.

In light of the above, such derogation is considered appropriate. The possibility could be considered to extend the scope to also include general forbearance measures based on private decisions (e.g. banking association initiatives), if fulfilling the same criteria. Moreover, such criteria could be refined, namely the definition of the public support measures could be clarified and not limited to fiscal measures adopted by central Governments.

Other BSG members warn against dismantling what they consider to be a key prudential safeguard based on the experience of a decade of regulatory improvement and a stronger banking system. They note that proposals to modify or remove the quantitative threshold from the present Guidelines would weaken a robust framework, misinterpret the CRR3 mandate, and undermine the financial stability it claims to protect. They point out that the EU banking sector's resilience, noted in the previously mentioned Joint Committee Report (Autumn 2025) is precisely the outcome of the robust prudential framework that includes strict, objective triggers like the 1% DFO threshold. Weakening this framework because it has been successful is akin to dismantling a fire department because there have been no major fires lately. The Report itself cautions against this complacency, highlighting significant risks from "geopolitical uncertainties," "deteriorating economic outlook," and an "observed uptick in cost of risk." In this context, it advises that "capital buffers remain essential for the robustness of the financial system, as they provide the capacity to absorb shocks and maintain confidence in times of heightened uncertainty." They argue that diluting a key metric that ensures these buffers are adequate is a direct contradiction of this advice. They note that "preventive restructuring" is designed for borrowers about to face difficulties—where early, minor concessions can prevent distress. – and argue that the 1% threshold is not a barrier here; a concession significant enough to breach a 1% NPV reduction is, by definition, a material economic loss, not a minor preventive adjustment. A borrower already in financial difficulty receiving a major concession should be classified as defaulted. This triggers the necessary capital requirements and heightened monitoring, preventing "evergreening". They note that CRR3 was never intended to encourage banks to hide impaired loans on their balance sheets. Replacing the NPV threshold with alignment to the existing classification of Non-Performing Forbearance (NPF) from EBA/GL/2018/06, on the basis this would be a more risk-sensitive approach, would be a very problematic regression. In the view of these BSG members, the NPF classification is a supervisory and reporting tool that often occurs after a loan is already in default or is severely impaired. The prudential definition of default, and the DFO threshold within it, are an early objective warning capital trigger. Removing the objective 1% threshold and relying solely on the NPE/forbearance framework could, in their view, allow a materially impaired loan to avoid a default classification—and its associated capital charges—for a prolonged period. This creates a glaring loophole and directly contradicts the post-crisis lesson that delayed recognition of losses amplifies systemic risk. They refer to the Joint Committee Report, which emphasizes the need for "forward-looking provisioning policies" and vigilance. An objective, early trigger like the 1% DFO is essential to this forward-looking view.

With respect to the EGOV report referenced in the previous section the same members note that the NPV test does not, in their view, impede or block restructuring; it ensures that when a restructuring is so significant that it causes a material economic loss to the bank, the exposure is appropriately categorized and capitalized. They reiterate that the suggestion that banks are refusing to offer forbearance or restructuring to borrowers because of the 1% threshold is, in their view, not supported by the data in the Joint Committee Report, which shows continued lending and restructuring activity. They believe that the real barrier to restructuring is not prudential clarity but economic uncertainty itself. The Joint Committee Report notes that while the system is resilient, there are clear signs of strain, including a 2% rise in Stage 2 loans (a key indicator of future deterioration). These BSG members believe that an objective, harmonized standard like the 1% threshold ensures consistency across all institutions and prevents a race to the bottom in risk identification. It is a critical component of the Level Playing Field that the Single Rulebook is meant to create, and express their concern about the proposed removal or adjustment of the 1% NPV threshold as a case of financial deregulation at the worst possible time.

These BSG members recommend retaining the 1% NPV threshold as a critical anti-evergreening tool, which should not be dismissed as a secondary concern, considering its proven role in prolonging financial crises (e.g., Japan's "lost decade"). Raising the threshold to 5% would allow banks to hide significant losses, which contradicts CRR3's goal of a "risk-sensitive" classification..

Annex

Case 1 (postponement only)

Simplified case of forbearance measure - suspension of payments

Case 1a

Assumptions

Loan original schedule
Exposure amount at origination: **250.000**
Interest rate: **5,00%**
Start date: 01/01/2020
Maturity: **20 years** (monthly instalments)
No fees (OIR = Interest rate)

Forbearance measure: 1 year postponement (12 instalments suspension) – e.g. moratoria
Date of suspension: from 01/01/2026 to 01/01/2027
Interest for suspension period split over the remaining life of the loan (non-maturing interests)

1 year postponement → Delta NPV = 1,45%

Case 1b

Assumptions

Loan original schedule
Exposure amount at origination: **250.000**
Interest rate: **5,00%**
Start date: 01/01/2020
Maturity: **10 years** (monthly instalments)
No fees (OIR = Interest rate)

Forbearance measure: 1 year postponement (12 instalments suspension) – e.g. moratoria
Date of suspension: from 01/01/2026 to 01/01/2027
Interest for suspension period split over the remaining life of the loan (non-maturing interests)

1 year postponement → Delta NPV = 0,86%

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Case 2 (change in interest rate)

Simplified case of forbearance measure - slight reduction of interest rate

Assumptions

Loan original schedule (same as above)

Exposure amount at origination: **250.000**

Interest rate: **5,00%**

Start date: 01/01/2020

Maturity: **20 years** (monthly instalments)

No fees (OIR = Interest rate)

Forbearance measure: reduction in interest rate, 20bp

Change in monthly instalment: from 1.650 to 1.629 (around 20 euro per instalment)

20bp reduction interest rate → Delta NPV = 1,24%

***

Case 3 (change in interest rate)

Simplified case of forbearance measure - slight reduction of interest rate

Assumptions

Loan original schedule

Exposure amount at origination: **100.000**

No fees (OIR = Interest rate)

Forbearance measure: reduction in interest rate, 25bp

Case 3a

Interest rate: **5,00%**

Remaining maturity: **10 years** (monthly instalments)

25bp reduction interest rate → Delta NPV = 1,15%

Case 3b

Interest rate: **5,00%**

Remaining maturity: **9 years** (monthly instalments)

25bp reduction interest rate → Delta NPV = 1,04%

Case 3c

Interest rate: **5,00%**

Remaining maturity: **8 years** (monthly instalments)

25bp reduction interest rate → Delta NPV = 0,94%

Case 3d

Interest rate: **8,00%**

Remaining maturity: **9 years** (monthly instalments)

25bp reduction interest rate → Delta NPV = 0,99%