



HELLENIC BANK ASSOCIATION

Response from the Hellenic Bank Association to the draft ECB guidance to banks on non-performing loans

I. General comments

The Hellenic Bank Association (HBA) was established in 1928 and is a non-profit legal entity, representing the vast majority of Greek and foreign credit institutions that operate in Greece, which hold more than 95% of assets of the Greek banking system.

The HBA appreciates the opportunity to participate in the public consultation of the draft ECB guidance to banks on non-performing loans. NPLs constitute a major problem with which the European banking sector has to cope. High NPL ratio is a significant source of risks for the banking sector because it affects banks' capital position and profitability. Also, it has negative consequences for the EU economy, since it constrains banks' ability to lend individuals and corporates.

Greek banks are engaged in addressing NPLs during the last years and, thus, developed and implemented a comprehensive strategy on identification, monitoring and workout of NPLs.

The ECB guidance is based on best practices applied to certain Member States and offers valuable guidance to banks on how they should tackle NPLs. We understand that the consultation paper contains guiding principles expected to be implemented by ECB supervised banks, unless they contravene relative Union or national legal acts. Banking industry welcomes the ECB initiative to promote harmonisation of divergent supervisory practices applied across SSM jurisdictions which is necessary to ensure financial stability and create a genuine single market for banking services. However, the ECB should acknowledge that it is unlikely to achieve that aim as long as differences exist in national legislation related to workout of NPLs.

The HBA agrees in principle with the majority of the proposed provisions provided for in the draft ECB guidance, while a lot of them are already applied by Greek banks in accordance with national legislation adopted in the context of the Economic Adjustment Programme implemented in Greece.

However, we consider necessary to raise certain issues which we consider appropriate to be clarified or amended in order to ensure that the ECB guidance would contribute to the aim of NPL reduction in an orderly and timely manner.

II. Specific comments

Chapter 1 - Introduction

The draft guidance establishes detailed and rigorous requirements which will be operationally challenging for banks to comply with. Therefore, it is deemed necessary that the ECB provides an adequate timeframe allowing banks to adapt their procedures, processes and policies to the ECB guidance, taking also into account the implementation of the IFRS 9 as of 2018 and the EBA Guidelines on definition of default by 2021.

Moreover, we understand that the ECB will assess in the context of the SREP whether banks have implemented the proposed arrangements effectively and in a timely manner. Possible non-compliance is expected to be incorporated in the outcome of the overall SREP assessment and may trigger supervisory measures. In that context, we ask to be clarified the



HELLENIC BANK ASSOCIATION

way that the ECB is going to assess the implementation of the ECB guidance, as well as the scale and range of possible supervisory measures.

Chapter 2 – NPL strategy

In the draft of the ECB guidance it is referred (p. 16) that *“high NPL banks are expected to report their NPL strategy, including the operational plan, to their Joint Supervisory Teams (JSTs) in the first quarter of each calendar year. To facilitate comparison, banks should also submit the standard template as included in Annex 7 of this guidance summarising the quantitative targets and the level of progress made in the past 12 months against plan”*. However, Greek banks are obliged to update NPL strategy and quantitative targets and submit them to JSTs by end-September of each year. Thus, we need clarification on whether the requirement for submission of NPL strategy and quantitative targets in the first quarter of each year applies also to Greek banks.

Chapter 3 – NPL governance and operations

Providing banks with sufficient timeframe in order to implement the ECB guidance, as referred above, is necessary also in respect of the provision referred to in p. 25, which requires an independent function (internal or external audit) to assess the adequacy of technical infrastructure, including data quality. In case the ECB does not determine a transitional implementation period, banks would be subject to assessments by internal or external auditors from the first day of application of the guidance and it is quite probable to be assessed as non-compliant.

Chapter 4 - Forbearance

The draft ECB guidance lays down a requirement (p.40) pursuant to which, *“where there have been previous forbearance solutions granted in respect of an exposure, including any previous long-term forbearance measures, the bank is to ensure that additional internal controls are implemented to ensure that forbearance treatment meets the viability criteria. These controls are to include, at a minimum, an explicit approval by the risk management function/senior decision-making body within the bank (e.g. NPL Committee).”* The HBA supports the proposed arrangement which is plausible from a governance perspective. In specific, it is necessary to ensure that decisions taken by functions competent for granting forbearance measures are subject to scrutiny and approval by the risk management function. However, pursuant to the principle of materiality we deem more relevant and appropriate that this requirement applies only to large exposures, mainly corporate ones, exceeding a specific threshold.

