ZBS | Združenje bank Slovenije
The Bank Association of Slovenia

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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
Switzerland

sent via http://www.bis.org/bcbs/commentupload.htm
and by email to baselcommittee@bis.org

Subject: Submission to Basel Committee on Banking Supervision in relation to consultative document: *Prudential treatment of problem assets - definitions of non-performing exposures and forbearance (April 2016)*

Dear Sir/Madam,

It gives me great pleasure to bring to your attention the views of the Bank Association of Slovenia on the proposed definitions of »non-performing exposures« and »forbearance«. Your effort to arrive at the definitions on a best-effort basis is much appreciated since in our view, putting in place clear and uniform criteria for identifying non-performing and forborne exposures is crucial to achieving comparable identification and reporting on problem bank assets and a precondition for reducing variation in practice across (and also within) jurisdiction which has been present for years.

The proposed definitions, if consistently applied by banks, should add to comparability of information regarding credit risk disclosed by banks and consistency in banks' practices at national and international levels. True as it may be that the harmonisation features of the proposed definitions taper off divergences, we strongly believe that despite historical and other differences between jurisdictions which hinder the ability to apply uniform set of concrete rules/criteria for classification of problem exposures, more elaborate rules should be defined in order to achieve the desired outcome (ie embracing consistent international standards for categorising problem exposures and reducing significant differences in how banks identify and report their asset quality). Defining clear, unambiguous and concrete rules in certain elements of definition of non-performing exposures would leave less room for open interpretation (by the local regulators or banks themselves) and thus increase the harmonisation level. In addition to the following harmonisation features already proposed in the consultative document, we believe that the following areas should be addressed in more detail:

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- materiality thresholds (material credit obligation / amounts in arrears and material credit-related economic loss),
- the level of application according to the nature of loans (the definition of retail non-performing exposures on a transaction or on a debtor basis),
- collateralisation, and
- the criteria for exit from the non-performing and/or forborne exposures category.

- **Definition of material credit obligation / amounts in arrears**

We are concerned that the document stops short of offering a definition of a materiality threshold for past due credit obligations and leaves national supervisory authorities to elaborate on the issue. We understand that fixing "one-size-fits-all" approach to adopting a common materiality threshold may not capture specific features of some jurisdictions exposures/portfolios but just might "do the job" at least for a transitional period. With the Basel Committee's document remaining silent on the materiality criteria for past due credit obligations, further progress toward the harmonisation of the criteria for credit categorisation and, as a consequence, of banks' information that can be identified and compared across jurisdictions will be needed.

- **Definition of material credit-related economic loss**

Along the same line of thought, we propose to set a clear materiality threshold to determine a credit-related economic loss we consider as being even more important in light of the fact that it is about assessing »unlikeliness to pay« based on qualitative factors. By setting up a rule that levels off differences in loan categorisation systems, a higher level of harmonisation and comparability would be achieved for this rather vague concept of »(un)likeliness of full repayment«.

- **Level of application (transaction- or debtor-based approach) for retail exposures**

We believe that in order to improve the ability to make comparisons between banks (across and within jurisdictions), the classification standards should be enhanced also in a sense that unambiguous criteria are set out for treatment of retail exposures on transaction and/or debtor basis.

In our view, agreeing a set of rule deemed to be appropriate in the case of a bank's exposures to a retail counterparty where the non-performing status measures *can be* applied at the level of each exposure (and not necessarily at the counterparty level, as it is in the case of exposures to a non-retail counterparty) (see paragraph 27) will be needed. We hereby refer to the rules contained in the EBA's Final Standards on Supervisory reporting on forbearance and non-performing exposures as a possible solution. These rules which have been submitted to the European Commission by the EBA state that »*when an institution has on-balance sheet exposures to a debtor that are past due by more than 90 days the gross carrying amount of which represents more than 20% of the gross carrying amount of all on-balance sheet exposures to that debtor, all on and off-balance sheet exposures to that debtor shall be considered as non-performing*«.

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- **Collateralisation**

In order to establish common grounds for more uniform asset classification practices and to tackle the issue of divergent views (and in fact rules) on the classification of collateralised loans, we strongly support the approach which the Basel Committee has taken with regard to the treatment of collateral when determining the (non)performing status of an exposure, ie that collateraliation should have no influence on the categorisation of non-perfoming exposures. This approach is in line with a widely accepted view that classification of an exposure should be based predominantly on an assessment of whether the counterparty is able to service its obligations, rather than on the value of the collateral which backs the bank's exposure. Nonetheless, we firmly believe that in certain cases (eg highly liquid collateral types such as cash or bank deposits), it might be reasonable to allow deducting the collateral value from the amount of the non-performing exposure.

- **Criteria for exit from the non-performing and/or forborne exposures category**

In accordance with the proposed text of the consultative document, an exposure ceases to be non-performing / can be (re)classified as performing, when certain criteria have been met (see paragraph 32). Among these criteria is also meeting all contractual repayment obligations when due *over a period of time which is specified by the local supervisor* (sub-paragraph (ii)). First, we find the condition for a continuous payment period unnecessary due to the binding conditions stipulated in the sub-paragraphs (i) and (iii), which are in our view sufficient to justify any reclassification to the performing status. Should you decide to keep this condition, we propose to define the length of the repayment (probation) period in the document instead of leaving its definition to local regulators. Moreover, in order to achieve greater harmonisaton and ensure a level playing field, we suggest to apply the rules which have already been enforced in the EU.

Similar comment is presented for the length of treatment of non-performing exposures, which were subject to forbearance measures (see paragraph 43 (ii)): we suggest to define the length of the probation period in the document instead of leaving its definition to local regulators.

Furthermore, in connection with the proposed criteria for the identificaton of forborne exposures and stipulating a continuous repayment ie probation period of not less than one year (see paragraph 41(i)), we propose to allow for a shorter probation period (eg 3 months) in cases where there is strong evidence for improved credit quality, either as a result of forbearance measures or any other activity or when circumstances change (eg upon finalisation of debt-to-equity swap by the bank which materialy improves the debtor's financial position and voluntary sale of the bank's equity stake to an established, well-capitalised and creditworthy counterparty which backs the debtor with funding and/or gurantee arrangements).

All told, the Bank Association of Slovenia welcomes the efforts of the Basel Committe and its proposals contained in the subject consultative document. Nevertheless, given the vague nature of some concepts, we propose to:

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a) set (even more) elaborate and unambiguous definitions regarding the materiality, level of application for retail exposures and exit from non-performing status, all with the aim to increase harmonisation and comparability, and
b) provide allowance for netting of first-class collateral and shortening the probation period for exit from the forborne exposure category in strongly justifiable cases, all with the aim to appropriately capture the actual level of risk of banks' assets.

We hope our comments will help to identify the areas where we believe further clarification might be needed and we are always interested in taking part in future consulations on this subject.

Thanking you once again for offering the opportunity to participate in this debate,

Sincerely,

Director

France Arhar, Ph.D.

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