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FRENCH BANKING FEDERATION RESPONSE TO DRAFT GUIDELINES ON MANAGEMENT OF NON-PERFORMING AND FORBORNE EXPOSURES

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The French Banking Federation welcomes the opportunity to share its comments on the EBA consultation on "Draft Guidelines on management of non-performing and forborne exposures". Please find our feedback to the different issues raised in the consultative paper.

Question 1: What are the respondents' views on the scope of application of the guidelines?

We welcome the EBA initiative to issue guidelines on NPL management to be applicable to all banks in the EU. We also appreciate the rationale of distinguishing between high and low NPL banks.

However, as detailed below (question 2), we think that chapters 4 and 5 of the draft guidelines should not have to be automatically applied when a credit institution displays a NPL ratio above the threshold. In particular at portfolio level, the approach should rather rely on a supervisory dialogue, through the "comply-or-explain" process.

Question 2: What are the respondents' view of the proposed threshold of 5 % NPL ratio?

In its draft guidelines, EBA says that: "Credit institutions should apply chapters 4 and 5 when their level of non-performing exposures is elevated. An NPL ratio above 5% should be considered as an elevated level of NPEs" (§10). The wording also implies that NPL ratios are defined at a granular level and also that NPLs reduction measure should be automatically taken when the threshold are triggered.

First, we think that the ratio should only be indicative of the need for **more scrutiny** by the bank senior management and the Competent Authorities. Let us just say that we see a **contradiction** in the fact of calculating it both at the consolidated level and at the portfolio level: a bank can have a portfolio with a NPL ratio >5% because this portfolio is related to a business activity where defaults are more frequent (consumer finance, for instance) and at the same time, its consolidated NPL ratio would be < 5% because the other business activities are less risky. There would not be any legitimate reasons for the bank to apply chapters 4 & 5 of the guidelines to the portfolio which displays high level of NPL.

So, we think that looking at the NPL ratio alone (especially when it is computed without taking into account the level of coverage of doubtful loans by provisions[1]) is **not enough to require a credit institution to apply chapters 4 and 5** of the draft guidelines. Competent Authorities also need to take into account **specific features of the credit institution or the portfolio of loans**. Indeed some activities have "by definition" a business model that demands high rates of gross NPLs without necessarily bearing high losses: loan restructuring department, consumer finance, social housing, etc. **The realized loss**, i.e. the net amount lost, is the true parameter to be considered (no need to remind that the Basel Committee combines the probability of default (PD) and the loss given default (LGD) to really assess the risks at stake).

For example, in the case of residential loans to borrowers with low incomes, probability of default is of course higher when compared to average-income borrowers (and in addition own initial contribution from low income borrowers are limited or even absent). The gross NPL ratio is therefore expected above 5%. However, taking this data alone would be completely misleading. There are indeed multiple remedies to address this issue and **the actual losses experienced by the lender are quite low. That is thanks to the guarantee scheme put in place at origination**. In France for instance, banks distributing housing loans to borrowers with low incomes (and which meet certain eligibility criteria) can benefit from a State-guaranteed scheme called FGAS. If the value of the loan is > 15.000 €, then a first-rank lien must be taken out by the lender. It means that, at the end of the day, those kinds of loans are twice guaranteed: first by the mortgage and second by FGAS. As a result, "expected losses" are quite low (as the LGD is low, while the PD is higher). So, in that case, the NPL ratio isn't the relevant feature to be considered by Competent Authorities.

It is therefore necessary **to watch for net ratio as well as expected losses over the long run**: in France, historical series from specialized brands show that these client categories do not suffer high losses. This shows that such business model, when properly managed, beats the predictions of the "usual" and in fact partial return indicators.

Finally, it is not useless to remind that the business model described here is necessary **to continue serving clients that would not have any access to credit if they had to turn to the "usual" financing providers**. If such business models were to strictly apply the rules elaborated by the EBA, then credit institutions would be required to elaborate and execute a plan to reduce the NPL ratio of the portfolio below the threshold, which would be counterproductive: since the Expected Loss is low, margin are also relatively low, and **operating a NPL portfolio according to the principles described in the EBA guidelines would put additional pressures on the operational margin of the banks**.

To sum up, **we think that chapters 4 and 5 of the draft guidelines should not have to be automatically applied when a credit institution displays a NPL ratio above the threshold. Credit institutions should**

[1] other relevant risk metrics such as broad coverage ratios (provisions, impairment, collaterals, among other) should be taken into account

have the possibility to provide explanations to competent authorities as regard their portfolio with an elevated level of NPL.

Question 3: Do you see any significant obstacles to the implementation date and if so what are they?

No specific remarks.

Question 4: Does section 4.3.2 capture all relevant options available for credit institutions to implement their NPE strategy?

For comparability purposes and effectiveness of NPE reduction strategies, the breakdown between “past due” and “Unlikely to Pay” (UTP) needs to be taken into consideration. Some of the criteria for the UTP part may not be sustained from a contractual, legal or judicial execution point of view which may constitute an effective impediment to NPE reduction.

Question 5: Do you see any significant obstacles to the operationalization of the NPE strategy as described in chapter 5?

No specific comments.

Question 6: Does the viability assessment of forbearance measures capture all relevant aspects?

No specific comments.

Question 7: What are the respondents view on the proposed requirements for recognition of non-performing and performing/non-performing forborne exposures?

No specific comment.

Question 8: What are respondents view on the requirements on timeliness of impairments and write-offs of NPEs?

No specific comments.

Question 9: Do you have any significant objection against the proposed threshold for property-specific valuation (EUR 300,000)?

In its draft guidelines, in the chapter about collateral valuation for immovable and movable property, EBA requires the use of a property specific appraisal (individual property valuation) instead of an indexed valuation when the gross carrying amount of a NPE is > EUR 300,000: “indexed valuation should not be used to update the valuation of immovable property collateral for a NPE the gross carrying amount of which is larger than EUR 300,000 or a lower amount defined by the compentent authority”.

We think that this threshold is too low, and that the rule will **substantially increase the cost of operating non-performing exposures**, and we would recommend both to increase the threshold (in order to take into account the high value of real estate in great European cities) and to require a less frequent individual property valuation (for instance, banks could use indexed valuation every year and property specific appraisal every 3 years).

Question 10: Do the requirements for valuation of movable property collateral capture all relevant aspects?

No specific comment.