Banca Sella SpA welcomes the opportunity to comment on the “Draft Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013” launched by EBA on the 22 September 2015.

Our comments are the followings:

i) **Distressed restructuring:**

As referred to point (d) of Article 178 (3) (d) of Regulation (EU) No 575/2013, the obligor should be considered defaulted where “*the institution consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the* *material forgiveness**, or postponement, of principal, interest or, where relevant fees.”*

In order to asses whether the financial obligation has diminished as a result of distressed restructuring, we agree to discount the expected cash flow using the customer’s original effective interest rate. The original effective interest rate is more in line with IAS 39.

Nevertheless, the percentage proposed by EBA (equal to 1%) with reference to the formula:

$DO=(NPV_0-NPV_1)\ /\ NPV_0$

where:

DO is diminished financial obligation;

NPV_0 is net present value of expected cash flows (including unpaid interest and fees) before the changes in terms and conditions of the contract discounted using the customer’s original effective interest rate;

NPV_1 is net present value of the expected cash flows based on the new arrangement discounted using the customer’s original effective interest rate.

is too low for the following reasons:

1) The point (d) Article 178 (3) (d) of Regulation (EU) No 575/2013 joins a dimished financial obligation at the material forgiveness of principal, interest or, where relevant fees. The percentage proposed equal to 1% isn't material.
2) When the bank applies a forbearance measure to a debtor, (particularly if the forbearance measure is a consolidation of short-term liabilities with a secured loan) frequently it grants the debtor a reduction in the interest rate beaucause:
    a. The law provides for compliance with the maximum rates applicable under the credit facility. The maximum interest rates that the bank can apply to the debtor are higher for short-term loans and lower for medium and long term loans;
    b. When the bank apply a secured forbearance measure, the reduction of the interest rate shows the decrease in the risk premium and the reduction is not a diminished financial obligation caused by material forgiveness of interest;
3) The proposed guideline can increase the defaults especially to SMEs. Support for SMEs is also crucial for the European Commissiona s stated in the document *"Possible impact of the CRR and CRD IV on bank financing of the economy"*

ii) Criteria for the return to a non-defaulted status

Under the proposed guideline, for the purposes of the application of Article 178(5) of Regulation (EU) 575/2013, except for situations referred to in paragraph 59, institutions should apply all of the following:

(a) consider that no trigger of default continues to apply to a previously defaulted exposure, where at least 3 months have passed since the moment that the conditions referred to in Articles 178(1)(b) and 178(3) of Regulation (EU) No 575/2013 were no longer met;

(b) take into account the behaviour of the obligor during the period referred to in point (a);

(c) take into account the financial situation of the obligor during the period referred to in point (a);

(d) after the period referred to in point (a), perform an assessment, and, where the institution still finds that the obligor is unlikely to pay its obligations in full without recourse to realising security, the exposures should continue to be classified as defaulted until the institution is satisfied that the improvement of the credit quality is factual and permanent;

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

Nevertheless, when a default shall be considered to have occured under Article 178(1)(b), the bank does not perform any additional assessment. The default is only a result of past due. Therefore, when the exposure is not more past due, we suggest that esposure is classified as non-defaulted status without respecting any probation period. The exposure continues instead to be classified in default when, in the opinion of the bank, it meets other indications of unlikeliness to pay.

Best regards