

## Template for comments

### Consultation on the draft ECB Guidance for banks on non-performing loans

**Institution/Company**

Federation of European Accountants (the Federation)

**Contact person**

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## Template for comments

### Consultation on the draft ECB Guidance for banks on non-performing loans

Please enter all your feedback in this list.

When entering your feedback, please make sure:

- that each comment only deals with a single issue;
- to indicate the relevant article/chapter/paragraph, where appropriate;
- to indicate whether your comment is a proposed amendment, clarification or deletion.

Deadline: 15 November 2016

ID	Chapter	Section	Page	Type of comment	Detailed comment	Concise statement why your comment should be taken on board
1	General	N/A	N/A	Clarification	It is questioned whether the ECB has a legal mandate to impose additional (i.e. beyond EU Regulation) supervisory reporting and public disclosure requirements.	The Federation is of the opinion that supervisory reporting and public disclosure requirements should be set by means of European Regulation.
2	General	N/A	N/A	Clarification	The Federation has the clear expectation that the ECB understands that it does not have the authority to establish requirements for financial statements.	We believe that prudential and accounting approaches in several aspects are not identical. Going forward, we are willing to engage in pro-active discussions with ECB concerning concerns of the latter with respect to accounting matters.
3	1 Intro	1.2 This guidance is addressed to credit institutions within the meaning of Article 4(1) of Regulation (EU) 575/2013 (CRR)2, hereinafter named "banks". It is generally applicable to all significant institutions (SIs) supervised directly under the Single Supervisory Mechanism (SSM), including their international subsidiaries. However, the principles of proportionality and materiality apply.	5	Clarification	The draft paper includes guidance regarding proportionality to be applied in the process. The Federation wonders whether this concept is also deemed to be applicable with respect to disclosure requirements. We also question at what level this notion of proportionality is to be applied (portfolio versus entity level).	Detailed implementation guidance with respect to the proportionality concept would help applying the draft guidance in a consistent and accurate manner.
4	5 - Recog	5.1; 5.5	46-47; 60-61	Amendment	The draft guidance lays out the definitions of respectively NPE (supervisory framework, i.e. EBA-ITS), default (regulatory framework, i.e. CRR) and impaired (accounting framework, i.e. IAS 39/ IFRS 9). We regret the use of different concepts throughout the set of frameworks (namely the supervisory, regulatory and accounting frameworks).	The Federation supports the use of a single harmonised asset quality concept throughout the set of frameworks (namely the supervisory, regulatory and accounting frameworks). We believe that this would result in more straightforward implementation and would allow streamlining of processes.
5	5 - Recog	5.2.2 Banks should ensure that the definition of NPE and the criteria for identifying UTP are implemented identically in all parts of the group.	49	Amendment	We recommend to replace the term "identically" by "homogeneously".	We believe that a homogeneous approach is more appropriate in this context as it entails that the application of the definition/criteria should be tailored where appropriate and consider specific characteristics of the exposure, counterparty and/or market.
6	5 - Recog	5.2.2 A bank should regularly assess the creditworthiness and repayment capacity of its customers. For standard non-retail customers this should be done, at least, at key reporting dates.	49	Amendment	We suggest to include this assessment in the existing processes instead of performing it at "key reporting dates".	We believe that our proposal covers the ECB requirement in a cost effective way.
7	5 - Recog	5.2.2 The non-provision or the unreasonably late provision of information may be seen as a negative sign for the customer's creditworthiness. For customers who have been identified as financially weak, such as customers on a watch-list or with a weak rating, more frequent review processes should be in place depending on the materiality, segment and the customer's financial standing.	49	Clarification	We would like to highlight that banks apply the "watch list" concept in a different way in practice. Some banks may simply mean that there are concerns about possible/emerging risks that merit more frequent or specific monitoring. Other banks may want to point out that customers in the "watch list" have been identified as financially weak.	Detailed implementation guidance would help applying the draft guidance in a consistent and accurate manner.
8	5 - Recog	5.2.2 Best practice examples of UTP events	50-53	Clarification	We would really appreciate clarification of the concepts outlined in this section, e.g. what is meant by the concept "market availability" in this context.	Detailed implementation guidance would help applying the draft guidance in a consistent and accurate manner.
9	5 - Recog	5.5.2 The definition in IFRS 9 comes from IAS 39 (not amended).	62	Amendment	We suggest to take out the link between the definition of "credit-impaired financial assets" under IFRS 9 and IAS 39.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
10	5 - Recog	5.5.2 Under IFRS 9, default leads to a transfer from Stage 2 to Stage 3. However, both Stages 2 and 3 require provisions for lifetime losses, and lifetime losses grow continuously as creditworthiness decreases.	62	Clarification	We suggest to add additional colour to the definition of "creditworthiness", since we believe that the meaning of this sentence depends on this definition. For example, lifetime losses will not grow significantly in line with default risk if there is sufficient collateral.	Detailed definitions would help applying the draft guidance in a consistent and accurate manner.

