

COMMISSION de SURVEILLANCE  
du SECTEUR FINANCIER

Luxembourg, le 13 juin 2013

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**Concerne: Votre lettre du 24 avril 2013 en relation avec la circulaire CSSF 12/552**

Monsieur,

Nous avons l'honneur de nous référer à votre lettre du 24 avril 2013, que vous nous avez adressée en relation avec les vérifications à faire par les réviseurs d'entreprises agréés dans le cadre de la circulaire 12/552, telle que modifiée par la circulaire 13/563.

En réponse à votre lettre, nous pouvons vous informer que la CSSF s'attend à ce que les réviseurs d'entreprises agréés contrôlent plus particulièrement les éléments suivants de ladite circulaire :

- le chapitre 5 de la partie II traitant de l'organisation administrative, comptable et informatique ;
- le chapitre 6 de la partie II sur le contrôle interne ;
- le sous-chapitre 7.4 de la partie II en relation avec la sous-traitance ;
- le chapitre 3 de la partie III concernant le risque de crédit ;
- le chapitre 5 de la partie III en relation avec la gestion patrimoniale privée.

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A toute fins utiles, et dans le cadre de la revue du chapitre 3 de la partie III sur le risque de crédit, nous nous permettons d'attirer votre attention sur le « Consultation Paper » EBA/CP/2013/06 sur « Supervisory reporting on forbearance and non-performing exposures under article 95 of the draft Capital Requirements Regulation » ci-joint.

Veillez recevoir, Monsieur, l'assurance de nos salutations distinguées.

COMMISSION de SURVEILLANCE du SECTEUR FINANCIER



Gaston COLBACH  
Attaché de direction



Claude SIMON  
Directeur

Annexe: EBA Consultation Paper

## Consultation Paper

Draft Implementing Technical Standards

On Supervisory reporting on forbearance and non-performing exposures under article 95 of the draft Capital Requirements Regulation



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# Consultation Paper on Draft Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under article 95 of the draft Capital Requirements Regulation

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## 1. Responding to this Consultation

The EBA invites comments on all proposals put forward in this paper and in particular on the specific questions summarised in 6.2.

Comments are most helpful if they:

- respond to the question stated;
- indicate the specific point to which a comment relates;
- contain a clear rationale;
- provide evidence to support the views expressed/ rationale proposed; and
- describe any alternative regulatory choices the EBA should consider.

Please send your comments to the EBA by email to [EBA-CP-2013-06@eba.europa.eu](mailto:EBA-CP-2013-06@eba.europa.eu) by 24.06.2013, indicating the reference 'EBA/CP/2013/06' on the subject field. Please note that comments submitted after the deadline, or sent to another e-mail address will not be processed.

### Publication of responses

All contributions received will be published following the close of the consultation, unless you request otherwise. Please indicate clearly and prominently in your submission any part you do not wish to be publicly disclosed. A standard confidentiality statement in an e-mail message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with the EBA's rules on public access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the EBA's Board of Appeal and the European Ombudsman.

### Data protection

Information on data protection can be found at [www.eba.europa.eu](http://www.eba.europa.eu) under the heading 'Legal Notice'.

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## 2. Executive Summary

The EBA is consulting on two definitions and templates to define the notions of **forbearance and non-performing exposures** on the one hand, and to capture the related data on the other. The EBA has drafted these definitions and templates in application of article 95(2) of the proposed Capital Requirements Regulation (CRR) and they will therefore be added to the FINREP framework as defined by the ITS on Supervisory reporting. This ITS was consulted upon in 2011/CP50.

The newly introduced definitions are provided in Annex II of this Consultation Paper, as part of the instructions accompanying the new reporting templates presented in Annex I. Annex III contains the Data Point Model and Annex IV the validation rules associated with these templates. The definitions are set out together with questions on specific elements of them in Part 4 of this Consultation Paper.

In the current context of uncertainties surrounding asset quality for European banks, the European Banking Authority wishes to empower supervisors with the appropriate tools to assess on a comparable basis across the European Union the level of non-performing exposures as well as of forbearance activities. As institutions may deal with non-performing exposures by extending forbearance measures, comprehensive and harmonised reporting on these two issues is needed.

Facing the lack of existing harmonised definitions able to offer this comprehensive coverage, the EBA decided to draft its own definitions of forbearance and non-performing exposures for supervisory reporting. They will complement but not supersede existing definitions of these notions used for other purposes.

The definition of forbearance therefore builds on existing accounting and regulatory provisions and encompasses transactions that are generally regarded as forbearance in most of the accounting and regulatory frameworks considered by the EBA in the preliminary mappings it conducted. As for the definition of non-performing exposures, it builds on the definitions of impairment and default according to IFRS and the proposed CRR, while being broader than these notions to serve as a more harmonised asset quality indicator across Europe.

The proposed forbearance and non-performing exposures definitions would apply to all loans and debt securities that are on-balance sheet, irrespective of their valuation methodology for accounting purposes or of their classification, in the banking and trading book, for regulatory purposes. All off-balance sheet items (financial guarantees given, loan commitments given and other commitments) are covered by the definition of non-performing, and some off-balance sheet commitments are covered as well by the forbearance definition. These definitions are to be applied on an accounting scope of consolidation.

Separate reporting templates are proposed for forbearance and non-performing exposures, to be completed on a consolidated basis, with some aggregate data also to be provided on a country-by-country basis. To lessen implementation costs, the EBA has adapted information to be provided under previous proposals for FINREP templates, thus avoiding redundancy.

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These harmonised definitions and data collection means will complete the tools available to both the EBA and the national supervisory authorities for the assessment and conduct of work on the asset quality issues at the European Union level.

The same provisions as currently set out in the March 2013 update of the ITS on Supervisory reporting, for instance regarding reporting frequency and proportionality criteria, will be applied to the reporting templates presented in this consultation paper.

This draft additional material to the ITS on supervisory reporting is expected to be finalised in Q2/ Q3 2013. The exact implementation date of the reporting templates will depend on the entry into force of the provisions of the ITS on Supervisory reporting and feedback from the consultation.

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### 3. Background and rationale

The EBA has been concerned by a general trend of deteriorating asset quality across the European Union due to the recessionary economic environment triggered by the 2007 financial and the 2010-ongoing sovereign crises. This trend has been evidenced over the last quarters by increased impairment coupled with a decrease in loan loss coverage across the EU. This deterioration does not occur in every country, occurs at a different pace in different countries, and tends to affect some portfolios more than others. The current macroeconomic environment nevertheless makes it a major risk for the banking sector and the real economy, in particular as asset quality issues can slow new lending down and delay economic recovery.

Concerns mostly relate to uncertainty surrounding (i) the extent of the use of forbearance, potentially with the aim of delaying loss recognition and masking asset quality deterioration, and (ii) the consistency of asset quality assessment across the EU, particularly regarding the line drawn in the different jurisdictions between the performing and non-performing categories.

Experience from past crises suggests tackling asset quality issues is required for economic growth to recover through new lending to sound borrowers, and that cleaning of balance sheets may require public intervention given the lack of incentives for self-action by institutions. The EBA acknowledges loan forbearance measures are regular banking practices that allow banks to adapt their risk profiles, especially in the downward phase of the economic cycle. Nevertheless, loan forbearance can also delay necessary actions by masking the real situation of the debtor. In addition, lack of comparable and sound data on forbearance transactions and more generally on exposures qualified as non-performing can prevent clear national and European supervisory assessments and actions regarding asset quality issues.

Collecting comparable and harmonised data on forbearance transactions and asset quality is therefore needed. However, the current state of play appears unsatisfactory due to differing national practices and the absence of harmonised definitions that make the collection of comparable data at the EU level difficult, even when using the existing definition of default or impairment. This situation has contributed to the rise of uncertainties about the actual level of credit risk in banks' balance sheets, and the consistency/comparability of credit risk figures reported by banks.

Building on the recent identification by the ESRB of the need to properly assess forbearance on a consistent basis across the EU<sup>1</sup>, the EBA has therefore decided to propose harmonised and consistent definitions for both forbearance and non-performing exposures, and to supplement them with dedicated supervisory reporting templates. Together these tools will empower supervisors to:

- assess the extent of forbearance transactions and their effects on asset quality and loss recognition,
- capture asset quality deterioration,
- compare asset quality on a more consistent and homogeneous basis across EU institutions.

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<sup>1</sup> ESRB Press release 20 September 2012 ESRB General Board Meeting in Frankfurt  
<http://www.esrb.europa.eu/news/pr/2012/html/pr121220.en.html>



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This should contribute to early identification of risks, to the stability of the European financial system as a whole and facilitate any coordinated future action in the field of asset quality.

Prior to the drafting of its forbearance and non-performing definitions, the EBA conducted mappings across international accounting standards (IFRS) and regulatory frameworks (the Capital Requirement Directive, the CRR, the December 2011 proposed ITS on supervisory reporting, the European System of Accounts, the ECB Regulation 2008/32, the IMF Financial Soundness Indicators 2006 Guide), European jurisdictions (national accounting or regulatory frameworks), and credit institutions' disclosures, aimed at:

- Mapping among frameworks: assessing whether there are existing definitions of forbearance and non-performing or of similar concepts which are commonly used in the accounting and regulatory frameworks to help draw the boundaries of the EBA definitions
- Mapping among European jurisdictions: providing an overview of how different European jurisdictions define (or not) the notions of forbearance and non-performing and ensuring that the EBA definitions are consistent, to the extent possible, with existing definitions in Europe
- Mapping among credit institutions: shedding light on the use by credit institutions of the notions of forbearance and non-performing even in the absence of regulatory requirements or definitions in the applicable accounting and regulatory frameworks, and consequently on the definitions channelled to market participants through credit institutions' disclosures

The mapping of the existing international frameworks revealed the lack of clear and comprehensive definitions for the notions of forbearance (most of the frameworks or the institutions considered in the mapping did not even use this word) and non-performing, while mappings across jurisdictions and disclosures led to the identification of differences but also commonalities in the definitions and use of these notions. In particular, there were strong linkages between the notions of impaired, defaulted and non-performing, with the latter often being in most jurisdictions a synonym or a subcategory of the first two.

