

# POSITION PAPER



## **ESBG Response to EBA's consultation on Forbearance and Non-Performing Exposures**

WSBI-ESBG (World Institute of Savings Banks - European  
Savings Banks Group)  
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Dear Sir/Madam

Thank you for the opportunity to comment on the EBA consultation on *draft implementing technical standards on Supervisory Reporting on Forbearance and Non-Performing Exposures*. We welcome the proposal but we have got some concerns about the increase in the scope and we had been hoping for a harmonisation of the definition of forbearance between EBA and ESMA. We would encourage the EBA to undertake a further period of consultation when you have considered the industry views and responded to them. This is due to the industry-wide challenge in reaching consensus on the meaning of forbearance and non-performance.

We prefer the ESMA approach which tends to enlarge the scope of forborne exposures considered as impaired under ISA 39. By introducing new concepts, it seems that the EBA, in its role as prudential regulator do not rely on the credit risk measurement definitions under CRR/CRD IV (Non-Performing Loans vs. Default).

We do not understand the objective of applying the new concepts to the trading book. As assets in trading book are valued on mark to market, negative signals regarding the debtors are directly reflected in the valuation. Moreover, the requirement exceeds the scope of impairment under IAS 39 and the coming IFRS 9.

The content of the consultation also raises important operational issues, in particular as regards to IT, which will require time to implement.

**Q1: Do you agree that building definitions of forbearance and non-performing by taking into consideration existing credit risk related concepts enables to mitigate the implementation costs? If not, please state why.**

We do not agree as we consider that the adjustments would trigger substantial implementation costs without generating substantial new regulatory necessary information.

Concerning the definition of “non-performing” assets:

We strongly doubt that the approach of EBA – to add a new definition and by this ignoring existing data, ignoring potential synergies and opening redundancies and adding complexity by the introduction of an additional definition not aligned with the existing definitions and taking into consideration the background that even the existing definitions are not aligned – is of an additional regulatory use. We specifically question the use in light of the potentially huge implementation costs that depend on the final definition. Confronting the credit industry with additional regulatory burdens in this respect is simply unacceptable, specifically due to the fact that the credit industry is already overloaded with regulatory requirements.

The authors assume that today the default and impairment definition is the same across the European Union. We want to underline that this is not the case today in case of the default-definition, due to national discretions (many of them being removed by CRD IV/CRR, but not all, e.g. debtor/transaction view choice), due to existing differences between IRB and standardized



approach (which will also be aligned by CRD IV/CRR) but also by different levels of thresholds (which will not be aligned by CRD IV/CRR). This means that even after the implementation of CRD IV/CRR we will face differences in the default definition across countries. For cross-border banking groups this is already a challenge even without a new definition of non-performing assets. The existing differences are related to different geographical and economic situations (e.g. thresholds), to different histories, to different systems and to different goals (default vs. impairment vs. NPL). We doubt that a “single view”, capturing all dimensions, as set out on page 24 of the paper, can be achieved and is even useful to achieve.

The proposed new definition is – compared to the current definitions – also somewhat complex. As examples in regard of the complexity/lack of clarity following issues could be mentioned:

- Page 8, third paragraph: Need to assess if consideration of the trading book really is necessary/ reasonable

We would therefore strongly recommend for the time being to use existing data from COREP and FINREP in terms of defaulted and impaired assets. Changes in definitions or additional reporting requirements are from our perspective currently not necessary.

#### Concerning the definition of “forbearance”:

The complex definition presented by EBA, specifically with a view that every single transaction would have to be checked against this definition, is also simply unacceptable

As examples in regard of the complexity/lack of clarity the following issues could be mentioned:

- Page 11 first bullet point (“ a modified contract includes more favourable terms than those that the debtor could have obtained in the market”):

A comparison with other market terms appears challenging (e.g. how would the customer be rated by another institution, which conditions could he obtain); It is not realistic to expect lenders to check this: the loan conditions offered by competitors are not openly available in any market.

How are cases supposed to be handled where the change in contract is triggered by different issues (e.g. sales initiatives, different product strategy)?

- Page 11, third bullet point (“...or partially past-due more than 30 days”)

Concerning the proposed 30-day period we strongly doubt that this period is appropriate due to the fact that this would simply mean that any action taken after the due date of one instalment would have to be treated as a case of forbearance. The 30 days-past-due (henceforth DPD) -period is too early an indicator and not necessarily indicative of longer term risk performance. The proposed criteria to identify payment difficulty for retail clients is 1x 60DPD in the past 3 months. This helps differentiate risky clients (60DPD) vs. sloppy payers (30DPD) and covers recent difficulty (last 3months). We are of the opinion that only cases where at least two instalments are due should be taken into account, which means one time 60 days overdue during the past 90 days.



