



Comitato esecutivo del 19 gennaio 2016

**Punto 4 all' ODG
EBA-definizione di default**

**ALLEGATO 4.2
PP ABI in risposta a
EBA Consultation Paper (CP) on the "Guidelines on the application of the definition of
default under Article 178 of Regulation (EU) 575/2013"**

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NB L'ORDINE IN CUI PRESENTARE I PARAGRAFI DELLA SEZIONE GENERAL COMMENTS E' RIPORTATO NEI NUMERI DEI PARAGRAFI PER NON CREARE UN NUMERO ECCESSIVO DI SPOSTAMENTI SUL DOCUMENTO.

General comments

We welcome the objective of the Guidelines to harmonize the definition of default to ensure consistency of its application, transparency and comparability of risk parameters between banks across the Member States.

1) Time needed for implementation

The impact of the proposed definitions on financial institutions will vary depending on the extent to which the current approaches deviate from the proposals.

However, given the envisaged significant impact on substantial part of institutions, we would like to stress **that sufficient time needs to be granted** to change all the different **operative procedures** and to enable **banks customers** to become used to the new rules, sometimes very strict compared to the current ones. In addition to the **previous remarks, common to all banks**, the **IRB banks** needs to have sufficient time to enable the **recalibrations of models and banks internal systems** and also to factor in the time required for obtaining **supervisory approval** of the banks' internal models.

In order to **minimize the operative impact** it is important to ~~synchronise~~ synchronize the entry into force of the new definition with the **IFRS 9 standard**. The new rules on the definition of default should therefore not enter into force before the mandatory application date of IFRS9.

2) Application method of the new proposals

We understood that EBA is aware of difficulties to apply the proposals retrospectively. **Adjusting historical data** to the proposed application of the default definition will be challenging in terms of required cost and time, if not impossible due to unavailability of the data. There are cases in which the **retrospective application of the definition of default is not completely correct in principle**, as it occurs for the distressed restructurings and sales of credit obligations. It is indeed likely that different considerations would have been made when outlining the restructuring plan or the sale conditions, if the definition of default had been different. Through statistical adjustments on default, in addition, the **level of approximation also on other parameters could be very high** (it is difficult to predict a fictitious default, not detected in the procedures and not treated as such. This would affect PD models predictability, with potential distortive effects on LGD and EAD). An approach based on

generic **best estimates following the new rules**, opens the door to a high degree of **inhomogeneity**. At the same time also **parallel running** is almost unviable from an operational [perspective](#). Therefore, we would not say that the new definition should be applied only prospectively, but **it should be discussed how to balance a need of [retrospectively](#) with some constraints it has**. EBA should give some guidelines on this (following some criterions already issued for external data not compliant with the new definition). In this respect **ABI asks EBA for a strong collaboration with the industry** and is at EBA disposal for some ad hoc meetings in order to come up with a feasible proposal and with rules able to guarantee a level playing field in the migration to RWA deriving from IRB models based on a uniform definition of default.

[7\) Frequency of Past Due calculation](#)

While we understand that EBA's objective is to identify the default at the day when it occurs, for some banking products such as mortgage loans, the determination of default is performed at the end of each month. The required change to **daily determination needs to be adjusted and simplified** to avoid significant increase in the complexity of the implementation.

[6\) IFRS 9 considerations](#)

[With reference to point 29¹, it is important to avoid any disparity on the accounting framework side. It is crucial that Institutions adopting a different accounting Standard to IFRS9 at individual level \(i.e. French and German\) will have the same treatment as the others which adopts \(will adopt\) the IAS/IFRS9 at both individual and group level \(i.e. Italy\).](#)

The new accounting framework (IFRS 9) should be taken into account in developing proposals for the definition of default. While accounting and prudential regulations pursue different objectives, both must be aligned with the credit risk management of the entity.

We are concerned that the proposed default definition in the **EBA Consultation Paper** in several instances **leads to contradictions with the accounting framework under IFRS 9**. This would add undue complexity, create confusion to the investor community and put into question the comparability of the disclosed information.