However, none of the existing definitions or concepts alone appeared suitable to be used as the harmonised definitions of non-performing exposures and forbearance that are needed for an EU-wide reporting and assessment of asset quality. Indeed, even the most commonly used notions like impairment or default may in some aspects be implemented differently in the different European jurisdictions. It was also not possible to rely entirely on the IMF definitions of restructured and non-performing loans to achieve harmonisation across Europe given they are non-prescriptive and only set minimum standards while allowing jurisdictions to choose stricter definitions.

Consequently, the EBA chose to develop definitions tailored to supervisory needs. Informed by the results of its mappings, the EBA also decided to consider its proposed harmonised definitions of non-performing exposures and forbearance as umbrella concepts, meaning they cover some of the existing credit risk related concepts, without superseding them or modifying the way institutions implement them, while being potentially broader when necessary for supervisory purposes.

The EBA believes this approach will lessen the implementation costs of the proposed definitions since it ensures they are not at odds with the provisions from existing accounting or regulatory frameworks and the practices of institutions when implementing them.

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The proposed definitions are therefore additional to existing concepts for assessing asset quality. Their aim, by putting forward common elements, in terms of scope and identification criteria, while also leveraging on these existing concepts, is to strengthen supervisory tools available for asset quality assessment. These definitions will indeed lead to a harmonised understanding of the non-performing and forbearance notions and, ultimately, to the EU-wide collection of more consistent and comparable data on these issues.

The forbearance definition brings different practices under a common name. These practices may be covered in different accounting and regulatory frameworks but are sometimes named differently. It also applies to specific types of measures that it was deemed necessary to cover for supervisory purposes. It does not however modify the provisions that apply as part of the existing accounting and regulatory frameworks regarding the interactions between forbearance and impairment or default.

The proposed definition of non-performing exposures encompasses the impairment and default definitions, while being broader since it covers trading book exposures as well. However, the definition of non-performing, even if it aims at harmonisation, does not modify or supersede the rules and practices governing the classification of assets as impaired in financial reporting or as defaulted in prudential returns.

As stated above, the proposed definitions for forbearance and non-performing exposures will not supersede the existing credit quality concepts they build on. Their purpose is only to provide supervisors with harmonised understanding of these concepts, and they will only be used in FINREP as support for reporting templates focused on asset quality and as a standard for harmonised asset quality assessment across the EU. In particular, the notion of non-performing exposures will not replace the definitions of impaired or defaulted assets, or be used as an input in the computation of risk-weights, and regulatory capital amounts.

These definitions may however prove useful in terms of transparency and harmonisation in banks' disclosures on the issues of forbearance and non-performing exposures, if they choose to disclose them along with some associated data. These concepts are indeed currently widely used in credit institutions' disclosures, albeit not always in a comparable way. To that extent, the EBA work may also be seen as a complement of ESMA's work on forbearance<sup>2</sup>. The EBA may consider future liaisons with ESMA on the issues of forbearance and non-performing.

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<sup>2</sup> ESMA 2012/853 Public Statement Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions <http://www.esma.europa.eu/system/files/2012-853.pdf>

*Illustration of the umbrella approach for the forbearance and non-performing definitions:*

Performing	Cured	Non-performing	
<p><b>Fully performing</b> Loans and debt securities that are not past-due and without risk of non-repayment and performing off-balance sheet items</p>	<p>On- and off-balance sheet exposures that exited the non-performing category, including forbore exposures</p> <p>Forborne loans and debt securities (banking and trading books) and off-balance sheet commitments can be performing or non-performing or cured</p> <p>Refinancing      Other forbearances</p>	<p><b>Generic criteria:</b> past due more than 90 days and / or unlikely to pay</p> <p>All other non-defaulted and non-impaired loans and debt securities (banking and trading books) and off-balance sheet exposures meeting the generic criteria</p> <p><b>Defaulted banking book (loans &amp; debt securities):</b></p> <ul style="list-style-type: none"> <li>Fair value option</li> <li><b>Impaired</b> Fair value through other comprehensive income</li> <li>Amortised cost</li> </ul> <p><b>off-balance sheet items:</b></p> <ul style="list-style-type: none"> <li>Loan commitments</li> <li>Financial guarantees (except derivatives)</li> <li>Other commitments</li> </ul>	
<p><b>Performing assets past due below 90 days</b> Loans and debt securities between 1-30 days past due Loans and debt securities between 31-60 days past due Loans and debt securities between 61-90 days past due</p>			<p><b>Forbearance</b> Modifications of terms and conditions</p>
<p><b>Performing assets that have been renegotiated</b> Loans and debt securities which renegotiation or refinancing did not qualify as forbearance</p>			

1) 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.

Templates contained in this draft implementing technical are additional to the FINREP framework as it stands in the ITS on Supervisory reporting. Accordingly, the provisions and underlying principles that will be included in the final draft ITS on supervisory reporting will apply to the templates on non-performing and forbore exposures, for instance regarding reporting frequency and proportionality.

Any draft ITS is produced in accordance with Article 15 of EBA regulation. According to Article 15(4) of EBA regulation, an ITS shall be adopted by means of regulations or decisions.

According to EU law, EU regulations are binding in their entirety and directly applicable in all Member States. This means that, on the date of their entry into force, they become part of the national law of the Member States and that their implementation into national law is not only unnecessary but also prohibited by EU law, except in so far as this is expressly required by them.

Shaping the supervisory reporting rules in the form of a Regulation will ensure a level-playing field by preventing diverging national requirements and will ease the cross-border provision of services. Currently, each time an institution wishes to take up operations in other Member States it potentially has to comply with different set of requirements regarding supervisory reporting in each of them.

The EBA has developed the present draft addendum to the ITS on Supervisory reporting based on the European Commission's legislative proposals for the CRR/CRD IV. It has also taken into account major changes subsequently proposed by the revised texts produced by the Council of the EU and the European Parliament, during the ordinary legislative procedure (co-decision process).

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## 4. Definitions and explanations

### Definition of forbearance

### Definition of non-performing exposures

### Explanatory material and additional questions related to the forbearance definition

Overview of the main elements of the forbearance definition

Purpose of the definition

General explanations for the forbearance definition

Modifications of terms and conditions of troubled debt

Troubled debt totally or partially refinanced by the institution

Scope of exposures for the forbearance definition

Relations between the definition of forbearance and the impairment and default concepts

Definitions of debtor and lender and approaches used for forbearance classification purposes

Criteria for the discontinuation of the classification as forborne exposure

Forborne exposures and the non-performing category

Inclusion of forborne exposures in the non-performing category

Forbearance and exit from the non-performing category

### Explanatory material and additional questions related to the non-performing exposures definition

Overview of the main elements of the non-performing definition

Scope of application of the non-performing definition

Harmonisation effects of the proposed definition

The generic non-performing criteria

Non-performing value and past-due amount

Collateral consideration

Scope of exposures for the non-performing definition

Relations between the definition of non-performing exposures and the impairment and default concepts

Definitions of debtor and lender and approaches used for non-performance classification purposes

Criteria for the discontinuation of the classification as non-performing exposures

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## 4.1 Definition of forbearance

For the purpose of table FBE, debts with forbearance measures are contracts the terms of which the debtor is considered unable to comply with due to its financial difficulties so that the institution decides either to modify the terms and conditions of the contract to enable the debtor to service the debt or to refinance, totally or partially, the contract. Refinancing refers to the use of contracts to ensure the total or partial payment of other contracts the current terms of which the debtor is unable to comply with.

“Debtor” encompasses all the natural and legal entities in a group within the accounting scope of consolidation.

“Debt” includes contracts under which an amount of funds is borrowed, or made available to be borrowed, from the institution. It includes loans, debt securities and loan commitments given.

Refinanced and refinancing debt shall include refinanced and refinancing debt under the contracts of the debtor with the parent undertaking and with any of its subsidiaries within the accounting scope of consolidation.

Notwithstanding the first paragraph of the definition, the following situations shall be treated as forbearance measures:

- a modified contract includes more favourable terms than those that the debtor could have obtained in the market;
- a modified contract was classified as non-performing or totally or partially past-due more than 30 days (without being non-performing) at least once during the three months prior to its modification;
- a modified contract would without its modifications be classified as non-performing or totally or partially past-due more than 30 days (without being non-performing);
- the modification made to a contract implies a total or partial cancellation by write-offs of the debt, or repayments made by taking possession of collateral.

Refinancing has taken place when, simultaneously with or close in time to the concession of additional debt by the institution, the debtor made payments of principal or interest on another contract that was non-performing or totally or partially 30 days past due.

A contract ceases to be forborne only when all the following conditions are met:

- the contract is considered as performing;
- the institution has concluded, after an analysis of the financial condition of the debtor, that it is considered able to meet its payments;
- the debtor has met regularly the latest payments due.

A debtor has met regularly its latest payments due when both of the following conditions are met:

- it has paid, on a regular basis and according to the post-forbearance conditions, more than an insignificant amount of principal or interest due under the contract, including when applicable an

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amount equal to the entire amount that was past-due before the forbearance measures were extended or that was written-off by the forbearance measures;

- a probation period has passed.

The probation period shall end at the later of the following dates:

- two years after the date of the formalisation of the most recent forbearance measures without the debtor having any debt contract classified as non-performing or totally or partially 30 days past due;
- one year after the date at which the first payment of principal is due in the debt contract with the most recent forbearance measures without the debtor having any debt contract classified as non-performing, or totally or partially 30 days past due.

#### 4.2 Definition of non-performing

For the purpose of Table NPE, non-performing exposures are those that satisfy at least one of the following criteria:

- material exposures are more than 90 days past-due;
- exposures present a risk of not being paid back in full without collateral realisation, regardless of the existence of any past-due amount or of the number of days past due.

This categorisation shall apply regardless of the classification of exposures as defaulted for regulatory purposes according to Article 174 of Regulation (EU) No xxxx/2013 [CRR] or as impaired for accounting purposes.

