

Division Bank and Insurance
Austrian Federal Economic Chamber
Wiedner Hauptstraße 63 | P.O. Box 320
1045 Vienna
T +43 (0)5 90 900-DW | F +43 (0)5 90 900-272
E bsbv@wko.at
W <http://wko.at/bsbv>

Your ref., Your message of

Our ref., person in charge
BSBV 189/Horvath

Extension
3141

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BCBS Consultation Document on „Prudential treatment of problem assets - definitions of non-performing exposures and forbearance“

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the above cited consultation document and would like to submit the following position:

I. GENERAL COMMENTS

Compared to the EBA regulation on forbearance and non-performing exposures (hereinafter referred to as “EBA ITS”), the BCBS consultation paper is very general in terms of definitions, processes and timelines. The proposed definitions by the Basel standard setters can be considered as an open approach allowing a broader interpretation.

II. DETAILED COMMENTS

- **Page 8, point 23 (definitions/requirements used for off-balance exposure)**
We would like to mention that the BCBS proposal stands in contradiction with the current FINREP rules, where cancellable and un-cancellable commitments are considered.

- According to the Regulation (EU) 2015/227, Annex V, Article 56 all revocable (cancellable) and irrevocable (uncancellable) nominal amounts should be included.
- According to the BCBS we should report as non-performing just entire uncancellable nominal amounts.

But according to the default definition we consider the whole customer exposure as defaulted exposure (that means also the cancellable amount). In table 18 from FINREP we have to report both classifications: default and non-performing exposure.

As an example, if a defaulted customer has both, cancellable and uncancellable loan commitments with an exposure of 10 (cancellable), respectively 15 (uncancellable), we would report in table 18, according to the BCBS paper, 15 exposure as non-performing, but 25 as defaulted. This would violate the validation rule that impaired exposure $\leq$ defaulted exposure $\leq$ non-performing. For this example the non-performing exposure would be lower than the defaulted exposure.

- **Page 8, point 24 (definition of non-performing)**

Para 24 (iii) defines all exposures as non-performing where there is evidence that full repayment of principal and interest without realisation of collateral is unlikely, regardless of the number of days past due.

In order to have a common understanding of this definition it is crucial to clarify the meaning of “realisation of collateral”. We consider it as necessary to differentiate in an explicit manner exposures where the repayment of the exposure is intended to occur without a realisation of collateral from exposures and where the repayment is originally intended to be made through a realisation of collateral (e.g. “Tilgungsträgerkredit”, repayment vehicles or Debt Service Reserve Accounts).

Additionally, payments made by other parties, e.g. parent companies, should not be considered as a realisation of collateral if they are made voluntarily (“Patronatserklärung” or comfort letter). Such clarifications would also comply with the further content of these guidelines as para 28 - unlikely full repayment, 2. subparagraph stipulates that an unlikelihood to pay is indicated by a *forced* sale of collateral. In this regard it should be clarified that if the counterparty sells the collateral himself with the agreement of the bank to fulfil its obligations this is not seen as “realisation of collateral” because the bank is not directly realising the collateral (Remark: This would also include sales proceeds of financed commodities or financed assets like project finance, e.g. development of apartments for sale).

- **Page 9, point 28**

- **Explanation of Past due**

We ask for clarification of the treatment of immaterial exposure that is more than 90 days past due. For example, currently in table 18 of FINREP, if we disclose the immaterial exposure that is more than 90 days past due in the correct past due bucket, we would violate the requirements of non-performing exposures which require the necessity of materiality. In table 18 there is no possibility to disclose performing immaterial exposure that is more than 90-days past due.

- **Unlikely full repayment**

We ask for clarification whether the mentioned analysis for retail segment including LTV ratio is a recommendation or if it is binding. We consider LTV as non-relevant indicator for assessing unlikelihood for debt repayment as it is mentioned by the definition itself (“...without realization of collateral”) and mentioned by the regulator that collateralization has no impact on assessing NPE.

- **Material exposure**

“An exposure should be considered past due even when the amount of the exposure or the past due amount, as applicable, is not considered material.”

There seems to be a contradiction within in the BCBS document. The term “material exposure” is mentioned in connection with the “90 days past due criterion” both as trigger for NPE (page 8, point 24) and in the NPE exit criteria (page 11). There should be more consistency regarding the usage of the term “material and non-material exposures” within the BCBS paper in order to generate certainty of the concept.

- **Page 10, point 30 (Interaction of non-performing exposures with forbearance)**

According to para 30 a forborne exposure should be recognised as non-performing when it meets the conditions for such categorisation or when the original exposure would have been considered as non-performing had the forbearance measure not been granted to the original exposure.

We agree to the proposed specification that a forborne exposure should be recognised as non-performing when it meets the conditions for such categorisation but we disagree with the second half sentence. On the one hand we believe that it is not necessary to consider exposures as non-

performing when the original exposure would have been recognised as non-performing had the forbearance measure not been granted. The first half sentence already ensures that exposures which meet the conditions for such categorisation have to be qualified as non-performing. On the other hand the second half sentence seems too excessive since it would not complement the category of “defaulted” in the Basel framework (para 452 Basel II framework) but rather extend the current definition and therefore diverge to the aim of these guidelines only to complement the current categories (para 10).

- **Page 11, point 32**

- **Regarding the Reclassification of non-performing exposures as performing**

“the debtor does not have any material exposure more than 90 days past due;”, “repayments have been made when due over a continuous repayment period specified by the supervisor;” Regarding both conditions we ask for clarification with regard to the curing period. We suggest that it should be standardized in order to assure harmonization among banks. In the current form (as defined a continuous repayment period) there is space for different interpretations.

