EUROPEAN CENTRAL BANK

BANKING SUPERVISION

Template for comments

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

Institution/Company
The EU Federation for the Factoring and Commercial Finance Industry

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General comments

Template for comments

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

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	Clarification	The "Addendum" states that "This addendum does not intend to substitute or supersede any applicable regulatory or accounting requirement or guidance from existing EU regulations or directives and their national transpositions, applicable national regulation of accounting, binding rules and guidelines of accounting standard setters or equivalent, or guidelines issued by the European Banking Authority (EBA)". However, we underline our concern with the statement within this Addendum that the SSM expects and asks institutions to "comply or explain". Consequently we consider that those expectations cannot be really considered as "non-binding".We also see significant conflict with existing applicable accounting rules (both at national and international level) and in particular with IFRS 9. Furthermore, we wish to highlight that the Addendum addresses an issue that requires primary legislation. As a result we believe that the proposed approach far exceeds the powers of the SSM: In our opinion, the addendum should not havelegal force because non-compliance would trigger Pillar 2 effects.	We believe the Addendum conflicts with existing accounting rules and exceeds the powers of the SSM	[redacted]	Publish
2	1 - Background	1	2	Clarification	For an issue of such importance, we are uncomfortable with the lack of coordination between the European bodies (two ongoing consultations on the same topic are resulting in different approaches by the European Commission and the ECB). Additionally, there is insufficient time to analyse the framework, provide an impact assessment or propose appropriate solutions to the numerous issues that the proposal raises.	Lack of coordination generates uncertainty in institutions and markets	[redacted]	Publish
3	2 - General Concept	1	2	Deletion	The calendar approach is not consistent with the prudential and accounting systems that have been the basis of the current regulatory environment (CRD/CRR, IFRS 9), which are reliant upon the institutions' own internal estimates of expected loss.	Inconsistency between the calendar approach and current prudential and accounting regulations.	[redacted]	Publish

4	2 - General Concept	2.1	3	Deletion	"This addendum will be applicable as of its date of publication. Finally, the backstops are applicable at a minimum to new NPEs classified as such from January 2018 onward". We advise that the deadline for the consultation and the date of application are too close. The Addendum would impact significantly on business models and operations if adopted. Moreover, as the institutions are already engaged in the implementation of IFRS 9, requiring significant effort, we believe that the implementation of any further new requirement should be postponed until at least one year following the implementation of IFRS 9. Indeed, one of the main innovations of IFRS 9 is that it introduces forward-looking provisioning based on expected credit loss. We therefore strongly suggest that we await the results of implementing IFRS 9 before introducing another piece of regulation which appears to conflict with it.	The discussion should be postponed by at least one year, by which time the impact of implementing IFRS 9 can be measured.The Addendum appears to conflict with IFRS 9, which aims to improve the adequacy of provisioning.	[redacted]	Publish
5	2 - General Concept			Clarification	We would like however to underline some potential pitfalls of the approach that could generate practical implementation issues: • Potential conflict with the CRR treatment for credit risk, as the approach does not explain the effects of the deduction on risk weighted assets (150% for default exposures under the standardised approach). It appears that the waiver that allows for a weight of 100% instead of 150% for NPEs that are impaired by more than 20% of their value is being questioned in the evolution of the Basel agreement. Consequently, there could be double counting of risk; • Conflict with national laws or international regulations, such IFRS 9, providing different principles for loan loss provisioning; • Conflict between the legal validity of collateral/guarantees and the proposed approach to consider only collateral eligible for credit risk mitigation purposes; • Conflict with insolvency frameworks that are more and more oriented to encourage the continuity of businesses. Under this proposal institutions will be incentivised to enforce security immediately any client enters into a default status, thus reducing the likelihood of its survival.	A calendar approach to provisioning would raise a number of unintended consequences.	[redacted]	Publish
6	5 - Related supervisory reporting	5	12	Amendment	"All banks should report to their respective JSTs at least on an annual basis the coverage levels by NPE vintage, with regard to the newly classified NPEs after 1 January 2018." We disagree. We should consider the profound impact of such an approach on the institutions' credit policies. The proposed approach should apply only to newly originated exposures and not to newly classified NPEs in order to avoid bias. For revolving facilities, any backstop should apply to new client relationships starting from the cut-off date.	Impacts on credit policies suggest the change should apply only to newly originated loans	[redacted]	Publish

