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ECB: Public consultation on Draft guidance to banks on non-performing loans.

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 370 commercial, cooperative and mutual banks. FBF member banks have more than 37,500 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to share its comments on the ECB Consultation on Draft guidance to banks on non-performing loans. Please find our main comments below and our detailed feedback to the different issues raised in the consultative paper.

I. General comments

French Banking and Credit institutions fully agree with the need to implement a strong monitoring and supervision of non-performing loans, as they not only jeopardize banks, but also the global economy and customers who have to face hard situations. The 2008 crisis had devastating consequences on economy and banking industry, we are still facing today; however, it has to be noted that Non Performing Loans are already, and have been for several years, under a strong surveillance by French banks which have already considerably reduced their level of NPL. Beyond a certain level, if banks are constrained to decrease more and more their level of NPL, it will inevitably impact their credit lending activity, the economy and their profitability. Therefore, although we agree with the necessity to monitor very closely the NPL, we do not agree with the general objective of the ECB to decrease the volume of NPL unconditionally, without taking into account the business model and the level already reached by a credit institution.

Indeed it would be dangerous for the European financial stability to enter in a systematic NPLs sale process for the following reasons:

(i) Undervalued NPLs market prices may give the perception that banks provisioning is insufficient. As a matter of fact, it is legitimate that investors require a price lower than the net accounting value of the loans when on banks' balance sheet, as they apply different criteria, notably on internal rates of return[1].

(ii) Furthermore to request banks to transfer the risks of their non-performing loans to non-banking financial intermediaries, possibly less regulated and less aware of the specificities of this asset class, is not going to reduce the global risk. On the contrary, it may increase it by spreading risks in an uncontrolled way across the financial system and creating contagion effects between banks balance sheets and investment funds or insurers. In particular non-performing mortgage loans management is a socially very sensitive subject where financial investors may take destabilizing actions (as seen in the US sub-prime crisis)

(iii) Moreover the argument that non-bank investors are better armed than banks to assess and manage the NPLs risk does not apply for all European jurisdictions either. US investors notably are not the best placed to handle the complexity of recovery processes in European countries, thereby increasing the cost of the procedures and lowering their recovery expectations.

(iv) Finally we must bear in mind that the extremely favorable current monetary conditions which are currently pushing investors to search for yield in the considerably more yielding non-performing loans market are not meant to last. It would therefore result in a huge market imbalance between offer and demand, to the detriment of banks.

The scope of application should be clearly defined.

The guidance applies to all credit institutions supervised directly by the SSM proportionally to their level of non-performing loans. Notably chapter 2 Strategy and chapter 3 Governance apply more directly to banks that are considered as "high NPL banks" with reference to the European average NPL ratio defined by EBA dashboard. Clarification should be provided by the ECB on the retained criteria to identify banks with an NPL level that is considerably higher than the EU average level and the level of application of the guidance within a consolidated group (group level vs entity level) especially regarding NPL strategy.

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[1] For instance see "What's the value of NPLs?" from Banca d'Italia (Notes on Financial Stability and Supervision N°3, April 2016)

For banks not considered as "High NPL" banks or banks having a low level of NPL, we believe that the **ECB Draft guidance should be seen as a set of principles** and that these banks should be allowed to demonstrate that their methodologies of governance and management of NPLs are consistent with these principles without necessarily getting into the details of the indicators or triggers listed in the guidance.

The ECB Draft guidance should also better take into consideration the application of the banks' expert judgment and the appropriate risk strategies, both points should remain at the appreciation of credit institutions.

The ECB Draft guidance expects that banks will apply the Draft guidance proportionately and with appropriate urgency. Clarification should be provided by the ECB on the expected timeframe and potential milestones required to gradually implement the guidance and on the ECB expectations regarding the proportionate application of the guidance given the uncertainty resulting from the average levels of NPLs which are moving ratios.

Clarification should also be provided to the supervisory measures that may be triggered in case of non-compliance to the guidance and notably in the context of the SREP process.

The legal background of the ECB Draft guidance needs clarification

In Chapter 1, point 1.2 Applicability of this guidance, ECB expressly states the guidance is non-binding though it includes additional constraints to banks and non-compliance may trigger supervisory measures. Indeed, we would like to stress that the legal qualification of this guidance is not clear and has no expressed legal basis.

