

Consultation response

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

24 June 2013

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the EBA's recent consultation paper on Draft Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures under Article 95a of the draft Capital Requirements Regulation ('CRR'). AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76.

Observations and responses to questions

Definition of forbearance

The proposed definition of forbearance leaves a great deal of judgement to individual firms, in particular:

- (i) the definition of financial stress/difficulty
- (ii) determination of market terms
- (iii) payment of a "more than an insignificant" amount of principal or interest.

In order for Lenders to apply definitions consistently and achieve the EBA's stated objective of harmonisation, the definition of these terms would need to be very specific and include objective measures for their assessment. We would therefore request clarification of the EBA's definition of these terms.

Indeed, restructuring for financial difficulties might occur before a default takes place. Such renegotiations might not be captured in the reporting depending on the bank policy for the identification of forborne exposures. On the other hand, following a restructuring, a loan can no longer be in default. Is the aim of EBA to capture these types of restructuring? In any case, we urge that EBA provide clearer definition of forbearance so that the non defaulted forborne exposures be clearly distinguished from the defaulted ones, the latter being consistent with the definition in the CRR.

In addition, inconsistency in terminology as currently drafted would, in our view, capture events which are outside the spirit of what should be identified as forborne and non-performing exposures. In particular we note the use of the terms: "concessions", "amendments", "modifications" and "forbearance measures" and "financial difficulties", "financial stress" and "troubled debt". To the extent possible consistent terminology should be used to remove ambiguity and clearly define the exposures which intend to be captured. For example the forbearance measures listed on p11 of the Consultation Paper appear to include modifications outside of market terms even in the absence of financial stress and refer to "modifications" to contracts rather than "concessions". We assume that the EBA is only seeking to capture transactions that are as a result of financial stress and involve granting concessions.

Furthermore, the definition seems to in some places go beyond our view of forbearance and include inappropriate measures. In this respect it is important to differentiate between forbearance events and commercial renegotiation. In particular, we consider that there would be a number of unintended consequences of the definition as it is currently drafted as follows:

- The definition on page 11 of the consultation paper which sets out that 'a modified contract which includes more favourable terms than those that the debtor could have obtained in the market' should be treated as forbearance, appears to capture any refinancing undertaken below market rates as forbearance. In a competitive market a bank may choose to offer below market rates (or the lowest rates) to retain its strongest customers.
- We would note also that this particular definition, as worded, seems to bypass the need for financial difficulty/stress to be present, which we assume was not the EBA's intention. The forbearance measures listed on page 11 do not make reference to concessions, but rather to modifications. We assume that the intention was to capture concessions rather than any modification to a contract.
- The forbearance measures listed on page 11 also include circumstances in which repayments are made by taking possession of collateral. In isolation, we do not consider the repossession of collateral to be an act of forbearance. As defined, a concession (and financial stress) must be present for an event to be classified as a forbearance measure. Given that concessions include only refinancing or modifications to allow for 'sufficient' debt servicing ability (paragraph 3, page 15), it appears that the EBA has excluded circumstances where

the concession relates solely to the waiver of a covenant. We would agree with this treatment as in our view 'covenant only' concessions are qualitatively different in risk profile to types of concessions that modify the payment terms and as such we agree that they should not be subject to the same level of reporting detail as other forbearance types.

- The overall definition does not exclude restructuring a customer to 'on market' replacement facilities. This means that the original lender is required to report cases as forborne that could be provided by another lender. This could be deemed anti-competitive.
- Shipping finance is often deliberately provided over terms that are much shorter than necessary (e.g. typically over a period of five years against a useful life of a ship of thirty years) to allow flexibility to the bank to extend maturities during downturns. AFME's members are of the view that adjustments of this nature should not be automatically reported as 'forbearance'.
- In other cases of asset-backed finance, provided a restructured facility remains comfortably shorter than the useful life of the asset financed and as long as the restructured loan to value ratio remains within market standards, then it is questionable whether forbearance has necessarily taken place.

Definition of non-performing exposures

AFME and its members appreciate the need to ensure that the line between performing and non-performing exposures is drawn in way that is as consistent as possible across the EU. To the extent that changes need to be made to the definition of default under the CRR, some element of judgement needs to be retained to avoid the risk of purely mechanical downgrades. For example, CRR Article 174 allows for longer payment delays and a mechanistic application of the proposed definition could result in the classification of significant exposure to European local authorities as being non-performing which would not be representative of the true position.

