

Comments on

the EBA consultation paper “On Supervisory reporting on forbearance and non-performing exposures under article 95 of the draft Capital Requirements Regulation” - EBA/CP/2013/06

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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1. General Comments

In regard to the definition of the term "forbearance" and the new requirements, the EBA invokes article 95 of the CRR. The German financial industry has difficulty understanding why this subject is to be taken up again shortly before the finalisation of the FINREP framework. There are already comparable requirements in the framework of IFRS and these were fleshed out and expanded in the public statement on forbearance practices issued by ESMA on 20 December 2012. Even though ESMA does not have the legal authority to issue such specifications, ESMA's requirements are being fulfilled on a best effort basis in the entities' annual accounts. Further disclosure requirements are currently being discussed within the scope of IFRS 9. At this stage we do not see any need for further disclosure requirements on forbearance and non-performing exposures.

There should rather be synchronisation between the IFRS requirements and the requirements of FINREP with regard to content and timeline. This would also considerably facilitate the technical implementation.

The proposed definitions deviate from those customary and established under the IFRS and Basel III. Divergent definitions multiply the time and effort required for data compilation, generation and reconciliation, and impede implementation, especially in regard to differing business models in the financial sector. Despite the proposed EBA definition it is not possible to make an unambiguous allocation to loans involving forbearance measures. Rather, such allocation is a matter of how the pertinent requirements are interpreted by the given institution. We advocate the use of uniform definitions.

The suggested definition is disproportionately broad and would cover almost any renegotiation. Only a fraction of renegotiated loans should actually be classified as critical. Given this background, we would like to indicate that it is standard for German financial institutions to grant their clients for a wide range of business activities great flexibility in their method of repayment. A modification of the contractual cash flows with regard to the original contract conditions should thus expressly not be classified as a forbearance measure. This would not contribute to fulfilling the EBA's objectives of consistently determining and assessing the extent of non-performing exposures and forbearance measures across the EU. On the contrary, we expect that including modifications with regard to the original contract conditions will over-represent the relevant risks, as it would include and present not only cases of financial difficulties of clients with forbearance agreements, but far more cases of modifications to contracts. In total, it seems to us extremely questionable if, and to what extent, the data to be reported can be comparable across institutions.

It is essential to give entities adequate time to obtain the information required. A time frame of at least 1 ½ years is required to source the required information following publication of the final ITS. Finally, we would like to remark that, in the EU, there are many bank-led financial conglomerates (i.e. structures in which there is a financial institution with subsidiaries, for example insurance firms). If, as intended in the consultation paper, consolidated companies are treated according to commercial law instead of supervisory regulations with regard to

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FINREP reporting on forbearance and non-performing loans, it will be a de facto expansion of banking supervision to non-financial subsidiaries (as a rule insurance firms or building societies) that are part of the conglomerate. As these already have supervisory rules and bodies of their own, this would in effect result in an inefficient duplication of supervision that is neither necessary nor desirable and would create significant organisation effort for the reporting parent financial institution.

2. Detailed comments

Basic concept

1. *Do you agree that building definitions of forbearance and non-performing by taking into consideration existing credit risk related concepts enables to mitigate the implementation costs? If not, please state why.*

We expressly argue for the application of definitions that are already in use as part of common credit risk oriented approaches. Only this can keep the cost of implementation for financial institutions within reasonable limits. Differing definitions lead to duplication of effort and exponentiate costs associated with implementation. Uniform definitions on the other hand would reduce implementation costs. To avoid unnecessary increases in the implementation costs, definitions should be used that are currently applied and are already a part of existing processes and systems (e.g. IFRS, CRR-E).

This is particularly relevant considering that CRSA institutions and CRSA financial holding groups are obliged, according to article 122 of the CRR-E, to apply the IRB definition of default described in article 174 of the CRR-E by 1/1/2014. The IRB definition of default would then apply in future across Europe for IRB and CRSA institutions and financial holdings groups. A further Europe-wide standardisation is expected with the CRR guidelines in article 174, paragraph 5 of the CRR-E, which will by 13/12/2014 stipulate in a regulatory standard the criteria of determining the threshold for specifying the materiality of a default. Furthermore, the EBA should, according to article 174 paragraph 6, develop guidelines for the implementation of article 174 of the CRR-E. An independent definition of non-performing exposures based on the 90 day past-due criterion is then no longer required for Europe-wide uniform implementation. In this respect these drafts should be waited for and it should be ensured that the definition of non-performing, at least in the banking book, is identical to the definition of default according to article 174 of the CRR-E.

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Definition

2. Do you agree with the proposed definitions? Especially, do you agree with the inclusion of trading book exposures under the scope of the non-performing and forbearance definitions? If you believe alternative definitions could lead to similar results in terms of identification and assessment of asset quality issues, please explain them.