11	6 - Prov	6.2.1 For individual estimations, the expected future cash flows will depend on the type of approach that banks apply, i.e. a going concern approach or a gone concern approach.	66-67	Clarification	We would highly appreciate specific guidance on when one moves from a "going concern" to a "gone concern" scenario.	The estimation of future cash-flow allowances depends substantially on the applicable scenario (i.e. "going concern" versus "gone concern"). As such the Federation believes that specific practical guidance on when one moves from a "going concern" to a "gone concern" scenario is of the utmost importance.
12	6 - Prov	6.2.2 Individual significance of the exposure. As stated in IAS 39, provisions for individually significant exposures should be assessed on an individual basis. Institutions are responsible for defining the relevant thresholds (absolute and relative thresholds), taking into account, among other factors, the possible impact of the exposure in the financial statements and the concentration level (individual and sectorial).	67	Amendment	We are of the view that the IFRSs state that exposures should first be assessed for impairment on an individual basis; however if they are not impaired on an individual basis, they should generally be included in a collective assessment.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
13	6 - Prov	6.2.3 The entity's internal audit department should monitor the implementation of this plan, verifying that the corrective measures are adopted and that the timetable is followed correctly.	69	Amendment	We agree that the internal audit function should to a certain extent be involved in this process, nevertheless we believe that the second line of defense in the control environment should take the primary responsibility in this field.	The directive 2013/36/EU Article 88 says that the management body defines, oversees and is accountable for the implementation of the governance arrangement that ensure effective and prudent management of an institution, including the segregation of duties in the organization and the prevention of conflicts of interests. Those arrangement shall comply with the following principles (e.g.): i) The management body must have the overall responsibility for the institution and approve and oversee the implementation of the institution's strategic objectives, risk strategy and internal governance. ii) The management body monitors and periodically assesses the effectiveness of the institution's governance arrangements and takes appropriate steps to address any deficiencies.
14	6 - Prov	6.2.4 Future operating cash flows should be based on the financial statements of the debtor.	71	Amendment	It is currently unclear to us how banks should use financial statements to estimate future cash flows.	Financial statements contain historical data and as such can not be used to determine prospective data for other purposes than plausibility checks.
15	6 - Prov	6.2.4 When projections assume a growth rate, a steady or declining growth rate over a maximum growth period of 3-5 years should be used, and afterwards steady cash flows. The growth rate should be based on the financial statements of the debtor or on a conservative business restructuring plan, taking into account the resulting changes in the structure of the business (e.g. due to divestments or the discontinuation of unprofitable business lines).	71	Amendment	Although the Federation agrees that projections should reflect a realistic growth, we believe that this statement suggests a bias towards conservatism that may not be compatible with the neutral/ unbiased perspective required by IFRS.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
16	6 - Prov	6.2.4 For instance, the 2014 AQR exercise provided a benchmark multiple of 6 (general case), 10 (utilities) or 12 (infrastructures). The cash flows should then be allocated to each exposure.	72	Amendment	We would appreciate a clarification regarding how these benchmark figures have been considered appropriate for the purpose indicated. Currently we cannot see the basis presented for why they would be appropriate in the future. Whether these or alternative multiples would be appropriate will depend on the facts and circumstances. It is particularly difficult to see how this approach appropriately addresses differences and changes in effective interest rates.	The Federation is of the opinion that the proposed approach might be valuable in a prudential context but may not be appropriate from an accounting perspective.
17	6 - Prov	6.4.1 To measure the most likely drawn exposure, reliable cash-flow forecasts or loan contracts should be used. This reliability should be confirmed through the existence of robust historical data and back-testing procedures demonstrating adherence of past estimations to the incurred credit losses.	77	Amendment	It is currently unclear to us how loan contracts would be used in this context.	We are of the opinion that loan contracts do not impact the estimations of incurred credit losses.
18	6 - Prov	6.4.1 As an alternative, the credit conversion factors stipulated in Article 166(10) of the CRR should be applied following the classifications in Annex I of the CRR on the nominal value of the commitment.	77	Amendment	First of all we suggest to change the wording "as an alternative" into "only in rare cases". Secondly we advise to state that these conversion factors should only be used as a starting point and modified appropriately to reflect relevant facts and circumstances.	The Federation believes that this option (i.e. use credit conversion factors) should only be used in rare cases when no better data is available. If these factors are applied - in rare cases - then they should in our opinion merely serve as as basis which should subsequently be modified to fit the specific situation.