The following main divergence between the EBA proposal and the accounting framework have been identified:

[a\) Distressed Restructuring:](#)

The EBA defines a distressed restructuring as an indication of unlikeliness to pay where this is likely to result in a diminished financial obligation. The assessment should be based on the comparison between the present value of expected cash flows before the changes in terms and conditions of the contract and present value of the expected cash flows based on the new arrangement. If the difference between the net

¹ 29. ["Where the institution uses both IFRS 9 and another accounting framework it should choose whether to classify exposures as defaulted in accordance with paragraphs 25 to 27 or in accordance with paragraph 28. Once this choice is made it should be applied consistently over time."](#)

present values of cash flows before and after restructuring arrangements exceeds a certain threshold the exposure should be classified as defaulted. If however the diminished financial obligation is below the specified threshold, and in particular when the net present value of expected cash flows based on the distressed restructuring arrangement is higher than the net present value of expected cash flows before the changes in terms and conditions institutions should assess such exposures for other possible indications of unlikeliness to pay.

Comparing the criteria considered in the consultative paper with IFRS 9, **the degree of certainty included in the estimation of the diminished financial obligation is different in IFRS9.**

IFRS 9 considers a loan as credit impaired (Bucket 3) in case of a “detrimental impact in the cash flows”. The EBA paper definition is based on the concept of “likeliness to result in a diminished financial obligation”. Under the 3 staged approach of IFRS 9, the restructuring operations (if not derecognized) will be assessed for inclusion in one of the 3 stages of IFRS 9 depending on whether there has been a significant increase in the credit risk of the financial instrument in accordance with paragraph 5.5.3 of IFRS 9 comparing:

- *the risk of a default occurring at the reporting date (based on the modified contractual terms); and*
- *the risk of a default occurring at initial recognition (based on the original, unmodified contractual terms)’*

b8) Return to Non Defaulted Status

As a general rule, according to the CP, the probation period should not be shorter than 3 months from the moment that the obligor was no longer past due more than 90 days on any material credit obligation and none of the indications of unlikeliness to pay still apply. If after the probation period institution still assesses that the obligation is unlikely to be paid in full without recourse to ~~realising~~ realizing collateral, the exposures should continue to be classified as defaulted.

Furthermore for loans under distressed restructuring it has been specified that a longer probation period and additional conditions should apply before such exposures can be reclassified to a non-defaulted status. It is proposed that the probation period should be defined as at least 1 year from the latter of:

- i) the moment of extending the restructuring measures,
- ii) the moment when the exposure has been classified as defaulted or
- iii) the end of grace period included in the restructuring arrangements.

Additionally, this period should not be shorter than the period during which material payment has been made by the obligor (ITS on non performing exposures and forbearance).

IFRS 9 maintains a symmetry regarding classification. Favourable changes in the credit risk should be recognized in a symmetric way with unfavourable changes. Changes from stage 1/2 to stage 3 are a consequence of impairment evidence. **Changes from stage 3 to stage 1/2 are to be performed when there is an evidence of recuperation.** IFRS 9 does not establish a specific minimum cure rates, where the classification is based on different types of operations and the effective knowledge of the underlying risks.

c) Trigger for default

Further inconsistencies have been identified as follows:

- IFRS 9 uses the term 90 days and more past due (90+) while the consultation paper refers to 'more than 90 days past due' (91 +). While this is just a minor difference it can increase the complexity and it is relevant also for other past due/overdue disclosures and triggers. **We would therefore propose an alignment to 90 days past due.**
- The **non-accrual concept** is not an IFRS concept (under IFRS 9 or in the current IAS 39) nor to our understanding covered by one of other European GAAPs. Under IFRS9 and IAS 39 it is not allowed to no longer recognize interest income before the asset is deemed to be impaired. The "non-accrual concept" is grounded in the US-GAAP, indicating an unlikeliness to pay. The circumstance in which according to US-GAAP a non-accrual status is required are than covered by other trigger listed in the CP (namely the link between impaired and default definition) so we believe **paragraph 24 should be dropped.**
- Similarly to what is specified currently in the paper, with reference to the incurred but not reported provision, not implying default, it is essential that the final paper clarifies ~~as well~~ that **classification as "stage 2" under IFRS 9 does not imply "default"**.
- While we agree that in most circumstances, exposures in stage 3 would be considered defaulted, there are some specific types of assets such as **Purchased or Originated Credit Impaired assets (POCI)** which are treated differently because they are credit impaired at initial recognition. According to the accounting principles of IFRS 9 under certain conditions the **POCI must remain in Stage 3** for their entire maturity regardless of their credit recovery and performance **also if they could be classified as performing.** Hence, we would suggest **a more flexible approach which does not imply any automatism between stage 3 and default.**

