EBF_019138

22 January 2016

EBF response to EBA Consultation Paper (CP) on the "Guidelines on the application of the definition of default under Article 178 of Regulation (EU) 575/2013"

Key messages

- Sufficient time needs to be ensured for the implementation given the significance of the envisaged changes to banks systems and processes;
- A dialogue with the industry should be established in developing the Application Guidelines as the pros and cons of possible application methods need to be thoroughly analysed;
- Default should be triggered only for reasons that are directly linked to the credit risk of the counterparty;
- Defaults related to exposures that are disputed or waived or that are not related to the decrease in the quality of the credit risk should be considered technical defaults;
- Possibility to net the past due exposure with the available margin should be introduced;
- Specific treatment should be introduced for public entities;
- Given that the wording "significant perceived decline in credit quality" as an indication of unlikeliness to pay might be misleading and wrongly equated with the stage 2 of IFRS 9, the Guidelines should clarify that classification in stage 2 should not be considered as an indication of default;
- Introduction of only an absolute materiality threshold for retail exposures risks an undesirable impact in particular on SMEs portfolios. A 4% threshold, both for retail and non-retail, would be more appropriate as already stated in the previous EBF position paper on this topic. The relative threshold should be implied only when the relative amount exceeds the absolute thresholds of EUR 200 for retail and EUR 1000 for non-retail exposures;
- The sale of credit obligations should be associated with other indicators of unlikeliness to pay and not as a stand-alone criterion. Introduction of a threshold is considered inappropriate. The threshold should be removed to avoid restricting the selling activity and liquidity of financial markets;
- The threshold for calculation of the diminished financial obligation as proposed in the QIS should also be revisited. The relevant measure for recognition of default should be set at a level, when the new cash flow (NPV) would no longer be adequate to cover the value at origination of the obligation, regardless of the decline in NPV;
- The suggested probation periods are considered too long in relation to both large corporate exposures and retail consumers in particular when applied together with the strict definition of the technical default as proposed in the CP. The institutions are best placed to recognize when a customer is no longer in default. The probation period should be set in a way that minimizes the "re-defaults" of the clients.

General comments

We welcome the objective of the Guidelines to harmonize the definition of default to ensure consistency of its application, transparency and comparability of risk parameters between banks across the Member States.

Time needed for implementation

The impact of the proposed definitions on financial institutions will vary depending on the extent to which the current approaches deviate from the proposals.

However, given the envisaged significant impact on substantial parts of institutions, we would like to stress that sufficient time needs to be granted to change the operative procedures and banks' systems.

For IRB banks, additional time will have to be factored in for recalibrations of models and banks' internal systems. This should include changes to the IT systems, policies, data and data structures, internal models and human resources. The time necessary for obtaining supervisory approval of the banks' internal models (if needed) should be factored in on top as banks are not in control of the supervisory timelines.

In order to minimize the operative impact it is important that the entry into force of the new definition does not precede the entry into force of the IFRS 9 standard. The new rules on the definition of default should therefore not enter into force before the mandatory application date of IFRS 9.

Application method of the new proposals

We understood that EBA is aware of the difficulties to apply the proposals retrospectively. Adjusting historical data to the proposed application of the default definition will indeed be challenging in terms of both required cost and time, if not impossible in certain cases due to the unavailability of the data (in particular when the unlikeliness to pay trigger is changed). Retrospective application would imply a manual review in order to assess whether the customer should be considered defaulted according to the new definition.

The historical data may not always be available, for example, for forborne exposures given that no data other than the required opening balance are kept in the banks' internal systems. Also the implementation of specific criteria for the proposed probation period would require data that are historically not available.

Besides, in certain instances the retrospective application of the definition of default will not be appropriate. This is valid for example for distressed restructurings and sales of credit obligations. It is likely that different considerations would have been made when outlining the restructuring plan or the sale conditions, if the definition of default had been different.

Statistical adjustments on default are also likely to create distortions on other parameters although the distortive effect on LGD and EAD are difficult to predict.

While retrospective application will be operationally challenging and not always possible, parallel running would also entail significant complexity and operational difficulties.

While we believe an approach based on "best estimates" following the new rules would be operationally least challenging, we acknowledge that it would open the door to a high degree of inconsistency, contrary to the CP's harmonization objective.

