14/10/2025

European Banking Authority

Consultation paper amending Guidelines on definition of default

Answers to questions under consultation

Question 1: Do you believe the current guidelines result in some exposures under forbearance measures to be incorrectly classified as defaults, thus hindering proactive, preventive and meaningful restructurings given the detrimental effects that defaulted status has for the affected obligors? If so, please further specify the characteristics of the exposures, which you deem as being subject to an incorrect classification of default.

Answer: Yes, we believe that application of the current guidelines results in exposures under forbearance measures to be incorrectly classified as defaults, thus hindering proactive, preventive and meaningful restructurings.

That especially incorrectly classified defaults hinder proactive, preventive and meaningful restructuring is explained by the fact that defaults lead to a deteriorated capital adequacy ratio for credit institutions (and especially for credit institutions using the IRB F-approach) and additionally it contributes to an incorrect target variable for modelling and calibration, which e.g. may create challenges in modelling as well as in credit institutions' credit risk assessments when using such models for credit decisions. Performing NPV calculations (diminished financial obligation) for forbearance measures can also be very time consuming, which also provides negative incentives for credit institutions to give forbearance measures. Find below a description of (a) why application of the current regulation related to this default trigger leads to incorrect defaults, (b) why assessment of this default trigger is very time-consuming, especially when performed logically correctly, (c) why moratoriums create challenges related to this default trigger and (d) a suggested solution to significantly reduce these problems.

1. Application of the current DoD Guidelines trigger defaults due to forbearance measures which, from a logical perspective, should not be considered having diminished financial obligation and where the credit risk of the counterparty is not high enough to motivate default (i.e. incorrect defaults). This is especially the case for floating rate loans (or counterparties which have floating rate loans) which get

forbearance measures in the form of “postponed instalments/extended maturity”. At least in the Swedish market, floating rate loans represent a very large part of credit institutions’ loans and EAD and so does the forbearance type “postponed instalment/extended maturity” in percent of number of granted forbearance measures.

2. The reason for illogical defaults is that the DoD Guidelines require that both cashflows for the NPV0- and the NPV1-value shall be discounted using the original effective interest rate and Q&A-answers from EBA state that this should not be read as the interest rate prior to signing the restructuring/forbearance agreement[1].

3. When the original effective interest rate is applied as a discount rate, a relatively small decrease (between the time of loan origination and the time of the forbearance measure) of the reference rate (e.g. 3-months Euribor) to the floating rate loan and therefore also to the floating interest rate that shall be paid by the counterparty, in combination with a forbearance measure in the form of a relatively small postponement of instalment, may trigger a default due to the diminished financial obligation definition in the DoD Guideline. This, even in situations where there is no up-front fee in the original contract of the counterparty’s loan and even though no other concession, such as e.g. remission of claim or reduction of interest rate margin, is granted[2]. Note that the volatility of the Euribor rates is high. E.g., during the period from October 10, 2008, to April 5, 2010, the 3-months Euribor rate decreased with 4,75 percentage points and between December 24, 2021, and October 20, 2023, it increased with 4,56 percentage points (to be compared with the 1,2 percentage points decrease used in the example below).

4. The following simple example illustrates such a situation as described under section 3 above: A counterparty with one loan (floating) where the original maturity was 5 years, and the original effective interest rate was 6,2 percent (yearly interest payments) gets a forbearance measure when one year remains of the maturity of the loan. The forbearance measure implies that the last instalment that was originally to be paid in one year will now be paid in two years. No additional concessions are given, and no concession has been made in the past for this counterparty. The effective interest rate at the time of forbearance measure is 5 percent. The only reason for the interest rate reduction (compared to the original effective interest rate) is a reduction of the Euribor rate which the counterparty’s

[1] From EBA/GL/2016/07, 28/09/2016, question 5 (page 95-96): “The majority of respondents supported the use of the original effective interest rate while a few respondents were in favour of using the current (before signing the restructuring contract) effective interest rate. The majority view of the respondents was taken into account and, as proposed in the Consultation Paper, the original effective interest rate was specified as the appropriate discounting factor for the purpose of NPV calculation.”.