8) Probation Period

As more precisely described in answer to question 7, we ask that counterparties being classified as defaulted could return to non-default status as soon as the obligation is paid in. The three months period should therefore be eliminated as mandatory provision. This is particularly crucial for default triggered by past due. If left unchanged there might be

unintended impact on [credit risk bureaus](#) and on [relationship with costumers](#) registered on them. Customers, specially retail one, will probably not understand and easily accept a rule that marks them as defaulted debtor after the obligation is paid (considering all the related consequences on credit application).

3) Materiality thresholds

While materiality threshold was subject to separate consultation, we have noted the inclusion of a scenario in the QIS that assumes application of an absolute limit 200 EUR for retail exposures and 1000 EUR for non-retail exposures and a 2.5% relative limit for non-retail exposures. This means that, at least for retail exposures the new proposal is stricter than the previous one that was challenged by majority of the respondents to the consultation, requesting a more relaxed rules.

While we appreciate that some of the industry comments in response to the consultation on materiality threshold have been reflected (with particular reference to the breach of both absolute and relative thresholds to trigger default calculation), we believe that the 2.5 % relative threshold is still low. In line with our previous comments [and of those of the EBF](#), we ~~believe~~ [ask for](#) a 4% threshold, both for retail and not- retail. [The macroeconomic and credit risk management ground for this request can be found in our previous position paper on this topic.](#) ~~would be more appropriate,~~

Introducing only an absolute threshold for the retail exposures risks undesirable impact in particular on SMEs portfolios.

We note that QIS (par. 3.3 “Part 2: Quantitative questionnaire – policy options - 3.3.1 Materiality threshold”, letter d) says that *“the counting of 90 days (or where relevant 180 days) begins at the moment this amount breaches the threshold”*. Wording of this specific section suggests that the counting of days past due starts only at the moment when the amount past due breaches the materiality threshold. We therefore **ask for confirmation** that this interpretation is correct. Consequently, that will mean that **an exposure which is materially past due has to be considered defaulted only after 90 days of continuing past due status.**

[We would like to stress that the approach proposed in the QIS \(paragraph 3.3.1\) may be particularly detrimental in **factoring operations** for exposure to assigned debtors referred to in paragraph 23, where a lot of past due invoices are often present for each debtor by reason of the common payment practices in trade relationships. In fact considering all amount past due in order to verifying the breaching of the threshold in order to identify default after 90 days of consecutive breach on the thresholds would certainly bring to recognize most of the debtors as defaulted, even in the absence of any invoice past due from more than 90 days. Should this approach be confirmed, a clarification and a relief for these exposures should be provided, e.g. by **conditioning the identification of default to the presence of at least one invoice consecutively past due for all the counting of the 90 days.**](#)

Moreover, further specifications about the counting rules of days have not been still stated. In particular, it is not clear if reset, suspend or continue the counting of days in case the materiality threshold is no more breached before the 91 day. In addition, more details about which conditions need to be satisfied before to return from the past due status would be appreciated (e.g. the reduction of the materiality past due below the threshold is sufficient to remove the past due classification or the entire past due amount needs to be paid?).

4) Compensation of past due amounts with unused credit lines

We ask for the introduction of a provision that will allow compensation of past due amounts with unused general credit lines for the same debtor. The possibility to compensate would allow avoiding considering as defaults the cases where a customer has past due amounts on a line of credit and available margin on another one. In such situations, the anomaly in the payment structure is likely to be due to **a non-optimal management of the position**. The possibility to net the past due exposure with the available margin would avoid this situation, and moreover would be more in line with the counterparty level approach followed by this consultation.