We would note also that the definition of non-performing includes exposures that 'present a risk of not being paid back in full without collateral realisation, regardless of the existence of any past-due amount or the number of days past due' (page 12). In our view this definition is too broad because all exposures present a risk of not being paid back in full without collateral realisation (albeit in most cases a very small risk); this is a risk inherent in lending. In other areas of the document there is mention of 'unlikely full repayment'. It is not clear from the definition provided what level of risk of non-payment the second limb of the generic criteria is seeking to capture and how the level of risk would be objectively measured. In our view, to be classified as non-performing, there would need to be some objective evidence of impairment such that the full repayment of obligations to the group is unlikely without resorting to recourse such as realising security.

In addition, we do not understand the need for the definition of non-performing exposures to be over and above the definitions of default and impairment as this appears to add complexity without providing any further useful information. Comprehensive data is also readily available at present in FINREP which requires the breakdown of impaired and non-impaired loans by ranges of past due dates, including more than 90 days past due.

Trading book considerations

We are not convinced that trading book exposures should be included within the scope of non-performing and forbearance exposures. Trading books are usually marked to market and the proposed treatment would lead to the need for firms to apply credit risk approaches to these books which do not reflect the way in which the businesses are managed. At present, credit risk associated with derivatives are also subject to significant prudential charges through the CVA and stress VaR frameworks. Considerations in relation to the trading book are also being considered separately under the Fundamental Review of the Trading book and as part of work on Prudent Valuation.

Basis of consolidation

As mentioned in the consultation, FINREP templates are completed upon a regulatory scope of consolidation whereas it is proposed that the returns on forbearance and non-performing exposures should be completed on the basis of an accounting scope of consolidation. We would, however, urge the EBA to align the scope of consolidation with the FINREP templates on a prudential regulatory basis. This would allow also supervisors to assess numbers prepared on a consistent basis across different reporting tables. In addition, AFME and its members disagree with the rationale for the intended adoptions of accounting scopes of consolidation on page 19 of the consultation, as the regulatory scope of consolidation includes entities on an individual or 'solo' basis as well as at a group-wide level.

Examples of current practice

The Consultation Paper asks for information on the current definitions of forbearance and non-performing exposures that firms are currently using for accounting and prudential purposes and we are pleased to provide the following examples:

- The French Accounting Standard CRC 2002-03 already requires banks to identify and monitor exposures that have been restructured and returned to performing status with a view to:
 - i) The disclosure of such assets in financial statements; and,
 - ii) The re-classification of an exposure as soon as an amount due remains unpaid by only one day.
- A UK banking group considers forbearance to have been granted when the group provides temporary or permanent concessions to a customer experiencing financial stress. This aligns with the Prudential Regulatory Authority definition in the UK.

The UK banking group's definition of non-performing is as follows:

'non-performing loans' – loans classified as risk elements in lending and potential problem loans. They have a 100% probability of default and have been assigned a pre-defined internal credit grade;

'risk elements in lending' – impaired loans and accruing loans which are contractually overdue by 90 days or more in relation to principal or interest; and,

'potential problem loans' – loans for which an impairment event has taken place but no impairment loss is expected. This category is used for advances which are not past due 90 days or for revolving credit facilities where identification of 90 days overdue is not feasible'.

- iii) the re-classification of an exposure as soon as an amount due remains unpaid by only one day.

Disclosure

The consultation notes that at present there is no clear or consistent disclosure of forborne exposures in firms' accounts and we would support increased transparency and harmonisation in the disclosure of forbearance and non-performing exposures.

We do not, however, consider that the proposals as they are currently drafted would achieve this. We consider that the goal of harmonisation needs to be weighed up having regard to the tangible benefits that will arise and the costs and complexity of implementation of the standards required to achieve harmonisations. In our view, the only way that true harmonisation could be achieved is through robust, consistent and clearly defined concepts of forbearance and non-performing exposures, using objectively measurable triggers.

Timing of implementation

The implementation timeframe for the proposals is not clear, but it is understood to be 1 January 2014. We do not consider this timeline to be achievable given that the proposals still require clarification together with the scope and granularity of the proposed reporting.