7	2 - General Concept			Amendment	Given that NPLs are not a real issue for the factoring industry, we understand that the backstop does not address it directly. Nevertheless, as we have already mentioned, we see a number of significant pitfalls and unintended consequences due to the design and calibration of a prudential backstop. In general: • an incentive for institutions to enforce the collaterals immediately at any time that a client falls into a default status, thus reducing the likelihood of its survival, in spite of the attention that e insolvency frameworks place upon the necessary efforts to save the client's business • an increase in legal claims against the institutions due to the incentive to enforce early. • an alteration of the parity between European institutions and a breach of the principle of a level playing field In particular, in the case of factoring and purchased trade receivables: • an inconsistent treatment of the collateral (trade receivables or credit insurance) • a massive use of exemptions under a "comply or explain" principle which would impose significant operational burden • an increase in volatility of P&Ls or CET1 due to the large amount of past due exposures that falls under the EBA definition of default but which later cures to a performing status • all in all, factoring, as well as other low risk products, would be unduly punished by an unnecessary increase in the cost of risk. We therefore suggest that no general prudential backstops are introduced but individual assessment of i provision adequacy under the current powers of the SSM would be a better solution. Should a mandatory prudential backstop be introduced, we feel that the proposed approach would be oversimplified and would generate more problems it solves. To summarise, a common regulatory prudential backstop on provisioning for NPLs could have unintended negative effects on: • the regulatory capital level and the credit policies of the institutions • the par condicio between European institutions • the comparability of the financial reporting forf institutions operating in different Countries • an increase in the cost of r relatively low risk, asset-based financial products such as factoring arising from unnecessary provisioning which would disincentivise their use. This would give rise to increasing the overall systemic risk • the real economy, that will eventually be harmed by stricter credit policies and reduced possibilities for the turnaround of the businesses in financial distress Thus we strongly suggest, again, to adopt a granular approach, considering the type of collateral, the type of security, the type of debtor and the length of legal proceedings to provide a reliable picture of the actual value and recoverability of the collateral. In particular, the inclusion of trade receivables and credit insurance within the definition of eligible collateral is essential to avoid illogical provisioning on factoring and purchased trade receivables. Further, there should be an exemption for debtors that are public sector entities (where there is minimal credit risk even in the case of past due-driven default. In order to minimize the negative effects of backstops, a more progressive approach is recommended.	In general, an approach to provisioning based exclusively on vintage will generate significant bias for relatively low risk exposures such as factoring	[redacted]	Publish