19	6 - Prov	6.4.2 Reversal of impairment should occur when there is objective evidence that the impairment is lower than previously computed with the available information at that time. This may be assumed in the following cases (non-exhaustive list): the debtor has amortized a higher fraction of the outstanding debt than anticipated at the time of the previous impairment.	78	Amendme	We would suggest that the wording "assumed" in this context should be further clarified since the application of this context should only be done when reasonable given all the evidence. In addition, we believe that the term "amortized" in this context is unclear.	The Federation believes that a reversal of impairment can only occur, if any, after a thoughtful analysis of all facts and circumstances involved. We also suggest to replace "amortized" by "repaid" based upon our understanding.
20	6 - Prov	6.5 When loans are deemed uncollectable/unrecoverable, they should be written off in a timely manner. An entity should write off a financial asset or part of a financial asset in the period in which the loan or part of the loan is considered unrecoverable.	79	Clarificatio	The Federation is of the opinion that the focus should be on the timing of the impairment assessment instead of the timing of the impairment booking.	We believe that the timing of the impairment analysis is crucial. Once an impairment loss has been identified, as a result of the impairment analysis, the impairment should immediately be accounted for.
21	6 - Prov	6.6 For parts of exposures covered by collateral, the establishment of a minimum provisioning level depending on the type of collateral is deemed supervisory best practice. Empirical evidence and conservatism should be applied when calibrating the described provisioning and write-off periods referred to above.	79	Amendme	We believe that this statement suggests a bias towards conservatism that may not be compatible with the neutral/unbiased perspective required by IFRS.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
22	6 - Prov	6.6 Exposures with prolonged arrears: Different thresholds may be adequate for different portfolios. Banks should assess the recoverability of exposures classified as non-performing due to arrears for a prolonged length of time. If, following this assessment, an exposure or part of an exposure is deemed as unrecoverable, it should be written off in a timely manner.	80	Clarificatio	The Federation is of the opinion that the focus should be on the timing of the impairment assessment instead of the timing of the impairment booking.	We believe that the timing of the impairment analysis is crucial. Once an impairment loss has been identified, as a result of the impairment analysis, the impairment should immediately be accounted for.
23	6 - Prov	6.7.1 Furthermore, entities should adopt, document and adhere to sound methodologies that address policies, procedures and controls for assessing and measuring allowances on non-performing loans They should encompass appropriate conservatism and be supported by objective evidence.	80-81	Amendme	We believe that this statement suggests a bias towards conservatism that may not be compatible with the neutral/ unbiased perspective required by IFRS.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
24	6 - Prov	6.7.1 In addition, banks should be sufficiently prudent when considering the write-back/reduction of existing provisions ensuring that the revised estimates and assumptions reflect the current economic condition and the current view of the expected economic outlook.	81	Amendme	We believe that this statement suggests a bias towards conservatism that may not be compatible with the neutral/ unbiased perspective required by IFRS.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
25	6 - Prov	6.7.1 Those estimations should consider all the relevant and supportable information, including forward looking information.	81	Amendme	The Federation supports well supported estimations as long as it does not result in undue costs.	We strongly believe in an appropriate cost/ benefit analysis in relation to the estimation process.
26	7 - Coll	7.2.2 Additionally, the internal audit department should regularly review the consistency and quality of the immovable property valuation policies and procedures, the independence of the appraisal selection process and the appropriateness of the valuations carried out by both external and internal appraisers.	86	Amendme	We agree that the internal audit function should to a certain extent be involved in this process, nevertheless we believe that the second line of defense in the control environment should take the primary responsibility in this field.	The directive 2013/36/EU Article 88 says that the management body defines, oversees and is accountable for the implementation of the governance arrangement that ensure effective and prudent management of an institution, including the segregation of duties in the organization and the prevention of conflicts of interests. Those arrangement shall comply with the following principles (e.g.): i) The management body must have the overall responsibility for the institution and approve and oversee the implementation of the institution's strategic objectives, risk strategy and internal governance. ii) The management body monitors and periodically assesses the effectiveness of the institution's governance arrangements and takes appropriate steps to address any deficiencies.
27	7 - Coll	7.3 The valuation of the immovable property collateral should be updated on an individual basis at the time the loan is classified as a non-performing exposure and at least annually while it continues to be classified as such.	89-90	Amendme	We question the proposed frequency (i.e. at least annually) of the valuation review of immovable property collateral related to NPEs as a general principle. On the other hand, we agree that an at least annual review might be appropriate in certain specific situations.	We have difficulties in understanding the usefulness of a <i>yearly</i> assessment as a general principle which, on top of that, does not seem to be consistent with the requirements stipulated in Article 208 of CRR (i.e. every three years with regard to retail portfolios).