[2] Similarly, an increase in the Euribor rate between the time of loan origination and the forbearance measure can prevent a legitimate default through this default trigger where a forbearance measure in the form of “reduction of interest rate margin and postponement of installments” has been granted.

floating rate is tied to. The loan contract has never required any fees to be paid (only interest).

Such forbearance measure should logically not lead to any change in DO-value. But, since the DoD-regulation requires discounting with the original effective interest rate and not an interest rate that reflects the Euribor rate reduction between the date of loan origination and the forbearance measure, the DO-value result is 1,1% and the counterparty is to be set in default. Had the effective interest rate at the time of forbearance measure decision been used for discounting, the DO-value had been unchanged, which is logically correct. On the contrary, **it is not in any way reasonable that fluctuations of a reference rate for a floating rate loan (e.g. Euribor rate) should determine if the counterparty should be set into default or not.**

5. Already under the current DoD Guidelines**, the assessment of this default trigger is time consuming**. One reason for this is that many credit institutions apply definition of default on counterparty level, which is also a regulatory requirement for non-retail counterparties. This means that when any forbearance loan under the counterparty gets a DO-value above 1 percent, all loans must be assessed as part of a <u>counterparty</u> DO-value calculation, no matter if they are loans with forbearance measures or not.

6. Additionally, to rectify the problem mentioned under point 2-4 above, a different discount rate must be used. The likelihood of credit institutions having updated effective interest rates available at the time of the forbearance measure is however lower than at the time of loan origination. It is even less likely to have updated effective interest rates that are adjusted for previous forbearance measures in the form of e.g. reduced interest rate margins. A new discount rate must be calculated for such cases, which is also time-consuming.

7. The IFRS 9 principles suggests that NPV-calculations are performed when an institution modifies a financial asset (which does not result in a derecognition) to recognize a gain or loss by comparing the gross carrying amount of the financial asset before and after the modification, where the gross carrying amount of the financial asset shall be calculated as the NPV of the cash flows discounted at the financial asset's original effective interest rate. Due to this, DoD regulators may think that since NPV-calculations are already in place under accounting rules for all modifications of assets, using these calculations for default purposes should imply little work. However, some of the issues that are mentioned from a default perspective above also applies from an accounting perspective. Due to this and since the IFRS 9 ECL procedures are normally set up to be automatically calculated for all loans, a simplified NPV calculation is often implemented for all loans due to expediency and undue cost and effort, and this is also the case for identifying loss

or gain for modified loans, fulfilling the intent and directional impact for modification under IFRS 9 principles. Basing default decisions on such simplified NPV calculation in place for IFRS 9 is, however, often not suitable.

8. Performing logically correct DO-value calculations is time consuming for credit institutions, performing these for fewer forbearance measures would reduce the administrative burden.

9. Forbearance measures in the form of postponed instalments/extended maturity should logically only lead to a reduction of NPV if the initial contract required that one-off fees were paid at the origination of the loans and where the contract change does not compensate by requiring a one-off change fee for the extended duration of the loan. Our experience is that the limited size of the up-front fees charged in the initial contract in combination with the change fee charged in the amended contract results in a fairly small proportion of defaults out of all such forbearance cases, given that the logically correct discount rate is used. But given the current regulation all assessment work still must be done.

10. Moreover, counterparties that get forbearance measures only in the form of postponed instalments/extended maturity generally have a lower credit risk than counterparties with more severe forbearance measures in the form of e.g. postponement of interest payments, interest margin reductions or other remissions of claim. And **it is not, from a logical point of view, obvious that forbearance measures in the form of postponed instalments/extended maturity must be assessed under the *Distressed restructuring with diminished financial obligation*[3] default trigger**. These types of forbearance measure may sometimes change the NPV-value, according to the current formula provided by EBA, but verbally, they do not lead to a "diminished financial obligation". From a workload perspective these defaults also lead to burdensome and inefficient work. This since many credit institutions, amongst others due to EBA DoD Guidelines (article 61), have processes that trigger special assessment of default for all counterparties in a group of connected clients, when any counterparty in this group becomes defaulted.

