Consultation Response

EBA Consultation paper amending Guidelines on definition of default

13 October 2025

Introduction and General Comments:

The Association for Financial Markets in Europe (AFME) welcomes this opportunity to comment on the EBA **Consultation paper amending Guidelines on definition of default.**

In respect of this, we strongly advocate to review and allow banks to cap the NPV threshold at 5% at their discretion, taking account of the following statement from Ronny Mazzocchi and Kai Spitzer from the Directorate-General for Economy, Transformation and Industry (Public hearing with Claudia Buch Chair of the ECB / SSM Supervisory Board Banking Union Scrutiny. July 2025. Between prudence and politics: EBA default framework fails to reflect legislative intent. pg. 14[1])).

"***The EBA proposal appears to fall far short of what the co-legislators explicitly required****. [...] The request to revise the EBA Guidelines stems also from the need to align them with recent legislative changes introduced by the co-legislators most notably, the inclusion of a new Article 16a in Directive 2008/48/EC (so-called Consumer Credit Directive) and the amendment of Article 28 in Directive 2014/17/EU (so-called Mortgage Credit Directive). Through these amendments, the co-legislators made clear and deliberate choices*.[...] *At the same time, the legislators called for a more borrower-sensitive approach. [...]* ***The spirit and content of these provisions are difficult to reconcile with the current EBA Guidelines*** *- particularly the section on distress restructuring (paragraphs 49–55) - which largely omit the type of qualitative judgment foreseen by the co-legislators.* ***In practice, the rigidity of the framework and the narrow space for renegotiation discourage institutions from granting forbearance, even in situations where doing so would be economically and socially desirable. Yet, the EBA's proposal essentially dismisses this political mandate. By refusing to revise the 1% NPV threshold or to embed more qualitative assessments into default classification the EBA preserves a rigid framework that risks continuing to discourage debt renegotiation, hinder economic recovery, and contradict recent EU legislative efforts, including the new rules under the Consumer Credit Directive and the Mortgage Credit Directive***"*.*

Question 1: Do you believe the current guidelines result in some exposures under forbearance measures to be incorrectly classified as defaults, thus hindering proactive, preventive and meaningful restructurings given the detrimental effects that defaulted status has for the affected obligors? If so, please further specify the characteristics of the exposures, which you deem as being subject to an incorrect classification of default.

Yes, it is considered that current guidelines are already leading to some exposures under forbearance measures to be incorrectly classified as defaults, specifically for the cases under the Diminished Financial Obligation (DO) > 1% criterion. This question brings back the arguments previously raised by the industry during past consultations regarding the application of the DO criterion for default classification.

[1] Public hearing with Claudia Buch, Chair of the ECB / SSM Supervisory Board - July 2025

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The 1% threshold leaves very little room for banks to maneuver and provide financial support to viable clients who might face temporary difficulty in meeting their contractual obligation, it being possible that the threshold is breached because of technical or legal reasons. Moreover, this threshold is stricter for credit extended in periods of higher interest rates, given that the NPV outcome is affected by the applied discount rate.

Consequently, the incorrect classification of default is very common where interest rates are high, and it is common practice to apply forbearance measures to support the client's financial solvency and ensure better payment behaviour. In these cases, it is expected that an interest rate reduction will be offered, which triggers the 1% threshold and, consequently, leads to a default classification, even when studies have shown that profitability is not compromised by this practice.

- This situation is particularly concerning when the criterion is transferred to geographies such as LATAM. Forbearance operations in emerging markets, where rates are higher than in the EU, are a common practice to facilitate managing the customers' financial difficulties and ensure better payment behaviour. Forbearance operations usually imply a rate reduction which will lead to breaching the 1% threshold. However, experience shows that the profitability of the operation is not affected. Applying the EU threshold might push these clients out of the market, which is not optimal for the banks or the clients. An exemption should be applied to those jurisdictions.
- In the same vein, in EU markets when rates are rising (as recently has been the case), the 1% threshold is particularly detrimental, as breaching it becomes more frequent (by the mere application of the formula that calculates it); however, it is considered that the expected behaviour of the customer after the forbearance measure wouldn't be any worse than if the 1% threshold were not breached.

The DO and the 1% NPV threshold have meant the establishment of an additional criterion to identify if the forbearance is performing or not. Assuming that other default conditions are not met (e.g. no 90+ prior to the forbearance, capital grace periods, no debt forgiveness…) the DO criteria is the only trigger to classify a disruption in the loss's estimation.