We consider that the legal basis of the proposed guidance may be questionable, as long as some of its provisions may be considered as exceeding [or being in contradiction] with the Level 1 or 2 EU legislation. The Council Regulation No 1024/2013 of 15 October 2013 which confers specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions ("SSM Regulation") entrusts the ECB with precise supervisory tasks and provides that "*the ECB shall adopt guidelines and recommendations, and take decisions subject to and in compliance with the relevant Union law and in particular any legislative and non-legislative act, including those referred to in Articles 290 and 291 TFEU."*

Even though, the ECB has been empowered by the SSM Regulation to adopt guidelines and recommendations or to make recommendations and deliver opinions by virtue of article 132 of the TFUE, firstly, these powers are within the double limit of a) carrying the supervisory tasks which have been entrusted to the ECB and b) acting in compliance with binding relevant EU law and regulation and, secondly, document such as the "Guidance" are not expressly mentioned as possible act to be taken by the ECB and their legal regime is not specified.

As a consequence the lack of legal ground on which the ECB supports its proposed guidance, may raise some doubt about the validity of the legal basis of this document.

The focus put on NPL portfolios reduction creates wrong incentives

The strategy described by the ECB (in section 2) does not necessarily match with the way that all banks are used to manage their NPLs portfolios. Indeed the ECB asks banks to develop a strategic plan to reduce their NPLs exposure, to push it down to a level considered as acceptable, when usually banks adopt strategies that aim at maximising their recoveries. Accordingly, we also think that the guidance emphasises impaired asset sales too much.

Firstly, **banks manage their NPLs portfolios in an optimisation perspective and not in a reduction or liquidation one**. Therefore the total amount of their NPLs portfolio should not be an issue per se. Furthermore, such criterion could lead banks to focus on their NPLs net inflow which could create wrong incentives: on the one hand, this may incentive some of them to limit their NPLs inflows, and thus to limit defaults recognition; on the other hand it acts as an incentive to accelerate NPLs outflows, by over provisioning the portfolio to facilitate its transfer.

Secondly, the ECB focuses too much on collateral management when **collaterals** should not be seen as a means of reimbursement but rather as **an essential lever to incentivise debtors to pay.** From this perspective, the (forced) sale of collateral, is not a solution. In addition, to focus on collateral valuation may induce banks to lend against collateral i.e. to move from cash flow banking (that is banking proper), in which loans are made according to the value of the expected cash flow, to collateral-oriented banking (that is pawn brokering) in which loans are granted based on the value of their underlying security. As we are all aware, the problem of non-performing loans in connection with overall asset quality has played a central role in the last financial crisis.

Last, the metric to focus on is the net accounting value of the portfolio. Indeed it is on this amount that the bank is at risk. Accordingly it is the quality of the impairment process that should be at the heart of the supervisory approach, not collateral valuation.

The ECB Draft guidance should remain aligned with European regulation and should not override the accounting framework.

We understand the rationale of the ECB Draft guidance clarifying the supervisory expectations regarding NPL identification, management, measurement and write-offs. However, we have noted that a number of definitions regarding, notably, the notions of default or forbearance or the unlikely-to-pay criterion proposed in the ECB Draft guidance are not aligned with the European regulation and more specifically the EBA guidelines. We advocate for such alignment as this would allow keeping consistency with already available information within banks' risk systems and tools.

Moreover, some consistency should also be kept with IFRS 9 definitions although the ECB guidance does intend to interpret the accounting standard. Prudential definitions of the default and of the unlikely-to-pay criterion that are retained in the ECB Draft guidance should be coherent with the accounting notions.

Besides, in some instances, the ECB override the accounting standards' interpretation. Indeed, the ECB specifies that banks should classify the foreclosed real estate assets as non-current assets held for sale and refers to the application of IFRS 5 to justify the classification (§7.5). The ECB adds detailed disclosure requirements (quantitative analysis, NPLs policies) other than already required by IFRS 7.

Additional disclosures and reporting are imposed on banks.