An additional paragraph is preferable to an independent definition. It would however be preferable if the standard setters with comparable objectives could agree on uniform definitions. The suggested definitions are very broad, ambiguous and not selective, and demonstrate in part significant inconsistencies with the definitions provided under Basel III and IFRS (e.g. the definition of "loan commitments"). If the EBA feels the need for further change, the EBA should consult with the regulators and the IASB in its role as a standard setter.

By subsuming trading book exposures under the non-performing and forbearance definitions the paper's scope of application and reporting requirements go far beyond the scope of application of IAS 39/IFRS 9. This gives rise to high data procurement, consolidation and implementation costs (cf. question 15).

In addition, the definition of "trading book exposures" is clearly too imprecise. It needs to be clarified if this relates to all financial instruments recorded in the balance sheet at fair value through profit or loss, or if equality is being sought with the differentiation between the regulatory trading book and banking book. In our opinion, only financial instruments that are not designated at fair value through profit or loss may be included (IAS 39: LaR, HtM, AfS or IFRS 9: AC or FVOCI). For financial instruments designated at fair value through profit or loss any changes in performance are represented in the market value. A dependence on the differentiation of the regulatory trading book is in our opinion not advisable,

For instance, it is hardly feasible to judge whether a contractual change implies more favourable conditions for the debtor than it could obtain on the market as it is impossible to assume full market transparency in the lending business. What is typically involved here is an "inactive market". Moreover, all banks base their conditions on different, constantly changing foundations, so that any comparison is frustrated by the very lack of a benchmark, which is why it is particularly important for the content of definitions to take guidance from existing, periodically examined lending processes.

According to our understanding, it would be more productive to focus on modifications in connection with significant ratings downgrades or on treatment in the context of the Minimum Requirements for Risk Management (MaRisk). The lending process would then accordingly be reviewed as part of the audit of the annual financial statements, allowing borrowers in financial difficulty to be identified on a regular basis.

Regarding the second criterion in the definition of "non-performing", we wish to remark that this contradicts the incurred loss concept as detailed in IAS 39.

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Implementation effort

3. How long will it take you to implement, and collect data on, the definitions of forbearance and non-performing?

The implementation effort depends on the definition chosen. The current unequivocal and excessively broadly conceived definition would entail substantial implementation effort as all lending business segments (front and back office) would be affected. The definitional differences between accounting and disclosure place an additional burden on the time and effort of implementation on account of duplicate collection and the concomitant reconciliation effort. Procedural and technical implementation by the end of 2013 is not possible as the new processes require substantial systemic adjustments or even entirely new systems. On the basis of a final ITS and final tables an implementation period of at least 18 months would be a realistic proposal.

4. What definitions of forbearance and non-performing are you currently using respectively for accounting and prudential purposes?

Forbearance definition

5. Do you agree with the types of forbearance measures covered by the forbearance definition? If not, what other measure(s) would you like to be considered as forbearance?

The suggested definition is disproportionately broad and would cover almost any renegotiation. Only a fraction of renegotiated loans should actually be classified as critical.

We suggest that the ITS be oriented on credit risk oriented approaches. We think it advisable, for example, to define forbearance and non-performing in connection with the ratings category.

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6. Do you agree with the following elements of the forbearance definition:

- the criteria used to distinguish between forbearance and commercial renegotiation?
- the criteria used to qualify refinancing as forbearance measures?
- a 30 days past-due threshold met at least once in the three months prior to modification or refinancing, as a safety net criterion to always consider modification or refinancing as forbearance measures?
- the proposed treatment for exposures with embedded forbearance clauses?

In case you disagree with the EBA proposals on the above-mentioned issues, please explain and provide an alternative to them.

The distinction between forbearance and commercial renegotiation is in principle understandable. However, we consider the threshold of 30 days impracticable. Depending on the loan portfolio, this criterion also impacts a number of non-critical cases. Thus exclusively qualitative criteria should be applied.

Institutions currently possess no reporting information from which the reason for refinancing can be systematically retrievable. The new loan is independent, reliant on quality or changed market conditions. In this respect we consider the distinction impracticable.

Regarding remarks on modification of cash flows relating to original contract conditions please refer to the general comments section.

Scope of exposures for the forbearance definition

7. Do you agree with the proposed scope of on- and off-balance sheet exposures to be covered by the definition of forbearance?

We do not agree with the scope, as, in our opinion, assets assessed at fair value through profit or loss should not be included (cf. general comments section as well as the answer to question 15.)

8. Do you agree not all forbearance transactions should be considered as defaulted or impaired?

9. What types of forbearance transactions are likely, according to you, not to lead to the recognition of default or impairment?