Exposures that are defaulted according to Article 174 of Regulation (EU) No xxxx/2013 [CRR] and exposures that have been found impaired according to the applicable accounting framework shall always be considered as non-performing exposures. Exposures with “incurred but not reported losses” shall always be considered as performing exposures.

Exposures shall be classified as non-performing without considering the existence of any collateral.

“Exposures” includes all debt instruments (loans and advances and debt securities), regardless of their classification for prudential or accounting purposes, as well as off-balance sheet exposures. “Exposures” comprises, among others, trading book positions and debt instruments held for trading. Off-balance sheet exposures comprise loan commitments given, financial guarantees given, and other commitments given.

“Past-due” means any amount of principal or interest that has not been paid at the date it was due.

A commitment shall be regarded as non-performing if, when withdrawn or otherwise used, it would lead to exposures that present a risk of not being paid back in full without realisation of collateral.

Financial guarantees given shall be regarded as non-performing in each of the following situations:

- when the counterparty is either past-due on the amount due under the guarantee contract or is considered unlikely to pay the amount in full;

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- when the underlying guaranteed exposure meet the criteria to be considered as non-performing,

Whether an exposure is non-performing shall be assessed following a “debtor approach” or a “transaction approach” according to the following criteria:

- for non-performing exposures that are defaulted or impaired the approaches used shall be those provided for in Regulation (EU) No xxxx/2013 [CRR] and used for the recognition of impairment, respectively
- For other non-performing exposures, including those held for trading exposures, the provisions of Regulation (EU) No xxxx/2013 [ CRR] for defaulted exposures shall be applied.

When a debtor has exposures past due more than 90 days representing 20% of all its exposures, or when the past-due amounts for this debtor represent 5% of its total exposures, all on- and off-balance sheet exposures to this debtor shall be considered as non-performing.

Exposures may be considered to have ceased being non-performing when, simultaneously, the situation of the debtor has improved to the extent that full repayment, according to the original or when applicable the modified conditions, is likely to be made and the debtor does not have any amount past-due. These generic exit criteria shall apply in addition to the criteria applied by reporting institutions for impaired and defaulted exposures.

Exposures exiting the non-performing category shall, upon exit from the non-performing category, be subject to special monitoring and separately reported for one year.

- 2) 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
- 3) How long will it take you to implement, and collect data on, the definitions of forbearance and non-performing?
- 4) What definitions of forbearance and non-performing are you currently using respectively for accounting and prudential purposes?

#### 4.3 Explanatory material and additional questions related to the forbearance definition

##### 4.3.1 Overview of the main elements of the definition

###### Purpose of the definition

The forbearance definition aims at achieving comprehensive coverage of forbearance transactions as well as harmonisation to the fullest possible extent of the notion of forbearance by:

- bringing under the common term “forbearance” all the different concepts that are used in various international or European frameworks or disclosures, which rather refer to “restructured”, “renegotiated” or “modified” loans, when the restructuration, renegotiation or modification has been triggered by financial difficulties of the debtor

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- broadening the notion of forbearance to have it encompass all transactions, even when they are not associated with impairment or default, and cover debt refinancing transactions
  - stating common principles to identify forbearance transactions and laying down exit criteria for the forbearance status, currently lacking in the different frameworks assessed.

General explanations for the forbearance definition

The EBA proposes to tie the notion of contract with forbearance measures (or forbore exposure) to the simultaneous presence of two elements: (i) the debtor is or will be considered as unable to meet the terms and conditions of the contract due to its financial difficulties ("troubled debt"), and (ii) the debtor's situation (financial difficulties) leads the credit institution (lender) to decide to make "concessions" (i.e. to refrain itself from enforcing the payment of its claim under its current conditions) that it would not otherwise consider.

The terms and conditions referred to in the forbearance definition can be the original ones, or modified ones, since forbore exposures can have forbearance measures extended multiple times (forbearance can be extended to an already forbore exposure).

These "concessions" comprise: i) modification of the previous terms and conditions of the troubled debt to allow for a sufficient debt service ability, and ii) granting financing to be used to repay, totally or partially, the troubled debt.

Neither the financial difficulties of the debtor nor the concessions automatically entail losses for the lender. The definition therefore covers all contracts to which forbearance measures are extended, including when it does not lead to the recognition of losses.

The identification of forbearance measures requires first considering whether the contract is troubled and then assessing whether the modifications or refinancing granted to the contract qualify as concessions, meaning whether they are solely justified by the financial difficulties of the debtor. In this case, the contract becomes a contract with forbearance measures.

The EBA proposes to always consider a contract as troubled when, before the modification, it was classified as non-performing or had been totally or partially past-due more than 30 days without being non-performing (being past-due less than 30 days is not a conclusive indicator of inability to pay) at least once during the last three months prior to the modification. However, a contract will also be considered as troubled even if it is not non-performing or totally or partially 30 days past due if modifications or refinancing are necessary for it to avoid the non-performing or 30 days past due status.

Additionally, the EBA believes several other indicators could be used to conclude that a contract is troubled. These indicators include, among others, the fact that the contract has suffered write-down(s) or total cancellation by write-offs, or the fact that the institution has taken possession of collateral to partially or totally repay the contract.



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The cornerstone of the proposed definition is the financial difficulties of the debtor or the debtor's future financial difficulties, not the number of days an exposure has been past due before being modified. The 30 days past due is not a threshold to be reached for the qualification of the contract as troubled and the modification or refinancing as forbearance. As long as the lender considers it is necessary to modify the terms or refinance a contract to deal with the financial difficulties of the debtor, it is granting concessions to a troubled contract and the transaction qualifies as forbearance, regardless of the numbers of days the exposure has been past-due.

The EBA acknowledges that in some situations, modification or refinancing measures can be extended not due to the institution's decision but to comply with legislative provisions. To the extent these legislative provisions aim at achieving modifications or refinancing of contracts for debtors experiencing financial difficulties, they lead the institution to grant concessions to the debtors. Therefore, contracts modified or refinanced in application of public schemes qualify as contracts with forbearance measures.

#### Modifications of terms and conditions of troubled debt

The EBA defines concessions as modifications of the previous terms and conditions of a troubled debt contract to allow for sufficient debt service ability. These amendments comprise, among others:

- a reduction in, or total cancellation of, the amount of past due and/or future payments of principal (e.g. via a partial write-off or by taking possession of collateral) and/or interest (e.g. by changing the applicable interest rate);
- a rescheduling of the dates of payment of principal and/or interest (e.g. by delaying the date on which principal and/or interest payments are due or by extending a "grace" period previously agreed);
- agreement to the release or the liquidation of collateral, or to any kind of partial settlement of the debtor's obligation through the use of non-monetary means or of means other than those agreed upon in the terms and conditions of the debt contract; and
- agreement to repackage different debts of a debtor into a new loan with more favourable conditions.

The above list is non-limitative and other situations may evidence modifications of the terms and conditions of troubled debt.

Only those modifications that qualify as concessions constitute extensions of forbearance measures: there is forbearance only when the lender would not have considered the modifications were the debtor not experiencing financial difficulties. Contract modification granted for other reasons than to alleviate the financial stress of the debtor are not forbearance but commercial renegotiation.

To simplify the distinction between forbearance and commercial renegotiation, the EBA proposes to apply the following safety nets:

- it is presumed that the contract has received "concessions" when the modified contract includes more favourable terms than those the debtor could have obtained in the market;

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- modifications of the terms and conditions always result in forbearance when they apply to a contract in the following situations since the contract is always considered as troubled:
    - the contract is classified as non-performing; or
    - they contract is or has been classified as more than 30 days past-due (without being non-performing) at least once during the last three months prior to the modification; or
    - modifications were necessary to avoid the contract becoming non-performing or 30 days-past due.

The EBA again nevertheless emphasises the non-performing or 30 days past-due statuses are safety nets and not prerequisite for contract modification to qualify as forbearance. Modifications can qualify as forbearance measures even when carried out before a contract reaches the non-performing or 30 days-past due status, if they are concessions that aim at dealing with financial difficulties of the debtor.

The EBA is aware that some loan or debt contracts may contain embedded forbearance clauses which, when enforced at the discretion of the debtor, enable the latter to change the term and conditions of its contract (for instance, switching from an instalment to a bullet loan) but without modifying the contract. As these clauses are very likely to be enforced in times of financial difficulties for the debtor, the EBA proposes that:

- to the extent this exercise has to be approved by the lender, this one should assess whether this exercise will result in a concession and is justified by financial difficulties of the debtor and, if so, the contracts will be covered by the proposed forbearance definition, as if its contractual provisions had been modified; and
- contracts have to be considered automatically as with forbearance measures when these clauses are enforced by debtors under non-performing or 30 days past-due statuses, or to avoid being qualified as non-performing or 30 days past-due, when lenders do not oppose this enforcement.

Troubled debt totally or partially refinanced by the institution

The EBA considers refinancing as forbearance measures when at the same time (i) the debtor is unable to meet the existing terms of its contract(s) ("troubled debt") and (ii) payments are fully or partially made on these contracts using refinancing granted by the institution (the refinancing qualifies as a concession). The contracts are therefore refinanced without their current terms and conditions being modified.

The EBA believes it is important to collect data on these refinancing transactions since they involve granting new loans or extending existing loans to debtors already under financial difficulties.

The EBA defines as refinancing debt those contracts used to ensure the payment of other contracts in which the debtor is unable to meet the existing terms and conditions (refinanced debt). Both the refinanced debt and the refinancing debt should be classified as forborne. Refinancing operations normally lead to derecognition of part or all of the refinanced debt in application of the relevant accounting standards.

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The EBA considers that refinancing qualifies as a concession and leads to classification as forbearance when, among others:

- simultaneously or close in time to the granting of additional debt by the institution, the debtor makes payments of principal or interest in another contract that is under non-performing status or has been more than 30 days past-due at least once during the last three months prior to the modification (the refinanced contract is considered as troubled), resulting in either principal or interest ceasing to be overdue;
- a contract is completely repaid with a new contract granted on or close to the day when the initial contract expires (so the initial contract is never past-due) – in this situation the refinancing is deemed necessary to prevent the refinanced contract from being past-due and therefore the refinanced contract qualifies as troubled.

