Template for comments

Public consultation on the draft addendum to the ECB guidance to banks on non-performing lo

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☐ Pleas

General comments

The French Banking Federation fully agrees with the importance of an efficient monitoring and supervision of Non-Performing Loans
, as they may not only jeopardize banks, but also the global economy and customers who have to face hard situations. As such(NPLs)
NPLs are already, and have been across the economic cycle, under a strong surveillance in many countries, especially French banks
.which are actively managing both the level and the “quality” of their NPL
As a consequence French banks support a proportionate approach, applied on a case by case basis and based on the existing powers of
the supervisors as was confirmed by the Commission. In this context, French banks would deem more relevant a supervisory approach
based on analysis and judgment instead of a mechanical approach as described in the draft addendum to the ECB Guidance on NPL
.which appears problematic in several respects
Regarding the Eurozone’s banks under its direct supervision, the SSM already has the authority and tools to adjust provisions and/or
require additional capital under existing Pillar 2 process whenever it deems it necessary. We would even argue that the SSM’s demand
indicates the desire to restrict its power by a quantitative rule (total prudential provisionning after 2 years for unsecured exposures or 7
.years for secured ones) which is a self-imposed constraint to its supervisory powers
Moreover, this approach relies first on a prudential backstop and then on a supervisory dialogue, through the “comply-or-explain” process
, while the industry would expect the(which at this stage remain insufficiently detailed to allow for an actual and secured implementation)
.backstop to be used only after the supervisory dialogue, and depending on the outcome of this exchange
The automaticity of this additional "prudential provisioning" is not justified. Indeed accurate provisions calculation relies on an assessment
of the NPL’s cash flow, which requires a case-by-case analysis in order to duly reflect the actual situation. Furthermore, the proposed rule
regarding "secured" loans refers to the Standard Approach eligibility criteria which are very restrictive regarding physical collateral. As a
consequence a significant part of collateralized corporate loans turning non-performing may well be considered as "unsecured" and be
!provisioned after only 2 years 100%
While this framework aims at incentivizing banks to rapidly get rid of large amounts of NPLs, unsecured loans notably, despite the ECB’s
apparent willingness to adopt a more nuanced approach with regard to existing assets provisioning, a convergence between the flow and
.stocks approaches is inevitable in the long run
This proposal illustrates the lack of "check and balance" towards supervisory authorities’ unilateral decisions which more and more use
the Guidance notion to override or anticipate Level 1 and 2 rules. More generally, the Guidance notion, initially intended to clarify the
implementation of Level 1 and 2 texts, is now regularly diverted from its object to go further than existing regulations or to anticipate
.(.see IFRS 9 and disclosure requirements, Pillar 3 requirements not yet voted, IRRBB anticipation, etc)regulations under discussion
These decisions are not subject to any democratic control, nor to any effective dialogue with the industry, and are imposed with immediate
.application without any "check and balance". This initiative stresses that regarding guidance a check and balance should be put in place
.The EBA could be mandated to ensure that the European rules are properly applied but also that they are not over-applied
Problems that have yet to be solved are mainly problems from the past, geographically localised, and the one size fits all approach
.proposed in the ECB addendum is not the right answer

LIKELY IMPACTS OF THE FRAMEWORK

:It stands in contradiction with prudential regulation already in place and accounting as well as tax principles /1

Prudential regulation already in place: The ECB proposal results in considering as ineffective collaterals that have not been realized(a) after a period of 7 years from the date when the underlying exposure was classified as non-performing. These decisions are one-sided . and they conflict with the CRR

Denying recognition of collaterals that banks’ rating policies take into account in their credit risk assessments and which contribute to banks’ recovery statistics will question LGD modelling and create confusion. Regarding prudential rules, we are not convinced by a flat rate approach that is disconnected from the risk-based approach introduced by internal models. Furthermore we are wondering about the compatibility of the ECB approach with the risk parameter estimation and treatment of defaulted assets proposed by the EBA in its .Guidelines on LGD in-default, ELBE and IRB shortfall calculation