- Certain terminology is too vague, for instance on page 11 – last bullet point- “more than an insignificant amount”; page 12 first bullet point – how is a “probation period” defined? The significance of these terms appears questionable. Please refer to our response to Q2 for more details re these concerns.
- As far as we understood, the proposed criteria would apply on a single transaction basis. Due to the fact that this would trigger enormous implementation/training costs, we would suggest setting up a simple framework, especially by formulating a definition that would allow implementing an automated process. Please also see below.

The forbearance definition should leave room and not be too close to the default/impairment-definition, otherwise forbearance could trigger default. Credit institutions need room to manoeuvre to handle cases of forbearance without automatically triggering a default.

On the other hand the quantity of forbearance cases is very limited. In terms of a comparison of the regulatory use vs. implementation costs this means that the definition has to be formed in a way that allows automation with a view to the generation of reporting data. It would at least be necessary to take out complexity to allow an automated analysis of existing data.

This could be done e.g. by focusing on:

- Large customers only, e.g. by using the large exposures definition
- Introducing a simple overdue definition, e.g. 60 days (see also below)
- Combination with the fact of a change in contracts
- No other criteria

We have to bear in mind that on the one hand the forbearance definition has to leave room vis-à-vis the default-definition. On the other hand the definition has to be distinct from any other cases of a change of contracts in the normal course of business and which should therefore not be included in the forbearance-definition. We believe that this issue could be handled by an appropriate overdue-criterion of 60 days.

**Q2: Do you agree with the proposed definitions? Especially, do you agree with the inclusion of trading book exposures under the scope of the non-performing and forbearance definitions? If you believe alternative definitions could lead to similar results in terms of identification and assessment of asset quality issues, please explain them.**

Regarding the proposed definition of forbearance we consider that there should be a differentiation between a situation where the contract is modified and a situation where a new contract is signed.

The consultation paper establishes the conditions to be considered when deciding whether a debtor has regularly met the latest payments due. One of these conditions states that the debtor has paid “more than an insignificant amount of principal or interest due under the contract (...)”. The “insignificant amount” should be defined in order to achieve a homogeneous treatment. For



example, the Bank of Spain's Circular no 6/2012 considers this amount to be more than 20% of the principal.

Regarding the inclusion of trading book exposures under the scope, we are strongly opposed to the concept of forbearance and Non-Performing Exposure (NPE) being applied to the trading book. Instruments recognised at amortised costs are subject to impairment in case there is objective evidence that the instruments are impaired. Management monitors these instruments in order to track and identify potential impairment evidence. For instruments accounted for at fair value the risk is accounted for within the fair value and the P&L impact is recognised either within the P&L or OCI (Other Comprehensive Income). The disclosure of the specific fair value component attributable to credit risk is highly judgemental as the split between credit risk, liquidity risk and interest rate risk is not really observable. We would also like to mention that an institution does not have a direct business relationship with the issuer of a traded debt instrument and no influence on forbearance practices or non-performing status. Debt instruments of issuers facing financial difficulties can be traded more quickly than the reporting can be processed. Therefore we believe that the potential timing issue of the reported data as well as the diverse nature of the business relationship with debtors of trading and banking book positions could lead to misleading results.

**Q3: How long will it take you to implement, and collect data on, the definitions of forbearance and non-performing?**

For members that are already subject to reporting requirements in terms of forbearance for national supervisory, the new requirements proposed by the EBA should not have a big impact in terms of implementation and data collection provided that it will be similar to the existing national requirements.

For others members, data implementation will take time, at least one year after the final ITS, in order to review the full portfolio of loans and identify those which were granted forbearance measures. The forbearance characteristic will need to be dated and flagged into the systems to be reported.

Including the trading book into the scope of forbearance and non performing reporting would be much complex and would further delay the implementation date because we would have to include all the trading exposures into the credit risk system and that means at least an additional year of IT works to prepare the systems, populate it with the trading book validate all the deals, and perform validation loops and data checks.

**Q4: What definitions of forbearance and non-performing are you currently using respectively for accounting and prudential purposes?**

Spanish institutions currently use the modification of the Circular no. 4/2004, of 22<sup>nd</sup> December of the Bank of Spain. Credit institutions' public and confidential financial reporting rules and formats, introduced by the Circular no. 6/2012, establishes among others the definition of refinancing debt, refinanced debt and restructured debt. The difference between the aforementioned options lies in whether the terms and conditions of the contract changed or if a new contract is signed but they all have a common characteristic namely the financial difficulties of the debtor to comply with its



payments obligations. The Circular also defines the concept of renegotiated debt and renewal debt which do not imply financial difficulties of the debtor.