We believe it is therefore important that EBA enters into dialogue with the industry to understand the operational limitations and also to discuss pros and cons of possible approaches, including a phased approach. The EBF stands ready to discuss with EBA and offer its assistance in developing the envisaged Application Guidelines. We believe it is in our mutual interest to develop a feasible proposal that will guarantee a level playing field in the migration to RWA deriving from IRB models based on a uniform definition of default.

Past Due

a) Days Past Due calculation

IFRS 9 uses the term 90 days and more past due (90+) while the consultation paper refers to 'more than 90 days past due' (91 +). In our understanding the intention of the IASB was not to create any divergence with the Basel regulatory framework (See IFRS 9 BC5.253). Also the Basel Committee does not seem to see any divergence between IFRS 9 and Basel requirements (reference is made to paragraph A4 of the Basel Guidance on Credit Risk and Accounting for Expected Credit Losses). We are therefore seeking confirmation that the two concepts are identical despite the difference in the language used.

b) Frequency of Past Due Calculation

While we understand that EBA's objective is to identify the default at the day when it occurs, for some banking products such as mortgage loans, the determination of default is performed at the end of each month (some institutions determine the default on a daily basis but the information is sent to the central data basis in batch form at the end of the month). The required change to daily determination needs to be adjusted to avoid significant increase in the complexity of the implementation.

IFRS 9 considerations

Paragraph 178.3 b) of the CRR mentions "a significant perceived decline in credit quality" as an indication of unlikeliness to pay. This wording might be misleading and wrongly equated with the stage 2 of IFRS 9 ("significant increase in credit risk"). We would therefore suggest that the Guidelines clarify that IFRS 9 stage 2 should not be considered as an indication of default.

In addition to this, the non-accrual concept considered within the EBA paper is not an IFRS concept (under IFRS 9 or in the current IAS 39) so we believe paragraph 24 should be deleted.

Materiality thresholds

While the materiality threshold was subject to separate consultation, we have noted the inclusion of a scenario in the QIS that assumes the application of an absolute limit of 200 EUR for retail exposures and 1000 EUR for non-retail exposures and a 2.5% relative limit for non-retail exposures. This means that, at least for retail exposures, the new proposal is stricter than the previous one that was challenged by the majority of respondents to the consultation, requesting more relaxed rules.

While we appreciate that some of the industry comments in response to the consultation on the materiality threshold have been reflected (with particular reference to the breach of both absolute and relative thresholds to trigger default calculation), we believe that the 2.5 % relative threshold is still low. As stated in the previous EBF position paper, a 4% threshold, both for retail and non-retail, would be more appropriate. The relative threshold should be implied only when the relative amount exceeds the absolute threshold of EUR 200 for retail and EUR 1000 for non-retail exposures.

Introducing only an absolute threshold for the retail exposures risks undesirable impact in particular on SMEs portfolios.

On top, the following issues should be considered:

- An absolute threshold could be a reference in a single uniform context of standard of living, consumer costs, etc. This is however not the case for institutions present in different geographical regions, currencies and markets. Consequently, it does not seem possible to establish a single absolute threshold for diverse aggregations of geographies, products and customers.
- It would be necessary to bear in mind the effect of inflation on the absolute threshold over time. A frequency and a procedure would have to be established for the updating of the threshold for application in all institutions. This would potentially give rise to "cliff effect" at each update. The inflation level to be applied for the update would have to be decided, with the associated difficulty of considering not only the portfolios in the various European countries, but also outside Europe.
- FX volatility would compound the cost of computation for debts denominated in currencies other than Euro. Banks would have to readjust models and parameters only due to a breach of an absolute threshold after FX fluctuation if the defaulted amount in local currency remains unchanged.

We note that the QIS (par. 3.3 "Part 2: Quantitative questionnaire – policy options - 3.3.1 Materiality threshold", letter d) says that *"the counting of 90 days (or where relevant 180 days) begins at the moment this amount breaches the threshold".* Wording of this specific section suggests that the counting of days past due starts only at the moment when the amount past due breaches the materiality threshold. We therefore ask for clarification on whether this interpretation is correct. Consequently, that will mean that an exposure which is materially past due has to be considered defaulted only after 90 days of continuing past due status.