Furthermore, the ECB guidance presupposes that a forbearance solution including short-term forbearance measures is viable where, inter alia, no other short-term forbearance measures have been applied in the past to the same exposure. We urge the ECB to reassess that requirement, since it is rather usual and prudent from a risk management perspective to grant more than one short-term forbearance solution to the same exposure. Viability of forbearance solutions can be ensured, if banks adopt a tailor-made approach to grant forbearance measures based on the borrowers' specific characteristics and financial needs.



HELLENIC BANK ASSOCIATION

Chapter 5 – NPL recognition

The consultation paper contains certain criteria for reclassification of forborne exposures from non-performing to performing status (p. 56). In specific, in addition to a “cure period” of one year, *“all of the following criteria should be satisfied:*

1. *the exposure is not considered as impaired or defaulted;*
2. *there is no past-due amount on the exposure, meaning that the exposure is current and that any accrued unpaid principal and interest instalments have been repaid;*
3. *the borrower should have settled, by means of regular payments, an amount equivalent to all the amounts past due on the date the forbearance measures were granted (if there were past-due amounts at this date), or to the amount written-off as part of these forbearance measures (if there was no past-due amount at the date of the forbearance measures);*
4. *the borrower has demonstrated its ability to comply with the post-forbearance conditions”.*

On the contrary, the EBA definition provides that a non-performing forborne exposure must be classified as performing, *“where all the following conditions are met:*

- a) *the application of forbearance measures does not lead to the recognition of impairment or default;*
- b) *one year has passed since the forbearance measures were applied;*
- c) *there is not, following the forbearance measures, any past-due amount **or** concern regarding the full repayment of the exposure according to the post-forbearance conditions. The absence of concerns shall be determined after an analysis of the debtor’s financial situation by the institution. Concerns may be considered as no longer existing where the debtor has paid, via its regular payments in accordance with the post-forbearance conditions, a total equal to the amount that was previously past-due (where there were past-due amounts) or that has been written-off (where there were no past-due amounts) under the forbearance measures **or** the debtor has otherwise demonstrated its ability to comply with the post-forbearance conditions.”*

It is evident that the proposed arrangement differs from the exit criteria provided for in the EBA definition of non-performing exposures (par. 157 of Annex 5 of the Commission Implementing Regulation 680/2014). Therefore, the HBA considers necessary that the ECB guidance will not contain an amended wording of the definition on exit criteria adopted by the EBA and applicable to the whole EU. In that way, it can be ensured a level playing field between banks included in the scope of the SSM and those outside the SSM.

Furthermore, the ECB guidance includes provisions regarding the consistent application of the non-performing definition at the banking group level. Harmonised and consistent implementation of the non-performing definition across group’s entities located in different jurisdictions is a heavy burden for banks -especially but not exclusively- in terms of internal procedures and policies and IT infrastructure in respect of entities incorporated in third countries.

Therefore, the application of the proposed requirement should be proportionate to the size of the subsidiary or branch concerned and the impact of its NPL ratio at consolidated level.



HELLENIC BANK ASSOCIATION

Chapter 6 – Impairment measurement and write-offs

According to the consultation paper (p. 81), the ECB expects from banks to back-test their loss rates at a minimum every six (6) months. However, that requirement is substantially different from the provision included in the CRR, as well as in the EBA RTS on the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB. In specific, pursuant to Article 11(3) of the aforementioned RTS, back-testing of all rating systems must be performed at least on an annual basis.

The Single Rulebook seeks to provide a single set of harmonised prudential rules which banks throughout the EU must respect and its main goal is to ensure a unified regulatory framework for the EU financial sector that would complete the single market in financial services. Consequently, it is suggested to align the requirement on back-testing with the aforementioned EBA RTS.

Chapter 7 – Collateral valuation for immovable property

7.2.3 Individual versus indexed valuations

The ECB guidance requires individual valuation for non-performing loans to be performed annually, where the loan exceeds 300.000 euro. Although such a requirement may be plausible in respect of banks with a low NPL ratio, in the case of high-NPL banks compliance with that requirement is particularly burdensome and costly, since it entails individual valuation for a large number of loans. Furthermore, that requirement is far more conservative than the one referred to in Article 208(3)(b) CRR which provides that: *“the property valuation is reviewed when information available to institutions indicates that the value of the property may have declined materially relative to general market prices and that review is carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process. For loans exceeding EUR 3 million or 5 % of the own funds of an institution, the property valuation shall be reviewed by such valuer at least every three years”*.