- **Non-performing exposures, NPE**

The following technical issue differs from the official EBA ITS:

In regard to reclassification of non-performing exposures as performing: repayment period specified by supervisor (page 11, point 32) is mentioned instead of a one year probation period. This might generate uncertainty due to the fact that supervisors get more discretionary power.

- **Page 11, point 33 (following situations will not lead to the reclassification of a non-performing exposure as performing)**

- **Partial write-off of a non-performing exposure**

Para 33 (i) defines which situations do not lead to a reclassification of a non-performing exposure as performing and explicitly mentions a partial write-off of a non-performing exposure.

We believe that the current wording of para 33 (i) is too excessive and therefore should not be maintained. The extent of this provision is unclear since it may cover situation which occur due to court compensation proceedings or court insolvency proceedings resulting in an undermining of the legal effects of (national) legal acts which result in a restructured borrower. Furthermore, it has to be clarified when a non-performing exposure can be reclassified if the partial-write off was part of an out of court settlement that resulted in a significant improvement of the counterparty's creditworthiness and financial standing.

Additionally, the proposed provision does not differentiate if the write-off concerns material amounts in relation to the exposure or just insignificant parts. A possible solution could be the setting of a materiality threshold, e.g. 2.5 % and 250 Euro of all committed lines (both conditions have to be fulfilled). If the write-off of the non-performing exposure goes beyond the materiality threshold a reclassification of the exposure as performing would not occur. Furthermore, it has to be distinguished between revenue out of credit related interests and non-credit related revenues out of fee income (e.g. maintenance fees for accounts). In this regard, the write off (booking out) of fees is a correction of too high income expectations. As only income expectations get corrected, no economic loss is resulting out of the procedure and therefore no Individual Loan Loss Provision (ILLP) can be allocated to this exposure type.

We suggest a defining minimum curing period for an upgrade from write off. But we ask for clarification whether partial write-off is considered on single exposure level or total debtor.

- **Repossession of collateral on a non-performing exposure**

It should be clarified that this rule does not apply in the event that the debtor takes over the shares of a client, thus becoming the owner of the former customer. At the same time

repossession of collateral triggers the default event recognition for which a curing period should be established.

- **Page 12, point 38 (off-balance sheet items)**

The Regulation (EU) 2015/227, Annex V, Article 169 includes loans, debt securities and revocable and irrevocable loan commitments given, but excludes exposures held for trading. In contrast to that, in the BCBS paper financial guarantees are mentioned, but in the Regulation not. We ask for harmonization.

- **Page 12, point 40 (Financial difficulty)**

- **(a) A counterparty is currently past due on any of its material exposures**

We suggest establishing a certain DPD level. We consider that the current definition may lead to misalignment with the introduced EBA concept where 30+ days in the last 3 months without a materiality threshold are considered.

- **(c) A counterparty's outstanding securities have been delisted**

According to the proposed definition within the guidelines (Financial difficulty lit c) a delisting of securities should be considered as financial difficulty of the counterparty.

In Austria a delisting of securities from an exchange is subject to the fulfilment of formal requirements, e.g. if the distribution falls below 725,000 Euro or 10,000 shares. None of the reasons for a delisting depends on the financial situation of the issuer and therefore there is neither any reason nor any justification for qualifying a delisting as financial difficulty. To the contrary, issuers may even aim at a delisting of their securities for several non-financial reasons, e.g. reducing the disclosure requirements resulting from the listing to an exchange.

In the light of the above mentioned reasons we believe that a delisting from an exchange (lit c) should not be considered as a financial difficulty of the counterparty.

- **Page 13, point 40 ("the most common concessions are")**

- **(h) releasing collateral or accepting lower levels of collateralization**

In our view in case of releasing collateral or accepting lower levels is supported by full debt repayment or repayment capacity analysis, this should not be treated as concession.

- **(j) deferring recovery/ collection actions for extended periods of time**

In our view this should not be considered as forbearance, because this is not a contractual concession. At the same time we ask for clarification what is exactly meant by "for extended period of time". Is it to be assessed in connection with certain DPD level or duration of collection process? Debts that are under collection process for significant period of time are addressed in the existing default definitions thus already provisioned.

- **Page 14, point 41 (Criteria for exit from the forborne exposures category)**

From our point of view there is a divergence between the Regulation (EU) 2015/227, Annex V, Article 176 b and the respective BCBS CD: the minimum probation period according to the Regulation is 2 years and for BCBS 1 year.

At the same time we suggest defining clearly ("repayments to be made in a timely manner") in the current form, because it may lead to different interpretations, thus will not bring harmonization among banks. We suggest establishing separate conditions for exiting from NPE forbearance and from performing forbearance as it was defined in the Regulation (EU) 2015/227.

- **Contradictions with EBA ITS**

- The definition of "rebuttable presumption" is triggered by certain conditions (EBA ITS, page 17). The BCBS paper does not include such a presumption.
- The prohibition to use rating models is not mentioned.

- NPE which are nor in default or impaired do not seem to be commented at all.
- NPE exit criteria mentioned above.

These differences might cause unnecessary complexity in the future reporting requirements.

We ask you to give our remarks due consideration.

Yours sincerely,

Dr. Franz Rudorfer
Managing Director
Division Bank and Insurance