However, refinancing does not qualify as forbearance when it can be demonstrated that the debtor's inability to comply with the terms and conditions does not come from financial difficulties. This provision does not apply when the refinanced contract is considered non-performing or has been more than 30 days past-due at least once during the three months prior to the refinancing. In these cases, the refinancing qualifies as forbearance.

- 5) 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?
- 6) Do you agree with the following elements of the forbearance definition:
- a. the criteria used to distinguish between forbearance and commercial renegotiation?
  - b. the criteria used to qualify refinancing as forbearance measures?
  - 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?
  - d. the proposed treatment for exposures with embedded forbearance clauses?
- In case you disagree with the EBA proposals on the above-mentioned issues, please explain and provide an alternative to them.

#### 4.3.2 Scope of exposures for the forbearance definition

The EBA considers forbearance can apply to all contracts representing amounts of funds borrowed or available to be borrowed by the counterparty:

- every loan and debt securities exposure, regardless of their valuation methodology or classification for regulatory or prudential purposes (even though, as forbearance evidences an on-going contractual relationship between the lender and the borrower, it is expected to be more frequently extended to banking than trading book exposures);
- loan commitments that have been withdrawn and have become loans and advances or debt securities;
- loan commitments given as part of the extension of forbearance measures (for instance a line of credit could be made available to pay a “troubled” debt instrument) – these commitments should be considered as refinancing debt even though they are undrawn; and
- loan commitments (for instance an existing line of credit) the terms of which have been modified and become more favourable for the beneficiary.

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The EBA believes forbearance cannot apply to financial guarantees given or to derivatives. Indeed, their notional amounts are not representative of amounts borrowed or available to be borrowed. Financial guarantees or derivatives the terms and conditions of which have been modified to alleviate the financial stress of the counterparty (for instance a reduction in the periodic fee to be paid or amount due at settlement/margin call dates) are therefore out of the scope of the forbearance definition, even though they should be monitored over time.

However, past-due payments on financial guarantees or derivatives give rise to the recognition of receivables, which may in turn be subject to forbearance measures. Similarly, in financial guarantee contracts where in exchange for compensating the beneficiary of the guarantee, the institution receives the exposure towards the debtor that has been guaranteed, the financial instrument that then replaces the financial guarantee can, as with any debt instrument, benefit from forbearance measures.

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

#### 4.3.3 Relations between the definition of forbearance and the impairment and default concepts

Contracts with forbearance measures could be either impaired or not impaired although, as it was recently stated by ESMA<sup>3</sup>, forbearance will normally result in the recognition of impairment on forborne assets. Indeed, forbearance is a trigger for impairment according to IAS 39.59(c), and the lender should consequently always assess whether this triggering event gives rise to impairment.

However, the EBA acknowledges there may be forbearance measures that do not result in an impairment loss for the lender, when the forbearance measures do not lead to a decrease in the net present value of the exposure. Such situations can occur for instance as indicated in Implementation Example 4.3 of IAS 39, or because the lender only extends a grace period and resets the amounts due without any cancellation/reduction, or because the extension in maturity of a loan is matched by a corresponding rise in interest rates. Regarding default classification, only forbearance measures that result in a diminished financial obligation for the lender (compared to its pre-forbearance obligation) should be considered as defaulted, which means some forborne exposures might not be classified as defaulted.

Nevertheless, as forbearance proceeds from financial difficulties of the debtor, the EBA expects most forbearance transactions to lead to impairment or default, and institutions should be cautious in classifying a forborne exposure as performing. As ESMA noted in its statement<sup>4</sup>, impairment testing has to be based on the expected rather than contractual cash-flows, to take into account the uncertainty surrounding future compliance of the debtor with the modified conditions or the refinanced/refinancing exposures. Moreover, non-impaired forborne exposures could be considered as defaulted, since the concept of loss used in the default definition is broader than the sole impairment losses and covers situations where incurred losses on forbearance are not booked as impairment losses (for instance, when the forbearance accounting policies of an institution lead to the

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<sup>3</sup> ESMA 2012/853 Public Statement Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions <http://www.esma.europa.eu/system/files/2012-853.pdf>

<sup>4</sup> ESMA 2012/853 Public Statement Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions <http://www.esma.europa.eu/system/files/2012-853.pdf>

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derecognition of the exposures followed by recognition of new exposures under the modified terms, resulting in a fair-value loss instead of an impairment loss).

While forbearance is expected to lead to impairment or default, but does not always, impairment or default always prevents the discontinuation of the forbearance classification for an exposure.

Some jurisdictions or institutions enforce a “pulling effect” and recognise as impaired or defaulted all on- and off-balance sheet exposures to a given debtor whenever its impaired or defaulted exposures reach a certain level. To the extent that forbearance leads to the recognition of impairment or default, a “pulling effect” may be triggered. However, the simple extension of forbearance measures (without recognition of impairment or default) may not lead to the classification of all exposures to a debtor as impaired or defaulted, and there is no triggering effect for the classification as forborne exposure (see below section 4.3.4).

- 8) Do you agree not all forbearance transactions should be considered as defaulted or impaired?
- 9) What types of forbearance transactions are likely, according to you, not to lead to the recognition of default or impairment?

#### 4.3.4 Definitions of debtor and lender and approaches used for forbearance classification purposes

The EBA proposes that:

- “debtor” refers to all the entities in the group within the accounting scope of consolidation (parent plus all subsidiaries); and
- “lender” encompasses all the entities in the group within the accounting scope of consolidation.

The reason to adopt this definition of debtor and an accounting scope of consolidation, as opposed to a CRR scope of consolidation in other FINREP templates, is to ensure proper monitoring of credit risk at a group level. Indeed, monitoring of debtors on an individual basis or of lenders under the regulatory scope of consolidation could fail to reflect the level of credit risk at a group level, especially considering refinancing forbearance measures.

The EBA considers the level of refinanced and refinancing debt could indeed be underestimated if:

- the exposures to a debtor were seen as exposures towards a natural or legal person and not to a group of connected natural or legal persons (parent and the subsidiaries under an accounting scope of consolidation): a debtor would be able to obtain financing from the lender and to use this financing to refinance troubled debt of another entity towards the same lender, without the lender reporting the transaction as forbearance; and
- the lender were defined according to the regulatory scope of consolidation: for instance one insurance undertaking of a bank’s group (the banks being the lender) could buy bonds issued by the debtor to repay a troubled loan granted by the bank with the purpose of avoiding increases in the amounts reported as forbearance.

The definition of lender can be used for reporting on a consolidated basis or on an individual basis. The scope of reporting delimits the population of contracts to be included: when reporting on an individual basis, only debt instruments and loan commitments given by the institution to which

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forbearance measures have been extended will have to be reported. For instance, in the case of refinancing of a troubled debt by a subsidiary of the lender, the lender will only report on an individual basis the refinanced debt, and not the refinancing debt, as it is not reported in its balance sheet on an individual basis.

Regarding the classification of exposures as forborne, the nature of forbearance transactions has led to the choice of a mixture between a debtor approach (classification of all contracts with a debtor as forborne as soon as one contract has forbearance measures), and a transaction approach (classification on a contract by contract basis).

A debtor approach has to be used when evaluating the situation of the debtor (identification of troubled debt) since it is necessary for a lender to adopt a consolidated view of its exposure to a debtor (the parents and all other entities within the same group). Nevertheless, only the specific exposures to an individual debtor to which forbearance measures have been extended should be classified and reported as forborne. As an example, when a credit institution renegotiates the debt from a parent but not the debt from its subsidiary, it should only report the debt of the parent as forborne. It is however possible that the forbearance agreement encompasses all the contracts between a lender and a debtor (on a group basis). In that case, all contracts to the debtor will be classified as forborne.

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)?

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

#### 4.3.5 Criteria for the discontinuation of the classification as forborne exposure

At the time at which decisions on forbearance measures are taken, the lender expects they will enable the debtor to overcome its financial difficulties. After the passage of time, institutions should monitor whether their judgment was correct. Discontinuation shows forbearance was successful and justified (meaning driven by consideration for and truly adapted to the financial situation of the debtor).

Discontinuation of the forbearance classification is only allowed if the exposure is considered as performing. In this case, the discontinuation requires both that:

- the lender has made an analysis of the financial condition of the debtor to ensure it will be repaid (it becomes clear that the debtor can and will comply with the contract), and this analysis has been approved by a resolution by the management of the lender; and
- the debtor has met payments regularly, which means (i) it has paid more than an insignificant amount of principal or interest of the contract, including when applicable an amount equal to all amounts past-due before the forbearance measures were extended or all amounts that were written-off by forbearance measures, and (ii) a probation period has passed.

The requirement for the debtor to pay more than an insignificant amount of principal or interest is aimed at preventing a contract from exiting the forbearance category when the debtor has only paid a very small amount and let time pass.

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The probation period shall end at the latest of the following dates:

- two years since the date of the formalisation of the latest forbearance measures granted by the lender without the debtor seeking for refinancing or modifications of the contract as he is unable to meet previous terms, or having any exposure classified as non-performing or totally or partially past due more than 30 days; and
- one year since the date in which the first payment of principal is due in the debt contract with the latest forbearance measures without the debtor having any exposure classified as non-performing or totally or partially past due more than 30 days.

For instance, a modified loan under which the first repayment of principal is due six months after the date of modification would terminate its probation period two years after the modification, provided that the debtor met all payments when due. A modified loan under which the first repayment of principal is due two years after the modification would be released from probation one year after this payment, provided that the debtor met all other payments when due. The modified loan will therefore remain classified as forborne for three years.

If the debtor exceeds 30 days past-due on any of its exposures with the lender, or if any of its exposures is considered as non-performing, the probation period shall restart for the entire probation period time at the date the amount-past-due is repaid or the exposures cease to be considered as non-performing.

