Comments of the KNF - Polish Financial Supervision Authority to the *Guidelines on Prudential treatment of problem assets – definitions of non-performing exposures and forbearance*, issued for comment by 15 July 2016.

The Polish Financial Supervision Authority (the "KNF") is pleased to be given an opportunity to provide its comments to the Consultative Document *Guidelines on Prudential treatment of problem assets – definitions of non-performing exposures and forbearance*.

In 2014 the KNF, acting in line with the methodology used by the ECB, conducted an asset quality review with respect to several chosen Polish banks. Having in mind the experience and the results of that exercise, the initiative of the Basel Committee leading to a further harmonization of the approaches taken by different supervisors is very welcome. Seeing much added value in the BCBS proposal, we would like to provide some comments on its certain aspects.

<u>Level of application (par. 19)</u>

The criteria concerning the contagion effect are not precise enough and can lead to divergence in their application by different banks. It would be beneficial to define the maximum share of the exposures which are 90 days past due, in the total of the exposure towards the client, that does not trigger the automatic contagion effect. An example of such approach can be found in par. 155 of the Annex V to the Commission Implementing Regulation (EU) No 680/2014.

<u>Examples of financial difficulties and concessions (par. 20)</u>

In cases where the concessions include refinancing of exposures it should be clarified how such exposures are classified. Such exposures should still be flagged as forborne to distinguish them from the sound credit portfolio, applying the same conditions as for the forborne exposures to the transferred back to the performing portfolio. This issue is also not clarified in the section 4.1, where the definition of concession is explained.

<u>Exposures considered as non-performing (par. 24 (iii))</u>

This point clarifies non-default and not impaired material exposures to be considered as non-performing, identifying 90 days past due trigger. This approach is not consistent with the point (ii) of this section which covers impaired exposures. Days past due is an impairment trigger and if correctly applied should lead to the assignment of the non-performing status in case of 90 days past due. If this point refers to the specific application of 180 days past due and definition of default under IRB approach for retail and public sector exposures it should be clearly stated to avoid misunderstanding. This remark also applies to par. 32 and 90 days past due trigger for the reclassification from non-performing to the performing exposures.

Indetermination of the *non-performing exposures* and *forbearance*

Indetermination of the terms *non-performing exposures* and *forbearance* may limit the comparability and coherence of banks' reports. This holds for the materiality thresholds (par. 28), both absolute and relative, as well as for continuous repayment periods (par. 32 and par. 43). Clear identification of the above-mentioned periods, by specifying the particular values would lead to greater consistency.

Reclassification of performing forborne into non-performing forborne

In our opinion the mechanics of the automatic reclassification of the performing forborne exposures into non-performing forborne (par. 31 and 43(ii)) in the event of the bank starts subsequent restructuring in the quarantine period or when the period of non-performance lasts long enough is not precise enough. The approach presented in par. 179 of the Annex V to the Commission Implementing Regulation (EU) No 680/2014 provides some solution where the 30-days period of non-performance is applied as criterion for such reclassification.

Explanation of term "Financial difficulty" (par. 40 (b))

Probability of being past due - it is not clear why it applies only to the material exposures, as the appropriate loan classification applies to all credit exposures of the bank.

Criteria for exit from the forborne exposures category (par. 41)

The criteria defined in par. 41 should be supplemented by the one included in the par. 176 letter d) of the Annex V to the Commission Implementing Regulation (EU) No 680/2014. This additional criterion requires that none of the exposures to the debtor is more than 30 days past due at the end of the probation period.

Categorisation of forborne exposures (par. 43 (ii))

In order to avoid different classification of forborne, non-performing loans between jurisdictions it would be more transparent to use the same one-year period of continuous repayment, as it is defined for the exit from forborne exposures category, together with the other criteria related to the exit from the non-performing category.

Restructuring as a way to evade the classification of some exposures as non-performing

The empirical analysis invoked by the author of the document suggests a correlation between the extent of restructuring actions and the growing level of credit risk. The document acknowledges therefore the risk of using restructuring as a mean to evade the classification of some exposures as non-performing, but does not propose any solution to the problem. It provides only suggestion that legislation should be enacted to prevent the banks from delaying the recognition of impairments. Having that in mind, the solutions presented in par. 157 and par. 178 of the Annex 5 to the Commission Implementing Regulation (EU) No 680/2014 should be taken into account.