Therefore, we consider appropriate the ECB to amend the proposed threshold for indexation. Setting a threshold of one (1) million euro would be more suitable both in terms of prudence and efficiency. That threshold ensures consistent monitoring of collateral valuation as it is considerably more conservative than the one applied by banks in accordance with CRR. In any case, banks may adjust downwards the threshold requirement based on their credit policy.

Moreover, clarification should be provided regarding the use of indexed valuation since there is a contradiction in the document. More specifically, based on the ECB guidance indexed valuations do not constitute a revaluation or an individual property valuation. However, afterwards it is proposed that the indexed valuation can be used in order to update the valuation of non-performing loans creating, thus, a contradiction.

7.2.4 Appraisers

Although the ECB guidance requires banks to ensure that external appraisers have an appropriate level of professional indemnity insurance, it should be noted that such request cannot be applicable since it has not been fully implemented in all EU countries (including Greece).



HELLENIC BANK ASSOCIATION

7.3. Frequency of valuations

The ECB guidance encourages banks' management to define criteria in their collateral policies and procedures for determining that a significant decline in collateral value has taken place and these to be based on empirical data. However, we need to stress out that the specific proposal would be very difficult to be implemented due to lack of empirical data, especially in Greece where the real estate market is not mature and there is lack of transactions. In addition, during the last years of recession Greek real estate market is highly stressed and opportunistic.

7.4.1 Valuation methodology

In accordance with the ECB guidance, valuations based only on the discounted replacement cost should not be used. Nevertheless, pursuant to the International and European Valuation Standards, the discounted replacement cost method is one of the acceptable methodologies and therefore cannot be excluded.

7.4.3. Market Price discount

Based on the ECB guidance, market price discount is proposed to be applied to the property price (OMV at the time of liquidation) and encourages banks to develop their own liquidation cost and market price discount assumptions based on observed empirical evidence. Due to the volatile macroeconomic conditions experienced for the last years, there is significant instability and uncertainty in the real estate market and, thus, lack of empirical data since no transparent evidence exist.

7.5 Valuation of foreclosed assets

Although the ECB guidance encourages banks' management to approve individual plans to sell foreclosed assets "within a short timeframe (normally one year)", we consider appropriate that this timeframe should be consistent with the economic situation, the liquidity and activity of the market in each jurisdiction as well as the applicable legal framework and judicial system.

In addition, under the ECB guidance, banks are strongly encouraged to classify foreclosed real estate assets as non-current assets held for sale under IFRS 5. In our view, this simplification is not in accordance with IFRS 5, since assets must satisfy the specific criteria set by the standard in order to be classified as non-current assets held for sale.

Annex 7 – Summary of supervisory reporting and disclosure items related to NPLs

Taking into account the significance of NPLs, enhanced disclosure requirements on that issue are considered reasonable, since they promote transparency and market discipline. Disclosure of information relevant to forbore and non-performing exposures provides investors with a better understanding of banks' creditworthiness and credit risk management practices.

The majority of the proposed qualitative and quantitative information provided for in Annex 7 of the ECB guidance is already disclosed by Greek banks, since shareholders, creditors and other stakeholders focus on NPLs trend and their workout and resolution. However, we need clarification on the date of entry into force of the disclosure requirements, particularly with regard to the necessity for banks to publish relevant templates for the year ended



HELLENIC BANK ASSOCIATION

31.12.2016. Supervisory reporting requirements and KPIs requested should be harmonized with target KPIs agreed with the SSM and be in alignment with the relevant time frame; otherwise it would be operationally challenging for Greek banks to comply with different requirements within a short timeframe.

In addition, we understand that Table 5 is used for indicative purposes in order to illustrate the information that banks should disclose. In general terms, Table 5 provides investors with useful information on forborne exposures. Nevertheless, disclosing information on impaired or defaulted forborne exposures before the application of the IFRS 9 (2018) and the (new) harmonised definition of default (2021), would lead investors to misleading conclusions, since they would compare non-comparable information. Therefore, we consider appropriate the ECB to reassess that requirement before harmonisation of the relevant definitions is achieved among SSM jurisdictions.