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Finance for Europe

Association for Financial Markets in Europe

AFME Response:

Consultation on Draft EBA Guidelines on disclosure of non-performing and forborne exposures

8 June 2018

Overarching comments:

AFME is generally supportive of measures being taken to tackle NPLs in Europe and we welcome the initiative and opportunity to contribute to Consultation on EBA on **'Draft Guidelines on disclosure of non-performing and forborne exposures'**. Nonetheless, we are concerned about the number of overlapping and inconsistent measures which are being undertaken by EU institutions in relation to this topic. Overall, we would urge for EU institutions to reflect on the plethora of overlapping initiatives under the NPL action plan could be better streamlined and coordinated to minimise the operational burden for banks to implement.

In particular, we would welcome clarity on the relation of the EBA Guidelines to the ECB templates on NPL disclosure from March 2017. As drafted, we welcome the EBA approach, in particular in relation to the proportionality, i.e. imposing more disclosure requirements for significant credit institutions that report high levels of non-performing loans, which is in contrast to the ECB approach, which imposed the same high disclosure requirements on all banks under its NPL Guidance. Nonetheless, we consider the 5% threshold may not be fully appropriate as it based on an EU average. Other options could be to calibrate the NPL ratio on the basis of the last quartile or with a 10% ratio for all jurisdictions, or alternatively to focus on a limited number of countries where NPLS are a major concern. We also recommend that once the EBA Guidelines on disclosure have been completed, as per the European Council's action plan mandate, credit institutions in compliance with the future EBA Guidelines should also be considered in full compliance with the ECB-SSM Guidance. We understand that the ECB participates in the EBA working group on disclosure and that this should help to ensure full alignment between EBA guidelines and ECB guidance. A transitional period should also be considered when the bank NPL ratio becomes above the threshold.

Separately we also consider the EBA should reconsider implementation of the templates in relation to those that will be mandated under Article 442 of CRR2 which is yet to be agreed and will only be applicable as of January 2021. As the EBA intends to implement their Guidelines as of 1 January 2019, which should apply from 31 December 2019, the overlap should be taken into consideration and any duplication mitigated where possible. Clarification on this alongside the publication of final templates would be welcomed. We urge for these future EBA final guideline to be fully aligned with the EBA draft implementing technical standards specifying uniform disclosure formats mandated by the European Commission in Article 434a of the CRR2, in order to avoid disclosure frameworks changes between Dec 2019 and Jan 2021. We would also highly appreciate confirmation that the future EBA Guidelines will replace from 31 December 2019, the current EBA GL/2016/11 templates CR1-D and CR1-E. Our suggestion is that templates CR1-D and CR1-E should be replaced by Templates 1, 3, and 4 (refer to response to Question 5 for more detail). We also suggest that these templates should be aligned to FINREP templates 18 and 19 (i.e. the granularity prescribed in templates 1, 3 and 4 should not exceed what is currently required by FINREP 18 and 19). We also note that the templates proposed in this consultation will be affected by other regulatory developments under consideration such as the new definition of default. In order to have a consistent disclosure framework that will not create confusion

for the analysts and investors, therefore we recommend aligning their implementation date with the new definition of the "default" implementation date, i.e. 2021.

Finally, AFME recommends drawing on the key principles of Pillar 3 disclosure developed by the BCBS, which aims to promote clear and meaningful information and provide greater comparability of disclosure requirements between international banks.

Consultation response:

***Q1**: Could you provide your views on whether adding an "of which" column to column 'f' of template 1 - "Credit quality of forborne exposures", including the information on non-performing forborne exposures that are impaired (i.e. "of which impaired") would be useful?*

AFME considers that adding column F (provisions) relating to "the impairment of FB NPE" would be redundant, this additional column will not add-value, since the same information is already present in column D (amount).

Indeed, given the overlap with the EBA template CR1-E/CRR2 Art 422-C the template may well also be redundant.

***Q2:** Could you provide your views on whether adding the columns with the breakdown of provisions for non-performing exposures by buckets of the number of days that the exposure has been past due to template 3 - "Credit quality of performing and non-performing exposures by aging of past due days" would be useful?*

We do not consider inclusion of this new breakdown useful, on the contrary, it would add more complexity for many of the users of these disclosure templates. It is also important to maintain a level playing field at international level. With this in mind, we consider it would be better to align with BCBS's February 2018 consultative document on third phase of Pillar III disclosure requirements (p.16), which includes Table CRB-A (Additional disclosure related to prudential treatment of problem assets)". In this template, BCBS states that value adjustments and provisions for non-performing exposures should be disclosed but it does not require an additional breakdown by days-past-due. EBA should also take into account the requirements in CRR2 under Article 442 (currently under consideration by legislators) which requires ageing analysis of accounting past due.