Exposures guaranteed by collateral considered as eligible by the ECB will be split in two parts: one part, equal to the collateral value, will (by provision or capital)be recognised as secured; the residual part will be considered as unsecured and will have to be 100% covered .after 2 years. This collateral recognition will complicate banks’ portfolio management processes

Accounting principles: The new IFRS 9 accounting standard is going to be implemented from the 1st of January 2018. This new(b) standard which targets NPLs generation answers the G20’s request ("too little too late"). It will bring greater transparency and will also lead banks to build an additional capital buffer based on a forward looking expected loss basis. Therefore it can be inferred that, by introducing a further capital charge without due regard to the effective IFRS 9 provisioning level, the ECB does not consider the new IFRS .(this point is developed below)standard as prudent enough . By doing so the ECB is discrediting accounting provisions 9

Tax principles: The Addendum requirement will de facto put into question the fairness and the adequacy of the audited financial(c) statements. Banks will look for ad hoc solutions, leading to nonhomogeneous and uncoordinated practices. Especially since in the .Eurozone, currently there is no European level playing field regarding tax deduction of provisions

Most importantly, it is going to distort banks’ origination, disincentivising them to carry out detailed credit analyses at origination. Banks /2 will give more emphasis to collateral which could induce them to lend against collateral i.e. to move from cash-flow banking (that is banking proper) toward collateral-oriented banking especially for SMEs. Moreover, having to request collateral for most of the loans will complicate and slow down the granting process. The new framework may also lead them to limit their lending to the best credit quality .counterparties

.Therefore these prudential provisioning requirements are l kely to limit the financing capacity of banks

It aims at incentivizing banks to rapidly get rid of large amounts of NPLs, unsecured loans notably. Today however loans secondary /3 markets cannot absorb large quantities at fair prices. The European Commission consultation on the development of secondary markets for NPLs has just come to a close. Markets able to meet banks’ potential needs will not emerge overnight. From this perspective, the ECB .initiative is premature

Active portfolio management by banks must be encouraged. The development of deep and liquid secondary markets (as wanted by the /4 European Commission) would help to address the issue of some banks’ NPLs portfolios, however markets

must not be considered as the unique solution to the NPL issue. It will encourage banks, the weakest one notably, to forced selling. In the current European secondary markets context it would mean that an excessive value has been transferred out of the banking system to the .so-called shadow banking system, less regulated regarding this asset class

Indeed the required public disclosure by vintage of NPL will make potential buyers aware of when banks need to dismiss their NPL - .portfolios. Potential buyers will set discounted prices accordingly

In practice, banks time lines will be further shortened due the time needed to structure a sale (notably the period of 2 years for unsecured - .(loans

A wrong premise underpinning the European authorities’ analysis is to consider that NPLs portfolios are wrongly valued by banks (and external auditors). European authorities limit their findings to an analysis of NPLs gross amounts only. This confusion between ‘gross’ and ,net’ keeps the doubt on banks’ provisioning level alive and suggests that for banks the best strategy is to get rid of their NPLs. So doing‘ the ECB cannot then correctly address the issues raised by the active management of NPLs portfolios which are mainly work-out and .recovery, transparency, valuation and existence (or not) of active secondary markets for these assets

.It will create a strong incentive to realise collateral, which would be detrimental to borrowers /5

For loans recognized as non-performing ones, the recourse to the secondary market will contribute to accelerate or amplify the loss of - value for these loans in the banks’ balance sheet, even though an adequate strategy could guarantee recurrent cash-flows. Should an NPL disposal be impossible through the secondary market, banks will be constrained to realise the collateral, which increases the global .financial instability

It will also have a detrimental effect on consumer protection because of the systematic sale of NPLs to non-regulated investors and the - need to realize collateral much more quickly,. Banks build long-term relationship with their customers, whereas third parties will be more .interested in the short-term financial profit