11. During the covid 19 pandemic, EBA issued EBA/GL/2020/2 and EBA/GL/2020/15 to regulate that under certain circumstances, some payment reliefs (e.g. postponed instalments/extended maturity) that will be given by credit institutions to counterparties due to pressure/requirements from governments (moratoria), would not have to be assessed for forbearance measure or default through the D*istressed restructuring with diminished financial obligation* default trigger. We assess that this is reasonable and that postponed instalments/extended maturity is the most likely

[3] "*Diminished financial obligation due to a forbearance measure",* according to EBA' s suggested new wording.

form of temporary modifications that governments may push credit institutions to allow during future crises situations. If in the future EBA would allow the same approach, as described in EBA/GL/2020/2 and EBA/GL/2020/15, it would, however, under the current EBA DoD Guidelines, lead to somewhat different default definitions during crises periods compared to during normal periods (since during crises not all situations will be assessed for default), which is not optimal. Would such approach not be implemented by EBA in the future, but instead credit institutions would be required to perform forbearance assessment and default assessment through the default trigger *Distressed restructuring with diminished financial obligation* also for payment reliefs that are more or less forced upon credit institutions, it would be very time consuming to assess the DO-value change for all postponed instalment/extended maturity situations.

12. **Due to what is mentioned above (with the exception of section 11), credit institutions partly avoid giving forbearance measures, risking not supporting the customers/the economy. It is also common that credit institutions have not implemented the rules related to the default trigger *Distressed restructuring with diminished financial obligation* in the way that it is stated in the DoD Guidelines, which have in some cases also been accepted by IRB supervisors. It would make sense that the DoD Guidelines match what is accepted/required by supervisors.**

13. Due to what is mentioned above, amongst others under section 9 and 12, the proposal under section 14 is likely to have limited effects on exposures' default status in credit institutions and should therefore generally not require remodeling/recalibration of models under the IRB approach.

14. Due to all the above, and **to meet the concern expressed in CRR3, article 178(7), where it is stated that the EBA shall update the DoD Guidelines taking due account "the necessity to encourage institutions to engage in proactive, preventive and meaningful debt restructuring to support obligors" and "shall duly consider the need for granting a sufficient flexibility to institutions when specifying what constitutes a diminished financial obligation [...]"**,
    it is proposed to:
    A. Exclude forbearance measures in the form of postponed instalments/extended maturity from the forbearance measures that require assessment under the default trigger *Distressed restructuring with diminished financial obligation* given that no other forbearance measures, which changes future cash flows, are granted. The proposed change could be reflected in article 52.

    B. Clarify that in cases where the remaining forbearance measures, which shall trigger a DO-value calculation, are granted in combination with concession in the form of postponed instalments/extended maturity and postponed interest payments, the original interest rate is not a representative discounting factor for floating rate loans nor for loans where the interest rate has been changed for commercial reasons (non-forbearance reasons) after the time of loan origination. Instead, the interest rate just before the forbearance measure should be used, or in case the arrangement has had previous interest rate-related forbearance measures, such reduction should be proxied, and the absolute value of the reduction should be added to the interest rate at time of forbearance measure. One alternative would also be to skip the requirement to discount with effective rates and allow nominal rates to be used, which would make it much simpler to identify the discount rate[4] but which would underestimate the positive DO-value somewhat. The proposal could be reflected in article 51.

We also support EBF's proposal to increase the threshold for what diminished financial obligations that shall trigger a default, which would even further incentivize banks to give forbearance measures to customers with temporary financial difficulties.