***Q3:** Could you provide your views on whether the breakdown between "on balance sheet exposures" and "off balance sheet exposures" included in template 5 – "Quality of Non-performing exposures by geography" is useful?*

This breakdown is neither a requirement of the supervisory reporting package (COREP), nor in the BCBS consultative document mentioned above. Therefore, we believe that the breakdown is of little value to users and comes at a higher cost to credit institutions since the information cannot be taken directly from existing reports.

We also understand that the information should be disclosed according to the definition of non- performing and forbearance provided in Annex V of Commission Implementing Regulation 680/2014 since the disclosure requirements must be adapted to the regulation in force at each moment (i.e. definition of default). However, it is noteworthy that the disclosure templates proposed in this consultation will be directly affected and thereby amended accordingly to the EBA guidelines on the application of the definition of default and Commission Delegated Regulation (EU) 2018/171 on materiality threshold, (which will apply from 1 January 2021).

The use of different definitions and criteria for disclosure in a short timeframe could create confusion for investors. Therefore, if this template is to be maintained, we suggest aligning the definitions and criteria of these consultations, which are highly correlated. This would ensure the consistency and stability of the information to be disclosed to the market participants while reducing the operational burden for banks.

Please refer to further comments on template 5 under question 5.

Q4: *Could you provide your views on whether the information on loans and advances secured with immovable property with a loan-to-value higher than 60% and lower than 80% included in row 3 of template 7 – "Collateral valuation - Loans and advances at cost or amortised cost" is useful?*

AFME does not think this information is significant for banks to be required to disclose. Furthermore, it is not clear why EBA asks for feedback on the initial bucket only. We deem the collateral value underlying an exposure to default is not only affected by elements which are not strictly "market value", but also by valuation practices / practices influenced by the recovery procedures, therefore, any comparison between peers and geographies would be ineffectual.

Q5: *Do you agree with the overall content of these guidelines and with the templates proposed? In case of disagreement, please outline alternatives that would help to achieve the purpose of the guidelines.*

Comments on templates:

CR1-E should be replaced by Template 1 and Template 4 which should align to FINREP 18 and FINREP 19 respectively (i.e. the granularity prescribed in the new templates should not exceed what is currently required by FINREP 18 and 19). CR1-D should be replaced by Template 4 which should be also aligned to FINREP 18 (we also recommend deleting the column "of which impaired" as it adds undue complexity to the template with little benefit for end-users**).**

Template 3 should replace CR1-D and be aligned with Finrep 18 (we propose once again to delete column m "of which impaired").

Template 4 should replace CR1- E and be aligned with Finrep 4.3.1 & 4.4.1. We also recommend the "accumulated partial write-offs" column should be deleted for the following reasons:

- it will not help investors comparing write-off amounts from institutions based in different jurisdictions mainly due to significant differences in terms of tax treatment
- moreover, the disclosure of the stock of write off amounts may be relevant for supervisors having a good knowledge of the institutions' background, but it is misleading for the large part of investors as they confuse write off with provisions and impairments. Accumulated write off amounts will not impact the future financial performance of the institutions, and therefore is not useful for investors.
- Write off amounts are more relevant when they are related to a period to explain the variation of the stock of non-performing exposures (cf. Template 8).

Regarding **Template 5** - Quality of NPEs by geography and **Template 6** - Quality of loans and advances by industry – we do not consider these templates provide additional useful information in comparison to the existing CR1-B/C. Furthermore templates 5 and 6 deviate from CRR Article 442(e) while CR1 B/C are in line with the proposed text. We therefore suggest keeping CR1-B/C for which banks already have processes set up and remove the new templates (5-6) from the GL requirements.

Template 8 – should replace CR2-B for institutions meeting the criteria of paragraph 12 and 13. The column "Related net cumulated recoveries" is of interest for supervisors only.

Finally, as there are some differences in definitions and scope between COREP, and counterparties in FINREP and financial statements, the data reported in COREP and FINREP templates are not easily reconcilable. Therefore, to prevent comparisons between the two datasets and misunderstanding by the end users, we recommend deleting the "Total" lines from the templates.

Further specific comments on templates are also included in the sections below.

Scope of application:

it is specified that the guidelines apply to credit institutions that are subject to all or part of the disclosure requirements specified in Part Eight of Regulation (EU) No 575/2013 (CRR) in accordance with articles 6, 10 and 13 of the CRR. While we acknowledge this is aligned with Part Eight of the CRR, we consider the guidelines should specify that the scope of application is the same as the rest of the Pillar III disclosure requirements (e.g. If a credit institution, based on article 13 is only required to disclose information on a consolidated basis, it should also only disclose NPLs templates on a consolidated basis).