The EBA points out that forbearance may be involved in certain circumstances even if there is no impairment pursuant to IAS 39, referring by way of example to E.4.3 of IAS 39 IG. According to IASB this example does reflect such an unrealistic case, which is why it is unsuitable as a justification for divergent definitions. We strongly argue for the waiver of

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differing definitions. A take-over of the IFRS definition would moreover enhance comparability with IFRS.

10. Do you agree with the proposed definitions of debtors and lenders and the scope of application of the forbearance definition (i.e. accounting scope of consolidation)?

11. Do you agree with the proposed mixed approach (debtor and transaction approaches) for forbearance classification?

We disagree with the definition of "debtor". The definition is too broad and does not correspond with other regulatory definitions. In addition, loan reporting processes have to be extended with disproportionate effort and transferred to the accounting systems to fulfil the EBA's requirements. This is not realistically achievable by 1/1/2014.

We see the following issues for the forbearance definition arising from the treatment of consolidated companies according to commercial law:

- In many institutions, the treatment of consolidated companies differs under supervisory regulations and commercial law respectively. The information displayed in tables 10 and 14 is based on different populations is thus not reconcilable. There is no recognisable value add to this information. For example, in connection to this, we note that the data on forbearance and non-performing loans in table 14 relate to a table originally from FINREP, which is overridden by the supervisory regulations for consolidated companies. The addition of forbearance and non-performing loans in this table relates to the IFRS treatment of consolidated companies, so that there is no consistency in requirements here and no reconciliation is possible.
- Insurance companies can also be included in consolidated companies treated under commercial law. These are not required to provide data in FINREP reports. The departure from the supervisory regulation treatment of consolidated companies regarding this point would require such companies to generate corresponding reports for the parent company. Banking supervision would thereby effectively be extended to insurance firms. It would lead to an inefficient duplication of the supervision of insurance companies by involving both the banking supervisory authorities (FINREP) and the insurance supervisory authorities (VAG/Solvency). This would create a significant amount of additional organisational cost for the insurance companies impacted.
- We also feel that the consideration of debtors in connection with their consolidated company is not proper. A forbearance measure relates to a loan/a series of loans taken out by a specific debtor. Other companies in a group are not impacted. If a risk oriented approach were selected regarding capital adequacy, the difficulties would affect the rating of the other companies in the group not impacted by payment difficulties.

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In addition, the debtor approach is very complicated in its implementation and as well not appropriate for all cases in the investment business. For example, if many contracts are entered into with a debtor (investee), according to our understanding, two cases are to be distinguished:

- a) conclusion of at least two financial transactions of mezzanine character (e.g. silent participation, profit participation right, shareholder loan). In this case, the debtor approach would be appropriate.
- b) conclusion of at least one mezzanine financial transaction in combination with a direct investment (e.g. acquisition of shares in combination with the granting of a shareholder loan or silent participation). In these cases, the debtor approach seems inappropriate to us, as mezzanine financing in the categories of "forbearance" or "non-performing" cannot be "automatically" assigned to the open participation. These should rather be separately assessed, as they don't represent a loan relationship but rather an investment of the institutions. Take, for example, the case of a successfully concluded self-administered insolvency. In this case the mezzanine financing should, as a rule, be classified as "non-performing", while the shares should once again have value after the conclusion of the self-administered insolvency.

In addition, according to our understanding, the categories of forbearance and non-performing do not in principle apply to an open investment, as normally no contractual remuneration or repayment claims arise.

- 12. Do you agree with the exit criteria for the forbearance classification? In particular:*
- a. what would be your policy to assess whether the debtor has repaid more than an insignificant amount of principal or interests?*
 - b. do you support having a probation period mechanism?*

We find the exit criteria for the forbearance classification inappropriate. The definition is too abstract and the technical and procedural implementation would require disproportionate effort, particularly with regard to "regular payments" and the "probation period".

The introduction of a probation period of at least two years until a loan is cleared of forbearance reporting obligations is in our view inappropriate in that the credit risk is not adequately reflected if, for example, a real estate company became forborne as a result of the loss of a tenant and a financially strong tenant is subsequently found to take over for a sufficiently long period. Such a probation period is incompatible with the time-bound character of a report. This kind of probation period also does not comply with banks' internal procedures and conventions. It should therefore be entirely cancelled. Moreover, the cost associated with the tracking of data and criteria is extremely high. Assuming a project duration of 18 months and a probation period of two years, implementation would not be possible until the reporting deadline, viz. 31 December 2016.

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In addition, we refer to our remarks regarding departures from IAS 39/IFRS 7 or, in future, IFRS 9 or ED/2013/3.