The Draft guidance defines specific disclosure requirements for the purpose of transparency and market confidence. These disclosures are added to the other existing disclosures required under accounting (IFRS 9) or prudential (Part Eight CRR) frameworks creating voluminous disclosure that will be burdensome to provide without proven usefulness for the readers of financial statements.

Besides, new templates and new breakdowns of forborne exposures are required for supervisory purposes (i.e. table 6: use of different types of forbearance options and table 7: estimation of allowances on a collective basis). They are added to the existing EBA ITS. We question how the additional reporting will fit with the EBA current reporting and whether the additional reporting is relevant regarding the cost of collecting the information and the benefits of such new information.

The Draft guidance aims at imposing additional reporting requirements on SSM banks.

We believe that supervisory reporting and public disclosure requirements should be set by means of European Regulation and the SSM has no legal authority to impose the reporting and disclosure requirements which the consultation paper envisages.

Within the EU, the European Banking Authority has been provided with the task to contribute to the creation of the European Single Rulebook in banking, the objective of which is to provide a single set of harmonised prudential rules for financial institutions throughout the EU. The EBA has been mandated to develop implementing technical standards to specify the uniform formats, frequencies, dates of reporting, definitions and the IT solutions to be applied in the European Union for the reporting on own funds requirements and financial information (Article 99 of Regulation 575/2013). The EBA has effectively prepared those ITS which have been adopted by the European Commission subsequently by means of EU Regulation 680/2014.

Relevance of governance and NPL management indicators is questioned.

We question the relevance of some indicators related to governance and NPL management that are retained to trigger NPL measures.

The ECB defines a lot of automatic triggers and many of them are too general to be implemented. Banks already have triggers to detect credit difficulties that will provide a basis for expert judgment. May be it would useful to make a clear distinction between early-warning indicators of obligors that could be about to face financial difficulties and a NPL (or financial difficulties).

In addition, through the requirement to reconcile the definition of non-performing, impaired, defaulted assets and forborne exposures, the ECB seems to promote an alignment of the three regulatory concepts (NPE / Default / Impaired). We believe that such harmonization should be conducted within the EU legislation framework. .

The setting of NPL targets

The section 2.3.2. “Targets” requires the setting of long-term objectives in terms of NPL levels, including on a portfolio-level basis, while the related granularity is not defined. Moreover, the Draft guidance acknowledges the high-level of uncertainty attached to this type of exercise, which question the relevance of this requirement, especially at granular level.

Moreover, it is also indicated in this section that the macroeconomic factors can be used to determined target levels, if "based on solid external forecasts". Banks may already use internal forecasts to compute some metrics and having consistency between different planning processes is a must, which questions the relevance of this restriction to external forecasts.

Besides, when setting up yearly NPL target, these latest should be first calibrated and second assessed ex post in the context of local macroeconomic and political situations. Indeed, achieving large NPL reduction without consideration of financial stability may jeopardize the ultimate goal of the ECB.

A transitional implementation period would be beneficial to implement the NPL Strategy.

To develop and implement their ambitious NPL Strategy (a thorough self-assessment, a comprehensive operational plan, an adequate granularity of qualitative & quantitative information and an independent monitoring) described in chapter 2, High NPL banks and significant credit institutions, potentially impacted, may have to change their organizational and governance structure and adapt their processes, tools and IT systems. Thus, it seems necessary to benefit from a transitional period to prepare and implement these changes, before the Draft guidance's enforcement is effective. Moreover, the ECB could provide a "priority list" of what should be implemented in a short term period and a long term period.

In addition, although the Draft guidance will probably not be set up and communicated to credit institutions before end of 2016, we understand that they will be part of the SREP process in 2017. However, credit institutions are currently elaborating their 2017 strategies (budgets, Risk Appetite, Risk strategy, etc.). So we would like to underline that without a transitional implementation period, credit institutions may not be in a position to fully comply with the guidance.

NPL operating model

The requirements regarding organizational structure and operational set-up to address the principle of separation between the units responsible for loan origination and the ones in charge of NPL management are quite rigid. We recommend that it should be up to the banks to decide how to apply the principle of separation of these units, and to introduce some flexibility.

This recommendation also applies to the requirement of mandatory split of the restructuring and liquidation processes in different units.

