NPL framework

European Banking Authority, European Central Bank and European Commission

List of abbreviations

Abbreviation	Meaning
CET1	Common Equity Tier 1
CRM	Credit Risk Mitigation
CRR	Capital Requirements Regulation
CP	Consultation Paper
COREP	Common Reporting
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
ECL	Expected Credit Losses
EU	European Union
FBEs	Forbearance exposures
FINREP	Financial Reporting
GL	Guidelines
G-SIIs	Global Systemically Important Institutions
IAS	International Accounting Standard
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
ITS	Implementing Technical Standards

Abbreviation	Meaning
JSTs	Joint Supervisory Team
KPI	Key Performing Indicators
NPEs	Non-Performing Exposures
NPLs	Non-Performing Loans
NPV	Net Present Value
OJEU	Official Journal of the European Union
OMV	Open Market Value
O-SIIs	Other Systemically Important Institutions
PD	Probability of Default
P&L	Profit and Loss
RAF	Risk Appetite Framework
RAS	Risk Appetite Statement
SI	Significant Institution
SSM	Single Supervisory Mechanism
SREP	Supervisory Review and Evaluation Process
UTP	Unlikeliness to Pay
WUs	Workout Unit

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Introduction

In March 2017 the ECB published a Guidance to banks on NPLs. Along with this document, the ECB, the EBA and the EC also published several document regarding NPLs in March 2018

Introduction

- NPLs amount have started to decline. Nevertheless, a number of banks in Member States across the Euro area are still experiencing high levels, which ultimately have a negative impact on bank lending to the economy. In this context, in July 2017, the European Council concluded an **Action Plan to tackle NPLs in Europe** in order to prevent the emergence and accumulation of new NPEs on banks' balance sheets. According to this Action Plan, the ECB, the EBA, and the EC have published several documents on NPLs:

ECB

- In March 2017, the ECB published **Final Guidance to banks on NPLs** with the aim of developing a consistent supervisory approach (supervisory expectations) regarding the identification, measurement, management and write-off of NPLs.
- Further, in March 2018 the ECB published the Final **Addendum to the ECB Guidance to banks on NPLs**, specifying quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for NPEs[1].

EBA

- In March 2018, the EBA published a **CP on GL on management of NPEs and FBEs** which establishes sound risk management practices for managing NPEs and FBEs; requirements on processes to recognise NPEs and FBEs; and requirements for CA's assessment of NPE management; and asks for views on a **NPL threshold above a 5%** to consider high NPL banks.
- In April 2018, the EBA issued **a CP on GL on disclosure of NPEs and FBEs** including definitions and ten disclosure templates.

EC

- The EC published in March 2018 a **Proposal for a Regulation on amending the CRR as regards minimum loss coverage for NPEs** which aims at ensuring banks set aside funds to cover the risks associated with loans issued in the future that may become NPLs.

This **Technical Note** summarises the content of the NPL framework including a comparison between the ECB Guidance to banks on NPLs and the EBA CP GL on management of NPEs and FBEs, as well as a summary of the content of the Addendum to the ECB Guidance on NPL and the EC Proposal for a Regulation on amending the CRR as regards minimum loss coverage for NPEs.

(1) Neither the Guidance nor the Addendum substitute or supersede any applicable regulatory or accounting requirement or guidance from the existing EU regulatory framework.

Introduction

Over 2017 and 2018, the European financial regulators and supervisors have focused on NPLs. In this regard, they have published several documents to tackle NPLs in Europe

Timeline

Mar. 17

- The ECB issued **Final Guidance to banks on NPLs**.

Jul. 17

- The European Council issued an **Action Plan to tackle NPLs** in Europe.

Mar.18

- The EBA issued a **CP on GL on management of NPEs and FBEs**.
- The ECB published the **final Addendum to the ECB Guidance to banks on NPLs**.
- The EC issued a **Proposal for a Regulation on amending the CRR as regards minimum loss coverage for NPEs**.

Apr. 18

- The EBA issued a **CP on GL on disclosure of NPEs and FBEs**.

Documents summarised in this Technical Note. The CP GL on disclosure templates is summarised in the annex.

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Executive summary

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

The ECB Guidance on NPL and the EBA CP GL on NPEs and FBEs cover similar recommendations on NPLs, regarding aspects such as the NPL strategy, and governance and operations framework

Executive summary

Scope of application	Regulatory context	Next steps
• The ECB Guidance on NPL are addressed to **significant institutions**. • The EBA CP GL on NPEs and FBEs is addressed to all **credit institutions**[1].	• **CRR** (June 2013). • **EBA GL on credit risk management practices and accounting for ECL** (May 2017).	• The ECB Guidance on NPL is applicable as of its **date of publication**. • The EBA Final GL will apply from **January 2019**.

Main content and conclusions

ECB Guidance on NPL vs EBA CP GL on NPEs and FBEs

- **Both documents should be read together for the definition of the NPL and forbearance framework** (e.g. governance, strategy, and definitions). The content of EBA CP GL on NPEs and FBEs is quite similar to the one established in the supervisory expectations published by the ECB, although the EBA additionally requires credit institutions to have in place a specific policy for forbearance. Therefore, although the EBA Final GL will entry into force in 2019, its impact should be minimum as credit institutions are already applying these practices. Moreover, the EBA Final GL will apply to all credit institutions, requiring greater efforts to non significant institutions.
- This NT includes the comparison between these two documents and covers the following aspects:
  - **NPL strategy** (e.g. assessing the operating environment, and developing the NPL strategy).
  - **Governance and operations** (e.g. steering and decision-making, NPL operating model, and control framework).
  - **Forbearance** (e.g. forbearance options and viability).
  - **NPL recognition** (e.g. application of NPE definition, and link between NPE and forbearance).
  - **NPL impairment measurement** (e.g. individual and collective estimation of provisions, and other aspects of impairment).
  - **Collateral valuation for immovable and movable property** (e.g. governance, procedures and controls).
  - **Supervisory reporting and evaluation of management of NPLs**.

(1) Credit institutions whose NPL level is above 5%, or below but with a high share or material amount of NPEs in an individual portfolio or with a specific concentration of NPEs towards a geographic region, an economic sector or group of connected clients, should have in place, at least, a NPE strategy as well as a NPE governance and operations framework.

Executive summary

ECB Addendum and EC Proposal for a Regulation on amending the CRR

Further, the ECB Addendum provides information about the prudential provisioning expectations, whereas the EC Proposal aims at ensuring sufficient loss coverage

Executive summary

Scope of application	Regulatory context	Next steps
• The ECB Addendum on NPL are addressed to **significant institutions**. • The EC Proposal applies to all **CRR institutions**.	• **CRR** (June 2013). • **EBA GL on credit risk management practices and accounting for ECL** (May 2017).	• The ECB Addendum on NPL is applicable to new NPEs classified as such from **April 2018**. • The EC Regulation shall enter into force on the **day following** that of its publication in the OJEU.

Main content and conclusions

- For **calculating and reporting the minimum coverage of NPL**, the institutions should consider the ECB Addendum and the EC Proposal for a Regulation. Both documents provide minimum regulatory coverage requirements for NPEs.
- This NT includes a summary of the following documents:

ECB Addendum to the ECB Guidance on NPL

- The Addendum sets out **definitions to be considered**, such as new NPEs, NPE vintage, eligible credit protection to secure exposures, etc. Further, it also introduces prudential backstops requirements.

EC Proposal for a Regulation on amending the CRR as regards minimum loss coverage for NPE

- The EC Proposal introduces **amendments to the CRR** regarding aspects such as the definition of NPE, forbearance measures, the deduction of NPEs or the introduction of a principle of prudential backstop.

