

## **ESRB response to the EBA 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**

### **Introduction**

The European Systemic Risk Board (ESRB) welcomes the publication by the European Banking Authority (EBA) of the draft Implementing Technical Standards (ITS) on forbearance and non-performing exposures. In fact, the ESRB believes that having reliable information on both forbearance and non-performing exposures is of key importance for systemic risk assessment. Such information may come from supervisory reporting as well as from stress tests or Asset Quality Review, but, in any case, in order to be reliable it needs to be based on harmonised definitions.

Forbearance has been a phenomenon highly present in the agenda of the ESRB in the past two years. It first arose when the ESRB looked at the macro-prudential consequences of an environment of persistent low interest rates. Later, in July 2012, the Advisory Scientific Committee (ASC) published a paper focused on loan and regulatory forbearance<sup>1</sup>. The press releases issued after the meetings of the General Board in September and in December 2012<sup>2</sup> also contained a reference to forbearance. The ESRB Chair mentioned the concerns of the ESRB regarding widespread forbearance in his hearing in front of the European Parliament in October 2012<sup>3</sup>.

### **General comments**

The ESRB overall agrees with the stated motivation that calls for harmonised definitions of forbearance and non-performing exposures. It must be considered, in fact, that at the moment the lack of harmonised definitions and, consequently, of reliable and comparable data across countries creates a wide uncertainty about asset quality and credit risk in the balance sheets of banks: such uncertainty is in itself a relevant source of systemic risk. Policy-making based on unreliable data risks becoming ineffective. Finally, the ESRB agrees that the proposed definition of non-performing exposures should not affect the current accounting or regulatory definitions, such as impaired or defaulted loans.

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<sup>1</sup> See [http://www.esrb.europa.eu/pub/pdf/asc/Reports\\_ASC\\_1207.pdf](http://www.esrb.europa.eu/pub/pdf/asc/Reports_ASC_1207.pdf).

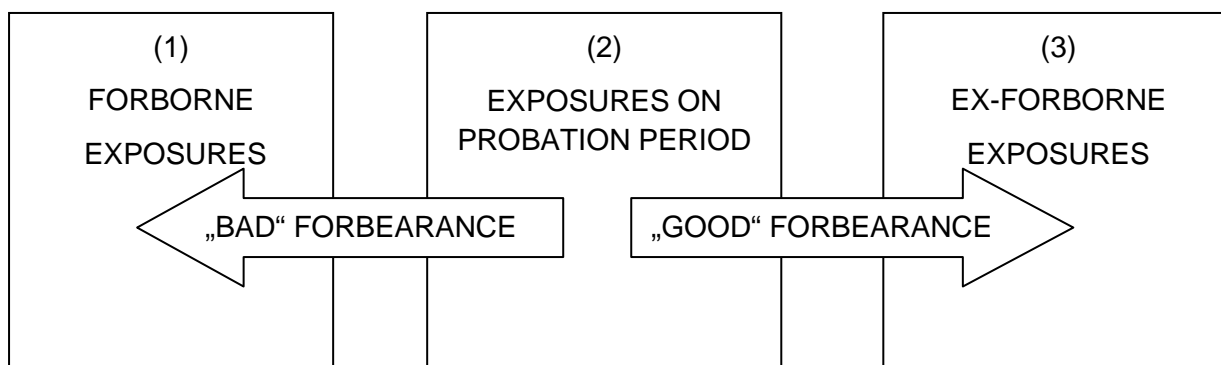
<sup>2</sup> See respectively <http://www.esrb.europa.eu/news/pr/2012/html/pr120920.en.html> and <http://www.esrb.europa.eu/news/pr/2012/html/pr121220.en.html>

<sup>3</sup> See <http://www.esrb.europa.eu/news/pr/2012/html/is121009.en.html>.

The ESRB considers important, that harmonised definitions apply to both IFRS and non-IFRS banks, even if reporting, being part of the FINREP framework, could apply only to the former. The benefits of harmonised definitions mentioned before, in fact, apply also to smaller banks not following IFRS and applying them should not be too burdensome for these banks as they mostly rely on already existing concepts in the prudential regulation field. Moreover, the fact of an exposure being performing or non-performing does not depend on the accounting standards used

As a consequence of all the considerations made so far, the ESRB believes that the data collected through the attached templates will be an important tool to assess systemic risk and therefore strongly support the work done by EBA so far. .