5) Specific treatment for public entities

Low thresholds as those proposed by EBA give raise to concern about the exposures of institutions to public administration and government institutions that are in some instances obliged to postpone their payments for administrative reasons. **We believe that the default of a public administration requests further considerations and evaluations.**

During the **public hearing**, EBA has indicated that it will be proposing **a specific treatment for public institutions on the evaluation of unlikeliness to pay**. We do believe a **similar exceptional treatment** should be introduced for the **past due trigger for default**. This we believe would be justified given the specificities of the trade debts of the public administrations, where payments habits vary amongst Member States. In some, the average past due day exceed 180 days while the actual risk of losses is very limited. We would like to propose to EBA to consider introduction of a waiver that would allow the institution to suspend the counting of past due days if the debtor (being a public administration) makes a payment on at least one of its past due exposures.

9) Past Due criterion in case of variation in the repayment schedule

According to paragraph 17 and 18 of the Consultation Paper, if the law or the credit arrangement explicitly allow the obligor to change the schedule or suspend/postpone the repayments and the debtor acts within the granted rights, the counting of days past due shall be based on the new schedule.

We deem that the final Guidelines should specify that the **counting of days past due shall be based on the new schedule** not only if the review in the repayment conditions is allowed by the contract or by the law, but **also in case it is due to a renegotiation of the credit arrangement performed by the parties.**

*1. Do you agree with the proposed definition of technical defaults?
Do you believe that other situations should be included in this definition?
If yes, please provide detailed proposals on how to address further possible situations.*

Wording of Section 3.2.2 (first bullet point on page 7) and section 5.1 D c (pages 50-52) seem to suggest that only data or system errors caused by the *institution* are covered in the definition of technical default as opposed to including data or system errors caused by counterparties.

In the modelling of larger customers it is expected to be rather common that payment delays not caused by financial issues would exceed the materiality threshold. If defaults that are a result of data or system errors of the counterpart are not regarded as technical defaults, modelling of PDs for large corporates will turn into a matter of modelling probability of errors in customer's data and payment systems. With the strict interpretation of a technical default suggested by EBA, the most relevant risk driver in Large Corporate portfolios would be the size of the company. **We believe that payment delays not related to deterioration of the credit quality of the counterparty should not lead to default.**

We do not share the view in paragraph 20 that the classification of the obligor to a defaulted status should not be subject to additional expert judgement. Expert judgement has an important place within credit risk management and should continue to be used. **Situations may occur that will result in past due exposure of more than 90 days, however not due to a credit deterioration of the counterparty.**

For example:

- In leasing business lines, a client could suspend payments not only for a difficulty to reimburse the bank but also for a management decision if a dispute occurs on the leased good (e.g. regarding the quality of goods).
- The same might occur in factoring business. In case of a controversy on a supply, litigation or discussion, the debtor can decide not to pay the invoices, although his creditworthiness is unchanged. This furthermore will often be unknown to the factor and could lead also to damaging contagion effects (please see also our response to question 3 below)
- Commercial dispute on a SBLC (Standby Letter of Credit) would put in default a bank or a large corporate with a potential contagion effect in the case of a syndication of the SBLC (i.e.: all the participating EU banks would place the corporate in default, resulting in a possible limitation of the customer's access to the credit).
- Call of suretyship where the suretyship contest the legitimacy of the call which entail a past due situation (case of unfair/abusive claim).
- Logistic process issues for Energy & Commodities financing or generally for Trade Finance leading to delays in the delivery. For example, merchandise blocked at the customs, prohibition on entering or leaving ports, strike etc.

- Disputes regarding the amount or the nature of collaterals in case of margin calls.
- As for asset financing long term loans, amendments/waivers or consents are possible due to, for example, a lack of customer responsiveness, maintenance check of products, reality check of the financing according to new market conditions. The expert assessment is essential.
- Specific cases of sovereign counterparts, for which default may be assessed at political level.
- Cases of force majeure (environmental disasters, legally imposed measures, riots, strikes, wars...).
- Payments made by debtors to a factor for certain ceded invoices and not yet registered on the right account due to difficulties in the payment reconciliation process.
- Invoices due but not correctly and promptly dispatched to the debtor by the seller.

Some commercial disputes can last for several months or even years meaning that borrower would stay in default during the whole period. We believe it is important to avoid capturing defaults related to exposures that are disputed or waived or that are not related to the decrease in the quality of the credit risk.