Compensation of past due amounts with unused credit lines

We believe that a provision should be introduced that will allow compensation of past due amounts with unused general credit lines of the same debtor. The possibility to compensate would allow avoiding considering as defaults the cases where a customer has past due amounts on a line of credit and available margin on another one. In such situations, the anomaly in the payment structure is likely to be due to a non-optimal management of the position. The possibility to net the past due exposure with the available margin would avoid this situation, and moreover would be more in line with the counterparty level approach followed by this consultation.

Specific treatment for public entities

Low thresholds as those proposed by EBA give raise to concern about the exposures of institutions to public administration and government institutions that are in some instances obliged to postpone their payments for administrative reasons. We believe that the default of a public administration requests further considerations and evaluations.

During the public hearing, EBA has indicated that it will be proposing a specific treatment for public institutions on the evaluation of unlikeliness to pay. We do believe a similar exceptional treatment should be introduced for the past due trigger for default. This we believe would be justified given the specificities of the trade debts of the public administrations, where payment habits vary amongst Member States. In some, the average past due day exceeds 180 days while the actual risk of losses is very limited. We ask EBA to consider the introduction of a waiver that would allow the institution to suspend the counting of past due days if the debtor (being a public administration) makes a payment on at least one of its past due exposures.

A specific treatment should be envisaged also for cases of factoring with the public entities involvement. Where the risks and benefits related with the assigned receivables are fully transferred to the factor and the factor has exposures to the debtor (being a public entity) of the client where the repayment of the obligation is suspended because of a law allowing this option or other legal restrictions, the payment date is not the one formally indicated on the invoice, but instead the one stated by the same debtor after a procedure of credit certification. Moreover, in respect to that date, the public entity usually has 30 more days to make the payment. We believe such cases would justify specific treatment.

Pulling effect

We have noticed a potential inconsistency regarding the "pulling effect" between this consultation paper and the EBA ITS on forbearance and not performing exposures. Its application seems to be binding in the 2014 EBA standards, while we deem that in the consultation paper its use is discretionary for banks. We believe the use should indeed be optional and would appreciate clarification.

Examples of default calculation

We ask EBA that in the final draft of the Guideline some examples are introduced in order to better clarify the mechanism regarding the compensation of past due amounts, the counting of days past due and the computation of the sum relevant for the materiality threshold.

Response to the specific questions of EBA

1. *Do you agree with the proposed definition of technical defaults?*
   Do you believe that other situations should be included in this definition?
   If yes, please provide detailed proposals on how to address further possible situations.

Wording of Section 3.2.2 (first bullet point on page 7) and section 5.1 D c (pages 50-52) seem to suggest that only data or system errors caused by the *institution* are covered in the definition of technical default as opposed to including data or system errors caused by counterparties.

If defaults that are a result of data or system errors of the counterpart are not regarded as technical defaults, modelling of PDs for large corporates will turn into a matter of modelling probability of errors in customer's data and payment systems. With the strict interpretation of a technical default suggested by EBA, the most relevant risk driver in Large Corporate portfolios would be the size of the company. We believe that payment delays not related to deterioration of the credit quality of the counterparty should not lead to default.

We do not share the view in paragraph 20 that the classification of the obligor to a defaulted status should not be subject to additional expert judgement. Expert judgement has an important place within credit risk management and should continue to be used. Situations may occur that will result in past due exposure of more than 90 days, however not due to a credit deterioration of the counterparty.

For example:

- In leasing business lines, a client could suspend payments not only for a difficulty to reimburse the bank but also for a management decision if a dispute occurs on the leased good (e.g. regarding the quality of goods).
- The same might occur in factoring business. In case of a controversy on a supply, litigation or discussion, the debtor can decide not to pay the invoices, although his creditworthiness is unchanged. This furthermore will often be unknown to the factor and could lead also to damaging contagion effects (please see also our response to question 2 below).
- Commercial dispute on a SBLC (Standby Letter of Credit) would put in default a bank or a large corporate with a potential contagion effect in the case of a syndication of the SBLC (i.e.: all the participating EU banks would place the corporate in default, resulting in a possible limitation of the customer's access to the credit).
- Call of suretyship where the suretyship contest the legitimacy of the call which entail a past due situation (case of unfair/abusive claim).
- Logistic process issues for Energy & Commodities financing or generally for Trade Finance leading to delays in the delivery. For example, merchandise blocked at the customs, prohibition on entering or leaving ports, strike etc.
- Disputes regarding the amount or the nature of collaterals in case of margin calls.
- As for asset financing long term loans, amendments/waivers or consents are possible due to, for example, a lack of customer responsiveness, maintenance check of

products, reality check of the financing according to new market conditions. The expert assessment is essential.