Executive summary

ECB Addendum and EC Proposal for a Regulation on amending the CRR

Both the Addendum to the ECB Guide and the Proposal for amending the CRR define a minimum NPE provisioning level, sharing similar objective, NPE definition and CRM measures recognition…

Definitions: Addendum vs CRR

	ECB – ADDENDUM	EC – PROPOSAL CRR
Objective of provisioning backstops	• **These backstops aims to:** ✓ **reduce financial stability risks** arising from high levels of insufficiently covered NPEs, by avoiding the build-up or increase of such NPEs with spill-over potential in stressed market conditions; and, ✓ ensure that institutions have sufficient loss coverage for NPEs, hence protecting their profitability, capital and funding costs in times of stress. In turn, this would **ensure that stable, less pro-cyclical financing is available to households and businesses**.	
NPE & CRM definitions	• **NPE**: **consistent with prudential** definition (CRR, COREP) **and accounting / financial definition** (IFRS9, FINREP). • **CRM**: **consistent with prudential** definition (CRR, COREP), then, **more restrictive than accounting / financial definition** (IFRS9, FINREP).	
Scope (new NPE definition)	• Applicable for **exposures that are reclassified from performing to non-performing after 1 April 2018**.	• Applicable for **exposures originated after 14 March 2018**.
Backstop calculation	• Named as "provisioning expectations". • Drivers: **vintage of NPE[1], CRM recognition** (secured vs unsecured)	• Named as "prudential backstop" • Drivers: **vintage of NPE, kind of NPE** (90 days past due vs unlikely to pay), **CRM recognition** (secured vs unsecured)

More NPEs are supposed to be **subject to the Addendum due** to the gap of starting dates of application

More sensitiveness

(1) The length of time an exposure has been classified as non-performing.

Executive summary

ECB Addendum and EC Proposal for a Regulation on amending the CRR

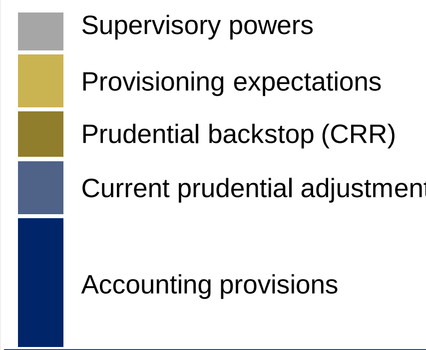
…. However, the NPEs included in the scope and the definition of the shortfall of provisioning are slightly different

Definitions: Addendum vs CRR

	ECB – Addendum	EC – Proposal CRR
Shortfall calculation	• Defined as the gap between the **banks supply** and the **supervisory expectations**. • Banks supply includes: – All accounting provisions – Expected loss shortfalls for the respective exposures in default – Other CET 1 deductions from own funds related to these exposures.	• Defined as the gap between the **prudential backstop** an the sum of the **following items** provided they relate to a specific NPE: – specific credit risk adjustments – expected loss shortfall which is already deducted from own funds – additional value adjustments for fair-valued assets – other own funds reductions
Shortfall recognition	• Two options: ✓ booking the maximum level of provisions possible under the applicable **accounting** standard ✓ **adjusting the CET 1 capital** on their own initiative, applying CRR stricter requirements to be reported in the COREP C01.00, row 524 "(-) Additional deductions of CET1 Capital due to Article 3 CRR"	• The proposal modifies the CRR adding a **new deduction of CET1** (Article 36.1.m). • Therefore, the modification of C01.00 is expected for creating a new item to include the new deduction.

Similar recognition of previous provisions.
Therefore, they both **complement (i)** the application of **accounting standards** with regard to loan-loss provisioning for NPEs, and (ii) the use of existing **Pillar 2 supervisory powers** following case by-case assessment by the competent authority.

Representation of minimum coverage suposing all the levels entering into play



Executive summary

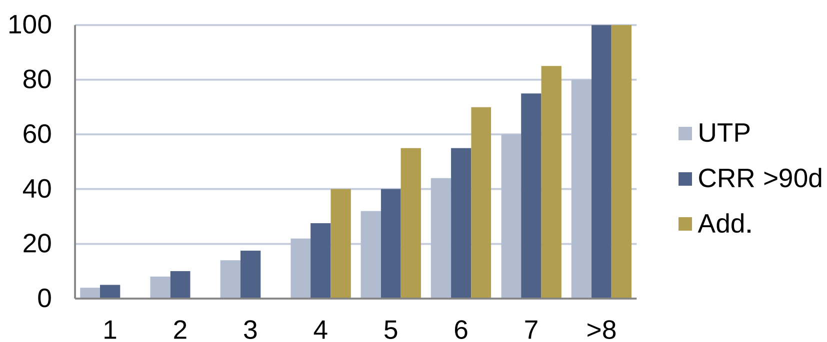
ECB Addendum and EC Proposal for a Regulation on amending the CRR

During the first years, Proposal thresholds establish the minimum provisioning level but as the NPE matures the Addendum thresholds conduct the minimum requirement

Minimum coverage: Addendum vs CRR

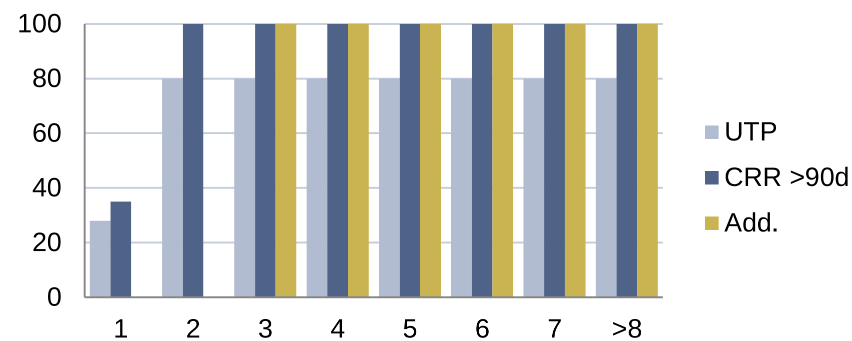
- The **Proposal** defines a gradual deduction approach following a **progressive path**, **with higher provisioning requirements for…**
  - **NPEs where the obligor is past due > 90 days** than for other NPEs.
  - **Secured exposures** than for unsecured exposures.
- The **Addendum** defines a gradual deduction approach following a **linear path starting after 3 years for secured exposures and full provision requirements for unsecured exposures after 4 years.**
- When **the Addendum** starts playing, the **thresholds for minimum coverage are always higher** than those defined in the Proposal.

Secured NPEs[1]



NPL Categories	Vintage (years)							
	1	**2**	**3**	**4**	**5**	**6**	**7**	**>8**
UTP	4	8	14	22	32	44	60	80
CRR >90d	5	10	17.5	27.5	40	55	75	100
Add.				40	55	70	85	100

Unsecured NPEs[1]



<table>
<tr><th rowspan="2">NPL Categories</th><th colspan="8">Vintage (years)</th></tr>
<tr><th>1</th><th>2</th><th>3</th><th>4</th><th>5</th><th>6</th><th>7</th><th>>8</th></tr>
<tr><td>UTP</td><td>28</td><td colspan="7">80</td></tr>
<tr><td>CRR >90d</td><td>35</td><td colspan="7">100</td></tr>
<tr><td>Add.</td><td colspan="2"></td><td colspan="6">100</td></tr>
</table>

(1) Minimum required coverage, expressed in percentage.

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NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Firstly, according to both documents, credit institutions should assess and regularly review their operating environment, define the NPL strategy and develop an operational plan that complements the strategy

NPL strategy (1/2)

	ECB – GUIDANCE ON NPL	EBA – CP GL on NPE and FBEs
Assessing the operating environment	• When developing and implementing an NPL strategy, banks should assess: • Their **internal capabilities** to effectively manage and reduce NPLs. • **External conditions** (e.g. market expectations, macroeconomic conditions, tax implications). • **Capital implications**, considered in conjunction with the RAF and the ICAAP.	• Credit institutions should complete an assessment of the following elements: • **Internal capabilities** to effectively manage and reduce NPEs (e.g. magnitude and drivers of their NPEs size and evolution of NPE portfolios). • **External conditions** and **operating environment**. (e.g. macroeconomic conditions, tax implications). • **Capital implications** of the NPE strategy.
Developing the NPL strategy	• The NPL strategy, including the operational plan, should be **approved by the management body** and **annually reviewed**. It should cover: • **Strategy implementation options**. Banks should review the range of NPL strategy implementation options available[1] and their respective financial impact. • **Targets**. High NPL banks should include clearly defined quantitative targets approved by the management body[2]. • **Operational plan** (how the NPL strategy will be implemented). High NPL banks should have an operational plan approved by the management body, defined over a time horizon of at least 1 to 3 years.	• The NPE strategy and the operational plan, should be **approved by the management body** and **annually reviewed**. It should cover: • **Strategy implementation options**. Credit institutions should consider at least the following implementation options: hold/forbearance strategy, active portfolio reductions, changes of type of exposure or collateral, and legal options. • **Targets**. Credit institutions should include, quantitative targets in their NPE strategy[2]. • **Operational plan**. Credit institutions should have an operational plan approved by the management body, defined over a time horizon of at least 1 to 3 years (depending on the type of operational measures required).

