



NPL Regulatory Developments – EBA perspective

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Outline



1. Background and EBA mandates
2. The EBA standardised NPL templates
3. Guidelines on management of non-performing and forborne exposures
4. Enhanced disclosure requirements for non-performing and forborne exposures
5. Guidelines on loan origination, monitoring and internal governance

EU Council conclusions relevant to the EBA (July 2017)



The EBA mandates

- Issue **Guidelines on NPE/FBE Management**, to apply to all EU banks
- Issue **Guidelines on banks' loan origination**, monitoring and internal governance
- Implement, together with ESMA and CAs, **enhanced disclosure requirements** on asset quality and NPLs
- Issue **Guidance on loan tapes monitoring**, specifying information required on banks' credit exposures / data templates

The EBA to work with the ECB and the Commission

- Propose initiatives to **strengthen the data infrastructure** with uniform and standardised data for NPLs and consider setting-up platforms

Mandates where the EBA is not in the lead

- **Blueprint of AMCs**
- **Structural reforms of insolvency** and debt recovery frameworks
- Fostering **restructuring of the banking system**

Supervision

Secondary markets

EU Commission proposals relevant to the EBA (March 2018)



Furthermore:

- The Council conclusions invites the Commission to consider **prudential backstops addressing potential under provisioning** which would apply to newly originated loans → The EBA was mandated to provide advice, mainly in the form of impact assessment
- The Commission proposes the EBA to develop **ITS that specify the format of the information for the screening, financial due diligence and valuation of the credit agreements** → link to the guidance on loan tapes monitoring and EBA work on NPL templates



- The EBA published (in March 2018) its advice on the Commission's proposal for statutory prudential backstops on banks' provisioning practices for new loans that turn non-performing:
- The EBA notes that the backstop complements the existing prudential set of measures and the new accounting provisions under IFRS9 and the advice aims at providing some qualitative considerations as well as a conservative impact analysis of the proposed measures

EBA's work on NPLs

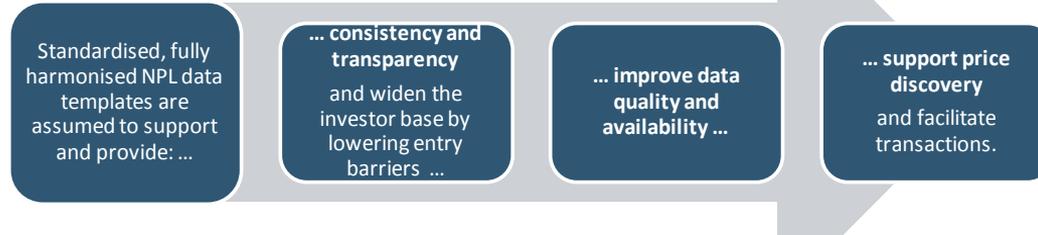


Name of the product	Focus of the product	Current status
<p>1</p> <p>The EBA Standardised NPL templates</p>	<p>The main objective of these templates is first to improve consistency and transparency and widen investor base by lower barriers to entry, secondly, to improve data quality and availability, and finally, to support price discovery and facilitate transactions.</p>	<p>Published in December 2017</p>
<p>2</p> <p>Guidelines on management of non-performing and forborne exposures</p>	<p>Aiming to achieve a sustainable reduction of NPEs in credit institutions' balance sheets.</p>	<p>Consultation will end in June 2018 and the Guidelines should be implemented by January 2019</p>
<p>3</p> <p>Enhanced disclosure requirements for non-performing and forborne exposures</p>	<p>Specifying a common content and uniform disclosure formats on information on NPEs, forborne exposures and foreclosed assets that credit institutions should disclose.</p>	<p>Planned finalisation of the product is end of 2018</p>
<p>4</p> <p>Guidelines on loan origination, monitoring and internal governance</p>	<p>Addressing in particular issues such as transparency and borrower affordability assessment and where relevant will leverage on existing national experiences.</p>	<p>Planned finalisation of the product is Q1 2019</p>

1. The EBA standardised NPL templates

The EBA published (in December 2017) **Standardised NPL templates**:

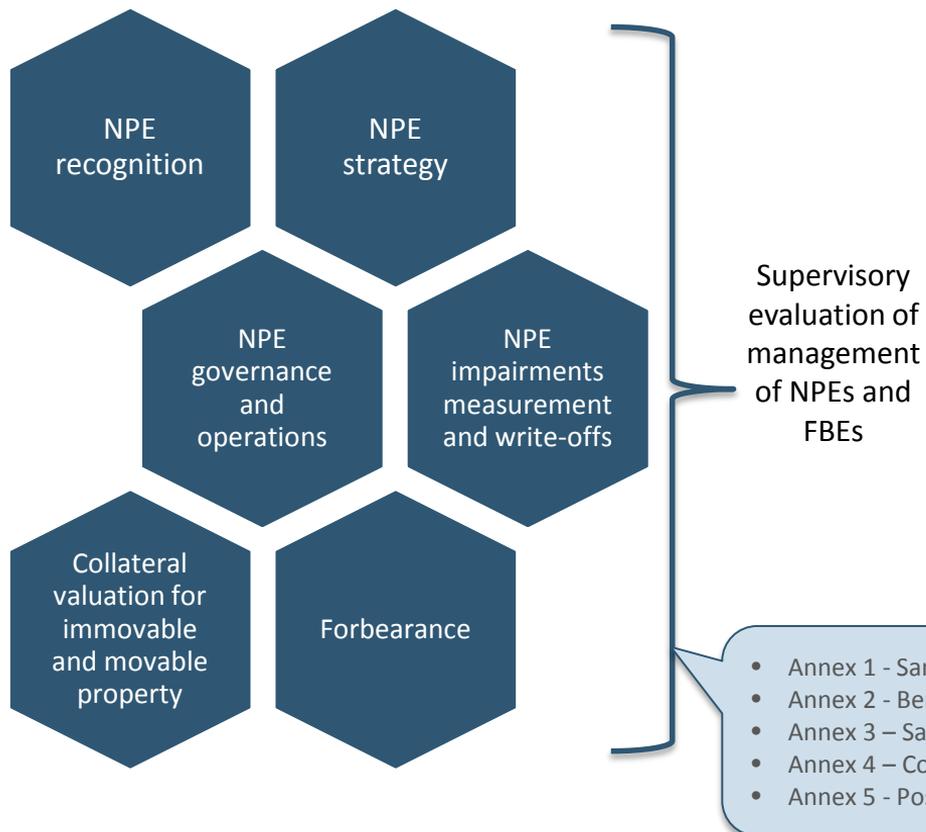
- The main objective of these templates is first to **improve consistency and transparency** and widen investor base by lower barriers to entry, secondly, to **improve data quality and availability**
- These transaction and portfolio screening templates provide data loan by loan, i.e. at the most granular level, including information on counterparties related to the loan and the collateral provided
- Standardised NPL templates are fundamental to help **develop secondary markets where banks can sell their NPLs** to credit services and investors with no (or minimum) distortions (e.g. asymmetric information) in the market → AMC blueprint refers to the NPL templates
- EBA NPL templates are also used by ESMA in the **securitisation templates**



The EBA NPL templates are based on **data needs for investors**, and as such include e.g. very granular info about **collaterals and status in the enforcement process**

From a banks' perspective, filling the templates should **not result in major additional costs**: **data anyhow needs to be readily available** for NPL transaction and other purposes, **e.g. collateral and borrower related** data that shifts into focus for non-performing exposures

2. Draft GL on NPE and FBE management: overview



- The draft GL specify sound risk management practices for credit institutions for managing NPE and FBE, looking at the governance and operations of a NPE workout framework, the internal control framework and NPE monitoring, and warning processes.
- The aim is to achieve a sustainable reduction of NPEs in credit institutions' balance sheets.
- The guidelines focus on prudential aspects, but consumer protection perspective is also important.