Question 2: Do you think that relaxing the criteria for the minimum period before returning to the non-defaulted status for defaulted forborne exposures could be an appropriate measure to alleviate a higher burden on your institution and clients? How material would the difference be in your case between the amounts of forborne exposures classified as NPE and as defaulted if the minimum one-year probation period in the definition of default were reduced to three-months for certain forborne exposures (with change in NPV below 5% and no loss on the nominal amount)? Would that proposal create additional operational burden or practical impediments? Do you see support such proposal, and if so, for which reasons?

Answer:

1. No, we do not support the proposal since it is too burdensome. It introduces additional burdens for credit institutions through amendments of the curing process.
2. We do support changing the curing condition in article 73 a). Our suggestion is, however, that the condition is instead fully deleted. The arguments for this are provided under question 8 below.

Question 3: Do you see any alternatives other than those referred to in this section that the EBA should consider under Article 178(7) CRR to update the Guidelines and encourage institutions to engage in proactive, preventive and meaningful debt restructuring to support obligors?

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[4] In such case, change fees that follow with the amended contract should not be considered in the NPV1-calculation.

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Answer: Yes, see the answer under Question 1.

Question 4: Do you use internal definitions of default and NPE that are different from each other? Which differences are these and how material are those differences? Do you have any reasons or observed practical impediment that warrants a different definition of NPE and de-fault? If so, please provide examples where a different definition of NPE and default is appro-priate.

Answer: Since the external regulation (CRR3) defines "default" and "non-performing loans" slightly differently, the internally used definition of "non-performing" is slightly wider than the default definition. We however, strongly support an alignment between the definitions to reduce the long-term regulatory burden for credit institutions, where it is suggested that "non-performing loans" are defined as "defaulted loans", since the latter is a definition that generally is clearly defined, used for modelling by credit institutions with permission to use IRB approach and which at least for such credit institutions has been thoroughly scrutinized by supervisory authorities.

The reduction of non-performing loans should only affect FINREP reporting and the capital deduction article 36.1.m in CRR3.

If non-performing exposures are aligned with defaulted exposures in CRR3, we suggest removing article 54, article 59 h and article 107 in the EBA DoD Guideline. This change should have a very small effect on how much EAD that is classified as defaulted.

Question 5: Would a potential lack of alignment between the default and NPE definition lead to issues in accounting in your case?

Answer: No, not if "non-performing exposures" is set equal to default, as suggested under Question 4 above. Changing the definition of default would however have some implications on the accounting side. The main reason to align the default and non-performing definitions is that, even though such measure, short term requires alignment work for credit institutions already reporting these definitions, it long term reduces the regulatory burden for both new and current credit institutions as only one set of rules (default rules) have to be read, implemented, controlled and reported. An alignment should also benefit regulators and investors, not having to supervise or/and interpret/analyze two definitions.

Question 6: Do you agree that no specific provisions should be introduced for moratoria on the grounds of the sufficient flexibility of the revised framework? In case you think the proposed alternative treatment for legislative moratoria should be included in these guidelines, do you have any evidence of the definition of default framework being too procyclical in the context of moratoria? Do you agree with the four conditions that need to be satisfied?

Answer: If in the future credit institutions are pushed/forced to give counterparties payment reliefs, such as postponed installments, in severe crises situations, we think it makes sense to alleviate the burden for these credit institutions by, under certain conditions, allowing for exemption of e.g. forbearance assessment. Our view is, however, that such rules do not belong in these DoD guidelines. We instead suggest that such rules are issued if/when needed, which implies that all circumstances relevant at the time of the crisis can be considered in the temporary regulation.

Question 7. Do you agree with the revised treatment of technical past due situations in relation to non-recourse factoring arrangements? And if you do not agree, what are the reasons? Do you have any comments on the clarifications of paragraphs 31 and 32 in the current GL DoD?

Answer: We support the proposal.

Question 8. Do you agree with the other changes to the guidelines to reflect updates from Regulation (EU) 2024/1623?