Control framework

As the Draft guidance describes both the risk management and the compliance function as second-line functions, we would welcome the confirmation that the veto right is applicable to both risk management and compliance function.

II. Specific comments.

1. Further explanations are needed.

1.1 - The scope of application should be clarified

Chapter 2 (NPL Strategy) and 3 (NPL Governance and Operations) apply to high NPL banks. In chapter 2 (NPL Strategy), page 7, it is stated:

> *"An NPL strategy establishes strategic objectives for high NPL banks for the time-bound reduction of NPLs over realistic but sufficiently ambitious time-bound horizons (NPL reduction targets)".*

The term "high NPL bank" is defined page 5 with reference to footnote 3:

> *"For the purpose of this guidance, the ECB's banking supervision defines high NPL banks as banks with an NPL level that is considerably higher than the EU average level."*
>
> *"A suitable reference to determine EU average NPL ratios and coverage levels is the quarterly published European Banking Authority (EBA) risk dashboard."*

This definition is vague and the ECB in fact acknowledges its definition's weakness (cf. 1er §, page 6):

> "However, this definition is highly simplified and banks not falling under its terms might still benefit from applying the full content at their own initiative or on request by supervisors"

This definition calls for three main comments:

- "the EU average level": the level of the reference calculation must be clarified (at the consolidated group vs subsidiaries or even portfolios level?).

The question as to what "NPL bank" identification criteria are is a key one. Inter alia, as said in § 1.2 the guidance may apply to "high NPL portfolios" [see: "Hence, parts of this document, namely chapters 2 and 3 on NPL strategy, governance and operations, may be more relevant for banks with high levels of NPLs ("high NPL banks") that need to deal with this extraordinary situation. Nonetheless, Sis (Significant institutions) with a relatively low overall level of NPLs might still find it useful to apply certain parts of those chapters, e.g. to high NPL portfolios"]. Therefore the question is how the granularity of these above-mentioned portfolios will be set and what will be the corresponding "EU average" at their own level.

- "considerably higher": what does "considerably" mean?
- Quarterly ratios do change through time. Hence they are not stable enough to be used as a basis for strategic decisions that may prove to be costly.

1.2 - Sections that apply to all banks are not clearly identified

As written it is unclear which part of the guidance will apply to all banks. It seems that parts 2 and 3 do not apply to all of them but the wording is rather ambiguous. For instance Section 3.6.1 (referring to the automatic early warning process) sets that "all banks should implement ..."

1.3 - Finding the right granularity and governance for reporting sent to the management body.

In contradiction with the requirement expressed in chapter 3 (NPL Governance and Operations) § 3.2 "Steering and decision making" the reporting that should be submitted to the bank's management body are over-detailed (going often deeper than the EBA reporting – see below); they are accounting or risk management level:

> *"In accordance with international and national regulatory guidance, a bank's management body must approve and monitor the institution's strategy. For high NPL banks, the NPL strategy and operational plan forms a vital part of the overarching strategy and should therefore be approved and steered by the management body. In particular, the management body should […]"*

1.4 – We may also question the consistency between ECB's expectations and what banks are asked for within the context of their risk appetite framework (as well as their ICAAP). Notably when the ECB states that institutions must consider the reduction in NPL exposures as a strategic objective for the bank.

This would mean that the scope of application of the guidance is defined in a consistent way with what may be a strategic objective for the bank.

We think that the kind of NPL strategy described in section 2 does not necessarily match with the way banks are used to manage their NPLs portfolios. The ECB asks banks to develop a strategic plan to reduce their NPLs exposures (see for instance § 2.1 and 2.3.2) to push them down to a level considered as acceptable. Usually most of banks adopt strategies that aim at maximising their recoveries more than at reducing the size of their portfolios. From this perspective we also think that the guidance emphasises impaired asset sales too much.

Generally speaking, the risk appetite framework should set early warnings and limits which are reference levels under which banks wish to stay and which allow them to assess their NPLs portfolios' quality and which are obviously not target levels resulting from a NPLs management policy.