In addition we strongly ask to underline that in case of a new and wider definition of default (defined among others by way of new and stricter rules on technical default), floors on the minimum level of LGD have to be reviewed or completely removed. In addition some adjustment will be needed to the general calibration of standardised approaches.

HP1) As a final consideration, it would be beneficial also to have the possibility of identifying technical defaults on a massive basis rather than case by case, for example adopting a thresholds in terms of number of days in default (e.g. days in default < 15 means the default is technical).

HP2) As a final consideration, with regard to the provision in paragraph 19, requiring to considered "the sum of all amounts past due... for purpose of comparison with the threshold", we ask to introduce a provision that gives the possibility of identifying amounts past due of technical nature on a massive basis rather than case by case. Our proposal is that all those items having less than 15 days past due have to be excluded, given that if the 15 days threshold is breached the amount became part of the above sum and the counting of days past due will start from 15.

2. Do you consider the requirements on the treatment of factoring arrangements as appropriate and sufficiently clear? If not, please provide proposals for additional clarifications.

We suggest to add the following sentence after §22: "When the factor and the client agree a due date for the credit granted to the client, the counting of days past due shall commence from such date."

~~In the factoring arrangements where the ceded receivables are not fully transferred to the factor, the timing for reimbursement/regularization of advances is contractually specified,~~

~~therefore, the counting of days past due should refer to that date. It does not necessarily require a breach in the percentage agreed between the factor and the client.~~

The treatment of exposures to debtors stemming from IAS/IFRS compliant purchased trade debts within a factoring agreement with a client (i.e. where the risks and benefits related with the assigned receivables are fully transferred to the factor and the factor has exposures to the debtors of the client) should take into account that **the reliability of the due date of the invoices may be affected by numerous events related to the trade relationship between the buyer and its supplier.**

In such cases, a significant delay of the payment may occur without any sign of deterioration of the situation of the debtor. Such situations may originate from contractual provisions or also from informal communication and exchange between the buyer and the supplier.

In such situations, we believe that **a relief should be introduced by way of a rebuttable presumption on the automatic classification as past due of trade debtors or of a suspension of days past due counting** when the factor is aware of these events, regardless the degree of formality. These occurrences shall however trigger an analysis of the debtor's situation in order to assess possible indications of unlikelihood to pay.

In particular, when the buyer disputes a receivable (e.g. receivables not existing at all or just partially existing, commercial supply not regular or different to the agreements, etc.), **the amount or even the very existence of the invoice may be challenged.** It is very uncommon that disputes are brought to a court. While disputing parties are usually try to settle the dispute **outside the court**, the process can **nevertheless be time-consuming and exceed the 90 days:** therefore a relief should apply whether or not the dispute has been put forward to a court. Indeed, from a risk perspective, disputes, as well as discounts, deductions, netting or in general credit invoices issued by the seller are not in the field of default risk but rather in the field of dilution risk. Hence, that disputes are not a signal of default risk on the debtor and therefore disputed invoices should not be considered past due. Those events should rather be classified within client risk, since they are not covered by credit insurance (and consequently do not represent debtor risk) and since, if they occur, the corresponding amounts are debited from the client account and finally generate client default if they are not reimbursed before 90 days. Therefore, dilution risk should be treated according to art. 230 of the GL10 and not represent a source of default risk on the debtor. The opportunistic use of disputes in order to hide financial difficulties could easily be detected through the analysis of the debtor's situation triggered by the occurrence of the dispute.

In the case of receivables purchased within a factoring agreement ~~-~~ in which risks and benefits have been fully transferred to the factor, but the debtor has not been informed of the factor's interest on the purchased debts ~~-~~, the debtor will pay on the client's account (usually a trusted account with a bind in favour of the factor), the client being obliged to transfer as soon as possible the collected amount to the factor. Therefore, it may happen that the payment ~~has is been~~ made, correctly and on time, to the client but the latter did not yet transfer the amount to the factor or, again, the factor and his client may have agreement so that the latter transfers the amount for all collected invoices at certain agreed dates rather than one by one. In these cases, - the counting of the days past due of the ceded receivables

should commence from the day when, according to the contract, the assignor should transfer the collected amount to the factor rather than from the due date.