(1) (e.g. hold/forbearance, active portfolio reductions, change of exposure type)
(2) Considering the following dimensions: time horizons, main portfolios and implementation options.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Once the NPL strategy has been developed, credit institutions need to implement the operational plan and embed the NPL strategy at all levels of the organisation

NPL strategy (2/2)

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs
Implementing the operational plan	• The implementation of the NPL operational plans should rely on suitable **policies and procedures**, clear **ownership** and suitable **governance structures**. Any deviations should be **reported to the management body**.	• The implementation of the NPE strategy operational plan should rely on suitable **policies and procedures**, clear **ownership** and suitable **governance structures**. Any deviations should be **reported to the management body**.
Embedding the NPL strategy	• The NPL strategy should be embedded in processes at **all levels of an organisation** (strategic, tactical and operational). • High NPL banks should put significant emphasis on **communicating to all staff** the key components of the NPL strategy. • All banks should clearly define and document the **roles, responsibilities and formal reporting lines** for the implementation of the NPL strategy, including the operational plan. • All relevant components of the NPL strategy should be fully aligned with the **business plan and budget**. • The NPL strategy should be fully embedded in the **risk control framework**. In that context, special attention should be paid to the **ICAAP**, the **RAF** and the **recovery plan**.	• The NPE strategy should be embedded in processes at **all levels of an organisation** (including strategic and operational). • Credit institutions should emphasise to **all relevant staff** the key components of the NPE strategy. • They should clearly define and document the **roles**, **responsibilities and formal reporting lines** for the implementation of the NPE strategy, and the operational plan. • All relevant components of the NPE strategy should be fully aligned with and integrated into the **business plan** and **budget**. • The NPE strategy should be fully embedded in the **risk management framework**. In that context, special attention should be paid to: the **ICAAP**, the **RAF**, and the **recovery plan**.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

The ECB and the EBA provide guidance on the key elements of the banks' governance and operations framework, such as the decision-making process, the definition of the NPL operating model…

Governance and operations (1/2)

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs
Steering and decision making	• The management body should **approve and monitor the bank's strategy**. Additionally, for **high NPL banks**, the management body should, among others, approve annually and regularly review the NPL strategy, and oversee the implementation of the NPL strategy.	• The NPE strategy and operational plan should be, set approved and reviewed by the **management body**. In particular, it should, among others, approve annually and regularly review the NPE strategy and the operational plan, and oversee the implementation of the NPE strategy.
NPL operating model	• High NPL banks should establish separate and dedicated **NPL workout units** (WUs)(1). NPL WUs should be set-up taking into account the full NPL life cycle: i) early arrears; ii) late arrears, restructuring or forbearance; iii) liquidation, debt recovery, legal cases or foreclosure; and iv) management of foreclosed assets. In this regard, a suitable operating model requires: • **Portfolio segmentation** to group borrowers with similar characteristics requiring similar treatments. • **Human resources** (with dedicated NPL expertise and experience) to the workout of those NPLs and to the internal controls of related processes. • **Technical resources** to centrally stored all NPL-related data in robust and secured IT systems.	• Credit institutions should implement separate and dedicated **NPE WUs** for the different phases of the NPE life cycle and also for different portfolios: i) early arrears, ii) late arrears/forbearance, and iii) liquidation/debt recovery/legal cases/foreclosure. Further, they should have a policy in place that describes the recovery process from foreclosed assets. The operational model requires: • **Grouping exposures** according with the EBA GL on credit risk management practices and accounting for ECL. • **Human resources** (with dedicated NPE expertise and experience) to the workout of NPEs and to the internal controls of related processes. • **Technical resources** to centrally stored all NPE-related data in robust and secured IT systems.

(1) Though NPL WUs should be separated from loan origination units, a regular feedback between both functions should be defined (e.g. exchange the information needed for planning NPL inflows).

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NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

…the definition of the NPL control framework, the NPL monitoring, and the early warning mechanisms

Governance and operations (2/2)

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs
Control framework	• High NPL banks should have in place a control framework involving the **three lines of defence**: • The **first line** comprises control mechanisms within the NPL WUs. • The **second line** comprises risk control, compliance and other quality assurance tasks. • The **third line** usually comprises the internal audit function.	• Credit institutions should establish a control framework involving all **three lines of defence:** • The **first line** should be embedded into the procedures and processes of the NPE WUs. • The **second line** should control the NPE WUs' implementation of risk management measures. • The **third line** (internal audit function) should review the effectiveness of the above controls.
NPL monitoring	• A **framework of NPL-related KPIs** should be developed to allow the management body to measure progress, grouped into **5 categories**: i) high-level NPL metrics (e.g. NPL ratio and coverage); ii) customer engagement and cash collection (relative efficiency vs benchmark); iii) forbearance activities (efficiency and effectiveness of activities); iv) liquidation activities (e.g. volumes and recovery rates of legal and foreclosure cases); iv) and others[1].	• A related **framework of KPIs** should be developed to allow the management body to measure progress, grouped into **5 categories**: i) high-level NPL metrics (e.g. NPL ratio and coverage); ii) customer engagement and cash collection (relative efficiency vs benchmark); iii) forbearance activities (efficiency and effectiveness of activities); iv) liquidation activities (e.g. legal procedures, foreclosing assets); iv) and other monitoring items[1].
Early warning mechanisms	• Banks should implement **adequate internal procedures and reporting** to identify potential non-performing clients at a very early stage (e.g. an early warning engine owned by the back office).	• All credit institutions should implement **adequate internal procedures and reporting** to identify and manage potential non-performing borrowers at a very early stage. This involves the identification of early warning indicators and a escalation process.

(1) (e.g. P&L items, foreclosed assets). The ECB and the EBA provide a list of NPL monitoring metrics in an annex of its relevant documents.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Regarding the forbearance options or measures, the ECB and the EBA provide guidance on the viability of forbearance measures distinguishing between long-term and short-term options

Forbearance (1/2)

Forbearance options and viability

ECB – Guidance on NPL

- The **viability assessment** of forbearance options should be carried out by distinguishing between short and long-term options[1]:
  - **Long-term options**, should be considered viable where: i) the bank can demonstrate that the borrower can realistically afford the forbearance solution; ii) the resolution of outstanding arrears is fully addressed and a significant reduction in the borrower's balance in the medium to long term is expected; and iii) in cases where there have been previous forbearance solutions granted in respect of an exposure, the bank ensures that additional internal controls are implemented to ensure the option's viability.
  - **Short-term options**, should be considered viable where: i) the bank can demonstrate that the borrower can afford the forbearance solution; ii) it is a solution truly applied temporarily (2 years maximum) and the bank is able to attest that the borrower demonstrates the ability to repay; and iii) the solution does not result in multiple consecutive measures to the same exposure.

EBA – CP GL on NPE and FBEs

- Credit institutions should distinguish between short-term and long-term measures implemented via forbearance:
  - **Long-term options**, should be considered viable where: i) the credit institution can demonstrate that the borrower can realistically afford the forbearance solution; ii) the resolution of outstanding arrears is fully addressed and a significant reduction in the borrower's balance in the medium to long term is expected; and iii) in cases where there have been previous forbearance solutions granted in respect of an exposure, the credit institution ensures that additional internal controls are implemented to ensure the option's viability.
  - **Short-term options**, should be considered viable where: i) the credit institution can demonstrate based on reasonable documented financial information that the borrower can afford the forbearance measure; ii) it is a measure applied temporarily and the credit institution is able to demonstrate that the borrower's ability to repay; and iii) the measure does not result in multiple consecutive forbearance measures having been granted to the same exposure.