1.5 – Further clarifications of expectations and requirements concerning the following points are needed:

- 7.2.1-General policies and procedures

The Draft guidance doesn't address the situation when the collateral valuation might be made only if an event would modify the collateral value especially when its value is well above the remaining debt or when cash-flows cover instalments.

- 7.2.2 Monitoring and controls

  Page 86: "*Banks are required to monitor and review the valuations performed by appraisers … The general principles are: … the independence of the external appraiser selection process should be tested on a regular basis as part of the quality assurance process;3*

  Last paragraph: *" … After two sequential updated individual valuations … of the same immovable property, the appraiser must rotate."*

Clarifications are needed regarding appraisers' role: the meaning of "regular basis" regarding the requirements of independence and the meaning of "rotate" regarding the diversification of the valuations among appraisers.

- 7.2.3 Individual versus indexed valuations

The Draft guidance defines a threshold for indexed values of €300.000.

  Page 87 "*Valuations derived from indexation … may be used to update the valuation for non-performing loans of less than 300,000 euro in gross value …"*

The threshold for the indexed valuation €) is too low and inadequate for individual property valuations in big cities.

Moreover, some clarifications on the indices to be used are needed in the last two bullet points regarding «sufficiently granular" and "sufficient time series". What does "sufficient" mean?

  "*The indices used to carry out this indexation may be internal or external as long as they are: … Sufficiently granular …, Based on a sufficient time series of observed empirical evidence …"*

- 7.4.3 Gone concern approach

  Page 91*. "In a gone concern scenario, the future sale proceeds from collateral execution should be adjusted taking into account the appropriate liquidation costs and market price discount to the open market value (OMV)"*.

Banks are required to apply a market price discount, if appropriate, to update the evaluation of the recoverable amount. Clarification is needed on how the ECB expect banks to use internal thresholds while valuation is based on an expert judgment in this area.

2. The ECB is over-prescriptive.

2.1 - The ECB is over-prescriptive with regard to indicators and valuation methods

The document goes in too much detail (notably regarding indicators) at the risk of an avalanche of specific instances that would not fit in the guidance standards.

For instance, banks do not decide on legal procedures formalism. This is recognized page 10 "Regulatory, legal and judicial framework":

> "*National as well as European regulatory, legal and judicial frameworks influence the banks' NPL strategy and their ability to reduce NPLs. For example, legal or judicial impediments to collateral enforcement influence a bank's ability to commence legal proceedings against borrowers or to receive assets in payment of debt and will also affect collateral execution costs in loan loss provisioning estimations."*

Notably, the document is based on the binary approach used in the AQR context and it extends it to the valuation of futures cash-flows and collateral i.e. in a management context which is far more complex than the AQR's one. We may question the relevance of the approach chosen and the ECB's legitimacy to impose it.

Indeed, in chapter 6 on impairment and write-offs, § 6.2.1 and § 6.2.4 "Estimating future cash flows" page 70, it is stated: "*The estimation of futures cash-flow allowances can be done under the following two broad approaches: Under a "going concern" scenario […] under a "gone concern" scenario*". The guidance seems to require either a going concern approach or a gone concern approach. However, the boundaries between the two approaches are not always clear in the document. Moreover some arguments in favour of the gone concern approach does not appear to reflect the businesses' economic and financial reality. We believe a combined approach might be also possible when it better justifies the impairment measurement or (partial) write-offs. Regarding this issue, the tax aspect should also to be taken in consideration.

In particular, as acknowledged in this Draft guidance, the legal framework and the possible involvement of public bodies for some files facing financial difficulties may also hamper the proper implementation of sound forbearance measures (as described in chapter 4 of the Draft guidance).

2.2 - The ECB is over-prescriptive with regard to processes

The ECB goes far inside processes description (cf. chapter 5 "NPL recognition": automatic decision trees, automatic triggers…). It gives the impression that NPL management processes are expected to be standardised and automatized (automatic reporting, automatic write off policies, automated market information...).

Indeed, paragraph 4.3 “Sound forbearance processes”, page 43 states:

"Standardised forbearance products and decision trees:

[..] In this context, the institution should consider developing “decision trees” and related standardised forbearance solutions (or “products”) for segments of heterogeneous borrowers with less complex exposures. Decision trees may help to determine and implement appropriate and sustainable forbearance (and more generically NPL workout) strategies for specific segments of borrowers in a consistent manner based on approved criteria. They may also help to foster the standardisation of processes."