- 13. Do you agree with the proposed approach regarding the inclusion of forborne exposures within the non-performing category? In particular:*
- a. Do you agree the generic non-performing criteria allow for proper identification of neither defaulted nor impaired non-performing forborne exposures? Would you prefer to have the stricter approach (all forborne exposures identified as non-performing) implemented instead?*
 - b. do you agree with the proposed consequences of forbearance measures extended to an already non-performing exposure? Especially, are the proposed exit criteria strict enough to prevent any misuse of forbearance measure or would stricter criteria be needed?*

Although the definition is conceptually accurate, the separate monitoring and reporting provides no significant additional information, while the processes are technically difficult to implement. In this respect we take a negative view of the definition as a whole.

Non-performing-definition

- 14. Do you agree with the following elements of the non-performing exposures definition:*
- a. the use of 90 days past-due threshold to identify exposures as non-performing?*
 - b. the proposed guidance for past-due amounts?*
 - c. the proposed treatment of collateral and especially the proposed valuation methodology for its reporting?*

In case you disagree with the EBA proposals on the above-mentioned issues, please explain and provide an alternative to them.

Non-performance is already defined under supervisory law in section 125 of the SolvV. An additional definition would make things less transparent and entail unnecessary implementation and reconciliation costs, which is why the existing definition should be maintained. In addition, harmonisation with IFRS requirements should be sought.

In the collateralised lending business, the failure to take account of collateral securities in defining non-performance leads to a marked increase in reporting obligations. The banks that are put at a disadvantage by this rule are in particular those which are active in the asset based finance business. Nor is this situation mitigated by the fact that collateral securities need to be shown in the tables as they cannot be attributed to the applicable portfolio.

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Moreover, the introduction of the proposed guidance requires disproportionate effort, especially relating to identifying debtors who are constantly past-due in a 90 day period, but have no payment that is past-due for more than 90 days. These can only be manually identified.

15. Do you agree with the coverage of the proposed definition and with the possibility to apply the generic non-performing criteria to all fair-valued non-performing exposures? Do you expect challenges when implementing them and collecting data on fair-valued non-performing exposures? Would you suggest other criteria instead?

The EBA proposes that financial instruments that are evaluated at fair value through profit and loss should also come under the non-performing definition. Subsuming the fair value category under non-performing exposure is not meaningful as fair value is the key performance indicator. Besides, such addition would entail a substantial extra burden (cf. question 2, second bullet). Moreover, this would run counter to the new regulations of IFRS 9 according to which fair value is to be reported by reference to the business model and to cash flow criteria, which is why fair value categories should remain excluded.

16. Do you agree with the proposed treatment for derivatives exposures? If not, what criteria would you suggest to enable identification of non-performing derivatives

We find the suggested treatment of derivatives exposures appropriate.

17. Do you agree with the proposed criteria to identify off-balance sheet exposures as non-performing?

The same criteria should apply to off-balance sheet positions as is applied to balance sheet assets being considered, as should the same points of criticism.

Relations between the definition of non-performing exposures and the impairment and default concepts

18. Do you agree not to consider exposures subject to incurred but not reported losses as non-performing?

19. Do you agree with the proposed approach regarding the materiality threshold?

We disagree with the suggested materiality threshold in the definition of non-performing. To apply the non-performing threshold at the group level implies de facto a single business perspective in group accounting. The necessary data pools and monitoring processes at the group level are not currently available in this form, and would be extremely costly to implement.

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20. Do you agree with the proposed definitions of debtors and lenders and the application of the non-performing exposures definition on an accounting scope of consolidation?

21. Do you agree with the proposed approaches (debtor approach for non-retail exposures, and possibility of a transaction approach for retail exposures)? In particular, do you agree with the idea of a threshold for mandatory application of the debtor approach? If so, which ratio methodology would you favor and why?

The application of mixed approaches is not necessary. If the default of one financial instrument impacts further financial instruments of the same debtor or the same transaction, these independently fall under the forbearance/non-performing definition, and should be correspondingly included in the tables. In accordance with this, we also hold that the introduction of thresholds in this context to be unnecessary.

23. Do you agree with the exit criteria from the non-performing category?

24. Do you agree with the separate monitoring in a specific category of exposures ceasing to be non-performing? Do you think this specific category should be integrated within the performing or the non-performing category?

The EBA plans to put recovered loans in a separate category with a view to returning them to performing status after a one-year probation period. A new category would make matters more complex while not allowing any qualitative conclusion about the credit risk (see commentary on question 12), which is why no new category should be introduced. Where a case like this becomes conspicuous again, it should be reported in the context of the forbearance definition, in which case transparency would be assured. The institutions have already prepared recovery definitions that have been approved by the German supervisory authorities. It should be possible to use these definitions.

Table performing and non-performing exposure

The table requires the disclosure of fair value changes of securities of the "available-for-sale" category triggered by changes in creditworthiness. This information is currently not available on the bank's systems. Moreover, this item is unlikely to be relevant in practice because typically securities, in case of default of payment, become non-performing immediately.