8	3 - Definitions	3.2	7	Amendment	we are concerned with the very definition of “secured NPLs”, intended here as “covered by eligible credit protection”. Indeed, the factoring industry presents different characteristics: it is based upon the purchase by a bank or finance company of trade receivables, against which the factor advances part or all of the purchase price . (Any remainder is paid across to the client when the factor collects payment from the debtor)This form of asset-based lendingcomprises a revolving facility, made available to the client. The purchase agreement (depending on the legal context) provides recourse to the client if the debtor fails to makethe payment, unless the factor agrees to underwrite the risk of the receivables, upon request from the client, under a “without recourse” agreement. It is useful to highlight that from a legal point of view “recourse to the client” means that the factor’s risk is, in the first instance, related to the payment by the debtor of its debt arising from the receivables. The recourse to the client only occurs when the debtor is unable to pay. According to IAS 39 and IFRS 9, the balance sheet exposures generated by such purchase depends on the substantial transfer of all risk and rewards of the receivable. To make it simple, the factor shows an exposure to the debtor of the purchased receivables when the assignment trasfers substantially all risks and rewards and an exposure to the client otherwise. Please note that across Europe the International Financial Reporting Standards are not applied uniformly, so that the factoring transaction is not represented in the same way in all locations. Differing accounting standards may provide different rules for provisioning: According to the CRR, purchased trade receivables are not considered as eligible credit protection for the purposes of credit risk mitigation except under some circumstances, for Internal Rating Based Models (see artt. 199, 209 and 230). The CRR also allows the adoption, under the IRB approach, for specific approaches to the estimate of expected credit loss in the case of purchased trade receivables that rest on the role of the underlying receivables as the primary source for reimbursement (see artt. 153, 154 e 184). Wwhen a factor purchases trade receivables, it often obtains further protection through insurance policies offered by a trade credit insurance company. Such policies can combine both recourse and non recourse agreement, in the latter case operating as a re-insurance of the debtor risk underwritten by the factor. Although they provide very effective protection, credit insurance policies are usually not eligible as credit protection under the CRM framework. In both the above-mentioned situations, according to the proposed model, the factor would have an unsecured exposure while, actually, it has strong collateralprovided by the purchased trade receivables and/or re-insurance., In Italy, according to recent figures, the factoring industry shows a significantly lower NPL ratio than traditional banking, respectively 7% (5.4% unlikely to pay) vs 15% (14.8% unlikely to pay). The numbers are even more compelling when looking at the full EU picture: data from the EUF White Paper on Factoring and Commercial Finance show that the total cost of risk in factoring is immaterial compared to that of banks (0.09% vs 0.32% in low risk Countries, 0.43% vs 1.6% in high risk Countries). We strongly challenge the assumption that factoring represents a form of unsecured lending and advise that every approach based on that assumption would generate bias in provisioning. Usually, such collateral provides benefit in the short term. However, in the case of legal proceedings, it is not uncommon for enforcement to take many months or even years (such as in the case of public sector entities which are subject to administrative procedures). There is no reason to penalize factoring exposures by way of a minimum level of provisioning or deduction from the regulatory capital. We therefore suggest that a backstop model on provisioning built on a separation between “secured” and “unsecured” exposures is too simplified and is likely to introduce bias. Moreover, we wish to underline that, due to the link with late payments in trade relationships, the factoring industry shows, in some Countries more than in others, a significantly larger amount of default exposures where many debtors appear to be in default due to the 90 days past due ruleSuch technical defaults are not normally a real indicator of increasing risk, but reflect the payment behaviour of a business or industry. Thus, the cure ratio of those past due exposures is very high (Assifact estimates that for Italy only 1.72% of new unlikely to pay exposures in 2016 in factoring came from exposures that were past due over 90 days). The coverage ratio on those exposures is lower than in traditional banking reflecting the above-mentioned overestimation of default due to late payment We wish to underline that if a prudential backstop is applied it would unnecessarily exacerbate volatility in the profitability and/or prudential CET1 of factoring companies . Indeed, it is highly probable that such unnecessary increased provisions would be compensated by recoveries in the following quarter(s) or year.	The definition of "eligible credit protection to secure exposures" must be clarified and amended to clearly include trade receivables and credit insurance	[redacted]	Publish
9	4 - Prudential provisioning backstop	4.2	10	Amendment	We note that the calibration lacks of any justification and statistical reference. We feel that the calibration of the approach should not be set arbitrarily but should take into consideration the length of legal proceedings to enforce the loan, which is different from country to country, so that any EU common backstop would breach the principle of a level playing field approach if not properly adjusted. Should a regulatory prudential backstop be implemented, we suggest that the National Supervision Authority should make such adjustments in order to get a consistent balance between the expectations of the EU Supervisors, the needs of the banking industry and the need for transparency in financial reports for the benefit of investors.	A "one size fits all" calibration would disrupt the level playing field principle: Country-specific adjustment must be allowed	[redacted]	Publish
10	4 - Prudential provisioning backstop	4.2	10	Amendment	One should also discriminate according to the counterparty: an unsecured loan to a business and an unsecured loan to a public administration bear very different risk profiles (credit risk is almost non existent in the latter case, even though the enforcement of the loan may take a long time). Debtor exposures that are public sector entities should be exemptfrom minimum levelsof provisioning.	Public Sector debtors deserve an exemption from minimum provisioning due to the absence of real credit risk	[redacted]	Publish

11	4 - Prudential provisioning backstop	4.2	10	Amendment	A calendar approach to provisioning applied to all institutions would be inconsistent with the actual recoverability of collaterals, which is a function of various factors that need careful assessment and valuation such as.: • Type of collateral • Type of security (i.e. pledge / assignment / …) • Type of debtor (e.g. private / public entity) • Local legal environment The high recovery rates of purchased trade receivables is confirmed by the low NPL ratio in factoring, which (in the case of Italy is on average 50% lower compared to that of general banking and even 64% lower when true unlikely to pay exposures are compared. Provisioning basing only on vintage would frustrate the institutions' efforts to estimate the LGD and penalie low risk products.	A calendar approach to provisioning is not consistent with the actual recoverability of a loan, thus penalizing low risk products such as factoring	[redacted]	Publish