Spanish institutions have to report the total amount of refinancing, refinanced and restructured debt, on a specific template, to Bank of Spain.

French institutions currently don't have specific supervisory requirements. Forbearance and NPE concepts are used in the context of assessment of impairment according to IAS39.59. For lots of them, the criteria used to identify objective evidence of impairment on a debt instrument for accounting purposes are the same as the ones used to qualify as defaulted according to the prudential rules. Thus they prefer not to have different scopes.

Non-performing, default or individual objective evidence of impairment are synonymous when related to debts instruments of the banking book.

**Q5. Do you agree with the types of forbearance measures covered by the forbearance definition? If not, what other measure(s) would you like to be considered as forbearance?**

Yes, we agree but when there is a more than 30 DPD amount at least once during the three months prior to modification, we do not agree to qualify the modifications as forbearance measure if the contract doesn't include more favourable terms than those the debtor could have obtained in the market or according to the specific local uses depending on the local competitors, because the modifications might be due to commercial renegotiation.

We would also seek a clarification of the differentiation between forbearance and default, especially in regards to "distressed restructuring".

**Q 6: Do you agree with the following elements of the forbearance definition:**

**a. the criteria used to distinguish between forbearance and commercial renegotiation?**

Yes, we agree but we believe that the distinction would be further strengthened with an additional bullet point covering financial difficulties of the debtor. If there is no doubt about the ability of the debtor to meet the terms and conditions of the contracts, any modifications should be considered as commercial renegotiation even if the contract includes more favourable terms than those the debtor could have obtained in the market. Financial distress should be evident to identify the existence of forbearance.

A comparison with other market terms appears challenging (e.g. how the customer would be rated by another institution, which conditions he could obtain). It is not realistic to expect lenders to verify this as the loan conditions offered by competitors are not openly available in any market. How are cases supposed to be handled where the change in contract is triggered by different issues (e.g. sales initiatives, different product strategy)?

**c. a 30 days past-due threshold met at least once in the three months prior to modification or refinancing, as a safety net criterion to always consider modification or refinancing as forbearance measures?**



The 30 days past-due threshold is the only quantitative criteria used to define forbearance whereas the other elements are more likely to be seen as principles. Even with thresholds there are some interpretation difficulties relating to whether a restructuring is commercial or due to financial difficulties.

A 30 days past due amount might have many different reasons to be, so this threshold is too strict to take into account all the cases. When there is no doubt on the ability of the debtor to meet the existing terms of the contract, a 30 days past due amount is not an appropriate indicator. The proposed criteria to identify payment difficulty for retail clients is 1x 60DPD in the past 3 months. This helps differentiate risky clients (60DPD) vs. sloppy payers (30DPD) and covers recent difficulty (last 3months). We are of the opinion that only cases where at least two instalments are due should be taken into account, which means one time 60 days overdue during the past 90 days.

**Q 7. Do you agree with the proposed scope of on- and off-balance sheet exposures to be covered by the definition of forbearance?**

We understand why the scope is large when taking into consideration the stated purpose of forbearance reporting. However we believe that some consideration must be taken when considering the management of instruments. The prudential classification will change dependent on the management of the instruments and we therefore propose that positions held in banking and trading books should be separated out.

**Q 8. Do you agree not all forbearance transactions should be considered as defaulted or impaired?**

Generally we would agree that not all forbearance transactions should be considered as defaulted or impaired as proposed in the paper. But this is related to the more general question in relation between the default – impairment – non-performing-definition; see also answer to question 1, where one proposal for a change would be an alignment between the definitions, which would – in turn – then mean also an alignment in the legal consequences.

**Q 9. What types of forbearance transactions are likely, according to you, not to lead to the recognition of default or impairment?**

Additionally to the examples set out in the context of the answers to question 1:

- In case the exposure is fully collateralized;
- Forbearance with no or insignificant negative Net Present Value impact;
- Under the threshold of 60 DPD (see answer 1 & 6);
- Under the definition of large exposures (see answer 1).

**Q 10. Do you agree with the proposed definitions of debtors and lenders and the scope of application of the forbearance definition (i.e. accounting scope of consolidation)?**

Concerning the scope of consolidation we urge the EBA to utilise the COREP scope of consolidation. The FINREP-scope should (according to a proposal by the EBA) in the future be



aligned with the COREP-scope. What is simply unacceptable is to link the definitions to the accounting scope of consolidation, i.e. including entities which are neither captured by COREP nor by FINREP. If it is the case that general data of these entities is not needed for regulatory purposes why should specific data be needed? It would drive up implementation costs enormously with – again – limited to no additional value added data.