Answer: Yes, we do, with the exception of the following articles:

Regarding article 72

To facilitate the understanding of the reader it is recommended to keep the reference to a situation where a "forborne status" applies and to use a more understandable language. The following amendments (in red and strike through text) are proposed:

"72. For the purposes of the application of Article 178(5) of Regulation (EU) 575/2013, and where forborne status according to CRR article 47 b) and 47 a) point 7 has applied at any time during the default period ~~regardless of whether the forbearance measure was granted before or after the identification of default, institutions should consider that no trigger of default continues to apply to a previously defaulted exposure, where at least 1 year has passed from the latest between one of the following events~~ at least 1 year must have passed from the latest one of the following events, to be able to return to non-default status:
(a) the moment of extending the forbearance measure;
(b) the moment when the exposure has been classified as defaulted;
(c) the end of the grace period included in the forbearance arrangements."

We also recommend using the expression "return to non-default status" rather than "no trigger of default continues to apply" in article 71, despite the use of this phrase in CRR, article 178.5.

Regarding article 73

We do support the change of article 73, point (f).

We do however also recommend that point (a) under article 73 is removed. The reasons for this are the following:

1. To be able to return the counterparty/arrangement to non-default status, article 73 (a) requires that payments equal to "the amount that was previously passed due"

must be made via the counterparty's regular payments during the ≥ one-year period (if there were amounts passed due). It is not only unclear "what past due" that is referred to in article 73 (a) (i.e. is it e.g. the past due amount at the default date or the maximum past due amount during the default period) but worse, in some cases this rule will prevent counterparties/arrangements with limited credit risk, not representative of a default status, to return to non-default status for a very long time.

There are e.g. examples when the full loan must be paid back before return to non-default status can occur due to article 73 (a):

a) when a loan has been terminated, but afterwards a peace agreement is signed with the counterparty which cancels the termination, and an extended repayment schedule is agreed. When the termination occurs the full loan amount becomes past due.
b) a loan type without regular instalments may have reached its maturity without repayments, before the counterparty approaches the credit institution, meaning the full loan amount is past due. It then sometimes happens that the counterparty gets a forbearance measure in the form of extended loan maturity. Also, in this case a full repayment of the loan amount would be required to fulfil the curing conditions in article 73 (a).

2. Another condition for return to non-default status (cure), under article 73 (a) is that, unless there were no past dues, regular payments must have been made equal to the amount that was written off during the restructuring measures. Like the past due example mentioned under point 1 above, if a large write-off was performed during the restructuring, it may not be possible to cure the counterparty for numerous years, even in cases where the counterparty has been completely restructured and its credit risk is low and not representative of a default status.

3. Given the conditions in article 72 (c), 73 (b) and (c), article 73 (a) is superfluous. This since:
   a) article 72 (c) requires that curing cannot be performed until the earliest one year after a potential grace period from the forbearance measure has ended, i.e. during at least a full year the counterparty must have paid interest and instalments[5].
   b) article 73 (b) requires that during this one-year period payments have been made regularly according to the applicable schedule, and
   c) article 73 (c) requires that at the time of curing there are no past due credit obligations.

   I.e. to fulfil all the conditions in 72 (c), 73 (b) and (c) "sufficient payments" should have been made during this ≥ one-year period.

[5] Payment of instalments required when the product type requires instalments.

4. Having had "very high credit risk in the past" may imply that the credit risk will continue being high for numerous years, but that is not always the case since large restructurings and other changes related to the counterparty could significantly reduce the credit risk and it makes sense that the possibility to cure a credit institution is based on the actual credit risk of the counterparty.

5. ECB has also assessed that the material payment requirements mentioned under article 73(a) in the EBA DoD Guideline are not always suitable and therefore states in the ECB guide to internal models (July 2025), article 171, that these examples shall not be construed as mandatory conditions.

SWEDISH BANKERS' ASSOCIATION