The mere application of a threshold that (i) is 'non-sensitive' to market practices; (ii) does not consider the entity's risk profile or (iii) does not take into account the portfolio characteristics, should not be the sole determinant of whether or not the forbearance defaults. Furthermore, this criterion DO 1% threshold is very sensitive to the new conditions granted to the customer, and it could lead to breaching this threshold and automatically record the facility as defaulted, even if the customer is performing and the loan or credit is profitable for the bank.

Indeed, prior to the establishment of the DO threshold, the existing criteria that referred to the status of the facility/obligor before the forbearance and to the characteristics of the new conditions, provided enough elements to discriminate against forbearances as performing and non-performing at the time of concession. These internal criteria (which consider banks' risk profiles and are consistent with the strategy of each bank) have been successfully applied by banking institutions for many years, and reviewed by the supervisor through many OSI, which has helped institutions refine their own internal governances, procedures and policies.

In conclusion, internal models and bank practices are sound and robust enough to establish when to apply forbearance measures. We therefore suggest the DO threshold should be amended to act as a backstop to the other forbearance criteria rather than an overriding measure to determine default and suggest the NPV threshold (as defined by the bank) is capped at 5%.

Question 2: Do you think that relaxing the criteria for the minimum period before returning to the non-defaulted status for defaulted forborne exposures could be an appropriate measure to alleviate a higher burden on your institution and clients? How material would the difference be in your case between the amounts of forborne exposures classified as NPE and as defaulted if the minimum one-year probation period in the definition of default were reduced to three-months for certain forborne exposures (with change in NPV below 5% and no loss on the nominal amount)? Would that proposal create additional operational burden or practical impediments? Do you see support such proposal, and if so, for which reasons?

As highlighted in the Consultation Paper, significant efforts have been made to align non-performance exposure (NPE) definition and default definition from both regulators and industry alike. Further changes in this area will have a high impact on rating systems and potential model changes. Consequently, we do not anticipate that the proposals in their current form for relaxing the probation period would be materially beneficial, as its implementation would add complexity to the risk management for banks, as well as having a large operational impact – far greater than any benefit that could be derived from the changes. Indeed, considering the conditions that need to be satisfied for any reduction to apply, the cases which would potentially benefit from this proposal could be limited, as changes in interest rates are usually applied in the forbearance. Hence, this proposal alone does not provide for a significant solution to all cases that are incorrectly classified as default.

That being said, we are not opposed a longer-term revision, if this is done from a holistic point of view and considers level 1 changes including to the accounting regulation to ensure the NPE and default of definition remain aligned. In any case, proposals should be built in a such a way that they provide reasonable benefits compared to the costs (e.g. enlarging conditions so that the targeted scope is material). In this process, we also encourage the EBA to provide, at the same time with greater flexibility, solutions to ease the implementation regarding impact on rating systems. Further, we encourage the EBA to finalise as soon as possible its updates on the RTS for assessing the materiality of extensions and changes of the IRB approach where the objective is among others to alleviate the materiality of certain changes to the definition of default.

Question 3: Do you see any alternatives other than those referred to in this section that the EBA should consider under Article 178(7) CRR to update the Guidelines and encourage institutions to engage in proactive, preventive and meaningful debt restructuring to support obligors?

Considering all the arguments provided in question 1, the DO>1% criterion is not deemed appropriate for determining the default classification and should be capped at 5%. As per question 1, banks already have sound and robust internal models and practices that avoid unwanted variability in capital requirement consumption – this has been enhanced through the implementation of Basel 3 (CRR3), and through the supervisory activity. Hence, the application of the DO threshold should be amended to be capped at 5% to act as true backstop to other forbearance criteria.

Regarding references to payments which have been written-off, some national jurisdictions (e.g. Spain) request to eliminate conditions related to payments on write-off amounts[2]. Thus, the EBA proposal raises issues as it may contradict national law. To avoid general misalignment, adaptation of the condition by the EBA is necessary to address such national specificities.

We would also like to highlight some other possible amendments to the EBA Guidelines which could improve the DoD framework.

First, we would propose to reword the paragraph 52 to align with CRR3 and the fact that the NPV test is only required for the objective of identifying defaults triggered by the diminished financial obligation which results from the forbearance measure (thus the NPV test needs not to be performed when the exposure defaults for other reasons).