**Q 11. Do you agree with the proposed mixed approach (debtor and transaction approaches) for forbearance classification?**

The dimensions should in any case be aligned with the default/impairment-definition, so to avoid implementation costs only to capture another dimension, e.g. debtor-view for NPL, transaction-view for default.

**Q 12. Do you agree with the exit criteria for the forbearance classification? In particular:**

- a) what would be your policy to assess whether the debtor has repaid more than an insignificant amount of principal or interests?
- b) do you support having a probation period mechanism?

Please refer to our comments above regarding “insignificant” and “probation” (answers to questions 1, 6, 9).

We consider that (in addition to our response above, a contract may cease to be forborne and exit forbearance classification when the forbearance contract (with modified payment terms) is followed for a period of six months. This would avoid placing an undue burden on the institution.

- a) We believe that the debtor should be following the revised contract to exit forbearance. We believe that if the customer is paying a commercial rate of interest that should be adequate rather than meeting original payments. The concept of requiring the obligor to "catch up" all missed payments or written off amounts could lead them to be reported forborne for the lifetime of any remaining facilities.
- b) We believe the probation period of 2 years to be too long. A period of 6 months is more appropriate. We would also allow an immediate fix from default and forbearance if we restructure an exposure and resize the customer and the banks' balance sheet by writing off an amount of debt. Similarly if the customer makes a full repayment of an exposure there may be an immediate cure (or full catch up under the 30 day rule if admitted).

**Q 13. Do you agree with the proposed approach regarding the inclusion of forborne exposures within the non-performing category? In particular: a. do you agree the generic non-performing criteria allow for proper identification for neither defaulted nor impaired non-performing forborne exposures? Would you prefer to have the stricter approach (all forborne exposures identified as non-performing) implemented instead?**

We do not agree with the implementation of the stricter approach.

**Q 14. Do you agree with the following elements of the non-performing exposures definition: a. the use of 90 days past-due threshold to identify exposures as non-performing?**





We agree with the use of the 90 DPD threshold but we consider that the EBA should add the provisions of the CRR which allow national discretions to take into account longer payment practices which are not evidence of default (eg public administrations and central government). This should also apply to the 180 DPD for retail exposures.

We believe that the 90 DPD definition should require missed payments throughout the period rather than the proposal in the paper of a single missed payment that is not recovered in 90 days. In addition we find the use of ratios to identify contagion to be unattractive as ratio methodology will be impractical and expensive to apply. It will lead to varying results as individual cases may move in and out of the contagion ratio rules in each reporting period.

We disagree with the introduction of a threshold for contagion. Our members already apply contagion without any threshold.

**Q 18. Do you agree not to consider exposures subject to incurred but not reported losses as non-performing?**

We agree with the proposal not to consider such exposures.

**Q 19. Do you agree with the proposed approach regarding the materiality threshold?**

We agree with the proposal not to define a specific threshold for the non-performing definition for now and to apply the default-threshold in the meanwhile.

**Q 20. Do you agree with the proposed definitions of debtors and lenders and the application of the non-performing exposures definition on an accounting scope of consolidation?**

We strongly oppose this approach; please refer to answer 10.

**Q 21. Do you agree with the proposed approaches (debtor approach for non-retail exposures, and possibility of a transaction approach for retail exposures)? In particular, do you agree with the idea of a threshold for mandatory application of the debtor approach? If so, which ratio methodology would you favour and why?**

We would strongly suggest using the default-definition in the CRR which allows implementing a debtor or a transaction in the standardised approach at the moment, and a debtor-only-view in the case of IRB. What should be avoided is an obligation for credit institutions to apply a different view on the basis of these new reporting requirements.

**Q 22. Do you agree with the exit criteria from the non-performing category?**

We refer to answer 12.

**Q 23. Do you agree with the separate monitoring in a specific category of exposures ceasing to be non-performing? Do you think this specific category should be integrated within the performing or the non-performing category?**

Performing exposures should be treated as performing exposures no matter their history. We strongly plead not to oblige banks to additionally report data on performing exposures.

**Q 24. Would you favour specific exit or specific separate monitoring criteria for non-performing exposures to which forbearance measures are extended?**

Please refer to answer 12.



## About WSBI-ESBG (European Savings Banks Group)

### WSBI-ESBG – The European Voice of Savings and Retail Banking

WSBI-ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,631 billion, non-bank deposits of €3,500 billion and non-bank loans of €4,200 billion (31 December 2011). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

WSBI-ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. WSBI-ESBG member banks have reinvested responsibly in their region for many decades and are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.



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