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Please enter all your feedback in this list.
When entering feedback, please make sure that
- **each comment deals with a single issue only**
- **you indicate the relevant article/chapter/paragraph, where appropriate**
- **you indicate whether your comment is a proposed amendment, clarification or deletion.**

Deadline	8 December 2017

ID	Chapter	Paragraph	Page	Type of comment	Detailed comment	Concise statement as to why your comment should be taken on board	Name of commenter	Personal data
1	1 - Background	1	2	Amendment	Add "The Guidelines provide with principles and criteria with a view to enable the ECB assessing the relevance and the materiality of the NPL risk	Should the ECB decides to assess a NPL risk under Pillar 2, we recommend that the ECB provides a preliminary approach to the determination of the materiality of the NPL risk. The ECB should set triggers for which the 'comply or explain' procedure is applied	[redacted]	Publish
2	1 - Background	new	7	Amendment	In a preliminary section the ECB should describe the dialogue process between a bank and the ECB: a bank communicating transparently on what it does and supervisors formingg an opinion upon it. This calls for better defining supervisors'expectations first and then reversing the burden of proof.	Regarding the burden of the proof, based on the Addendum it would not be to the supervisor to provide evidence that the provisioning level of the supervised bank is inadequate but to the bank to demonstrate that its provision policy is adequate. By doing so, the ECB goes against existing Level 1 legislation. No additional provisioning should be necessary when the bank can demonstrate that the existing provisions are calculated using rigorous risk management approaches. It is of the upmost importance that banks get upfront clarity about how to fulfil the explain procedure given the lack of visibility on the potential Pillar 2 capital requirements impact. 1/ Banks will have to explain the credit quality of their lending portfolios with particular focus on their NPL portfolios: identification, management/monitoring including provisioning and reporting and to which extent the current level of NPL is sustainable (consistency with long term averages, proper estimation in risk adjusted pricing, bank ability to fund its NPL portfolio, sectorial or cyclical considerations, etc.). 2/ As part of the regular relationship with the supervision teams (e g. JST meetings, deep dives), such detailed NPL analyses could be presented: - Structure of portfolios, broken down under meaningful granularity (depending on the business model, segments and geographies), - Relevant NPL indicators and ratios taking into account provisioning coverage, - Demonstration of appropriateness of level of accounting provisions, - Effectiveness of recovery actions including related cash-flow generation, - Collateral management, etc. 3/ Explaining business model specificities, including some fundamental market features (e g.: in France, mechanism of Credit Logement; priority given to borrowers' credit-worthiness rather than collaterals) does not hinder comparison across SSM banks, to the extent differences are well explained and understood. This would avoid applying a one size fits all approach, all the more so when it comes to tackling NPL issues which are of particular concern in certain geographies and portfolios. Based on these exchanges and explanations provided on NPL portfolios, the second step would be that the supervisors decide on whether they deem it necessary to apply complementary prudential provisioning.	[redacted]	Publish