(1) The ECB has also provided a list of the most common forbearance measures.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Moreover, the ECB and the EBA establish a set of issues that credit institutions should consider when developing forbearance processes

Forbearance (2/2)

Forbearance processes

ECB – Guidance on NPL

- The ECB highlights **best practices** specifically related to forbearance processes, which are specified below:
  - **Borrower affordability**. Before granting any forbearance measures, banks should conduct a complete assessment of the borrower's financial situation[1] (e.g. borrower's recurring income, expenditure, employment prospects).
  - **Standardised products and decision trees**. Banks should consider developing decision trees and related standardised forbearance solutions for segments of heterogeneous borrowers with less complex exposures.
  - **Comparison with other NPL workout options**. Before making a decision on the applicable forbearance option, banks should review other NPL workout options.
  - **Forbearance milestones and monitoring**. The forbearance contract and documentation should include a defined borrower milestone target schedule. The performance of the forborne borrower should be closely monitored by the NPL WU responsible for granting the forbearance, at least for the probation period.

EBA – CP GL on NPE and FBEs

- Credit institutions should developed **policy for their forbearance activities**, covering the process and procedures for granting forbearance measures, description of available forbearance measures, information requirements, documentation, and process and metrics to monitor efficiency and effectiveness of forbearance measures.
- Credit institutions should monitor **effectiveness of granted forbearance measures** using different metrics (e.g. cash collection rates and write-off).
- Before granting any forbearance measures, they should assess **borrower's creditworthiness**, taking into account all relevant factor and, in particular, the debt servicing capacity and overall indebtedness of the borrower or the property/project.
- Moreover, credit institutions should consider developing **decision trees** and **standardised forbearance measures** for portfolios of homogenous borrowers with less complex exposures; and should compare them with other NPE workout options.
- The **performance of the forborne borrower**, should be closely **monitored by the NPE WU** responsible for granting the forbearance, at least for the duration of the probation period.

(1) There is an annex to the ECB's Guidance that details the borrower affordability assessment and the associated documentation requirements, for both retail and corporate borrowers.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

The ECB and the EBA provide guidance on the definition of NPE, including references to the past-due and the unlikeliness to pay criteria, as well as on additional aspects regarding the harmonised implementation of the NPE definition at banking group level, among others

NPL recognition (1/2)

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs

NPE definition	• Banks are **strongly encouraged to use the NPE definition** issued by the EBA, not only for supervisory purposes but also in their internal risk control and public financial reporting. According to this definition, NPEs are those that satisfy either or both of the following criteria:
	  ◦ Material[1] exposures which are more than **90 days past-due**.
	  ◦ The debtor is assessed as **unlikely to pay** its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or number of days past due.
	• Banks should have clearly defined **internal policies** to identify **indicators of UTP**, including a list of **UTP events** (e.g. the debtor enters into an insolvency procedure).
		• Credit institutions should use the **definition of NPE** as defined in Commission Implementing Regulation (EU) 680/2014[2] in their risk management. In this regard, credit institutions should consider:
		  ◦ **Past due criterion**. They should recognise exposures as being past due in accordance with the EBA GL on the application of the definition of default and Commission Delegated Regulation (EU) 2018/171 on the materiality threshold for credit obligations past due.
		  ◦ **Indicators of UTP**. They should recognise exposures as unlikely to pay and identify indications of UTP in accordance with the EBA GL on the application of the definition of default.
		• Credit institutions should regularly assess the creditworthiness and repayment capacity of borrowers.

Additional aspects	• If more than **20%** of the exposures of one obligor are past due by more than 90 days, all other exposures to this obligor should be considered as non-performing (**pulling effect**). • The exposures should be categorised as NPE **for their entire amount** (not classified partly). • The identification of NPEs should be **consistent at the banking group level**.	• Regarding the consistent application of the definition of NPE, credit institutions should adopt adequate mechanisms and procedures for the **harmonised implementation of this definition** in all subsidiaries and branches. • This will ensure that the identification of NPEs is consistent at the entity and **at the banking group level**.

(1) The CRR and the RTS on the materiality threshold should be considered.
(2) Annex V of implementing Regulation 680/2014 on supervisory reporting.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Further, they provide the linkage between NPE and forbearance, establishing the criteria regarding the classification of forborne exposures as non-performing, the cure/exit from non-performing status, and the classification of forborne exposures as performing

NPL recognition (2/2)

Link between NPE and forbearance

ECB – Guidance on NPL

- **Forbearance measures** are concessions towards a debtor facing or about to face financial difficulties. In this regard, banks should be able to identify signs of possible future financial difficulties at an early stage[1]. Forborne exposures can be either performing or non-performing:
  - **Classification of forborne exposures as non-performing** when: i) they are supported by inadequate payment plans; ii) they include contract terms that delay the time for the regular payments; and iii) they include de-recognised amounts that exceed the accumulated credit risk losses for a NPE with a similar profile risk.
  - **Cure/exit from non-performing status** when: the non-performing forborne exposures complete a cure period of 1 year from the date the forbearance measures were extended, and debtor's behaviour demonstrates that concerns regarding full repayment no longer exist.
  - **Forborne exposure as performing.** Once a forborne exposure has been classified as performing, it will continue to be identified as forborne until some conditions are met[2].

EBA – CP GL on NPE and FBEs

- For identifying **forbearance measures** credit institutions should be able to identify signs of possible future financial difficulties at an early stage[1]. Forborne exposures can be either performing or non-performing:
  - **Classification of forborne exposures as non-performing** when: i) they are supported by inadequate payment plans; ii) they include contract terms that delay the time for the regular repayment instalments on the transaction; and iii) they include de-recognised amounts that exceed the accumulated credit risk losses for NPEs with a similar risk profile.
  - **Cure/exit from non-performing status**. Credit institutions' policies for the reclassification of non-performing forborne exposures should stablish criterion in terms of payments made during the cure period of at least 1year and define the borrower's ability to comply with post-forbearance conditions.
  - **Forborne exposure as performing**. Once a forborne exposure has been classified as performing, it will continue to be identified as forborne until all conditions for discontinuation for classification of exposures as forborne are met.

(1) This assessment should be only based on the situation of the debtor (e.g. increase of PD, past due>30 days, etc.).
(2) e.g. a minimum of 2 years has elapsed since the later of the date of concession.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Both the ECB and EBA documents also cover NPL impairment measurement and write-offs. In particular, they include expectations with regard to individual estimation of provisions although the ECB also sets out specific guidance on collective estimation of provisions

NPL impairment measurement and write-offs (1/2)

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs

Individual estimation of provisions	• Banks should define the criteria to identify exposures subject to **individual estimation of loss provisions**, taking into account several factors (e.g. individual significance of the exposure, there are no other exposures with common risk characteristics). These criteria should be **documented in the internal policy** of the bank.
	• The estimation of **future cash-flow provisions** can be done using a 'going concern' or a 'gone concern' scenario[1].
	• **Other provisions** on individual estimation are included (e.g. documentation for the purpose of checking the reliability of the individual estimations, review of the methods when backtesting reveals significant differences, etc.).
		• Credit institutions' policies should include criteria to identify exposures subject to **individual estimation of loss allowances**, taking into account certain criteria (e.g. individual significance of the exposure, common credit risk characteristics and availability of historical data).
		• They should estimate **future cash flows** using a 'going concern' or a 'gone concern' scenario[1].
		  • **Going concern scenario**. It should be considered if: i) future operating cash flows of the borrower are material and can be reliably estimated; and ii) there is only limited collateralisation of the exposure.
		  • **Gone concern scenario**. It should be considered if, among other cases, the exposure has been past due for a long period.

Collective estimation of provisions	• Collective estimation should be applied to calculate the provisions for NPLs for which an **individual estimation is not performed**. In this regard, the ECB provides guidance on general principles related with internal methodologies (e.g. internal governance and integration into risk control), and with its methodology.	• The EBA **does not provided specific guidance** on the collective estimation of loss allowances.