3. Do you agree with the approach proposed for the treatment of specific credit risk adjustments?

We agree with the proposal and we underline the importance of having the implementation of the new default definition not before the go live of IFRS 9 accounting principle. It would be overly burdensome for us from an operational perspective to adapt the new definition of default to current accounting practices and shortly after to the revised IFRS 9 principle.

Moreover, ABI disagrees that all exposures classified as 'Stage 3' under IFRS 9 are treated as defaulted. Such a condition should be applied in a more flexible way, otherwise it would prevent from reclassifying in performing status some asset typologies like purchase or originated credit impaired (POCI) assets, which according to the accounting principles remain in Stage 3 also after having being restructured. **Hence, we would suggest that the EBA's guidelines embed the Stage 3 definition as it will be adopted in the relevant accounting operative rules.**

4. Do you consider the proposed treatment of the sale of credit obligations appropriate for the purpose of identification of default?

While we agree that selling of a credit obligation resulting in a loss due to fall in credit quality could be an indication of default, we consider the proposed threshold of 5% too low given that even small deterioration in credit rating or changes in interest rate might lead to 5% impact on the market value of an asset. **We would therefore recommend to increase the minimum threshold to the level of 10%.**

The recent history has proved that when financial markets are highly volatile, some bonds could be under 95% of their par value because the markets anticipate a future decrease of the credit market **without the issuer being itself in default**. In consequence, the bank may cease granting facilities to the obligor and this could trigger an actual payment default.

Credit obligations could be sold for another reason than the anticipation of a decrease in credit quality of the issuer. A decision to sell participations in loans on performing clients and with a significant loss may be dictated by:

- Regulatory capital savings or employment
- Liquidity management
- Balance sheet management
- Country envelope consumption
- Counterparty exposure management
- Single limit concentration management

A sale price of an asset, which is the fair value, will include other elements besides the credit quality such as liquidity premium; general changes to market conditions, etc and it may not always be straightforward to distinguish which part of the economic loss is related to the

deterioration in credit quality. We would therefore suggest to set up objective criteria to identify sales of credit obligations not related to credit risk.

It also has to be taken into account that in case of sales of credit obligations 'en bloc', a discount is usually applied compared to one to one evaluation (in order to conclude the deal earlier) with no link to the real risk of the block.

We would propose that the sale of credit obligations is considered as an indication for unlikelihood to pay but should be associated with other indicators and not as a stand-alone criterion.

Furthermore, it is opportune to explicitly identify the different effects of the proposed measures in term of accounting, capital requirements and impact on the estimation of the risk parameters for Institution that use the IRB Approach.

Finally, we would appreciate a clarification by the EBA on whether securitized credits have to be considered within the "sale of credit obligation" category.

5. Do you agree that expected cash flows before and after distressed restructuring should be discounted with the customer's original effective interest rate or would you prefer to use the effective interest rate applicable at the moment before signing the restructuring arrangement? Do you consider the specification of the interest rate used for discounting of cash flows sufficiently clear?

In terms of discount rate, we are still evaluating the impact of the two alternatives in light of the **different market scenarios**. On the basis of the current market situation, characterized by low interest rates, the application of the **interest rate at the moment of the renegotiation** would seem preferable. —Therefore, we would appreciate a clarification from EBA to understand the rationale according to which the customer's original effective rate was chosen. However further analysis will be performed in order to better assess potential impacts should the market conditions change. A final position on the topic has not been taken yet.

Under IFRS a loss is recognised separately and the book value is adjusted for the "forbearance loss". Consequently IFRS 9.5.5.12 states that the institutions shall assess significant increase in credit risk by comparing the risk of a default occurring at the reporting date (based on the modified contractual terms). For that reason **forbearance measures that diminish the cash flows of the contract do not necessarily automatically result in a credit impaired status (default status) under IFRS 9.**

Considering the **1% threshold** for the diminished financial obligation we believe the threshold is set at a **too low level**. In our view, the relevant measure for recognition of default should be set at a level, when the new cash flow (NPV) would no longer be adequate to cover the book value of the obligation, regardless of the decline in NPV.

In addition art 178 (3.d) of CRR considers “*material forgiveness,..., of principal, interest or, where relevant fees*”. The proposed threshold seems not to be consistent with the above mentioned materiality criterion and has therefore to be set at a significantly higher level.