Paragraph 52 of EBA Guidelines details *"For the purposes of unlikeliness to pay as* ***referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013****,* <u>*for each distressed restructuring*</u>*, institutions should calculate the diminished financial obligation and compare it with the threshold referred to in paragraph 51. Where the diminished financial obligation is higher than this threshold, the exposures should be considered defaulted.*

We suggest replacing in paragraph 52 *"for each distressed restructuring" by "for an exposure subject to a forbearance measure potentially in default because of that measure likely to result in a diminished financial obligation due to the material forgiveness, or postponement, of principal, interest or, where relevant, fees*". In addition, we propose to add at the end of the paragraph "*For the avoidance of doubt, the NPV test should only be performed for exposures subject to forbearance measures and have not been recognised as defaulted yet*".

Indeed, such nuance is crucial as we understand that CRR targets the identification of default by performing NPV test only when the trigger is the forbearance measure likely to result in a diminished financial obligation due to the material forgiveness, or postponement, of principal, interest or, where relevant, fees. This is supported by the following references:

[2] See reference to Spanish Law here.

- In the level 1 text, article 178.3(d) of CRR was modified in CRR3 and now indicates*: "For the purpose of point (a) of paragraph 1, elements to be taken as indications of unlikeliness to pay shall include the following […] (d) the institution consents to a forbearance measure as referred to in Article 47b of the credit obligation* ***where <u>that measure</u> is likely to result in a diminished financial obligation due to the material forgiveness, or postponement, of principal, interest or, where relevant, fees;"***
- *Paragraph 50 of the EBA Guidelines specifies "given that,* ***as referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013****, the obligor should be considered defaulted where the distressed restructuring is likely to result in a diminished financial obligation, where considering forborne exposures, the obligor should be classified <u>as defaulted</u>* ***<u>only</u> where the relevant forbearance measures are likely to result in a diminished financial obligation****."*
- EBA feedback on the consultation of the first version of the Guidelines on definition of default mentions page 99 that *"As the calculation of NPV should be applied for the purpose of the identification of default,* ***it only applies to those exposures that are subject to distressed restructuring and <u>have not been recognised as defaulted yet</u>*** *[…]"*

As paragraph 52 of EBA Guidelines only mentions "for each distressed restructuring", there could be diverse supervisory understanding which deems for instance that the NPV test should be performed systematically for every exposure subject to forbearance measure, even if such exposure is subject to other default triggers (such as UTP or DPD) and is put into default in any case. From a pragmatic point of view, we would like to highlight that when the NPV test is performed for a forborne exposure only when the exposure has not defaulted yet for other triggers, this leads to the same outcomes that performing the NPV test systematically for every forborne exposure (in terms of status of default for obligors, same duration of probation period - 12 months - as the forbearance is identified before possible need to perform NPV test). This is why a more proportionate approach regarding performing the NPV test should be clearly referenced in the EBA Guidelines.

In addition, EBA provides clarification in Q&A 2022_6527 on the reset of probation period regarding forborne exposures. In particular, the following part of the EBA response to the Q&A should be reflected in the EBA Guidelines regarding forborne exposures in order to provide common understanding (across supervisors):

"Since Article 47a(3)(c) of the CRR requires an exposure that has been under distressed restructuring to be considered as non-performing in the case it becomes more than 30 days past due, there is a rebuttable presumption that the probation period referred to in paragraph 72 of the guidelines on the definition of default should be reset as soon as the exposure becomes more than 30 days past due, unless this delayed payment is not related to financial difficulties of the obligor."

Such clarification provides further alignment between NPE and default and implies that the probation period for defaulted exposures is not reset to zero when the obligor is not more than 30 days past due.

Finally we would like to highlight an issue with respect to the last version of EGIM, where the ECB confirmed in paragraph 12 (172(b)) that for distressed restructuring in default, institutions should refrain from allowing the return to non-default status as long as exposures are subject to outstanding past due amounts, **even if these past due amounts are immaterial** or are material and less than 90 days past due.

It means that for any very low technical past due (few euros) you can't return to non-default status. **This interpretation of article 73(c) of EBA GL on DoD is very restrictive**. During EGIM consultation we advocated for removing the sentence of paragraph 172(b) related to the immaterial past due without success.
The EBA should seek to clarify the treatment for immaterial exposures so that if past due amounts relate to a small amount of euros, then it should be possible for them to return to non-default status.