(1) The first one will be used when the debtor's cash flows can be used to pay the debt, and the second one when the collateral is executed and the obligor's cash flows ceased.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Furthermore, other aspects related to the impairment, the NPL write-offs, the timeliness of provisioning and write-off and the NPL procedures are also covered in these documents

NPL impairment measurement and write-offs (2/2)

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs
Other aspects related to impairment	• A sophisticated approach for estimating provisions for **financial guarantee contracts and loan commitments** (e.g. use of robust historical data and backtesting) should be used. • Regarding **foreclosed assets classified as held for sale**, banks should define the assumptions and main methodologies used to determine their fair value and the cost of selling them.	• To measure the most likely drawn exposure of off-balance sheet items, such as **financial guarantees and loan commitments**, and that accordingly represent potential additional credit losses, reliable cash-flow forecasts or credit conversion factors should be used (e.g. existence of robust historical data and back-testing procedures).
NPL write-offs	• When loans are deemed **unrecoverable**, they should be written off in a timely manner, taking into account several criteria. Once an amount has been written off from the balance sheet, it **is not possible to write-back/reverse** that adjustment**.**	• When the credit institution has no reasonable expectations of recovering contractual cash flows of the exposure it should lead to a **partial or full write-off** of the exposure.
Timeliness of provisioning and write-off	• Banks should include in their internal policies clear guidance on the **timeliness of provisions and write-offs**[1].	• Credit institutions should include in their internal policies clear guidance on the **timeliness of impairments and write-offs**[1].
Procedures	• The **management body** should be responsible for ensuring that the bank has appropriate credit risk practices. Regarding write-offs, they should have an **internal policy** approved by the management body. • Banks should comply with certain **requirements on documentation** and **IT Databases**.	• Credit institutions should adopt, document and adhere to **sound policies**, **procedures and controls** for assessing and measuring loss allowances and write-off on NPEs according with the EBA GL on credit risk management and accounting for ECL.

(1) e.g. for exposures that are not covered by collateral, banks should determine suitable maximum periods for full provisioning and write-off.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Regarding the collateral valuation for immovable* and movable property, the ECB and the EBA provide guidance on governance, procedures and controls, valuation frequency…

Collateral valuation for immovable* and movable property (1/3)

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs
Governance procedures, and controls * The ECB Guidance concerns only immovable property.	• Banks should have **written policies and procedures**, approved by the management body, governing the valuation of immovable property collateral for NPLs. • Banks are expected to **monitor and regularly review the valuations** performed by appraisers[1]. • In the collateral valuation for immovable properties, two methods are set out: i) **individual valuation**, performed by individual appraisers on a specific immovable property; and ii) **indexed valuation**, consisting on automated valuation processes for NPLs < 300.000€ (gross value).	• Credit institution should have **written policies and procedures**, approved by the management body, governing the valuation of property collateral. • Credit institutions should **monitor and regularly review the valuations** performed by internal or external appraisers[1]. • Credit institutions should monitor the value of immovable property collateral through: i) **individual property valuations**, performed by an appraiser; or ii) **indexed valuations** used to update the valuation for NPE secured by immovable property collateral not subject to regular property specific appraisal.

Valuation frequency	• The valuation of collateral of all exposures should be updated periodically, at a minimum:
	  • **Every year** for commercial immovable properties.
	  • **Every 3 years** for residential immovable properties.
	• The valuation of immovable properties for NPLs should be **updated on an individual basis** at the time the loan is **classified as a NPE** and at least **annually** while it continues to be classified as such.
		• Credit institutions should update individual valuations for the collateral, at a minimum:
		  • **Every year** for moveable property and commercial immovable property.
		  • **Every 3 years** for residential immoveable property.
		• The group of collaterals that are subject to property-specific appraisal on a regular basis should be updated at the time the exposure is **classified as a NPE** and at least **annually** while it continues to be classified as such.

(1) Additionally, the internal audit department should regularly review the consistency and quality of the property valuation policies and procedures, the independence of the appraiser selection process, etc.

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

…valuation methodology, including the individual estimations of allowances and backtesting…

Collateral valuation for immovable* and movable property (2/3)

Valuation methodology

* The ECB Guidance concerns only immovable property.

ECB – Guidance on NPL

- Banks should have defined **collateral valuation approaches** per collateral product type. Immovable property collateral should be valued on the basis of **market value** (and not on the basis of discounted replacement cost).
- Banks should have **databases** of transactions to enable the proper assessment and monitoring of credit risk and the preparation of reports, subject to certain expectations[1].
  - **Individual estimations of allowances**. It can be carried out by discounting future cash flows using two broad approaches: i) 'Going concern scenario' where the operating cash flows of the debtor can be used to repay the financial debt an collateral may be exercised to the extent it does not influence operating cash flows; and ii) 'Gone concern scenario' where the collateral is exercised (operating cash flows ceased).
  - **Backtesting**. Banks should regularly backtest their valuation history (last valuation before the object was classified as a NPL) vs. their sales history (net sales price of collateral). The results should be used to determine discounts on collateral valuations.

EBA – CP GL on NPE and FBEs

- Credit institutions should have defined **collateral valuation approaches** per collateral product type. All immovable property collateral should be valued on the basis of **market value**. For movable property, credit institutions should periodically assess the **liquidity of the property**.
  - **Expected future cash flows**. Individual estimations of loss allowance by discounting future cash flows using two broad approaches: i) 'Going concern scenario'; and ii) 'Gone concern scenario', where the operating cash flows of the borrower cease and collateral is exercised.
  - **Backtesting**. Credit institutions should regularly backtest their valuation history (last valuation before the object was classified as a NPE) vs. their sales history (net sales price of collateral).
  - **IT database requirements**. Credit institutions should have databases of transactions to enable a proper assessment, monitoring and control of credit risk. The databases should comply certain requirements, such as the depth and breadth, accuracy, integrity, reliability and timeliness of data; consistency; and traceability.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

The ECB and the EBA also provide guidance on the valuation of foreclosed assets establishing that these assets should be classified as non-current assets held for sale under IFRS 5

Collateral valuation for immovable* and movable property (3/3)

Foreclosed assets valuation

* The ECB Guidance concerns only immovable property.

ECB – Guidance on NPL

- Banks are encouraged to classify foreclosed real estate assets as **non-current assets held for sale under IFRS 5** (and discouraged from applying IAS 40).
- Foreclosed assets should be valued **at the lower** of:
  - The **amount of the financial assets** applied treating the asset foreclosed as collateral or;
  - The **fair value of the repossessed asset**, **less selling costs**. The inability to sell the foreclosed assets should be reflected in **appropriate liquidity discounts**.
- The frequency of valuation of foreclosed assets and the applicable procedures are aligned to the **treatment of immoveable property**.

EBA – CP GL on NPE and FBEs

- Credit institutions should strongly consider to classify foreclosed assets as **non-current assets held for sale under IFRS 5**. This accounting treatment implies that the asset must be available for immediate sale in its present condition and the management should approve an individual plan to sell the asset within a short timeframe (normally one year) and that an active sales policy should be pursued; thus, it favours recoveries.
- Foreclosed assets should be valued **at the lower of**:
  - The **amount of the financial assets** applied, treating the asset foreclosed or received in payment of debt as collateral;
  - The **fair value of the repossessed asset**, **less selling costs**.
- The frequency of valuation of foreclosed assets and the applicable procedures should follow the **treatment of immovable property**.