- 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?

#### 4.3.6 Forborne exposures and the non-performing category

Inclusion of forborne exposures in the non-performing category

The mappings revealed that forborne exposures (exposures resulting from forbearance measures as defined in this Consultation Paper) may, in some jurisdictions or according to some accounting or regulatory frameworks, be included in the non-performing category, at least to the extent forborne exposures are considered as impaired or defaulted. However, existing provisions of the different frameworks may lead to uncertainty regarding classification of forborne exposures as defaulted or impaired, due either to their lack of clarity and/or different practices by institutions. The EBA therefore chose to clarify how forborne exposures should be treated.

Not all forbearance transactions may result in the classification of resulting forborne exposures as defaulted or impaired, even though the EBA considers forborne exposures bear more risk than non-forborne exposures. The EBA therefore proposes that forbearance does not automatically lead to the consideration of the forborne exposure as non-performing. A forborne exposure will be considered as non-performing only to the extent it meets the non-performing criteria (the exposure is impaired, defaulted, or meet the other generic non-performing criteria – see below section 4.4.1), without considering collateral. Other forborne exposures will be considered as performing.

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However, because forbearance stems from financial difficulties of the debtor, and because these difficulties often mean the full repayment of an obligation is at risk, the EBA, as detailed in section 4.3.3 above, expects most forbore exposures to be considered as non-performing, even though they are not considered as impaired or defaulted.

As an alternative, the EBA acknowledges all forbore exposures could be automatically classified as non-performing, due their heightened credit risk compared to other exposures, and the fact that many of them would be classified as non-performing if they had not been forbore. However, the EBA proposes not to retain this option for the following reasons:

- a. It cannot be automatically assumed that forbore exposures are non-performing at the date of forbearance or will have been non-performing without forbearance measures
- b. Flexibility in classification is needed to reclassify as performing in subsequent reporting periods those exposures for which forbearance measures have succeeded in alleviating the financial distress of a debtor by providing him with temporary relief (on the contrary, exposures with forbearance measures that have turned out to be unsustainable over time should stay in the non-performing category or be included in if they were previously recognised as performing exposures)
- c. It would lead to a significant widening of the non-performing category due to the different entry criteria applied for exposures with and without forbearance measures.

The EBA believes the comprehensive reporting of forbearance transactions with separate identification of performing and non-performing forbore exposures suffices for supervisors to monitor the heightened risk presented by forbore exposures.

Forbearance and exit from the non-performing category

Forbearance is commonly seen as a way for institutions to deal with their non-performing exposures. Therefore, the EBA considered the impact of forbearance measures extended to exposures that are already non-performing, and more generally the most meaningful exit criteria from the non-performing category for non-performing exposures with forbearance measures. Exit criteria should be sound enough to prevent any misuse of forbearance while being flexible enough not to deter the use of forbearance as a credit management tool.

The EBA sees three types of non-performing exposures with forbearance measures:

- exposures to which forbearance measures are extended while they are already non-performing;
- exposures that have been non-performing due to forbearance measures (cases where the forbearance transaction has led to the recognition of default or impairment); and
- forbearance transactions that turned out to be unsustainable over time and that have been reclassified from performing to non-performing.

The EBA considers that any non-performing exposure presenting forbearance measures should exit the non-performing category only when it meets the exit criteria that also apply to non-performing exposures without forbearance measures (see section 4.4.5 for more details). This means non-performing exposures with forbearance measures will cease to be considered as non-performing when they cease to be considered as impaired, defaulted or otherwise non-performing. The EBA



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wishes to have consistency between the criteria used for including forbore exposures into the non-performing category, and the criteria used to exclude them from this category.

In this case of forbearance measures extended to already non-performing exposures, the EBA believes it is likely to lead to the recognition of additional impairment, default, or uncertainty regarding repayment, resulting in the exposure continuing to be recognised as non-performing.

Application of the generic exit criteria to already non-performing exposures to which forbearance measures are extended could allow exposures to exit the non-performing category as soon as these measures are extended to them, provided (i) they do not lead to the recognition of impairment or default and (ii) there is not, following forbearance, any amount past due or concerns regarding the full repayment of the exposure according to the post-forbearance conditions. This is why the EBA stresses that concerns about the solvency of the debtor should only be regarded as lifted, and reclassification of the exposures as performing allowed, when the debtor has:

- i) paid an amount equal to the amounts that were past-due before the extension of forbearance (in case forbearance measures were extended to an exposure with past-due amounts);
- ii) paid an amount equal to all amounts that have been written-off by the forbearance measures (where the exposure did not have past-due amount prior to forbearance)
- iii) otherwise demonstrated its ability to comply with the terms of the refinanced and the refinancing loan in cases other than i) and ii).

There is asymmetry in the relationship between the classification of non-performing and the classification as forbearance: forbearance does not automatically lead to the classification as non-performing (either at the time forbearance measures are extended or subsequently, i.e. a forbore exposure can leave the non-performing category and be recognised as performing); but the non-performing status (impaired, defaulted or otherwise non-performing) prevents an exposure from exiting the forbore status. This is because repayment ability has to be demonstrated to exit forbearance and non-performing status proves this repayment ability does not exist.

- 13) Do you agree with the proposed approach regarding the inclusion of forbore 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 forbore exposures? Would you prefer to have the stricter approach (all forbore exposures identified as non-performing) implemented instead?
  - b. do you agree with the proposed consequences of forbearance measures extended to an already non-performing exposure? Especially, are the proposed exit criteria strict enough to prevent any misuse of forbearance measures or would stricter criteria be needed?

## 4.4 Explanatory material and additional questions related to the non-performing exposures definition

### 4.4.1 Overview of the main elements of the non-performing definition

#### Scope of application of the non-performing definition

The definition of non-performing that is proposed by the EBA aims at drawing a clear line between what has to be considered as “performing” and what has to be considered as “non-performing” exposures following an asset quality approach focused on the creditworthiness of the counterparty.

Therefore, the proposed definition supplements the concepts of impairment and default with **generic non-performing entry criteria** (90-days past-due or unlikely full repayment of the obligation) to identify as non-performing all exposures with deteriorated creditworthiness regardless of:

- the prudential portfolio (banking or trading book) or the accounting portfolio (held for trading, fair-value option, held to maturity, loans and receivables, or available for sale) where the exposures are classified, and the associated measurement criteria (fair value or amortized cost); and
- the position in the financial statements (on or off-balance sheet items).

A simple combination of default and impairment would not have achieved such comprehensive coverage, as illustrated in the table below. It would have dealt with the issue of collateral and recognition of impairment, but would have failed to cover trading book exposures.

Financial assets	EBA NPE definition	Default definition under CRR	Impaired definition ex IAS 39
Trading Book	√		
Banking Book	√	√	√ (except Fair Value Option)
On balance sheet items	√	√	√
Off-balance sheet items	√	√	
FVTPL	√	(only Fair Value Option)	
Amortized Cost	√	√	√
FTOCI	√	√	√

#### Harmonisation effects of the proposed definition

The EBA also considered that to ensure the line between the performing and the non-performing categories was drawn in the best consistent way possible across the EU, it was necessary to provide a higher level of harmonisation than it results from the existing concepts of impaired and defaulted, as defined in applicable accounting standards and the CRR and used in every European jurisdiction. Indeed, the definitions of impaired and defaulted are often applied differently in the different institutions and jurisdictions, mostly due to the existence of national options, leeway left in standards, and the reliance on judgement.

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To provide this higher level of harmonisation, the EBA believes the non-performing definition has to contain specific provisions harmonising some of the aspects of the default and impairment definitions that lead to inconsistent implementation and may affect the consistency of reported figures for non-performing exposures.

The harmonisation elements brought by the proposed definition of non-performing exposures are the following:

- Unique past-due threshold (generic entry criterion): a unique 90 day past-due threshold is applied to all types of exposures whereas, in the current European Parliament version of the CRR default definition, different past-due thresholds are allowed to be used for the recognition of default for different types of exposures; the unique past-due threshold for all types of exposures will enable harmonised identification of non-performing exposures, notwithstanding the approach used for default calculation;
- "Pulling effect" (see section 4.4.4): the EBA definition contains a threshold above which all exposures to a debtor have to be considered as non-performing; currently, in the absence of clear elements in the CRR and IFRS, there could be differences between institutions in amounts of reported non-performing exposures in the banking book which, everything else being equal, would only be justified because the different approaches followed to identify exposures as defaulted or impaired vary;
- Objective exit criteria for every type of exposures (generic exit criteria - see section 4.4.5): the EBA definition provides for common exit criteria that apply to all exposures identified as non-performing; currently, the lack of specification of the current impairment or default exit criteria may also lead to differences in reported figures between institutions that would, everything else being equal, only be grounded in differences in discontinuation criteria used for impaired or defaulted assets.

These harmonisation elements may lead to qualify as non-performing a non-defaulted and non-impaired exposure in the banking book. This will occur for instance when the non-performing "pulling effect" has applied, or when the exit criteria for the impaired and defaulted categories are met but not those of the non-performing category. This may also occur, depending on the final version of the default definition in the CRR, for those exposures that are 90 days past-due without being defaulted.

The harmonised option will therefore tackle some, albeit not all, of the possible drivers for data inconsistency in reported figures for defaulted and impaired exposures. It would then reduce the differences in reported figures between institutions that come solely from differences in the implementation of the impairment and default definitions. However, the EBA acknowledges it is likely to lead to a higher impact on credit institutions, as institutions may have to adapt their systems to capture and monitor those non-performing exposures that are neither impaired nor defaulted, for the sole purpose of reporting on non-performing exposures. This may in the short term, when system(s) are still in a run-up phase, negatively impact the quality of reported data.

As an alternative the EBA envisaged a simplified option which would have identified as non-performing only the exposures classified as impaired or defaulted, with the generic entry and exit criteria only applied to trading book and forborne exposures. Although easier to implement for institutions, this approach would have resulted in less consistent and harmonised figures at the European level due to differences in the implementation of these definitions, and no enhancement of data available for supervisors.