3	2 - General Concept	2.1	3	Clarification	The scope of application needs to be clarified and its consequences addressed.	- CLARIFICATION OVER SCOPE OF APPLICATION FOR SUBS DIARIES OUTSIDE THE EUROZONE , it is of great importance that not only banks directly supervised by the ECB have to comply with the guidance but also less significant institutions to ensure the level-playing field. - LEVEL PLAYING F ELD WITH N THE EU: The guidance applies to all credit institutions supervised directly by the SSM (as specified in point 2.1 Scope and applicability). While we expect this guidance to be applied for every bank within the EU, depending on the constraints at the national level, it should be clarified if the subsidiaries implemented in a Member State outside the Eurozone have also to be compliant with this addendum, should a parent undertaking have one or more subsidiaries. - CONVERGENCE NEEDED WITHIN THE EU: Significant arbitrage opportunities may emerge from inconsistent implementation principles between countries. Above all, a regulation should not create disparities which may be seized by banks to transfer NPL portfolios between entities / jurisdictions solely to arbitrage capital requirements around this backstop. EBA, through its supervision conversion mandate shall ensure that common rules to be applied within the EU.	[redacted]	Publish
4	2 - General Concept	2.3	5	Clarification	The last paragraph ("Banks are encouraged to close potential gaps " should be clarified or delated.	The new IFRS 9 accounting standard is going to be implemented from the 1st of January 2018. This new standard which targets NPLs generation answers the G20's request ("too little too late"). It will bring greater transparency and will also lead banks to build an additional capital buffer based on a forward looking expected loss basis. Accounting is principle-based: it requires a fair assessment, on a case by case basis, which is the auditors' task. By encouraging banks to modify their accounting provisions on the basis of a standard rule which does not discriminate between banks risk profiles, the ECB calls into question the accounting principle. It introduces a new concept, the "systematic prudential provision", which will discredit accounting provisions therefore considered as insufficiently prudent.Therefore it can be inferred that, by introducing a further capital charge without due regard to the effective IFRS 9 provisioning level, the ECB does not consider the new FRS 9 standard as prudent enough . By doing so the ECB is discrediting accounting provisions. In any case, there is a risk of prudential / accounting mismatch with potential fiscal effects (deferred tax asset) questioning the principle of transparency and leading to a lack of homogeneity among banks. It is in contradiction with ECB goals stated in recent publications, as for instance in the methodological guidance published by the ECB in October 2017 for the IFRS 9 workshop where it is specified that "From a supervisory perspective there is a preference to foster harmonization of prudential and accounting frameworks".	[redacted]	Publish
5	3 - Definitions	3.1	3	Amendment	Replace « from January 2018 » with « The date of entry into force will be one year after the date of publication».	ECB provisioning measures must be built on banks' implementation of the existing NPL Guidance as well as the other initiatives (IFRS 9 notably). Permanently moving regulatory and supervisory landscape would result in blurring interactions and make it extremely difficult to understand related effects on cost of risk. An observation period is necessary to assess these different impacts and better calibrate any prudential provisioning if deemed relevant. To develop and implement their ambitious NPL reporting and disclosure strategy, significant banks, potentially impacted, may have to adapt their tools and IT systems. Moreover, other important reforms like FRS9 or AnaCredit will enter into force during the same year. Thus it seems necessary for banks to benefit from a transitional period to prepare and implement these changes, before the added guidance's enforcement is effective. 1st of January 2018 is too short, notably when taking into account the lack of coordination between accounting and regulatory initiatives. The timing to introduce an additional "prudential provisioning" is also particularly inadequate given the fact that preliminary works have also been undertaken by the Basel Committee regarding the calibration of the "EL/Prov" shortfall.	[redacted]	Publish