We would also **see no need for specifying additional indicators to be considered for identification of default** if the net present value of expected cash flows on the distressed restructuring arrangement is higher than the net present value of expected cash flows modifications.

In addition, we believe that the **cash flows should be calculated at the level of customer**.

Concerning the formula for calculation of the diminished financial obligation (DO), it is not clear whether the cash flows include the **expectation of recovery**. If they do not take into account recovery expectation, the threshold would not make much sense as the new restructured loan could include a reinforcement of the collateral value which might mitigate (partially or totally) the diminished financial obligation measured with the proposed formula.

Also the formula provides possibility to hide a distressed situation by sufficiently extending maturity and maintaining an equivalent NPV of cash flows. It is also not clear if **the two NPV parameters only include the future contractual cash flows or also PD and LGD associated to those cash flows in each moment**. In the case of latter, the approach would suffer from a **circularity problem**. Some restructuring would not be considered as defaulted under the proposed formula for instance when the credit obligation is turned into a PIK loan (payment in kind) with capitalized interest during the period. The proposed formula gives an economic loss of 0.

Concerning **paragraph 43**, we see it **contradictory to the Chapter 5 part D**. Paragraph 43 states that “*All exposures classified as forborne non-performing should be classified as default and subject to distressed restructuring*”.

Chapter 5 Accompanying Documents part D however states that the preferred option of EBA is a “*non-obligatory alignment of the definition of default with the non-performing exposures*” given the unintended consequences and high default rate should definition of default be aligned with the non-performing exposures. This would be consistent with EBA answer on 2/10/2015 to a question for “exit criteria NPE” where it is mentioned that “*the category of non-performing exposures can be broader than the category of defaulted or impaired exposures. Defaulted or impaired exposures are mandatorily considered as non-performing but non-performing exposures need not be impaired or defaulted.*”

Finally, we would like to underline that the **concept of distressed restructuring** does not apply in case a revision of the conditions is allowed by the contract (e.g. embedded clauses) or by specific laws (e.g. moratoria issued by banking association/government) or to commercial renegotiations (e.g. change of interest rate for commercial purposes or alignment with current market practices).

6. Do you agree that the purchase or origination of a financial asset at a material discount should be treated as an indication of unlikeliness to pay?

We disagree. Basing the definition of default on the price of purchased asset is in our view not appropriate. The price of an asset ought to reflect its value at that point in time. **A material discount can be the result of other than financial distress** such as general changes to market conditions and a result of negotiations e.g. settling other transactions.

Therefore it seems unreasonable that the discount as such should be an indicator of unlikelihood to pay. Such assessment is normally a part of the due diligence of the asset to be bought, to be able to establish a relevant value/price of the asset.

Introduction of rules linking default to the price of purchased (or sold) assets could in effect lead to disincentives for banks to purchase/sell assets at discount to avoid putting its client in default (if a bank already has an exposure to the issuer). This would have negative effect on the role of the banks as intermediaries on the financial markets. Purchased receivables management is an integral part of the banking sector's activities.

In our view, default should be triggered only for reasons that are directly linked to the credit risk of the counterparty.

7. What probation periods before the return from default to non-defaulted status would you consider appropriate for different exposure classes and for distressed restructuring and all other indications of default?

We believe the institutions are best placed to recognize when a customer is no longer in default and **we consider the set probation periods inappropriate**. Any probation period from default to non-default status is inconsistent with what is set out in Article 178(5) where it is stated that: *"If the institution considers that a previously defaulted exposure is such that no trigger of default continues to apply, the institution shall rate the obligor or facility as they would for a non-defaulted exposure."*

Also, under IFRS 9 favourable changes in credit risk should be recognised symmetrically with unfavourable changes in credit risk (IFRS 9 BC 5.210). **By applying a probation period, financial instruments would move into default quicker than back to non-defaulted status**. This can result in exposure being classified as defaulted but not credit impaired under IFRS 9 (bucket 2 exposures) or the exposure would be classified as defaulted and credit impaired (in bucket 3) but with no loan loss allowance which is contra intuitive.