However, the ESRB believes that some additional information may be necessary to make a comprehensive assessment of the effects of forbearance. It is widely agreed, that forbearance may have both positive and negative effects and that the best way to distinguish the two, or at least to assess the success of forbearance practices, is to check ex post how many forborne loans resume regular payments.



The scheme above summarizes the three phases of a forbore exposure, according to the definitions outlined in this Consultation Paper. One may assume that forbearance has been successful if a debt passes the probation period (phase 2 in the scheme) and enters the ex-forborne category (phase 3), without going back to either forbore or non-performing. The proposed templates give information on exposures under (1) and (2) cumulated, but not on exposures under (3). The ESRB proposes to collect data also on exposures which enters phase 3, checking also if remain in this condition in the longer run. The ESRB is ready to cooperate with EBA to define details at the technical level.

The ESRB believes that the templates introduced with this ITS will be an important part of the FINREP framework and is therefore firmly persuaded that they should start to be implemented at the same date as the rest of the FINREP, i.e. in the third quarter of 2014.

## Replies to EBA specific questions



The ESRB replies to the 30 questions raised in the EBA consultation paper are provided in the table below. As explained above, and given the fact that the ESRB is responding to the consultation from the viewpoint of a user, the replies focus on the merits of the EBA proposals, which would obviously have to be balanced against the costs.

The ESRB does not object to the EBA publishing the ESRB response to the EBA 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.

Questions	Replies
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.	Yes.
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	Yes, the ESRB agrees with the proposed definitions. The ESRB will in particular support the inclusion of trading book exposures, given that it will be of paramount importance to assess the credit quality of all the instruments subject to credit risk, regardless of their accounting or prudential classification. If trading books exposures were excluded from the definitions, strong unintended incentives would be provided to banks to classify most of their exposures in this portfolio. On average, in the EU the trading book represented 21% of the total assets of the IFRS banks as of June 2012 <sup>4</sup>

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<sup>4</sup> Source: ECB, Consolidated Banking Data <http://sdw.ecb.europa.eu/browse.do?node=71390>



	For some institutions such figures include also relevant amounts of loans and advances, as shown from their public reports. This fact reinforces the idea that it is important to examine both the banking and the trading book, when assessing the credit quality of the loan portfolio of an institution.
3. How long will it take you to implement, and collect data on, the definitions of forbearance and non-performing?	NOT APPLICABLE
4. What definitions of forbearance and non-performing are you currently using respectively for accounting and prudential purposes?	NOT APPLICABLE
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?	Yes.
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.	a. Yes b. Yes c. Yes, it is an indicator of difficulties in the payment. d. Yes.
7. Do you agree with the proposed scope of on- and off-balance sheet exposures to be covered by the definition of forbearance?	Yes. From a macro-prudential perspective, it is very important to include loan commitments within the scope of the



	forbearance definition, as this type of instrument can be used for refinancing purposes and will therefore mark the recourse to forbearance practices as an early indicator.
8. Do you agree not all forbearance transactions should be considered as defaulted or impaired?	Yes (see also answer below).
9. What types of forbearance transactions are likely, according to you, not to lead to the recognition of default or impairment?	Transactions caused by a very specific, conjunctural and reversible situation, most probably related to liquidity problems that leads the debtor not to be able to satisfy the next payments as they are in the original contract, but does not prevent the compliance with new conditions. In addition these transactions would have to be undertaken at market conditions (the modified conditions must reflect the current assessment of credit risk and the debtor must be assessed to be able to comply with these conditions).
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)?	Yes. In terms of credit quality assessment, and from a macro-prudential perspective, the ESRB supports the application of the accounting scope of consolidation, since it is broader and would permit to have a full picture of a group, regardless of the activities of its individual institutions.
11. Do you agree with the proposed mixed approach (debtor and transaction approaches) for forbearance classification?	Yes.
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?	Yes. a. Not applicable to ESRB. b. Yes. This helps to monitor the performance of forbearance measures.