- Specific cases of sovereign counterparts, for which default may be assessed at political level.
- Cases of force majeure (environmental disasters, legally imposed measures, riots, strikes, wars…).
- Payments made by debtors to a factor for certain ceded invoices and not yet registered on the right account due to difficulties in the payment reconciliation process.
- Invoices due but not correctly and promptly dispatched to the debtor by the seller.

Some commercial disputes can last for several months or even years meaning that borrower would stay in default during the whole period. We believe it is important to avoid capturing defaults related to exposures that are disputed or waived or that are not related to the decrease in the quality of the credit risk.

Finally, we assume that the technical defaults that do not lead to actual default do not need to be registered in a central risk database and registration in the local data base for audit trails would suffice. The audit trails of technical defaults that did not lead to actual defaults should only be required for new cases.

As a final consideration we would like to stress that should the EBA definition of default (defined among others by way of new and stricter rules on technical default) remain unchanged, floors on the minimum level of LGD have to be reduced or completely removed. In addition, some adjustment will be needed to the general calibration of standardised approaches.

2. *Do you consider the requirements on the treatment of factoring arrangements as appropriate and sufficiently clear? If not, please provide proposals for additional clarifications.*

We suggest do add the following sentence after §22: "*When the factor and the client agree a due date for the credit granted to the client, the counting of days past due shall commence from such date."*

In the factoring arrangements where the ceded receivables are not fully transferred to the factor, the timing for reimbursement/regularization of advances is contractually specified, therefore, the counting of days past due should refer to that date. It does not necessarily require a breach in the percentage agreed between the factor and the client.

The treatment of exposures to debtors stemming from IAS/IFRS compliant purchased trade debts within a factoring agreement with a client (i.e. where the risks and benefits related with the assigned receivables are fully transferred to the factor and the factor has exposures to the debtors of the client) should take into account that the reliability of the due date of the invoices may be affected by numerous events related to the trade relationship between the buyer and its supplier.

In such cases, a significant delay of the payment may occur without any sign of deterioration of the situation of the debtor. Such situations may originate from contractual provisions or also from informal communication and exchange between the buyer and the supplier.

In such situations, we believe that a relief should be introduced by way of a rebuttable presumption on the automatic classification as past due of trade debtors or of a suspension of days past due counting when the factor is aware of these events, regardless the degree of formality. These occurrences shall however trigger an analysis of the debtor's situation in order to assess possible indications of unlikeliness to pay.

In particular, when the buyer disputes a receivable (e.g. receivables not existing at all or just partially existing, commercial supply not regular or different to the agreements, etc.), the amount or even the very existence of the invoice may be challenged. It is very uncommon that disputes are brought to a court. While disputing parties are usually try to settle the dispute outside the court, the process can nevertheless be time-consuming and exceed the 90 days. The opportunistic use of disputes in order to hide financial difficulties could easily be detected through the analysis of the debtor's situation triggered by the occurrence of the dispute.

3. *Do you agree with the approach proposed for the treatment of specific credit risk adjustments?*

The stage 3 of IFRS 9 includes exposures where the credit risk of a financial asset increases to the point that is considered credit impaired. While most of the defaulted exposures would be classified as 'Stage 3' under IFRS 9, we believe it should not be assumed automatically. Also, given that banks must calculate PD by defining what is a default first in order to calculate impairment and not in the reverse order, impairment figures could not be used as an input for default triggers.

While we welcome the clarification made by EBA that the "incurred but not reported losses" (IBNR), which is a current notion of IAS 39 should not be considered as an indication of unlikeliness to pay (§ 26 of the CP), we consider that such a clarification should encompass the stage 2 of the forthcoming IFRS 9. Therefore, it should be stated clearly that the IFRS 9 stage 2 should not be considered as an indication of default. This is all the more important given that § 178.3 b) of the CRR mentions "a significant perceived decline in credit quality" as an indication of unlikeliness to pay that might be misleading and wrongly analogised with the stage 2 of IFRS 9 ("significant increase in credit risk").