The suggested 3 months' probation period is considered too long in relation to both large corporate exposures and retail consumers in particular when applied together with the strict definition of the technical default as proposed in the CP. In case of retail and SME customers, payments are not always fully automatized by systematic debit of the customer's account: **a delay in payment does not necessarily mean a deterioration in the credit quality of the borrower especially if the cure period is short (less than 30 days)**.. Delays in payments of large corporates may be caused by systems or data errors. Such defaults would not necessarily mean a deterioration in the credit quality of the borrower especially if the cure period is short (less than 30 days).

We ~~would ask suggest~~ that in such cases, ~~customers~~ counterparties being classified as defaulted could return to non-default status as soon as the obligation is paid in. The three months period should therefore be eliminated as mandatory provision. This is particularly crucial at least for default triggered by past due. If left unchanged there might be unintended impact on credit risk bureaus and on relationship with costumers registered on them. Customers, specially retail one, will probably not understand and easily accept a rule that marks them as defaulted debtor after the obligation is paid (considering all the related consequences on credit application).

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In case of **distressed restructuring**, we believe it is the assessment and **expert judgement** of remaining unlikeness to pay, that ought to be the determining criteria for a decision to return the exposure to non-defaulted status, not a minimum period of time.

However, if the proposed cure period for distressed restructuring will be maintained in the final draft of the Guidelines, having regard to Article 59 of the Consultation Paper, it is opportune to specify which repayment suspensions shall be considered as a “grace period”. In particular, if a restructuring arrangement provides a temporary suspension of the sole interest share of the loan, it is not clear if that suspension shall be treated as a grace period, considering that the principal share of the loan won’t be suspended.

Similarly, should a defaulted client of a bank be bought by another client of the bank (client B) that is not in default, the exposures of the client B should not be considered defaulted if there is no decrease in the credit quality of client B (due to the acquisition). The remaining unlikeliness to pay should be the decisive criteria. Depending on the portfolio specific characteristics, there might be different or no probation periods.

8. Do you agree with the proposed approach as regards the level of application of the definition of default for retail exposures?

To summarize our understanding of the proposed guidance:

The guideline confirms that for retail exposure, the financial institution in accordance with second sub-paragraph of Article 178 may apply the definition of default at the individual credit facility level rather than at the obligor level. Furthermore the choice should reflect the financial institution’s internal risk management practice. This may imply that a financial institution in general apply the definition of default at obligor level, but for some specific types of exposure apply it at facility level.

Under IRB the financial institution is required to ensure that the risk estimates correctly reflect the definition of default applied to each type of exposures.

We supports that the credit institution may decide when to apply the default definition at obligor level and/or facility level.

Moreover, we noticed a potential inconsistency regarding the “pulling effect” between this consultation paper and the EBA ITS on forbearance and non performing exposures. Its

application seems indeed to be binding in the 2014 EBA standards, while we deem that in the consultation paper its use is discretionary for banks. We would require a clarification on this point.

9. Do you consider that where the obligor is defaulted on a significant part of its exposures this indicated the unlikelihood to pay of the remaining credit obligations of this obligor?

Yes, if the default is credit risk related. We also agree that when an obligor defaults on a significant part of their exposures, the institution should consider this as additional indication of the unlikelihood to pay but it should not automatically indicate the unlikelihood to pay of the remaining credit obligations of this obligor. For example, a mortgage default might result in a higher Probability of Default on other credit obligations but not necessarily the default of them

10. Do you agree with the approach proposed for the application of materiality threshold to joint credit obligations?

~~We disagree and suggest assessment/judgement of each institution on a case by case basis.~~

If a joint obligation towards an institution defaults, the individuals taking part in the joint obligations (and their individual obligations, respectively) should **not be automatically considered as defaulted**. This mechanism is even more problematic when applied to joint obligations consisting of a **large number of individuals** in which case considering all the individuals involved in the joint obligation automatically as defaulted may not be economically justified at all.

Moreover, the identification of joint fully liability of retail obligors (f.e. married couple) would expose institutions to unbearable burdens especially when this implies ongoing updates of dynamic information (the marital status) difficult to obtain. As a result, we propose to drop article 85.

11. Do you agree with the requirements on internal governance for banks that use the IRB Approach?

We agree. The requirements seems to be in line with CRD IV requirements. It should be ensured **however** that there is also an **alignment with the final Basel Committee Guidelines on credit risk management processed** to be applied in accounting for expected credit losses