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The EBA acknowledges that some of these differences (for instance the higher number of days past-due to recognise default for some exposure classes) may proceed from economic rationales as well as market practices and that consequently the harmonised definition may in some cases lead to exposures being considered as non-performing only because they meet the non-performing criteria. However, the EBA considers it is sufficient that these exposures not be identified as defaulted or impaired, and that the granular breakdown of non-performing exposures by exposure classes will enable assessment of the amount of non-performing exposures that come solely from the application of the harmonisation elements.

The generic non-performing criteria

The generic non-performing criteria are similar to the main default criteria (90 days past-due and/or risk of non-full repayment). The EBA chose these criteria to ease the implementation costs of its definition. Indeed, the mapping among jurisdictions revealed that those countries without a non-performing definition used the default or impairment definitions instead, and those countries with a non-performing definition almost always resorted to a 90 days past-due threshold accompanied by a catch-all criterion to cover other cases of non-performance even without any day past-due.

Non-performing value and past-due amount

As accounting and regulatory frameworks may be unspecific, the EBA clarifies that:

- the exposure value to be classified as non-performing should be the gross outstanding amount of an exposure (before provisions), as opposed to only the past-due amount or the amount in risk (uncollateralised part of the exposure);
- the more than 90 days past-due amount should be any amount of principal or interest, meaning that loans for which only the interest or principal amount is past due can be considered as non-performing ; where a debtor has been constantly past-due on its payments for one or more credit obligation over a 90 days period, but without any single past-due amount reaching 90 days (for instance because late payments done within the 90 day periods are allocated following a first-in-first-out methodology to the oldest past-due amount), the obligation should still be considered as non-performing, on the basis of the likelihood of paying criterion.

Collateral consideration

Practices vary regarding the consideration of collateral and the EBA acknowledges that each approach has its pros and cons. On the one hand, collateral reflects the net credit exposure to counterparty and not taking collateral into consideration could lead to an overstatement of non-performing exposures, identifying exposures for which there are not really losses or risk of losses for the institution. On the other hand, counting collateral may lead to late identification of non-performing exposures, on the basis of expected flows from collateral while collateral valuation and time of repossession bear uncertainty.

The EBA has chosen a credit risk approach in its identification of non-performing exposures, and including collateral would be equivalent to adopting a loss approach: considering an exposure as non-performing only to the extent it may lead or has led to a loss for the lender. Moreover, using the default definition as a building block for the non-performing definition means that in practice collateral is not used in the assessment of non-performing exposures in the banking book. It was therefore decided to

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follow the same approach for trading book exposures and for other non-performing exposures that are not considered as impaired or defaulted. Consequently, non-performing status will be granted without consideration of collateral, which takes a prudent vision of credit risk.

Nevertheless information on collateral is seen as useful for supervisory purposes to allow supervisors to compute coverage ratios. It is proposed to follow the same valuation and reporting methodology as in other FINREP templates, meaning reporting collateral based on the fair value capped at the carrying amount of the collateralised exposure.

Alternative valuation methodologies for reporting purposes were considered, such as reporting of collateral at fair value less haircut, or the reporting of the lower of the carrying amount of the collateralised exposure or the fair value. The current FINREP methodology has however been retained for consistency with the other templates where information on collateral and/or collateralised exposures can be found.

- 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?
  - b. the proposed guidance for past-due amounts?
  - c. the proposed treatment of collateral and especially the proposed valuation methodology for its reporting?
- In case you disagree with the EBA proposals on the above-mentioned issues, please explain and provide an alternative to them.

#### 4.4.2 Scope of exposures for the non-performing definition

In line with a wish to take a broad approach to asset quality, the non-performing definition encompasses **all loans and debt securities exposures in the banking and in the trading book**, regardless of their valuation methodology.

The EBA considers the inclusion of trading book exposures is needed to capture every loan and debt security presenting heightened credit risk while trading exposures, including loans and debt securities, may represent a significant part of some banks' financial assets.

Nevertheless this represents a difference in the EBA definition compared with other existing definitions in European jurisdictions, as well as practices in credit institutions' disclosures. Indeed, in both cases, non-performing exposures refer to exposures held to maturity, at amortised cost and, where applicable, exposures at fair-value through OCI. To keep consistency with existing definitions and practices while ensuring more comprehensive coverage, the EBA therefore proposes to report non-performing exposures at fair value separately, with separate identification of held for trading exposures.

The EBA believes the non-performance generic criteria (90 days past due and/or likelihood of non-full repayment) can apply to trading book since trading and fair-valued exposures can be past-due or present unlikelihood to be repaid independently from their valuation methodology, and moreover these criteria already apply to exposures under the fair-value option, for which the definition of default

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applies. The EBA proposes not to treat a significant decline in the fair-value of an exposure as a presumption of non-performing status due to the uncertainty and consequent need for extensive guidance this presumption would generate.

The scope of the non-performing definition has been limited, for on-balance-sheet items, to loans and debt securities and excludes both hedging and trading derivatives, even though institutions should monitor and provide adequate disclosures on the risk of non-performance for their derivatives exposures. The EBA indeed considers derivatives exposures do not correspond to amounts due, unlike debt or loan securities. Moreover, the inclusion of derivatives would be very likely to have made the development of specific non-performing criteria necessary, since the approach used for debt and loan securities cannot be replicated for those exposures (for instance, the 90 days past-due threshold is too high for payment due on derivatives). However, whenever a payment due on derivatives is missed and becomes past-due, the exposure exits the derivatives category and becomes a receivable, which can be classified as non-performing at least on the basis of the second criterion (likelihood of non-payment) of the default definition or the generic non-performing criteria.

The EBA has decided to bring within the scope all the following off-balance sheet commitments: loan commitments given, financial guarantees given, and other commitments given. Such a decision is consistent with the comprehensive approach the EBA has adopted for the non-performing definition.

- 15) Do you agree with the coverage of the proposed definition and with the application of the generic non-performing criteria to all fair-valued non-performing exposures? Do you expect challenges when implementing them and collecting data on fair-valued non-performing exposures? Would you suggest other criteria instead?
  
- 16) Do you agree with the proposed treatment for derivatives exposures? If not, what criteria would you suggest to enable identification of non-performing derivatives?
  
- 17) Do you agree with the proposed criteria to identify off-balance sheet exposures as non-performing?

#### 4.4.3 Relations between the definition of non-performing exposures and the impairment and default concepts

Impairment and default are encompassed in the non-performing definitions, and impaired or defaulted loans and debt securities according to the applicable accounting standards or the CRR will directly qualify as non-performing exposures.

Under IFRS a financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated (IAS 39.59).

According to IFRS it would also be appropriate to recognise impairment losses for "incurred but not reported" losses (IAS39.64 and AG90). An entity should recognise such an incurred impairment loss

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that is supported by objective evidence, which might not have been reported before the entity's reporting date. In this case an entity should recognise an impairment loss for a group of financial assets although the entity is not yet aware of which specific assets are impaired.

The EBA believes that group of assets which are impaired because they are subject to "incurred but not reported losses" (IBNR) are not to be included as non-performing exposures, unless these assets comply with either the default or the generic criteria to identify non-performing exposures. The exclusion of exposures with IBNR from the scope of non-performing exposures is intended for asset quality assessment purposes only; it is not intended to impact the treatment of IBNR for other purposes.

As the impairment model will change in the future and move from an incurred losses model to an expected losses model, the definition of non-performing and its relations with the impaired exposures category might consequently be adapted.

The proposed Article 174 paragraph 1a, point d of CRR establishes that competent authorities will define a threshold in order to assess the materiality of a credit obligation whenever the obligor is past due more than 90 days. This materiality threshold results in no recognition of default in cases where an exposure is past-due more than 90 days when the exposure amount to an obligor is not higher than the threshold.

Current practices regarding these thresholds may vary but Article 174(5) of the CRR establishes that EBA shall develop draft regulatory technical standards to specify the conditions according to which a competent authority shall set the referred threshold. The EBA shall submit those draft regulatory technical standards to the Commission by 31 December 2014.

The EBA therefore proposes not to define for now a specific threshold for the non-performing definition, and to implement in the future in the non-performing definition the materiality threshold that will be established in the 2014 RTS. Meanwhile, as reporting institutions may, or may not, need to define a minimum reporting amount by debtor depending on the IT robustness processes, the EBA proposes institutions can apply the current materiality threshold used for the default definition to the non-performing past-due generic criterion.

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

19) Do you agree with the proposed approach regarding the materiality threshold?

#### 4.4.4 Definitions of debtor and lender and approaches used for non-performance classification purposes

The EBA proposes that:

- c. "debtor" refers to an obligor as used in the CRR; and
- d. "lender" encompasses all the entities in the group with the accounting scope of consolidation.

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The EBA chose to align on the CRR notion of "obligor" to identify the debtor both to keep consistency between the definition of default and the non-performing definition, i.e. an individual natural or legal entity, and to achieve more granular identification of non-performing exposures reporting as such only those whose creditworthiness is at risk. Nevertheless, in case of group of entities, the EBA believes that whenever an individual debtor is considered as non-performing, a lender should monitor whether a contagion effect can apply to other debtor in the same group and consequently, whether these debtors have to be identified as non-performing.

As for the lender, the reason to adopt an accounting scope of consolidation, as opposed to a CRR scope of consolidation in FINREP templates, is to ensure a proper monitoring of credit risk at a group level and to be consistent with the scope retained for the definition of forbearance.

As regards the use of a debtor or a transaction approach for classification of exposures as non-performing, the EBA is of the view that each approach has its pros and cons. A transaction approach (identification of non-performing exposures on an exposure by exposure basis) enables the characteristics of an exposure to be taken into account in the credit quality assessment, but may lead to a low level of non-performing exposures being reported and possibly to late identification of these exposures. The debtor approach (all exposures toward the same debtor are considered as forborne or non-performing whenever one exposures enters into these categories) seems more consistent with a credit risk approach (a debtor past-due on one of its exposures may very likely face difficulties regarding its other exposures) but could inflate the amount of reported non-performing exposures.