4. *Do you consider the proposed treatment of the sale of credit obligations appropriate for the purpose of identification of default?*

In the Consultation Paper (par. 25) it is mentioned that in general, Specific Credit Risk Adjustments (SCRA) should be treated as an indication of unlikeliness to pay if they concern *"losses as a result of current or past events affecting a significant individual exposure or exposures that are not individually significant which are individually or collectively assessed*".

This point seems to be in contradiction to recital 12 of Commission Delegated Regulation 183/2014, which clearly states that "*For the purpose of the determination of default under point (b) of Article 178(3) of Regulation (EU) No 575/2013, it is necessary to include only Specific Credit Risk Adjustments which are made individually for a single exposure or a single obligor, and not to include Specific Credit Risk Adjustments made for whole groups of exposures. Specific Credit Risk Adjustments made for whole groups of exposures do not identify obligors of exposures belonging to such groups for which a default event is considered to have occurred. In particular, the existence of Specific Credit Risk Adjustments for a group of exposures is not sufficient reason to conclude that default events have occurred for each of the obligor or exposures belonging to this group".*

While we agree that selling of a credit obligation resulting in a loss due to fall in credit quality could be an indication of default, we consider setting a threshold inappropriate. Even a small deterioration in credit rating or changes in interest rate might lead to impact on the market value of an asset greater than the proposed 5%. If an asset would deteriorate from AA to BB, the asset is still quite remote from default, but could be sold at a discount larger than 5% due to credit deterioration. This should however not trigger a default for IRB modelling. The proposed threshold would restrict the selling activity and lead to less liquid financial markets. We would recommend removing a minimum threshold and leave more room to expert judgement.

Moreover, this is not consistent with the incentive to use Basel parameters to assess the credit risks, nor with the notion of "use test".

For instance, the following revolving credit facility has been recently proposed to financial institutions:

Borrower: xx (metals and mining company)
Margin: LIBOR +85
Maturity: May 15, 2020
Facility Size: $3.0 billion Senior Revolving Credit Facility
Offering Amount: $25mm
Price/Par value: 84%
(source: xxx)

With a discount up to 16%, the counterparty would have been declared in default accordingly with the proposed definition. Nonetheless, the borrowing company is still rated Baa3/BBB+ by external credit agencies.

The recent history has proved that when financial markets are highly volatile, some bonds could be under 95% of their par value because the markets anticipate a future decrease of the credit market without the issuer being itself in default. In consequence, the bank may cease granting facilities to the obligor and this could trigger an actual payment default.

Credit obligations could be sold for another reason than the anticipation of a decrease in credit quality of the issuer. A decision to sell participations in loans on performing clients and with a significant loss may be dictated by:

- Regulatory capital savings or employment
- Liquidity management
- Balance sheet management
- Country envelope consumption
- Counterparty exposure management
- Single limit concentration management

A sale price of an asset, which is the fair value, will include other elements besides the credit quality such as liquidity premium; general changes to market conditions, etc and it may not always be straightforward to distinguish which part of the economic loss is related to the deterioration in credit quality. We would therefore suggest to set up objective criteria to identify sales of credit obligations not related to credit risk.

It also has to be taken into account that in case of sales of credit obligations 'en bloc', a discount is usually applied compared to one to one evaluation (in order to conclude the deal earlier) with no link to the real risk of the block.

We would propose that the sale of credit obligations is considered as an indication for unlikeliness to pay but should be associated with other indicators and not as a stand-alone criterion.

Finally, we would appreciate a clarification by the EBA on whether securitized credits have to be considered within the "sale of credit obligation" category.

5. *Do you agree that expected cash flows before and after distressed restructuring should be discounted with the customer's original effective interest rate or would you prefer to use the effective interest rate applicable at the moment before signing the restructuring arrangement?*
   Do you consider the specification of the interest rate used for discounting of cash flows sufficiently clear?

We would advocate the discounting with interest rate that is used as an approximation of the original effective interest rate on a best effort basis.

Considering the 1% threshold for the diminished financial obligation proposed in the QIS, we believe the threshold should be removed. In our view, the relevant measure for recognition of default should be set at a level, when the new cash flow (NPV) would no longer be adequate to cover the value at origination of the obligation, regardless of the decline in NPV.

In addition art 178 (3.d) of CRR considers *"material forgiveness,…, of principal, interest or, where relevant fees".* The proposed threshold seems not to be consistent with the above mentioned materiality criterion and has therefore to be set at a significantly higher level.