NPL framework

ECB Guidance on NPL vs EBA CP GL on NPE and FBEs

Finally, the ECB and the EBA set out that competent authorities should assess the credit institution's NPL strategy and their operational plan, among other aspects

Supervisory reporting and evaluation of management of NPLs

	ECB – Guidance on NPL	EBA – CP GL on NPE and FBEs

Supervisory reporting and evaluation	• High NPL banks should **report** their NPL strategy and their operational plan to their JSTs in the **first quarter** of each calendar year.
	• **Material and structural changes** in the NPL operating model or control framework should be communicated to the respective JST in a timely fashion. High NPL banks should proactively share **periodic NPL monitoring reports**, at a suitable level of aggregation, with the supervisor.
	• Banks should disclose the quantitative information on **credit quality of forborne exposures**, **quality of forbearance**, **ageing of forborne exposure**, and **net present value impact**.
	• Further, banks shall disclose some information items such as the assumptions underlying the **NPE definition**, the materiality thresholds, the methods used for days past due counting, etc.
	• Upon request by supervisors, banks should be able to provide them with **data on the models** they use to calculate impairment provisions for NPLs and the interest accrued on NPEs.
	• Banks should provide **information** on collateral held against performing exposures and NPEs, foreclosed assets values, etc.
		• Competent authorities' evaluation should include, but not be limited to whether the credit institution's NPE strategy:
		  • Is embedded into the **credit institution's overall strategy** and is subject to ap**propriate NPE governance**, including risk management and control framework.
		  • Relies on a credible self-assessment of the **credit institution's internal capabilities**.
		  • Adequately takes into account the credit institution's **operating environment**, **external conditions** and **capital situation**.
		  • Covers **not only short term time horizon**, but also medium and/or long term timeframe.
		  • Includes time-bound realistic, yet ambitious **quantitative NPE targets** and f**oreclosed assets targets** where appropriate and is supported by an operational plan.
		• Moreover, they should assess that credit institutions have in place **forbearance policy** and related **processes** to assess viability of forbearance measures; recognise and **classify NPEs and FBEs**; have in place policies and methodologies to recognise **impairments** and **write-offs**.

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NPL framework

ECB Addendum to the ECB Guidance on NPL

This addendum sets out definitions to be considered, such as new NPEs, NPE vintage, eligible credit protection to secure exposures…

Definitions (1/2)

New NPEs

- All those exposures that are reclassified from performing to non-performing **after 1 April 2018** irrespective of their classification at any moment prior to that date.
- Exposures classified as NPEs and cured before 1 April 2018 that are reclassified as non-performing after 1 April 2018 are considered to be **new NPEs** for the purpose of this Addendum, with the NPE vintage count starting at zero.

NPE vintage

- The NPE vintage concept is used for the application of supervisory expectations and is defined as the **number of days** (converted into years) from the date on which an exposure was **classified as non-performing to the relevant reporting or reference date**, regardless of what triggered the NPE classification. In this regard, the Addendum provides that:
  - The vintage count for **unlikely to pay** and **past due exposures is the same**.
  - For exposures moving from **unlikely to pay** to **past due**, the counting continues and is **not reset**.
  - If an exposure returns to a **performing classification**, the NPE vintage count for the purposes of this Addendum is deemed to be **re-set to zero**.

Credit protection to secure exposures

- The Addendum applies **prudential principles** to define the eligibility criteria for credit protection which are used to determine which parts of NPEs are to be deemed secured or unsecured and, consequently, whether to consider supervisory expectations for secured or unsecured exposures.
- The types of collateral or other forms of credit risk protection accepted for either **fully or partially securing NPEs** are the following:
  - All types of **immovable property** collateral.
  - Other eligible collateral or other forms of credit risk protection that fulfil the criteria of **credit risk mitigation** of the CRR, irrespective of whether an institution uses the standardised approach or the internal ratings-based approach.

NPL framework

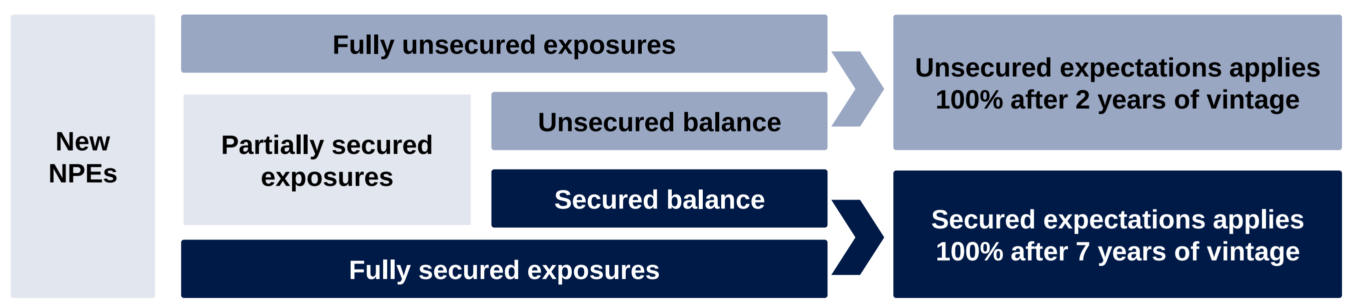
ECB Addendum to the ECB Guidance on NPL

…and secured and unsecured part of NPEs, which include fully unsecured NPEs, fully secured NPEs, and partially secured exposures

Definitions (2/2)

Secured and unsecured parts of NPEs

- The Addendum distinguishes between the unsecured and secured (parts of) NPEs as follows:
  - **Fully unsecured NPEs**, if they do not benefit from credit risk protection. These exposures are assessed in the supervisory dialogue using the supervisory expectations for unsecured exposures.
  - **Fully secured NPEs**, if the credit risk protection exceeds the current drawn and potential undrawn credit facilities of the debtor[1]. These exposures are assessed in the context of the supervisory dialogue using the supervisory expectations for secured exposures.
  - **Partially secured NPEs**, if the value of eligible credit risk protection does not exceed the current drawn and potential undrawn credit facilities. Once the bank has established the value of its credit risk protection, the exposure should be split into the following two elements:
    - **Secured balance**, which are valued by the bank according to the credit risk protection outlined above for fully secured exposures.
    - **Unsecured balance**, which will be equal to the original drawn and potential undrawn credit facilities minus the secured balance of the exposure.
- For fully and partially secured exposures, banks are expected to **review regularly the collateral value** in line with the NPL Guidance, and to take into account any changes in a timely manner.



ECB, 2018

(1) However, undrawn credit facilities may be disregarded and cancelled unconditionally at any time and without notice. Collateral values should represent the value reported in line with FINREP instruction whereas the valuation of immovable property should be done according to the ECB Guidance.

NPL framework

ECB Addendum to the ECB Guidance on NPL

Further, this Addendum provides the following information regarding the prudential provisioning expectations: minimum level, adjustments…

Prudential provisioning expectations (1/3)

Minimum level of provisions

- The prudential provisioning expectations supplement the NPL Guidance by specifying **what the ECB deems to be prudent levels of provisions**. In its assessment of a bank's levels of provisions for NPEs, the ECB will take into account the level of existing credit protection and, crucially, the NPE vintage category.
- These expectations may go beyond, but not stand in contradiction to, accounting rules. Therefore, if the applicable accounting treatment is not considered prudent from a supervisory perspective, the **accounting provisioning level is fully integrated in the banks' supply** to meet the supervisory expectation.
- A bank's supply for the purposes of the prudential provisioning expectations is made up of the following items:
  - **All accounting provisions** under the applicable accounting standard including potential newly booked provisions.
  - **Expected loss** shortfalls for the respective exposures in default, and other **CET 1 deductions** from own funds related to these exposures.

Accounting regime		Prudential regime[1]				Bank-specific supervisory three step approach	
Accounting provisions	+	Own funds deductions	=	Bank's supply	«	1. Supervisory expectations	2. Supervisory dialogue	3. SREP decisions

ECB, 2018

Adjustments

- Banks are encouraged to close potential gaps relative to the prudential expectations by booking the **maximum level of provisions** possible under the applicable accounting standard.
- If the applicable accounting treatment does not match the prudential provisioning expectations, banks also have the possibility to **adjust the CET 1 capital on their own initiative**, applying CRR stricter requirements[2].

(1) For more detail on the own funds deductions see the EC Proposal.
(2) Those deductions are to be reported in the COREP template C01.00 in row 524.

NPL framework

ECB Addendum to the ECB Guidance on NPL

…divergences, categories and quantitative supervisory expectations. In this regard, these expectations aim to ensure that banks do not build up aged NPEs with insufficient provision coverage

Prudential provisioning expectations (2/3)

Divergences

- During the supervisory dialogue, at least annually in the context of the SREP, the ECB will discuss with banks any **divergences** from the prudential provisioning expectations.
- When assessing such divergences, the ECB will consider **specific circumstances** which may make the prudential provisioning expectations inappropriate for a specific portfolio/exposure.
- This process might include off-site activities performed by the respective JST, on-site examinations or both[1].

Categories[2]

- **Supervisory expectations for unsecured exposures**, that apply to fully unsecured NPEs and to the unsecured balance of partially secured NPEs.
- **Supervisory expectations for secured exposures**, that apply to fully secured NPEs and the secured balance of partially secured NPEs.