However, the EBA has chosen an umbrella approach, with as its basis the principle that the implementation of the default and impairment definitions that are the building blocks of the non-performing notion should not be modified.

It is proposed that the following provisions will therefore apply:

- for impaired or defaulted exposures, institutions will apply the approaches they otherwise use for the recognition of default and impairment:
  - for impairment, as recommended by ESMA in its public statement<sup>5</sup>, a debtor approach should be used for assessing the existence of objective evidence of impairment, and then a transaction approach to calculate the amount of impaired exposures;
  - for default, a debtor approach will be used for non-retail exposures and institutions will have an option to resort to a transaction approach for retail exposures.
- for other exposures that are not defaulted or impaired (trading book exposures and other banking book exposures) the approach used for defaulted exposures in the CRR will be applied.

Practices as regards the approach used for the recognition of impairment vary, with some jurisdictions or institutions enforcing a "pulling effect", with all the exposures to a debtor being recognised as impaired whenever the debtor presents a certain amount of impaired exposures. As for the default definition, the option to use a transaction approach for retail exposures enables the differences

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<sup>5</sup> ESMA 2012/853 Public Statement Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions <http://www.esma.europa.eu/system/files/2012-853.pdf>



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between borrowers to be taken into consideration: individuals might be expected to behave differently across their different loans (contagion may be possible in case of a defaulted mortgage but the opposite need not be true and a defaulted credit card might not imply a defaulted mortgage); firms on the contrary (including public sector and financials) are expected to behave equally (or at least not so differently). However, it results in divergences in the implementation of the default definition and the amount of reported figures.

The EBA therefore proposes to introduce a threshold above which a “pulling effect” would come into force (i.e. recognition of all exposures to a debtor as non-performing) for all banking and trading book exposures. This threshold will consist of a ratio that can be built in two ways:

- with a numerator consisting of the gross carrying amount of the whole on-balance sheet 90 days past-due exposures (retail or non-retail) to a debtor, and as a denominator the gross carrying amount of the whole on-balance sheet exposures to this debtor; or
- with a numerator consisting of the past-due portion of retail and non-retail on-balance sheet exposures (both below and over 90-days) related to each transaction and as a denominator the whole on-balance sheet exposures to this debtor.

When this ratio surpasses 20% under the first method or 5% under the second method, a debtor approach will be applied to retail exposures for the purpose of the reporting regardless of the approach used for the recognition of default or impairment, leading to all on- and off-balance sheet exposures to a same debtor being considered as non-performing.

Should the credit institution not apply a pulling effect for its default or impairment definitions, the proposed effect would result in the identification of non-performing exposures, for the purpose of supervisory reporting only, which would not be recognised as impaired or defaulted in the financial statements or prudential returns of the debtor.

- 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?
- 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 favor and why?

#### 4.4.5 Criteria for the discontinuation of the classification as non-performing exposures

The different mappings revealed the discontinuation criteria tended to vary across frameworks and jurisdictions, with some of them keeping the classification as non-performing until derecognition, and some others discontinuing it once payments have resumed and arrears balances have been settled, sometimes after a period of time following resumption of payments.

The exit criteria are therefore a tool for harmonisation of the non-performing definition. As the non-performing definition builds on the impaired and defaulted categories, the EBA therefore proposes that, on the top of meeting the impairment and default applicable exit criteria, all banking and trading

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book exposures will only be able to exit the non-performing category when they meet generic exit criteria.

As generic exit criteria the EBA proposes exposures should only be allowed to exit the non-performing when there is sufficient evidence of recovery, meaning the two following criteria are simultaneously met: (i) any concern related to its full repayment according to its original or when applicable modified conditions has been lifted and (ii) the exposure does not have any payment past-due, including any amount past-due for less than 90 days.

As the generic exit criteria are more specific than what currently exists in the accounting and regulatory frameworks without superseding these existing exit provisions, they will not diminish the leeway currently left to institutions to remove exposures from the defaulted categories. They will however lead to exposures being kept under the non-performing status for the purpose of reporting because they do not meet the exit criteria, even though they are not considered as impaired or defaulted any more.

Upon exit from the non-performing category, including due to the extension of forbearance measures, all former non-performing exposures should be included in a specific category, given their higher risk of experiencing non-performance again compared to other performing exposures. They should stay in this specific category for a period of one year. The EBA believes there could be a specific time requirement to remain in the cure category for exposures removed from the non-performing category after forbearance measures but has not decided to set such a specific requirement yet.

22) Do you agree with the exit criteria from the non-performing category?

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?

24) Would you favor specific exit or specific separate monitoring criteria for non-performing exposures to which forbearance measures are extended?

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## 5. Draft Implementing Technical Standard (*addendum*)

### **COMMISSION IMPLEMENTING REGULATION (EU) No .../... laying down implementing technical standards with regard to supervisory reporting of institutions according to [Regulation (..) No xx/xxxx] of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms**

Explanatory text for consultation purposes

All ITS related to reporting requirements (Articles 95, 96 and 383 of CRR) are intended to be put forward as one integrated ITS. The recital focused on forbearance and non-performing exposures is an addendum to the ITS on Supervisory reporting and needs to be read in conjunction with this ITS published for consultation on EBA's website on 20 December 2011 and its subsequent March 2013 update.

This addendum to the ITS contains definitions and reporting templates on forbearance and non-performing exposures that will be part of the financial reporting framework (hereinafter FINREP). All the provisions of this ITS on supervisory reporting applying to FINREP will consequently apply to the reporting templates on forbearance and non-performing exposures. However, no decision has been made yet regarding the entry into force of these templates.

To assist in reading the main new material for the purpose of consultation, the definitions of non-performing exposures and forbearance, accompanied by their respective reporting templates and associated instructions, are presented together in Annex I and Annex II of this Consultation Paper.

Definitions are nevertheless recalled in Part 5 of this Consultation Paper, accompanied by explanations regarding their main elements.

#### **The following Recital is inserted:**

- (11) In order for the EBA and competent authorities to obtain a comprehensive view of the risk profile of institutions' activities as well as for the ESRB to perform its macro-prudential oversight tasks, institutions should be required to report information on forbearance activities and non-performing exposures. Although forbearance activities and non-performing exposures are covered by the existing requirements, both in Regulation (EC) No 1606/2002 and in Directive 86/635/EEC, to disclose information on loans and debt securities exposures and their credit quality, there are neither comprehensive, harmonised definitions of these notions nor specific and detailed disclosure requirements. The technical standards should therefore provide specific definitions and reporting templates.

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## 6. Accompanying documents

### 6.1 Draft Impact Assessment

#### 6.1.1 Introduction

As per Article 15(1) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any draft implementing technical standards developed by the EBA – when submitted to the EU Commission for adoption – shall be accompanied by an impact assessment (IA) annex which analyses 'the potential related costs and benefits'. Such annex shall provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

This section outlines the impact assessment (IA) on the methodology proposed for defining forbearance and non-performing exposures and on the reporting templates proposed by the EBA to report forbearance and non-performing exposures in FINREP.

#### 6.1.2 Problem definition

Due to the recessionary economic environment, asset quality has been a concern lately throughout Europe regarding the two following issues:

- ▶ the potential misuse of forbearance to avoid the recognition of some losses;
- ▶ the lack of a harmonised definition for forbearance and non-performing exposures, which prevents meaningful comparisons of asset quality between institutions established in different European member states.

The lack of harmonised definition also prevents harmonised data collection by supervisory authorities on asset quality. This in turn may impair coordination between authorities that may be necessary to conduct an EU-wide assessment of asset quality and if needed solve asset quality issues in an orderly fashion.

This issue also creates uncertainty for the markets: there is no standard to compare the soundness of banks' exposures and identify the soundest institutions. As a result it contributes to some general distrust regarding the asset quality of European banks that may be unjustified (asset quality is heterogeneous and may be more of a concern in some jurisdictions and in some banks than in others). Some proxies for asset quality have already been developed but as they are not harmonised they may add to the confusion around asset quality issues as they are using different definitions of asset quality.

For these reasons, the EBA proposes harmonised definitions and reporting templates for the non-performing and forbearance definitions.

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These definitions and templates are developed under CRR Article 95(2) allowing for information to be integrated in the supervisory financial reporting framework as long as it is considered necessary to obtain a comprehensive view of the risk profile of an institution's activities.

The definitions and templates complete the ITS on Supervisory reporting requirements. Accordingly, they will be integrated in the ITS on Supervisory reporting requirements.

#### 6.1.3 Objectives of the ITS

The ITS on Supervisory Reporting Requirements specifies which information credit institutions should report. The requirements proposed in this addendum to the ITS aim to achieve the following objectives:

- ▶ harmonising the understanding of the notions of non-performing and forbearance across the EU; and
- ▶ completing the supervisory reporting framework with new definitions and templates on asset quality issues that supplement existing definitions in this field

#### 6.1.4 Technical options proposed.

Work has led to the creation of new harmonised definitions for both forbearance and non-performing exposures; these definitions will be used for supervisory reporting and offer supervisors a common understanding of these notions. Definitions are accompanied by reporting templates to be added to the FINREP framework: supervisors will be empowered with harmonised data collection means enabling them to take any informed action they deem necessary.

#### 6.1.5 Impact of the proposals

##### Benefits

The proposals of this consultation paper will reduce the negative impact of unharmonised reporting at the EU level, and will therefore pave the way for more consistent and coordinated assessment and actions in Europe regarding asset quality issues. It will also reduce the likelihood of ad-hoc requests for consistent data on this topic.

The two definitions proposed will create more harmonisation and clarity for supervisors on the notions of forbearance and non-performing and build a common standard for asset quality assessment. The proposed reporting templates will enable supervisors to get more consistent and comparable data than what they currently have access to. Indeed, both the non-performing and the forbearance definitions offer more comprehensive coverage than the current impairment and default definitions and allow for better harmonisation of these concepts between EU members.