Question 4: Do you use internal definitions of default and NPE that are different from each other? Which differences are these and how material are those differences? Do you have any reasons or observed practical impediment that warrants a different definition of NPE and default? If so, please provide examples where a different definition of NPE and default is appropriate.

Question 5: Would a potential lack of alignment between the default and NPE definition lead to issues in accounting in your case?

There is no misalignment between definition of default and NPE. Potentially there's a misalignment between definition of default and Stage 3 classification, which depends on the bank's practice. There is no regulatory obligation to fully align default, IFRS 9 Stage 3, and NPE definitions. Some banks align them voluntarily for operational simplicity, but divergence is legitimate and acknowledged by regulators.

Question 6: Do you agree that no specific provisions should be introduced for moratoria on the grounds of the sufficient flexibility of the revised framework? In case you think the proposed alternative treatment for legislative moratoria should be included in these guidelines, do you have any evidence of the definition of default framework being too procyclical in the context of moratoria? Do you agree with the four conditions that need to be satisfied?

It is our understanding that the current default framework is not too procyclical in the context of moratoria as institutions are already applying measures and methods to mitigate such effects. However, the introduction of a specific treatment for legislative moratoria is considered positive, as it provides certainty and confidence by formally incorporating into regulation what is already applied in practice. We welcome the alternative treatment which clarifies that legislative moratoria under specific conditions are not forborne measures.

Regarding the conditions for legislative moratoria to benefit from the treatment underlined by EBA, we think that such conditions should align with the ones specified in legal texts detailing the moratoria (in particular regarding the fact that the moratorium does not apply to new loans granted after the date when the moratorium was announced).

This being said, we are of the view the first condition should be broadened to cover in addition to the payment schedule, those cases where the moratoria include a cap to the interest rates. Moreover, we do not support the fourth criteria identified by the EBA, which refers to the condition that the moratoria shall be accompanied by fiscal measures adopted by the respective Member State, which is too restrictive.

In addition, we would favour extending such treatment (derogation from reclassification to forbearance) to a non-legislative payment relief initiative of a bank as part of an industry- or sector-wide moratorium scheme agreed or coordinated within the banking industry. Indeed, some initiatives may take the form of industry-wide measures, agreed and documented by banks through industry associations in a given jurisdiction. In some Member States, such initiatives are openly encouraged by the government, sometimes supplemented by government guarantees, which provides incentives for banks to adopt these measures. In the context of an economic event (e.g. COVID), these industry measures would supplement the legislative moratoria. Thus, we consider that possible derogation given by the EBA should also target measures agreed or coordinated with the banking industry (even if moratorium is non-legislative).

Question 7. Do you agree with the revised treatment of technical past due situations in relation to non-recourse factoring arrangements? And if you do not agree, what are the reasons? Do you have any comments on the clarifications of paragraphs 31 and 32 in the current GL DoD?

We agree with the new proposal for the technical past due situations in relation to non-recourse factoring agreements -increasing the exceptional treatment of days past due at invoice level from 30 to 90 for factoring arrangements – as it is considered more aligned with the payment flexibility that typically characterizes this type of business; it better reflects the nature of the factoring product that during the last few years industry has supported.

Question 8. Do you agree with the other changes to the guidelines to reflect updates from Regulation (EU) 2024/1623?

The other changes to the guidelines aimed at reflecting the updates introduced by CRR3 are considered appropriate.

We have one additional proposal which we would like the EBA to take into account which is for the extension of the specific treatment for factoring to leasing since operational lease arrangements share many similarities with factoring arrangements.

Proposal for the **specific treatment for operational lease exposures:**

Business model of operational leases

There are 3 major process differences between operational lease and traditional bank loans:

1) Where bank loans are repaid by the Treasury department within the larger companies, the invoices related to operational lease are usually paid by the Procurement department. And since an operational leasing company is perceived by customers as a supplier rather than a Financial Institution, the due date on the invoice is not always adhered to. Similar to the energy bill or invoices from suppliers of office equipment. The late payment of the customer can be due to complex internal processes, due to working capital choices or otherwise.
2) Whereas the general monthly instalment could be paid timely by the customer, one-off charges related to damages, fines and end of contract costs are also invoiced on a regular basis. As these costs are not always understood directly by the client and again, their complex internal invoice-to-payment process has to be followed, these non-recurring invoices tend to be paid after the invoice due date more frequently.
3) It is not self-evident that this activity, which for example provides a service for managing a customer's vehicle fleet (invoices related to goods and services and not to debt/credit and loan products), should be classified as a purely financial activity. Indeed, car leasing competitors who are not affiliated to a banking company are not subject to banking regulation, which shows that car leasing, as an underlying activity does not in and of itself justify such a framework. Only membership of a banking group does, which creates distortions of competition between leasing entities that are subject to banking regulation and those that are not.