Quantitative supervisory expectations

- To avoid cliff edge effects, a suitably **gradual path towards those supervisory expectations** is important, starting from the moment of NPE classification. The ECB will assess prudential provisioning levels of new NPEs, taking into account the following quantitative expectations:

	Unsecured part	Secured part
After two years of NPE vintage	100%	
After three years of NPE vintage		40%
After four years of NPE vintage		55%
After five years of NPE vintage		70%
After six years of NPE vintage		85%
After seven years of NPE vintage		100%

- These expectations aim to ensure that banks do not build up aged NPEs with insufficient provision coverage. Therefore, the ECB considers that prudent provisioning implies the **continuation of booking accounting provisions** in line with banks' assessments and existing accounting principles.

(1) The outcome of this assessment will be considered in the SREP.
(2) The foreclosed assets are not currently in scope of this Addendum.

NPL framework

ECB Addendum to the ECB Guidance on NPL

Finally, this Addendum provides information on data to be reported to JSTs, and on public disclosure

Prudential provisioning expectations (3/3)

Supervisory reporting

- All banks are expected to **inform their respective JSTs** of coverage levels by NPE vintage with regard to NPEs classified after 1 April 2018. In this context, deviations from the prudential provisioning expectations as outlined in this Addendum will be carefully scrutinised.
- In this regard, the JSTs will provide banks with **further details** regarding this process, sufficiently in advance.

Public disclosure

- Banks are encouraged to include in their **public disclosures** the **provisions by type of asset and different NPE vintages**, as this is an important means of conveying their credit risk profiles comprehensively to market participants.

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NPL framework

EC Proposal for a Regulation amending the CRR on NPLs

The EC Proposal for a Regulation defines the exposures that shall be classified as NPL, as well as the forbearance measures that institutions may apply towards an obligor

Definition of NPEs and forbearance measures

Definition of NPE

- For the purposes of the prudential backstop, a definition of NPE is introduced in the CRR. According with this new definition the following exposures shall be **classified as NPE**:
  - An exposure in respect of which a **default** is considered to have occurred according to the CRR[1].
  - An exposure considered **impaired** in accordance with the applicable accounting framework.
  - An exposure **under probation** (e.g. at least until two years have passed since the date the forborne exposure was reclassified as performing) where additional forbearance measures are granted or where it becomes more than 30 days past due.
  - An exposure in form of a **commitment**, were it drawn down or otherwise used, would present a risk of **not being paid back in full** without realisation of collateral.
  - An exposure **in form of a financial guarantee** that is at risk of being called by the guaranteed party.
- The proposed amendments also introduce strict criteria on the conditions to **discontinue the treatment of a NPE** (e.g. the obligor does not have any amount past-due by more than 90 days).

Forbearance measures

- For the purposes of NPEs, **forbearance measures** refer to a concession by an institution towards an obligor that is experiencing or is likely to experience a deterioration in its financial situation. A concession may entail a loss for the lender and shall refer to either of the following actions:
  - A **modification of the terms and conditions of a debt obligation**, where such modification would not have been granted had the financial situation of the obligor not deteriorated.
  - A **total or partial refinancing of a debt obligation**, where such refinancing would not have been granted had the financial situation of the obligor not deteriorated.
- In this regard, certain **situations shall be considered forbearance measures** (e.g. new contract terms that are more favourable to the obligor than the previous contract terms). Further, the Proposal establishes indicators regarding the application of forbearance measures (e.g. the initial contract was past due by more than 30 days at least once during the three months prior to its modification).

(1) Where an institution has on-balance sheet exposures to an obligor that are past due by more than 90 days and that represent more than 20% of all on-balance sheet exposures to that obligor, all on- and off-balance sheet exposures to that obligor shall be considered as past due by more than 90 days.

NPL framework

EC Proposal for a Regulation amending the CRR on NPLs

Regarding the prudential backstop, the Proposal establishes that it consist of two elements: i) a minimum coverage requirement, and ii) a deduction amount to be deducted from CET1 items

Prudential backstop and deduction for NPEs

Principle of prudential backstop

- The prudential backstop consists of **two main elements**:
  - A requirement for institutions to cover up to common minimum levels the incurred and expected losses on newly originated loans once such loans become non-performing (i.e. **'minimum coverage requirement'**).
  - Where the minimum coverage requirement is not met, a **deduction of the difference** between the level of the actual coverage and the minimum coverage from CET1 items.
- The minimum coverage **requirement increases gradually** depending on how long an exposure has been classified as non-performing. This gradual increase reflects the fact that the longer an exposure has been non-performing, the lower is the probability to recover the amounts due.
- Some items would be **eligible for compliance with the minimum coverage requirements** (e.g. provisions recognised under the applicable accounting framework, and additional value adjustments for fair value-assets).

Deduction for NPE

- Institutions shall determine the applicable **amount of insufficient coverage for NPEs** to be deducted from CET1 items by subtracting the amount determined in i) from the amount determined in ii):
  - i) the sum of: the **unsecured part of each NPE**, if any, multiplied by the relevant applicable factor (see in next slide), and the **secured part of each NPE**, if any, multiplied by the relevant applicable factor (see in next slide).
  - ii) the **sum of the following items** provided they relate to a specific NPE: specific credit risk adjustments; additional value adjustments for fair-valued assets; other own funds reductions; and, for institutions calculating risk-weighted exposure amounts using the Internal Ratings Based Approach, the regulatory expected loss shortfall which is already deducted from own funds.

NPL framework

EC Proposal for a Regulation amending the CRR on NPLs

The Proposal distinguishes between secured and unsecured NPEs and assigns different factors for each one, depending on the past due date and the date of classification as non-performing

Deduction for NPEs

Deduction for NPE (continue)

- **Different coverage requirements** apply depending on the classification of the NPEs as secured or unsecured.
- A loan only **partly covered by collateral** would be considered as secured for the covered part, and as unsecured for the part which is not covered by collateral.
- The proposal for amending the CRR establishes different **factors for secured and unsecured NPEs**, depending on the past due date of the obligor and the period in which it should be applied following its classification as non-performing.
- For the **unsecured part** of a NPE, the following factors shall apply:

The obligor is past due more than 90 days		
Years[1]	1-2	2 onwards
Factor	0.35	1

The obligor is not past due more than 90 days		
Years[1]	1-2	2 onwards
Factor	0.28	0.8

- For the **secured part** of a NPE, the following factors shall apply:

The obligor is past due more than 90 days								
Years[1]	1-2	2-3	3-4	4-5	5-6	6-7	7-8	8 onwards
Factor	0.05	0.1	0.175	0.275	0.4	0.55	0.75	1

The obligor is not past due more than 90 days								
Years[1]	1-2	2-3	3-4	4-5	5-6	6-7	7-8	8 onwards
Factor	0.04	0.08	0.14	0.22	0.32	0.44	0.6	0.8

(1) Period following its classification as non-performing

NPL framework

EC Proposal for a Regulation amending the CRR on NPLs

The EC Proposal sets out the treatment of the expected loss amounts, the discount on the balance sheet exposures and specific risk adjustments; and defines the forbearance measures for NPEs

Treatment of expected loss and derogation for past loans

Treatment of expected loss amounts

- Institutions shall subtract the **expected loss amounts** from the general and specific credit risk adjustments and additional value adjustments and other own funds reductions related to these exposures except for the deductions for insufficient coverage for NPEs.
- **Discounts on balance sheet exposures** purchased when in default shall be treated in the same manner as specific credit risk adjustments. **Specific credit risk adjustments** on exposures in default shall not be used to cover expected loss amounts on other exposures. Expected loss amounts for securitised exposures and general and specific credit risk adjustments related to these exposures shall not be included in this calculation.

Derogation for past loans

- The prudential backstop would apply only to exposures originated **after 14 March 2018** as from that date there is sufficient clarity how the new rule would apply, so institutions shall not deduct from CET1 items the applicable amount of insufficient coverage for non-performing exposures where the exposure was incurred prior to 14 March 2018.
- Where the terms and conditions of an exposure which was incurred **prior to 14 March 2018** are **modified by the institution** in a way that increases the institution's exposure to the obligor, the exposure value should be treated as newly originated exposures.
- Exposures originated **before the date of the adoption of the proposal** should be treated accordingly to the rules in force at that date, even if they are refinanced or subject to other forbearance measures.