The analysis capabilities of supervisory authorities and institutions will therefore be enhanced, especially regarding the conduct of international or EU-wide asset quality assessments. Harmonised data collected by supervisors could then be more easily shared in common efforts undertaken to reduce concerns threatening several members of the EU or the whole EU banking system. On the contrary, the current status quo would represent a cost for the EU banking system as a whole, as lack

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of comparability of supervisory data may impair cooperation at the EU level to ensure more transparency in asset valuations and result in prolonged uncertainty about banks' asset quality.

As for credit institutions, especially international ones, harmonized definitions of forbearance and non-performing exposures may lead to cost savings as cumbersome double reporting on credit quality issues (for home and host authorities) could be reduced.

These harmonised definitions and data may also benefit the credit institutions that choose to use them in their disclosures. Increased transparency on these issues, by offering markets tools to compare institutions, and institutions the means to benchmark with peers, will very likely translate in the medium term and under proper functioning of markets into positive effects, for instance lower refinancing cost or cost of capital. This may, under a systemic perspective, contribute to reducing some of the concerns about the whole EU banking system.

Regarding especially the definition of non-performing exposures, the EBA considers going beyond the existing definitions of default and impairment will allow for better consistency in data collection and enhanced comparability of asset quality challenges across the EU, and even at the level of individual jurisdictions. Indeed, it sets common criteria to mitigate the effects on reported data of national discretions allowed by accounting and regulatory standards and of varying implementation practices of these standards at the institution level. By reducing the potential sources of inconsistency in the default and impairment definitions, it ensures that differences in reported figures will stem more from genuine differences in asset quality challenges rather than from a different degree of stringency in the implemented impairment and default definitions used either at the institution or at the jurisdiction level.

#### Costs

The proposed definitions and templates are new and will therefore require credit institutions to create or adapt information and reporting systems to capture and monitor over time transactions that are within these definitions. The definitions proposed, due to their intended comprehensiveness, indeed do not always exactly match with those that are used at the individual institutions or jurisdiction level (given the lack of harmonised definitions, each institution or jurisdiction can have its own).

The forbearance definition also covers forbearance transactions that are not considered as leading to impairment or default, as well as some refinancing transactions, and therefore may not be identified in the existing reporting systems. Also, it sets criteria to identify forbearance that may not be those used internally by institutions.

The drivers of costs for institutions in the non-performing definitions consist in the need to apply the definition to trading book exposures and therefore to set up processes and systems to capture and report credit risk in a way that may differ from the current processes used for valuation and risk-assessment of these exposures.

Also, harmonisation elements introduced by the non-performing definition are likely to lead to additional costs as institutions will also have to adapt their systems to:

- apply a harmonised 90 days past-due threshold to all types of exposures (depending on the final version of the CRR definition of default);
- apply a pulling effect to all their banking book and trading book exposures; and
- apply harmonised exit criteria to all non-performing banking book and trading book exposures

These elements will require the capture and monitoring, for the sole purpose of reporting on non-performing exposures, of some exposures that may, depending on the policies implemented at the jurisdiction or bank level, not currently be identified as defaulted or impaired. Additionally, this may in the short term, when systems will still be in a run-up phase, negatively affect the quality of reported data.

Costs are also likely to arise both for credit institutions and supervisory authorities in jurisdictions which currently have definitions for forbearance and/or non-performing, as these definitions, which often proceed from national accounting or regulatory frameworks, will not be automatically superseded by the new EBA definitions in those fields. Supervisors and institutions may therefore have to manage two sets of definitions (national and EBA), if national supervisory authorities do not choose to align their national definitions to the EBA one.

The EBA however has included some mitigation of the above-identified costs in its proposed definitions:

- ▶ The harmonisation of the definitions makes use to the best possible extent of what has been found in mappings of the various asset quality concepts that exist in various accounting, regulatory and reporting framework as well as in institutions' disclosures. This has permitted a high degree of consistency between the EBA definitions and what may exist at the various national levels.
- ▶ The non-performing definitions are umbrella concepts that build on existing definitions and accordingly gather the defaulted and the impaired assets, which will ease identification of assets that have to be considered as non-performing.
- ▶ The new reporting demands are limited to necessary information, with redundant FINREP templates proposed for deletion or modification.

Supplementary mitigation measures of the potential costs of the definitions for institutions may in addition be considered by the EBA, depending on the outcome of the consultation process.

*Table 1 - Summary of the costs of the proposals.*

Party Affected	Compliance Costs	
	One-off	Ongoing
<b>Credit Intermediaries</b>	A1. Data collection, record keeping and monitoring systems: A2. IT infrastructure A3. Staff Training	B1. Data collection, record keeping and monitoring systems B2. IT infrastructure B3. Staff Hire

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25) Could you indicate whether all the main drivers of costs and benefits have been identified in the table above? Are there any other costs or benefits missing? If yes, could you specify which ones?

26) For institutions, could you indicate which type of one-costs (A1, A2, A3) and ongoing costs (B1, B2, B3) are you more likely to incur? Could you explain what exactly drives these costs and give us an indication of their expected scale?

The EBA believes harmonisation elements were needed to create an EU-wide harmonised definition for non-performing exposures, since resorting to a definition without these elements would not represent an improvement compared to the existing situation, when data reported on default and impaired exposures may suffer from comparability issues.

The EBA therefore expects its proposed forbearance and non-performing definitions to lead to some reporting burden at the beginning, as system adaptations may be needed for some institutions. However, it believes the achievements in terms of harmonised data at the national EU level and better understanding of the asset quality issues faced by institutions for supervisory authorities outweigh these costs.

27) Do you agree with our analysis of the impact of the proposals in this Consultation Paper? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?



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## 6.2 Overview of questions for Consultation

### 6.2.1 Questions on the definitions

- 1) 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.
- 2) 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
- 3) How long will it take you to implement, and collect data on, the definitions of forbearance and non-performing?
- 4) What definitions of forbearance and non-performing are you currently using respectively for accounting and prudential purposes?

### 6.2.2 Specific questions on some aspects of the forbearance definition

- 5) 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?
- 6) Do you agree with the following elements of the forbearance definition:
  - a. the criteria used to distinguish between forbearance and commercial renegotiation?
  - b. the criteria used to qualify refinancing as forbearance measures?
  - 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?
  - d. the proposed treatment for exposures with embedded forbearance clauses?In case you disagree with the EBA proposals on the above-mentioned issues, please explain and provide an alternative to them.
- 7) Do you agree with the proposed scope of on- and off-balance sheet exposures to be covered by the definition of forbearance?
- 8) Do you agree not all forbearance transactions should be considered as defaulted or impaired?
- 9) What types of forbearance transactions are likely, according to you, not to lead to the recognition of default or impairment?
- 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)?
- 11) Do you agree with the proposed mixed approach (debtor and transaction approaches) for forbearance classification?

- 12) Do you agree with the exit criteria for the forbearance classification? In particular:
- what would be your policy to assess whether the debtor has repaid more than an insignificant amount of principal or interests?
  - do you support having a probation period mechanism?
- 13) Do you agree with the proposed approach regarding the inclusion of forbore exposures within the non-performing category? In particular:
- do you agree the generic non-performing criteria allow for proper identification for neither defaulted nor impaired non-performing forbore exposures? Would you prefer to have the stricter approach (all forbore exposures identified as non-performing) implemented instead?
  - do you agree with the proposed consequences of forbearance measures extended to an already non-performing exposure? Especially, are the proposed exit criteria strict enough to prevent any misuse of forbearance measures or would stricter criteria be needed?

#### 6.2.3 Specific questions on some aspects of the non-performing definition

- 14) Do you agree with the following elements of the non-performing exposures definition:
- the use of 90 days past-due threshold to identify exposures as non-performing?
  - the proposed guidance for past-due amounts?
  - the proposed treatment of collateral and especially the proposed valuation methodology for its reporting?
- In case you disagree with the EBA proposals on the above-mentioned issues, please explain and provide an alternative to them.
- 15) Do you agree with the coverage of the proposed definition and with the possibility to apply the generic non-performing criteria to all fair-valued non-performing exposures? Do you expect challenges when implementing them and collecting data on fair-valued non-performing exposures? Would you suggest other criteria instead?
- 16) Do you agree with the proposed treatment for derivatives exposures? If not, what criteria would you suggest to enable identification of non-performing derivatives?
- 17) Do you agree with the proposed criteria to identify off-balance sheet exposures as non-performing?
- 18) Do you agree not to consider exposures subject to incurred but not reported losses as non-performing?
- 19) Do you agree with the proposed approach regarding the materiality threshold?
- 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?

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- 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 favor and why?
- 22) Do you agree with the exit criteria from the non-performing category?
- 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?
- 24) Would you favor specific exit or specific separate monitoring criteria for non-performing exposures to which forbearance measures are extended?

#### 6.2.4 Impact assessment questions

- 25) Could you indicate whether all the main drivers of costs and benefits have been identified in the table above? Are there any other costs or benefits missing? If yes, could you specify which ones?
- 26) For institutions, could you indicate which type of one-costs (A1, A2, A3) and ongoing costs (B1, B2, B3) are you more likely to incur? Could you explain what exactly drives these costs and give us an indication of their expected scale?
- 27) Do you agree with our analysis of the impact of the proposals in this Consultation Paper? If not, can you provide any evidence or data that would explain why you disagree or might further inform our analysis of the likely impacts of the proposals?

#### 6.2.5 Appendix I questions

- 28) Do the instructions provide a clear description of the reporting framework? If not, which parts should be clarified?
- 29) Are there specific aspects of forbearance and non-performing loans that are not covered or addressed properly in the templates?
- 30) Do the reporting requirements include items which would be disproportionately costly to implement? If yes, how the templates could be modified to cover the necessary supervisory information? Institutions are especially encouraged to provide their views on which break-downs are easier to fill in, or whether they believe there are redundancies with information reported in other supervisory reporting templates, or if they believe alternative definitions could achieve similar results as those in this Consultation Paper but at lesser costs.