We would also see no need for specifying additional indicators to be considered for identification of default if the net present value of expected cash flows on the distressed restructuring arrangement is higher that the net present value of expected cash flows modifications.

Concerning the formula for calculation of the diminished financial obligation (DO), it is not clear whether the cash flows include the expectation of recovery. If they do not take into account recovery expectation, the threshold would not make much sense as the new restructured loan could include a reinforcement of the collateral value which might mitigate (partially or totally) the diminished financial obligation measured with the proposed formula.

Also the formula provides possibility to hide a distressed situation by sufficiently extending maturity and maintaining an equivalent NPV of cash flows. It is also not clear if the two NPV parameters only include the future contractual cash flows or also PD and LGD associated to those cash flows in each moment. In the case of latter, the approach would suffer from a circularity problem. Some restructuring would not be considered as defaulted under the proposed formula for instance when the credit obligation is turned into a PIK loan (payment in kind) with capitalized interest during the period. The proposed formula gives an economic loss of 0.

Concerning paragraph 43, we see it contradictory to the Chapter 5 part D. Paragraph 43 states that *"All exposures classified as forborne non-performing …. should be classified as default and subject to distressed restructuring".*

Chapter 5 Accompanying Documents part D however states that the preferred option of EBA is a *"non-obligatory alignment of the definition of default with the non-performing exposures'* given the unintended consequences and high default rate should definition of default be aligned with the non-performing exposures. This would be consistent with EBA answer on 2/10/2015 to a question for "exit criteria NPE" where it is mentioned that *"the category of non-performing exposures can be broader that the category of defaulted or impaired exposures. Defaulted or impaired exposures are mandatorily considered as non-performing but non-performing exposures need not be impaired or defaulted."*

Finally, we would like to underline that the concept of distressed restructuring does not apply in case a revision of the conditions is allowed by the contract (e.g. embedded clauses) or by specific laws (e.g. moratoria issued by banking association/government) or to commercial renegotiations (e.g. change of interest rate for commercial purposes or alignment with current market practices).

6. Do you agree that the purchase or origination of a financial asset at a material discount should be treated as an indication of unlikeliness to pay?

We disagree. Basing the definition of default on the price of purchased asset is in our view not appropriate. The price of an asset ought to reflect its value at that point in time. A material discount can be the result of other than financial distress such as general changes to market conditions and a result of negotiations e.g. settling other transactions.

Therefore it seems unreasonable that the discount as such should be an indicator of unlikeliness to pay. An asset purchased at a material discount should be checked for any other indicators of unlikeliness to pay. Such assessment is normally a part of the due diligence of the asset to be bought, to be able to establish a relevant value/price of the asset. For every asset or portfolio of assets that an institution purchases (with or without material discount) a

proper due diligence is made, including testing the 90 days and the unlikeliness to pay criteria. The assessment could trigger a default.

Introduction of rules linking default to the price of purchased (or sold) assets could in effect lead to disincentives for banks to purchase/sell assets at discount to avoid putting its client in default (if a bank already has an exposure to the issuer). This would have negative effect on the role of the banks as intermediaries on the financial markets. Purchased receivables management is an integral part of the banking sector's activities.

In our view, default should be triggered only for reasons that are directly linked to the credit risk of the counterparty.

7. *What probation periods before the return from default to non-defaulted status would you consider appropriate for different exposure classes and for distressed restructuring and all other indications of default?*

We believe the institutions are best placed to recognize when a customer is no longer in default and we consider the set probation periods inappropriate. The institutions should determine the probation period in a way that that minimizes the 're-defaults" of the clients.

Any probation period from default to non-default status is inconsistent with what is set out in Article 178(5) where it is stated that: *"If the institution considers that a previously defaulted exposure is such that no trigger of default continues to apply, the institution shall rate the obligor or facility as they would for a non-defaulted exposure".*

Also, under IFRS 9 favourable changes in credit risk should be recognised symmetrically with unfavourable changes in credit risk (IFRS 9 BC 5.210). By applying a probation period, financial instruments would move into default quicker than back to non-defaulted status. This can result in exposure being classified as defaulted but not credit impaired under IFRS 9 (bucket 2 exposures) or the exposure would be classified as defaulted and credit impaired (in bucket 3) but with no loan loss allowance which is contra intuitive.