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Next steps

The set of documents published regarding NPLs will apply at different dates. For example, the ECB Guidance on NPLs should be applicable as its date of publication whereas the EBA Final GL on NPE and forbearance will apply from 1 January 2019

Next steps

ECB

- The **Guidance on NPLs** should be applicable as of its **date of publication**. Further, in order to ensure consistency and comparability, the expected enhanced disclosures on NPLs should start from **2018 reference dates**.
- The expectations set out in the **Final Addendum to the ECB Guidance on NPLs** are applicable at a minimum to new NPEs classified as such from **April 2018 onward**. Moreover, banks will be asked to inform the ECB of any differences between their practices and the prudential provisioning expectations, as part of the SREP supervisory dialogue, from **early 2021 onwards**.

EBA

- Comments to the CP GL on NPE and forbearance shall be submitted by **8 June 2018**. The final GL will apply from **1 January 2019**.
- Comments to the CP GL on disclosure of NPEs and FBEs shall be submitted by **27 July 2018**. The Final GL will be published **before the end of 2018**, and apply from **31 December 2019**.

EC

- The Regulation shall enter into force on the **day following** that of its publication in the OJEU.

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EBA CP GL on disclosure of NPE and FBE

The EBA sets out two definitions that apply for the purposes of this CP GL regarding significant credit institutions and credit institutions with a high level of NPEs, respectively

Definitions

Definitions

- Unless otherwise specified, **terms used and defined in the CRR and in the Regulation (EU) No 680/2014 on supervisory reporting of institutions**[1] have the **same meaning in the CP GL**. In addition, for the purposes of this CP GL, the following definitions apply:

Significant credit institution

- A credit institution is considered **significant** if it meet one or more of the following **criteria**:
  - The credit institution is one of the **three largest credit institutions** in its home Member State.
  - The credit institution's consolidated assets exceed **30 billion €**.
  - The credit institution's 4-year average of total assets exceeds **20% of the 4-year average of its home Member State's GDP**.
  - The credit institution consolidated leverage exposures exceed **200 billion €** or the equivalent in foreign currency using the reference exchange rate published by the ECB applicable at the financial year end.
  - The credit institution has been identified by competent authorities as a **G-SII** or as an **O-SII**.

Credit institutions with an elevated level of NPEs

- A credit institution is considered with an **elevated level of NPEs** if it reports a **NPL ratio above 5%**. In this regard, the NPL ratio is the ratio between the gross carrying amount of NPLs and advances and the total gross carrying amount of loans and advances[2].

(1) Commission Implementing Regulation (EU) No 680/2014 laying down ITS with regard to supervisory reporting of institutions according to the CRR.
(2) NPLs and advances include loans and advances as defined in Annex V of Regulation (EU) 680/2014 that are classified as non-performing according to Annex V of Regulation (EU) 680/2014.

EBA CP GL on disclosure of NPE and FBE

The EBA establishes four templates applicable to all credit institutions on credit quality of FBEs, credit quality of NPEs by past due, performing and non-performing exposures and related provisions, and on collateral obtained by taking possession and execution processes

Templates applicable to all credit institutions

Scope and purpose	• Templates applicable to **all credit institutions**, showing the volumes and level of NPEs, forborne and foreclosed assets in their balance sheet, with the aim of **fostering transparency** or providing meaningful information to market participants **on the quality of credit institutions' assets**.
Frequency	• **Semiannual**. By **significant credit institutions with an elevated level of NPEs**, as well as by those identified as **G-SIIs or O-SIIs** in accordance with the definitions given in this CP GL. • **Annual**. By all other credit institutions.

Templates	Description
T1 Credit quality of forborne exposures	• Disclosure of the gross carrying amount, broken down by exposure class, of forborne exposures, the related accumulated impairment, provisions and/or changes in fair value, and the collateral and financial guarantees received, and to explain the drivers of any significant changes across the time.
T3 Credit quality of NPEs by past due days	• Disclosure of the gross carrying amount, broken down by exposure class, of performing and non-performing exposures, including a further breakdown for past due exposures by number of days that the exposures have been past due. Credit institutions are also requested to explain the drivers of any significant changes across the time.
T4 Performing and non-performing exposures and related provisions	• Disclosure of the gross carrying amount, broken down by exposure class, of impairments, provisions, accumulated changes in fair value due to credit risk, accumulated partial write-offs, collateral and financial guarantees received, both for performing and non-performing exposures • Explanation of the drivers of any significant changes across the time-periods[1].
T9 Collateral obtained by taking possession and execution processes	• Disclosure of the instruments that were cancelled in exchange of the collateral obtained by taking possession and on its value. • Explanation of the drivers of any significant changes across the time-periods.

(1) For IFRS banks, further details are requested on the stage of the exposures.

Annex

EBA CP GL on disclosure of NPE and FBE

The EBA establishes six templates applicable to significant credit institutions with a high level of NPLs on quality of forbearance, quality of NPEs by geography, quality of loans and advances by industry…

Templates applicable to significant credit institutions with a high level of NPLs (1/2)

Scope and purpose	• Templates required only to **significant credit institutions with a high level of NPEs** and provide **additional information** that would allow stakeholders to have a **better insight of the distribution and features of the problematic assets, the quality and value of the collaterals backing them and the efficiency of the institution's recovery function**.
Frequency	• **Annual**. By all significant institutions with a high level of NPLs.

Templates	Description
T2 **Quality of forbearance**	• Disclosure of the number of times that an exposure has been forborne and inform about the non-performing forborne exposures that failed to meet the non-performing exit criteria. • Explanation of the drivers of any significant changes in the amounts from the previous reporting period.
T5 **Quality of non-performing exposures by geography**	• Disclosure of the gross carrying amount of performing and non performing exposures and the related accumulated impairment, provisions, and accumulated change in fair value due to credit risk by geographical area and or country. • Explanation of the drivers of any significant changes across the time-periods. Further, when materiality of geographical areas or countries is determined using a materiality threshold, that threshold should be disclosed, as well as the list of immaterial countries included in the 'other geographical areas' and 'other countries' rows.
T6 **Quality of loans and advances by industry**	• Disclosure of the gross carrying amount of loans and advances to non-financial corporations and the related accumulated impairment and accumulated change in fair value due to credit risk by industry/sector of activity of the counterparty. • Explanation of the drivers of any significant changes in the amounts from the previous reporting period.

Annex

EBA CP GL on disclosure of NPE and FBE

…collateral valuation, changes in the stock of NPLs and advances, and on collateral obtained by taking possession and execution processes considering vintage breakdown

Templates applicable to significant credit institutions with a high level of NPLs (2/2)

Scope and purpose	• Templates required only to **significant credit institutions with a high level of NPEs** and provide **additional information** that would allow stakeholders to have a **better insight of the distribution and features of the problematic assets, the quality and value of the collaterals backing them and the efficiency of the institution's recovery function**.
Frequency	• **Annual**. By all significant institutions with a high level of NPLs.

Templates	Description
T7 **Collateral valuation - Loans and advances at cost or amortised cost**	• Disclosure of information on the gross carrying amount of loans and advances collateralized, the related accumulated impairment, the value of the collateral/financial guarantees received and partial write-off for these exposures. All these information is requested by past-due bucket. In addition, further detailed information is requested by loan-to-value bucket. • Explanation of the drivers of any significant changes in the amounts from the previous reporting period.
T8 **Changes in the stock of non-performing loans and advances**	• Disclosure of the movements of gross carrying amount of NPLs and advances during the period with specific details on the net cumulated recoveries related with these changes. • Explanation, regarding the outflow due to other situations, of the drivers that could cause a significant amount.
T10 **Collateral obtained by taking possession and execution processes - vintage breakdown**	• Disclosure of the value and the related impairment of the assets cancelled in exchange of the collateral obtained by taking possession, on the value and the related impairment of the collateral obtained and on the vintage of the foreclosed assets. • Explanation of the drivers of any significant changes in the amounts from the previous reporting period.