We may question the ECB’s legitimacy, in a supervisory context, to require a specific organisation of NPL management processes. It seems to be an interference with institutions responsibilities.

Regarding the NPL write-off, the issue is touchy. While we understand that the banks should include in their internal policies clear guidance on the timeliness of provision and write-offs, the ECB Draft guidance is too prescriptive and should not supersede any applicable EU or national legislation and regulation.

An excessive search for standardisation may lead to herding behaviours vis-à-vis some counterparts at the expense of financial stability.

Finally, we are concerned the guidance may apply not only in case of foreclosed assets but also more generally: “The main focus is on provisioning but the guidance can also be used where appropriate in the loan processing, monitoring and underwriting process”. (§7.1.”Purpose and overview– Scope of the chapter)

We are concerned the guidance may apply not only in case of foreclosed assets but also more generally: “The main focus is on provisioning but the guidance can also be used where appropriate in the loan processing, monitoring and underwriting process”.

We believe the guidance is too burdensome if it has to be applied to collateral valuation in general, and we ask that it should be restricted to the provisioning process only.

2.3 – The ECB is over-prescriptive with regard to supervisory reporting and public disclosures

We note that in § 1.2 (page 6) the ECB stresses that:

"*This guidance does not intend to substitute or supersede any applicable regulatory or accounting requirement or guidance from existing EU regulations or directives and their national transpositions or equivalent, or guidelines issued by the European Banking Authority (EBA). Instead, the guidance is a supervisory tool with the aim of clarifying the supervisory expectations regarding NPL identification, management, measurement and write-offs in areas where existing regulations, directives or guidelines are silent or lack specificity. Where binding laws, accounting rules and national regulations on the same topic exist, banks should comply with those."*

However, the Draft guidance imposes additional disclosures and reporting that interfere with those already requested by the existing European Regulation and that consistency with the regulation is questioned, as we explain in the paragraph 3.1 below.

3. Articulation between the ECB Draft guidance and the provisions of other European texts on the same issue

Generally, the ECB:

- seems to hesitate between prudential and accounting definitions;
- does not make a clear distinction between disclosure towards supervisors and public disclosure towards financial markets.

See for instance Annex 7, page 119, reporting form entitled "Chapter 2 NPL Strategy".

3.1 – Consistency with EBA's provisions

Last September, the EBA published its guidelines on the application of the definition of default. However the ECB's description of the processes to be put in place for forbearance goes far beyond the EBA's requirements. (Cf Annex 7, page 121, Table 5 "Public disclosure example tables for forbearance".)

Moreover, concerning the definition of forbearance (§5.3.1 "General definition of forbearance" - page 53), the identification of the financial difficulties should remain aligned with the EBA ITS. The following two conditions should not be considered as direct indicators triggers of financial difficulties:

- increase of probability of default (PD) of institution's internal rating class during the three months prior to its modification or refinancing;
- presence in watch-list during the three months prior to its modification or refinancing.

An increase in PD could be caused for reasons not directly related to the financial difficulties of the debtor (i.e. impact of macroeconomic factors). Therefore, this item should be seen only as an indicator, not as a direct trigger to identify conditions of financial difficulties.

The events contemplated in the table 2 of page 52 are way too wide (e.g. disappearance of refinancing options).

In its chapter 5 "NPL recognition", the Draft guidance go far beyond the information needed by supervisors. They are prescriptive on financial communication issues which are not part of the ECB mandate. CRD/R (and EBA) Pillar 3 addresses the issue already.

Regarding reporting provisions, the enforcement date of the guidance is unclear.

The EBA's Pillar 3 Forbearance Guidelines are mandatory by December 2017. The ECB's guidance enforcement date must not be prior to the EBA's one.

As said before we believe that public disclosures and supervisory reporting should be defined by European regulation rather than by guidance.