- Annex 1 - Sample criteria for grouping NPE in retail
- Annex 2 - Benchmark for NPE monitoring metrics
- Annex 3 – Sample of early warning indicators
- Annex 4 – Common NPE-related policies
- Annex 5 - Possible forbearance measures

2. Draft GL on NPE and FBE management: key aspects (1/2)



- The development and operationalisation of an **NPE strategy** is the core building block of the draft GL. The NPE strategy:
 - should be built on an **assessment of the operating environment** (internal capabilities, external conditions, capital implications)
 - should **set out time-bound realistic, yet ambitious reduction targets** and consider all available strategic options to reduce NPEs (covering short, medium and long-term time horizons)
 - should be **fully embedded management processes of the institution**, including regular review and independent monitoring (covering integration to ICAAP, RAF recovery planning)
- The draft GL outline the key elements of the governance and operations of a NPE workout framework with key aspects related to:
 - **steering and decision making** (covering all aspects of policies, strategy and monitoring of their implementation)
 - **the NPE operating model** (focus on NPE workout units and their operations aligned to the NPE life cycle)
 - **internal control framework** (application of general internal control requirements to NPE management and monitoring covering all three lines of defense)
 - **NPE monitoring** (defining and following metrics, engagement with borrowers, forbearance and liquidation activities)
 - **early warning processes** (designing and following EWS metrics, escalation procedures)

Proportionality: EBA propose a **threshold of 5% NPL ratio** which indicates that credit institutions should **establish a strategy** and the related operational and governance arrangements.

This is **not an automatic target** and competent authorities can request institutions below the threshold to implement NPE strategies if they identify evidence for deteriorating asset quality

2. Draft GL on NPE and FBE management: key aspects (2/2)



Forbearance

- Forbearance measures should be granted only when they aim to restore sustainable repayment by the borrower and are thus in the borrowers' interests
- Institutions should distinguish between **viable forbearance measures** contributing to reducing the borrower's exposure and **non-viable forbearance measures**
- Institutions should develop **a policy for their forbearance activities**
- Institutions should **monitor the quality of forbearance activities** for both performing and non-performing exposures → to make sure that it is not used for delaying of the assessment that the exposure is uncollectable
- Granting forbearance should be based on borrower creditworthiness assessment
- Forbearance activities should be compared with other workout options → NPV as a basis for comparisons

Collateral valuations

- General governance and control requirements → policies and procedures for valuation, monitoring, control and back-testing of valuations
- **Specific appraisals vs indexed valuations** of immovable property → threshold of 300,000 EUR for the indexed valuation
- General requirements for the use of **independent appraisers**
- Frequency of valuation and their monitoring → at a minimum on **annual basis for moveable property and commercial immovable property**, and every three years for residential immovable property → more frequent valuations where the market is subject to significant negative changes and/or where there are signs of significant decline in the value of the individual collateral
- Valuation methodologies: expected future cashflow, gone concern approach

3. Enhanced disclosure requirements for NPE and FBE



- Implementing, together with ESMA and competent authorities, enhanced disclosure requirements for non-performing and forborne exposures → draft **GL on disclosure of NPE and FBE**
- The draft GL specify a **common content and uniform disclosure formats** on information on NPEs, forborne exposures and foreclosed assets that credit institutions should disclose
 - The aim is to foster **transparency** and provide meaningful information to market participants and to **address any potential asymmetries of information**
 - Under the principle of proportionality, the guidelines include a set of **additional disclosure templates applicable to significant institutions with a high level of non-performing loans**
- The EBA will also will also **amend reporting (FINREP) of NPEs and FBEs** – consultation to be launched in H2 2018

4. Draft GL on loan origination, monitoring and internal governance

- The draft GL aim to tackle issues around loans at the origination phase and before they become non-performing
- These guidelines would in particular address issues such as transparency and borrower affordability assessment and where relevant will leverage on existing national experiences
- Whilst focusing on prudential aspects, these guidelines will also account for consumer protection issues

The draft GL would cover, inter alia:

- Application of internal governance and risk management requirements to loan origination and monitoring
- Loan origination policies and procedures
 - Creditworthiness assessment (including metrics)
 - Documentation
 - Sensitivity analysis in Creditworthiness assessment
- Risk-based pricing
- Collateral valuation
- Monitoring framework, including early warning signals



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