The suggested 3 months' probation period is considered too long in relation to both large corporate exposures and retail consumers in particular when applied together with the strict definition of the technical default as proposed in the CP. In case of retail customers, payments are not always fully automatized by systematic debit of the customer's account. Also, in some countries, loans with an undefined maturity are common for SMEs portfolios. Delays in payments of large corporates may be caused by systems or data errors. Such defaults would not necessarily mean a deterioration in the credit quality of the borrower especially if the cure period is short (less than 30 days).

We would suggest that in such cases, customers being classified as defaulted could return to non-default status as soon as the obligation is paid in. The three months period should therefore be eliminated as mandatory provision at least for default trigged by past due.

In the final draft of the Guidelines, having regard to Article 59 of the Consultation Paper, it is opportune to specify which repayment suspensions shall be considered as a "grace period". In

particular, if a restructuring arrangement provides a temporary suspension of the sole interest share of the loan, it is not clear if that suspension shall be treated as a grace period, considering that the principal share of the loan will not be suspended.

Similarly, should a defaulted client of a bank be bought by another client of the bank (client B) that is not in default, the exposures of the client B should not be considered defaulted if there is no decrease in the credit quality of client B (due to the acquisition). The remaining unlikeliness to pay should be the decisive criteria. Depending on the portfolio specific characteristics, there might be different or no probation periods.

Finally, we believe the following should be added at the end of paragraph 60a):
…*"or the debtor has otherwise demonstrated its ability to comply with the post forbearance conditions".*

The current EBA Definition of Default (effective from September 2014), Paragraph 157 (c) states that:

"Concerns may be considered as no longer existing when the debtor has paid, via its regular payments in accordance with the post-forbearance conditions, a total equal to the amount that was previously past-due (if there were past-due amounts) OR that has been written-off (if there were no past-due amounts) under the forbearance measures OR the debtor has otherwise demonstrated its ability to comply with the post-forbearance conditions."

The requirement that the "debtor has otherwise demonstrated its ability to comply with the post-forbearance conditions" has been removed from the EBA Consultation Paper, however we would consider this an important and more reliable indicator that the customer's situation has fully resolved itself. Therefore we would have a strong preference that the criterion for curing to non-defaulted status read as follows "a material payment has been made (a total equal to the amount that was past due or has been written off) *OR the debtor has otherwise demonstrated its ability to comply with the post-forbearance conditions*".

8. Do you agree with the proposed approach as regards the level of application of the definition of default for retail exposures?

To summarize our understanding of the proposed guidance:

The guideline confirms that for retail exposure, the financial institution in accordance with second sub-paragraph of Article 178 may apply the definition of default at the individual credit facility level rather than at the obligor level. Furthermore the choice should reflect the financial institution's internal risk management practice. This may imply that a financial institution in general apply the definition of default at obligor level, but for some specific types of exposure apply it at facility level.

Under IRB the financial institution is required to ensure that the risk estimates correctly reflect the definition of default applied to each type of exposures.

We supports that the credit institution may decide when to apply the default definition at obligor level and/or facility level.

9. *Do you consider that where the obligor is defaulted on a significant part of its exposures this indicated the unlikeliness to pay of the remaining credit obligations of this obligor?*

We agree that when an obligor defaults on a significant part of their exposures, the institution will consider this as additional indication of the unlikeliness to pay but it should not automatically indicate the unlikeliness to pay of the remaining credit obligations of this obligor. For example, a mortgage default might result in a higher Probability of Default on other credit obligations but not necessarily the default of them.

10. *Do you agree with the approach proposed for the application of materiality threshold to joint credit obligations?*

If a joint obligation towards an institution defaults, the individuals taking part in the joint obligations (and their individual obligations, respectively) should not be automatically considered as defaulted. This mechanism is even more problematic when applied to joint obligations consisting of a large number of individuals in which case considering all the individuals involved in the joint obligation automatically as defaulted may not be economically justified at all.

Moreover, the identification of joint fully liability of retail obligors (i.e. married couple) would expose institutions to unbearable burdens especially when this implies ongoing updates of dynamic information (the marital status) difficult to obtain. As a result, we propose to drop article 85.

11. *Do you agree with the requirements on internal governance for banks that use the IRB Approach?*

We agree. The requirements seems to be in line with CRD IV requirements. It should be ensured however that there is also an alignment with the final Basel Committee Guidelines on credit risk management processed to be applied in accounting for expected credit losses.

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