<p>13. Do you agree with the proposed approach regarding the inclusion of forborne exposures within the non-performing category? In particular:</p> <p>a. do you agree the generic non-performing criteria allow for proper identification for neither defaulted nor impaired non-performing forborne exposures? Would you prefer to have the stricter approach (all forborne exposures identified as non-performing) implemented instead?</p> <p>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?</p>	<p>Yes.</p> <p>a. The ESRB agrees that generic non-performing criteria allows for proper identification for neither defaulted nor impaired non-performing forborne exposures. Furthermore, the ESRB agrees with the published approach and do not prefer a stricter approach, even if it is expected that the amount of exposures that are at the same time forborne and performing to be very low. However, some cases might exist, given the generic definitions, and thus such option should not be closed.</p> <p>b. The ESRB agrees with the proposed consequences of forbearance measures, and with the exit criteria.</p>
<p>Specific questions on some aspects of the non-performing definition</p>	
<p>14. Do you agree with the following elements of the non-performing exposures definition:</p> <p>a. the use of 90 days past-due threshold to identify exposures as non-performing?</p> <p>b. the proposed guidance for past-due amounts?</p> <p>c. the proposed treatment of collateral and especially the proposed valuation methodology for its reporting?</p> <p>In case you disagree with the EBA proposals on the above-mentioned issues, please explain and provide an alternative to them.</p>	<p>a. Yes, it is consistent with other similar definitions.</p> <p>b. Yes.</p> <p>c. The ESRB agrees with the proposed treatment of collateral, and with using FINREP valuation methodology for consistency purposes. However, the ESRB would like to encourage the development of a more thorough methodology for collateral valuation for financial information purposes.</p>
<p>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</p>	<p>The ESRB generally agrees with a broad coverage for systemic risk monitoring. As mentioned above, the ESRB agrees with the extension of the coverage to trading book exposures. The extension of the scope to include off-balance sheets exposures is also of paramount importance, as these</p>



other criteria instead?	exposures might lead to losses related to credit risk. The rest of the questions are not applicable to ESRB.
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?	Derivatives themselves do not represent amounts due, and thus cannot be regarded as non-performing exposures.
17. Do you agree with the proposed criteria to identify off-balance sheet exposures as non-performing?	The proposed off-balance sheet exposures are in line with those included in FINREP, therefore the ESRB agrees with the proposed criteria.
18. Do you agree not to consider exposures subject to incurred but not reported losses as non-performing?	The ESRB agrees that exposures subject to incurred but not reported losses should not be considered as non-performing, given that it is possible that a large number of exposures are subject to IBNR losses, and only a small number of them will later become non-performing.
19. Do you agree with the proposed approach regarding the materiality threshold?	Yes, as it is important to have the same materiality threshold for both definitions (default and non-performing).
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?	In the case of debtors, the ESRB sees strong merits in aligning practices with the prudential definition. In the case of lenders, it is important to monitor the exposures towards a counterparty generated in the whole group, regardless the activity of the individual institution that generated it, so the definition should refer to the accounting scope of consolidation, even if for reporting it may be different.
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?	The proposed approaches are aligned to those already existing for the related concepts. Regarding the threshold, the ESRB would support the idea, and favour the second methodology (i.e. 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).



	<p>The rationale behind this position of preference for this ratio is that, once at least one exposure to a debtor is non-performing, the fact that others are past due is much more significant than what a normal past due is. On the other hand, a scenario where a non-performing exposure of a customer (for example, a credit card) triggered the classification of all the exposures of that customer as non-performing could also have negative effects, as it would over-react in some cases. Nevertheless, we think that further guidance is needed on how the “past-due portion” is calculated.</p>
22. Do you agree with the exit criteria from the non-performing category?	Yes.
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?	The ESRB considers that it is very important to monitor the exposures that are no longer classified as non-performing, and for this purpose it is crucial to have such a category. Regarding whether that category is considered as performing or non-performing, it would be preferable to consider them as performing, since it is defined after exiting the non-performing status.
24. Would you favor specific exit or specific separate monitoring criteria for non-performing exposures to which forbearance measures are extended?	The ESRB would generally support the generic criteria as it would suffice to cover the different situations that may arise.
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?	It could be useful to mention also the benefit of having harmonized exit criteria from both categories.
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?	NOT APPLICABLE





<p>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?</p>	<p>Yes. The ESRB overall agrees (please refer also to the answer to question 25).</p>
<p>Appendix I questions</p>	
<p>28. Do the instructions provide a clear description of the reporting framework? If not, which parts should be clarified?</p>	<p>Yes.</p>
<p>29. Are there specific aspects of forbearance and non-performing loans that are not covered or addressed properly in the templates?</p>	<p>There are strong merits in the proposed reporting templates as they would allow closing an important data gap identified by the ESRB. However, the ESRB would consider also important to have data on exposures which have exited the forborne category, as we have for NPEs, at least in a steady state (see also general comments).</p>
<p>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.</p>	<p>NOT APPLICABLE</p>