In addition, while we support the principle of proportionality embedded in this consultation, we consider that the definition of significant credit institution of this consultation, and the definition of significant bank of the ECB NPL guidance, should be aligned with the definition of large institution that will be included in the revised CRR. In this sense, the European Parliament has proposed the following definition (pending legislative approval):

"'large institution' means an institution that meets any of the following conditions:

(a) the institution has been identified as a global systemically important institution (G-SII) in accordance with Article 131(1) and (2) of Directive 2013/36/EU;

(b) the institution has been identified as another systemically important institution (O-SII) in accordance with Article 131(1) and (3) of Directive 2013/36/EU;

(c) the institution is, in the Member State in which it is established, one of the three largest institutions in terms of total value of assets;

(d) the total value of the institution's assets on the basis of its consolidated situation is equal to or larger than EUR 30 billion;

(e) the ratio of its total assets relative to the GDP of the Member State in which it is established is on average equal to or larger than 20 % over the four-year period immediately preceding the current annual disclosure period;"

Timing of application:

As drafted, the guidelines would suggest that when a bank crosses the EBA threshold and becomes a high-NPL bank, it would have to comply immediately with the full set of templates for disclosure. We consider this an unrealistic expectation, as it would mean planning ahead of time and on an unclear timescale. We would therefore suggest that the EBA provide for an adjustment or phase-in period for compliance with the full set of templates for banks that become high-NPL banks.

More generally we would note that the disclosure templates proposed in this consultation will be directly affected and thereby amended accordingly to align with the EBA guidelines on management of non-performing and forborne exposures, which will apply from 1 January 2019 and the EBA guidelines on the application of the definition of default and Commission Delegated Regulation (EU) 2018/171 on materiality threshold, which will apply from 1 January 2021. The templates will also be impacted by future revisions to the supervisory reporting data requirements (no implementation date is provided).

The use of different definitions and criteria for disclosure in such a short timeframe could create confusion for investors as well as challenges for banks when the new definitions kick-in. Therefore, we suggest aligning not only the definitions and criteria but also the implementation dates of all these 4 of these highly correlated consultations. Given the operational burden that banks are facing to implement all these regulatory standards, we consider that a more realistic timeframe for banks to comply with these disclosure requirements would be from 1 January 2021 instead of December 2019, which is the implementation date of the EBA guidelines on the application of default and the Commission Delegated Regulation on materiality threshold. This would ensure the consistency and stability of the information to be disclosed to the market participants while reducing the operational burden for banks.

Proportionality:

While we welcome the introduction of a threshold to introduce the concept of proportionality when applying the templates, we are not convinced setting this at a 5% ratio threshold is appropriate.

Firstly, setting it at 5% could be too low and affect institutions in geographic areas that not affected by high NPL ratios, or institutions with specific business models (for example consumer finance institutions) which have a structural higher NPL rate without having any issues related to solvency or profitability.

Secondly, the 5% is a fixed threshold and does not take into account the possibility of an economic downturn which would increase the proportion of non-performing exposures in all institutions throughout EU.

As a result, a large number of institutions that are "not likely to breach any solvency requirement" and with "a sound management and coverage of their risks" (as described in article 16 of regulation (EU) N° 1024/2013) would be impacted from having to apply a disproportionate disclosure requirement package during an economic downturn.

Moreover, from reviewing the EBA risk dashboards on NPL ratios by countries, we understand that high NPL level areas are limited to a few countries within EU. Therefore, in order to improve the proportionality criteria and meet the ECB and EBA objectives we recommend introducing an additional geographical specific criterion. This will give investors greater insight into institutions facing tough local macro-economic conditions. This criterion could require institutions located in countries which have an NPL rate in the fourth-quartile group to disclose the 6 additional templates.

Alternatively, EBA could set a higher standard ratio that would help investors to better focus on high NPL entities (at least a 10% rate defined on Dec. 2017 EBA risk dashboard p.10, tables "Dispersion" and "Country Dispersion").

Finally, further to the introduction of the proportionality principle introduced in these guidelines, we would urge for the ECB disclosure templates, which apply to all banks under their supervision, to be reviewed.

Clear and meaningful information:

Some of the key principles of Pillar III disclosure set by the Basel Committee (BCBS), EBA and the Enhanced Disclosure Task Force (EDTF) are that information should be clear, comprehensive and meaningful. In this sense, quality of information should prevail over quantity. We would like to express an overall concern about the quantity and granularity of information that in general the EBA requires banks to disclose in Pillar III reporting (not only related to NPLs but also in the EBA GL/2016/11 published in December 2016 – Guidelines on disclosure requirements under Part Eight of Regulation (EU) No 575/2013- and other guidelines).