6	3 - Definitions	3.2	7	Amendment	For the purpose of this addendum, the list of accepted collateral or other form of credit risk protection should be extended to be in line with provisioning policies and practices.	In point 3.2 Eligible credit protection to secure exposures, the Addendum explicitly states that all types of immovable property collateral are eligible and refers to the CRR for the other forms of credit protections. But, the CRR is not exhaustive with eligible credit risk mitigation for provisioning policies and practices impacting mostly SMEs and more fragile borrowers in general (for instance, personal guarantees of the owner or the management body of SME represent very effective protection that reduces significantly needs for provision). This may also lead banks to limit their lending to the ECB eligible collateral amounts.	[redacted]	Publish
7	3 - Definitions	3.0	7	Amendment	Add a preliminary paragraph "3.0 Determination of relevance of NPL risk"	Due to its automatic and standard nature the new mechanism can be considered as a Pillar 1 more than a Pillar 2 instrument. By doing so, the ECB is blurring the line between micro and macro prudential issues. The FBF advocates for an institution-specific approach. Decisions on provisioning are based on the information institutions have with respect to their particular client portfolios, including customers' payment history, financial forecasts and their degree of engagement across the full range of an institution's business. It is also well known that recovery periods vary according to jurisdictions (where national insolvency frameworks, currently being considered in the context of the boarder Council NPL Action Plan, and the tax treatment of write offs both play an important, jurisdiction-specific role) and also according to portfolios (for instance retail versus corporate, where the latter typically have more restructuring options) and type of security (which can go beyond rights on collateral but can also include for instance rights over future cash flows of an entity). It justifies an individualized approach under Pillar 2. Then the ECB should explain how the relevance of NPL risk will be assessed. For example, it could be stated that all in all, the mere existence of cash-flows should be enough to demonstrate that the back stop principle is unnecessary.	[redacted]	Publish
8	3 - Definitions	3.1	7	Amendment	Definition of the NPE vintage concept should be replaced with the following "NPE vintage is defined as the amount of days (converted into years) from when the last payment to the account occured to the relevant reporting or reference date "	All in all, the mere existence of cash-flows should be enough to demonstrate that the back stop principle is unnecessary. Hence, requiring for instance 100% capital coverage for unsecured NPLs that have not benefited from a significant repayment for more than [2] years could be a better solution. This would call for a case by case supervisory approach. At least a backstop based on the time since last payment to the account may be more consistent with the underlying risk of accounts in long term NPE status.	[redacted]	Publish
9	3 - Definitions	3.1	7	Amendment	Replace the last paragraph with "This addendum would only apply to newly originated loans (i e. loans which have been granted after [the date of entry into force of the addendum]) that thereafter turn non-performing"		[redacted]	Publish
10	3 - Definitions	3.1	7	Clarification	More clarity is necessary regarding NPL definition	NPL need to be qualified more precisely, not only according to their classification but also to their capacity to generate cash-flows. Also, the ECB should clarify the scope of the Guidance regarding uncalled market guarantees (and particularly Performance Bonds).	[redacted]	Publish
11	3 - Definitions	3.1	7	Amendment	Regarding NPL definition, add "NPL that are not defaulted exposures should be exempted"	Non-defaulted exposures (inc. non performing exposures which are no longer considered defaulted according to article 178 of the CRR) should be outside of the scope of the guidance.	[redacted]	Publish
12	3 - Definitions	3.1	7	Clarification	More clarity is necessary regarding NPL definition	The existing ECB Guidance includes an expectation that banks should "implement well-defined forbearance policies", something that banks would generally undertake through their normal course of business. Where a bank has aligned with this guidance and implemented a well-defined forbearance policy, NPE exposures that are currently adhering to a forbearance plan agreed in line with such a policy should not be subject to further regulatory provision. These NPEs should be removed from the scope of the Addendum, with no burden of proof on banks.	[redacted]	Publish
13	3 - Definitions	3.1	7	Clarification	More clarity is necessary regarding NPL definition	There are subsets of NPEs that should not be subject to the prudential backstop. These include exposure types already identified by the ECB as being possible justifications for non-compliance with the Addendum in the section that addresses deviations. The final Guidance should clarify that these are automatically exempt from the backstop (instead of forcing the "comply or explain" procedure) and are namely forborne exposures and NPEs solely through contagion.	[redacted]	Publish