28	7 - Coll	7.4.3 In a gone concern scenario, the future sale proceeds from collateral execution should be adjusted taking into account the appropriate liquidation costs and market price discount to the open market value (OMV).	91	Amendment	In this context we have difficulties understanding the definition of OMV. On the preceding page (section 7.4.1) the guidance says that valuation should reflect market value and gives a definition, but there is no mention of OMV.	The Federation suggests to align the two sections (i.e. harmonize concepts and their definitions) in order to avoid potential misunderstandings.
29	7 - Coll	7.4.3 A minimum discount of 10% should be applied if the collateral is sold by auction.	92	Amendment	We are currently unaware of what exactly the basis is for why such a minimum discount is or will remain appropriate. In our view, the discount (if any) required should depend on the facts and circumstances. A standard minimum appears to introduce a bias that may not be compatible with IFRS.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
30	7 - Coll	7.4.3 All banks are expected to develop their own liquidation cost and market price discount assumptions based on observed empirical evidence. If insufficient empirical evidence is available, discount assumptions should be sufficiently conservative and based on, at a minimum, liquidity, passage of time, and the quality/ageing of the appraisal.	92	Amendment	We believe that this statement suggests a bias towards conservatism that may not be compatible with the neutral/ unbiased perspective required by IFRS.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
31	7 - Coll	7.4.3 In estimating cash flows from property collateral liquidation, banks should use adequate and realistic assumptions and pay attention to the requirements of valuing cash flows under IFRS 13 on fair value measurements.	93	Amendment	In our view, IFRS 13 consists of guidance for measuring fair value whereas this statement is more about estimating the entity-specific cash flows the bank expects to receive.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
32	7 - Coll	7.4.3 Ensure that the property price used to determine the estimated market value of property collateral at the point of liquidation is not more optimistic than projections produced by international organizations, and that it does not result in an improvement on the current market conditions.	93	Amendment	1) In our view, it is the wrong way round to refer to the property price as "result(ing)" in an improvement on current market. Is it meant that the price should not assume or reflect an improvement on current market conditions. 2) We believe that under IAS 39, it is a moot point as to whether any change in current market conditions may be included in the analysis. However, under IFRS 9, in our view, it is clear that an entity should analyze expected cash flows in that way that considers the effects of changes in market conditions - both positive and negative - on a probability-weighted basis; in many cases, doing this will have a negative asymmetric impact.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
33	7 - Coll	7.4.3 Ensure that income from property collateral is not assumed to increase from the current levels unless there is an existing contractual arrangement for such increase.	93	Amendment	Please see previous comment in so far as it relates to expected cash flows.	The Federation recommends to apply the IFRS concepts in a consistent and accurate way.
34	7 - Coll	7.5 Banks are strongly encouraged to classify foreclosed real estate assets as non-current assets held for sale under IFRS 5	94-95	Amendment	In our opinion not all foreclosed real estate assets automatically fulfil the definition of "non-current assets held for sale" in accordance with IFRS 5. For this to be the case, the asset must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets and its sale must be highly probable (IFRS 5.7).	We believe that the classification assessment as "non-current assets held for sale" should be performed for every individual foreclosed real estate asset to determine whether the two criteria, as stipulated in IFRS 5, are met or not.
35	7 - Coll	7.5 In rare cases, banks acquire buildings still under construction and decide to complete construction before selling the building. In such cases, the bank should demonstrate the merits of such a strategy and the cost should not exceed the fair value less costs to complete and sell the asset considering adequate illiquidity discounts as described above. Foreclosures of property are merely a consequence of granting loans which later defaulted. Therefore, such foreclosures are not an expression of a property investment business strategy as defined in IAS 40. Nor are difficulties encountered by banks in selling foreclosed property evidence of such an investment strategy. Banks are therefore strongly discouraged from applying IAS 40 in such cases.	95	Clarification	The Federation understands that the accounting treatment of foreclosed under construction property assets can no longer be performed in accordance with IAS 40. Please include consequently the IFRS guidance which is applicable to those assets. We refer in this respect to comment 34.	Complete guidance is likely to result in a consistent and accurate implementation of the draft guidance. The Federation refers to comment 34 as well.
36	Annex 7	Sections related to public disclosures	118-126	Amendment	The disclosure requirements include the disclosure of details of the NPL portfolio. The Federation supports transparency but would like to highlight the sensitive nature of this information as well.	The Federation would like to point out that these additional disclosure requirements may have serious negative impacts on the banks and might even prevent the future sale of those portfolios.

37	Annex 7	Sections related to public disclosures	118-126	Clarificatio	<p>We are wondering where the additional disclosures (i.e. beyond EU Regulations) should be made (Management Report, Pillar III report, etc).</p> <p>We are also interested to know when these additional disclosures should be made for the first time.</p> <p>It is questioned as well how often (yearly, quarterly, etc.) these additional disclosures should be made?</p>	<p>Clear implementation guidance will facilitate the consistent and accurate implementation of the proposed guidelines.</p>
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