Promoting market discipline is an objective of Pillar III disclosures. Bearing in mind that the users of the related information are also small investors and the general public (not exclusively institutional investors or rating agencies), the information to be disclosed should be clear and comprehensive enough to all of them.

From our experience with investors/analysts and other users, we firmly believe that the increase in granularity of disclosures in most cases does not add value but transforms the final reporting into large, complex documents which can be hard to be interpret.

Moreover, we are of the opinion that some information is more targeted to the supervisors which already have access to the same information through supervisory reporting.

The increase of information to be disclosed to the market could result in higher complexity that could in turn lead to misinterpretation of the information and market participants drawing inaccurate conclusions. For instance, where the templates mix accounting information with prudential information despite different criteria/concepts are different within both these perimeters, entails a risk of misunderstanding of the information disclosed.

We would also note in particular on template 2 that the information does not seem relevant for investors. Forbearance policies depend on an institution's business model, hence related information may lead investors to a false interpretation of this information regarding the institution's risk profile. Secondly, forbearance is a complex concept for the vast majority of investors, with technical information such as the exit criteria and the probation period. At best, they will not use this information, at worst, wrongly interpret it and not be able to use it to compare institutions correctly. We therefore suggest this template only be disclosed to the supervisor so that it can better understand the quality of an institution's forbearance methodology.

The templates are also not aligned with the BCBS consultation on the third phase of Pillar III disclosure, which includes a template related to the disclosure of the prudential treatment of problem assets. We therefore urge the EBA to consider the operational burden where banks have to comply with different disclosures templates at an international and European level.

Confidential and sensitive information:

One final point to consider is the disclosure of templates 9 and 10 to supervisors and potential buyers of NPL portfolios only, not the public. The reason for doing so is that this information may be particularly sensitive or even confidential and therefore could be detrimental to the sale of NPLs.

Regarding template 9 specifically, the detailed disclosure on collateral obtained by taking possession does not provide any valuable information to investors, but, on the contrary may mislead, with the following consequences:

- Bank image / reputation risk for seizing residential houses, autos, SMEs properties;
- Difficult to benchmark as systems for seizing collateral differ across MS;
- Mis-interpretation of the figures as there is no link to either the risk management policy when the bank grants the loan, or with the recovery policy. For instance, the reader could mis-interpret the certain disclosure as a bank failing to do rigorous enough checks when granting a loan or when selling the collateral, where the bank may in fact be located in a jurisdiction where residential loans are guaranteed by an insurance scheme and not by residential properties, or the bank loan policy is based on income to value and not on loan to value;
- Finally, in the case of low NPL institutions (representing the majority of the case), institutions help the customer to sell the asset given as collateral on their own terms, in order to limit the cost and timing of legal procedures and to preserve the potential future relationship with this customer. Therefore, if this template is maintained as public disclosure, we strongly recommend that it is only mandatory only for high NPL institutions.

In addition, collateral taking possession policy is bank proprietary and confidential information. Disclosing it publicly would undermine banks competitive position.

We consider the columns "accumulated impairment" provide enough information that can already be used by collateral buyers to negotiate the price of collateral, to the detriment to the cash deriving from the sale of the collateral, at the expense of the NPL debtor and the bank.

Regarding template 10, the above concerns are even greater, as it will disclose how banks are left with collateral on a long-term horizon. In addition, from an operational point of view, the template is very operationally burdensome to build as it bears no relation to any Finrep/Conrep reporting.

Furthermore, if important stocks of foreclosed assets are publicly disclosed in specific geographical area, it could lead to a negative pro-cyclical effect with knock-on price decreases and make it more difficult for institutions to sell their foreclosed assets. Therefore, disclosing template 10 would go against both institutions' economic interest and the action plan released by the Council of the European Union aimed at reducing the stock of NPL in institutions balance-sheet.

We have the same concern for Template 8, column "Related net cumulated recoveries" from the lines 5 to 12.

Comparability: Another key principle of Pillar III disclosure is to achieve comparable information between international banks.

From an international perspective, the BCBS issued in February 2018 a consultative document on the third phase of Pillar III disclosure requirements, including a new standardized template regarding additional disclosure related to prudential treatment of problem assets. In order to maintain a global level playing field, the EBA templates should seek homogeneity and alignment with those of the BCBS (e.g.: Template 3 proposes a breakdown of non-performing exposures by past due bands whilst in the consultative document of BCBS there is no need to disclose it).

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About AFME:

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