14	3 - Definitions	3,3	9	Amendment	Add “3. As the difference of treatment between the secured and the unsecured part of the NPL could potentially lead to significant negative capital impacts, a haircut is introduced for the unsecured balance. If the eligible collateral covers at least 85% of the NPL value, it could be considered that the exposure is fully collateralised. “	As the difference of treatment between the secured and the unsecured part of the NPL could potentially lead to significant negative capital impacts as well as operational burden, we would like to suggest the introduction of a haircut for the unsecured balance. For instance, if the eligible collateral covers at least 85% of the NPL exposure, it could be considered that the exposure is fully collateralised.	[redacted]	Publish
15	4 - Prudential provisioning backstop	4.1	10	Deletion	Delete the sentence : "If collateral has not been realised after a period of several years from the date when the underlying exposure was classified as non-performing, the collateral is deemed to be ineffective and as such, the exposure is treated as unsecured from a prudential perspective."	To consider that collateral must be exercised is a wrong premises underpinning the European authorities' analysis The facts show that the (forced) sale of collateral is not a solution. All collaterals are not real estate; even if it were the case, to put people away from home is not a satisfactory solution at least within the European context. Corporate loans' collateral is usually operating assets whose value is maximized within the operating process; seizure of the firm's assets may also speed up the liquidation of the firm, with the related social cost. On a large scale, these ways of proceeding can impact the economy and create financial stability issues. Therefore it is in no-one's interest to exercise collateral. When banks have recourse on their debtors (which is the case for the majority of loans granted in Europe), collateral should first be seen as an essential lever to incentivise debtors to pay.	[redacted]	Publish
16	4 - Prudential provisioning backstop	4.2	10	Amendment	Calibration : For the secured part, replace "After seven years of vintage" with "After ten years of vintage"	The vintage period for secured exposures should be extended by 3 years to reflect legal procedure timeframe. When a loan is in litigation, the legal procedure can be delayed for reasons beyond the bank's control; in France, the debtor has the legal means to contest every aspect of a given credit (actual rate of the credit, credit's inadequacy, perimeter of the insurance, etc.), which has the effect of suspending the legal procedure.	[redacted]	Publish
17	4 - Prudential provisioning backstop	4.2	10	Amendment	Calibration : For the unsecured part, replace "After two years of vintage" with "After four years of vintage"	The vintage period for unsecured exposures should be extended in order not to modify The granting conditions and to enable banks to keep on lending unsecured loans. The threshold proposed by the ECB is going to distort banks' origination, disincentivising them to carry out detailed credit analyses at origination. Banks will give more emphasis to collateral which could induce them to lend against collateral i.e. to move from cash-flow banking (that is banking proper) toward collateral-oriented banking especially for SMEs. Moreover, having to request collateral for most of the loans will complicate and slow down the granting process. The new framework may also lead them to limit their lending to the best credit quality counterparties.	[redacted]	Publish
18	5 - Related supervisory reporting		12	Deletion	Delete the whole paragraph "Furthermore, in line with the recommandations contained [ ] to market participants"	The draft Addendum refers to a specific public disclosure contained in Annex 7 of the NPL Guidance. We consider that if banks can justify some deviations from the prudential provisioning backstops, they don't have to publicly disclose the level of deviation. Otherwise, market participants could adjust the CET1, regardless the reality of the situation. Banks already face this issue with grandfathering disposals. If banks' communication on their NPL portfolios might be deemed limited, things will change in the near future mainly through the rules that have recently been adopted by the ECB (at this stage for banks under direct supervision only), the Basel Committee (Pillar 3 is still evolving in this respect), accounting standard setters (IFRS 9 will oblige large banks to disclose more comprehensive information on their NPLs portfolios, information that should give third parties the possibility to understand and price these portfolios) or the EBA. Banks must now be given enough time to implement these reforms which will significantly increase the transparency on their portfolios. From this perspective, the ECB qualitative Guidance (published last March) is the right approach. t is consistent with a supervisory approach specific to each bank. Supervisors should rely on this Guidance to question the governance and processes of problematic banks.	[redacted]	Publish
19	5 - Related supervisory reporting		12	Amendment	Replace "with regard to the newly classified NPEs after January 2018" with "with regard to the newly originated loans (i.e. loans which have been granted after [the date of entry into force of the addendum]) that thereafter turn non-performing"	For a sake of consistency with our amendment proposal (chap3, paragraph 3.1, p7)	[redacted]	Publish