Regarding NPEs impairment and write-off (chapters 5 & 6 pages 122-124), some issues are already covered by the Pillar 3 EBA consultation (Table EU CRB-A, for definitions notably). However the Draft guidance goes deeper, notably concerning the following point: "A reconciliation of the definitions of non-performing, impaired, defaulted, restructured/modified assets and forborne exposures. This reconciliation should comprise both a conceptual explanation of the differences and quantitative information on the effects of these conceptual differences".

Banks are preparing to publish their reporting in the EBA's requested format. The ECB goes a step further than the EBA. Which one is to be applied?

Regarding collateral valuation (Chapter 7, page 126), the level of detail requested (sectorial and geographical breakdown) does not meet the EBA's expectations (sees its Pillar 3 consultation). The same with the cross referencing to disclosures in the financial statements demand: data granularity is a concern. It is not, however, certain that this excessive granularity will add value.

As said above, the EBA requirements should be the primary reference.

Concerning the "unlikely to pay" criterion (§5.2.2 "Remarks on the "unlikely-to-pay" criterion"), the ECB retains an approach based on automatic triggers that identified exposures as non-performing. We believe that pre-defined indicators or events relating to unlikeliness to pay should not trigger systematically the transfer of exposures into the NPL category. Some room for expert judgment must be left to banks' risk management when assessing creditworthiness of their debtors.

3.2 - Consistency with accounting provisions / in some instances the ECB override the accounting standards' interpretation.

For instance chapter 7 "Collateral valuation", page 94 (Valuation of foreclosed assets), the ECB refers to IFRS 5. The ECB specifies that banks should classify the foreclosed real estate assets as non-current assets held for sale and refers to the application of IFRS 5 to justify the classification (§7.5). Thus, they should sale foreclosed real estate assets within a short timeframe of the year following the foreclose measure. Such automatic classification is not realistic as in some circumstances foreclosed assets would not be sold within one year and as it would not be coherent with banks' management decisions and foreclosed asset sale policies. Banks should be able to keep expert judgment in such matter. Consequently, banks could classify the foreclosed real estate assets as non-current assets held for sale under IFRS 5, provided that they meet the IFRS 5 conditions."

Moreover, the ECB requirement to apply IFRS 5 without judgement would notably impact banks' published financial statements and disclosures.

The ECB relies on IAS 39 and IFRS 9 setting, but on a small of part of IFRS 9 only, at the risk of inconsistencies with the global IFRS 9 framework. Here are following some examples.

- Box IFRS 9 page 74 *"IFRS 9 requirement to incorporate forward-looking information in the collective estimation of allowances.*" This statement is not wrong but incomplete which makes it wrong.
- Page 62 "Outlook: IFRS 9": *"IFRS 9 defines credit-impaired financial assets in Appendix A. This definition is not only relevant for financial assets, but also for financial guarantees and loan commitments. The definition in IFRS 9 comes from IAS 39 (not amended).*" This statement is not wrong ("comes from" does not mean "identical to") but ambiguous.
- Box IFRS 9 page 68: *"Loans classified in "Stage 3" of IFRS 9 are similar to those "impaired" under IAS 39."*Incurred but not reported allowances (IBNR) (collective provisioning = portfolio based provisioning and not general provisioning) are not included in IFRS 9 stage 3; they are part of stages 1 and 2 while being impaired as per IAS 39.

In chapter 5 "NPL recognition", the ECB goes beyond the information needed by supervisors. The ECB adopts a prescriptive approach to financial communication issues which are not part of its mandate. To this end, there already is IFRS 7 recommendations.

For example, chapter 5, § 5.6 Supervisory reporting and public disclosures:

> *"On disclosures, banks should consider the EBA ITS supervisory reporting requirements as established in Commission Implementing Regulation (EU) No 680/2014 as a benchmark. […]For the sake of comparability and transparency, disclosure should therefore contain, in addition to the requirements of accounting standards (e.g. IFRS 7, which already covers data on portfolio quality and trigger events), the requirements as set out in Annex 7 of this guidance."*

3.3 - Consistency with FINREP and EDTF

Chapter 4 on forbearance requiring qualitative analysis and supervisory reporting and disclosure items (Pillar 3 publication) (annex 7) adds a layer of reporting over EDTF and FINREP.

Note: It is quite strange to note that forbearance comes first in the ECB Draft guidance when NPLs are at the heart of the matter.