Factoring similarities

"In relation to non-recourse factoring, the EBA understands that institutions with big corporate-loan portfolios are hesitant to provide factoring facilities to clients (often SMEs) who wish to sell the receivables of a company for immediate liquidity, where this company is also a non-retail obligor of the institution (i.e., the institution has a direct exposure to this company). A typical example would be the one where an SME (client) has sold the receivables of a large company (debtor /obligor) to the institution (factor). The credit risk and therefore the definition of default is assessed toward this large company. Furthermore, if the credit institution also has other direct exposures to the debtor (on which the debtor is timely paying according to the payment schedule), these direct exposures would also have to be placed in default if the large company is consistently paying late on the factoring."

The same is true of car leasing, where operating lease invoices may be processed less diligently by the large company's procurement department than credit repayments by the large company's treasury department. This implies a risk of default on the large company due to relatively low operating lease invoices and tends to make the institutions hesitant to get involved in this type of activity.

EBA's following arguments regarding factoring activities can also apply to automotive leasing: "The current 'days past due' (DPD) counting convention has limited impact on 'regular' products, while it does not reflect the economic reality of purchased receivables where repayments are made invoice by invoice:

- The DPD counter may keep increasing due to a consecutive overlap in non-payments of these invoices. If there is a high number of receivables, the DPD counter keeps on increasing with payment delays on each invoice.

- There are observed lengthy administrative processes with a natural long validation lifecycle of the receivables on invoices.

The fact of being in a two-party agreement, and not a three-party agreement as in non-recourse factoring, in no way mitigates the elements listed above.

As a result, we are fully in line with the EBA's finding that “The DPD criteria and materiality threshold should not be intended to go beyond identifying debtors who are not paying or are unlikely to pay their credit obligations. Stricter arrears criteria may not have the effect of reducing arrears, but rather of encouraging institutions to refuse to grant credit to companies”.

In conclusion, the above is resulting in obligors having to be considered defaulted after 90 days while this non-payment is fully unrelated to the creditworthiness of the obligor and as such the current default definition produces incorrect default classifications. Since the implementation of the new definition of default, the highest default rates are observed for governments, banks and corporates often with prime ratings. As these government bodies are in UK, France, Italy and Spain, we see no correlation between the days past due and the creditworthiness of the obligors. Furthermore, the cure rate in car leasing, i.e. the rate of obligors returning from a default to a non-default status or from default to full repayment is high. We consider that the new definition of default worsened the insight into the real credit risk levels.

While the reasons might not be fully comparable between operational leasing and factoring, the outcome that obligors have Days Past Due solely due to the nature of the product and completely unrelated to their creditworthiness is the same.

Therefore, we would like to request to consider the inclusion of leasing under the same specific treatment as factoring.

An example based on car leasing is presented thereafter for illustration and clarification.

Illustration

In car leasing activities, clients have a monthly rental to pay. The main advantage of a softening of the current rules for car lessors concerns slow payers, e.g. if a customer always pays 1.5 months late, as illustrated below:

	2025-01	2025-02	2025-03	2025-04
	January monthly instalment due 1-1 – 100K.	February monthly instalment due 1-2 – 100K. January Instalment paid 15-2	March monthly instalment due 1-3 – 100K. February Instalment paid 15-3	April monthly instalment due 1-4 – 100K. March Instalment paid 15-4
Overdue per instalment	30 DPD	0 DPD instalment of January (with a peak of 45 DPD mid of Feb.) 30 DPD instalment of February	0 DPD instalment of February (with a peak of 45 DPD mid of March) 30 DPD instalment of March	Proposal to consider No Default, as no invoice is/was individually more than 90 DPD but max.45 DPD.
Translation in current NDoD	30 DPD	60 DPD	90 DPD	Default

The rationale is the same as for factoring as explained before:

- The DPD counter may keep increasing due to a consecutive overlap in non-payments of these invoices.
- Current DoD applied on leasing activity does not sufficiently consider the specificities of the leasing product and its natural delays in the payment process, such that the current default definition produces incorrect default classifications. There are many corporates having at least one invoice on which they pay later than 30 days after the due date, whilst being rated at investment grade.

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