

## **Guidelines on management of non-performing and forbore exposures**

**(EBA/GL/2018/06)**

These Guidelines of the European Banking Authority (EBA) are addressed to competent authorities, as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010, and to credit institutions, as defined in point 1 of Article 4(1) of Regulation (EU) No 575/2013.

The Guidelines aim to ensure that credit institutions have an adequate framework in place to manage effectively their non-performing exposures (NPE) in order to achieve a sustainable reduction on their balance sheets. The Guidelines take into account the proportionality aspects in their implementation and provide concrete examples in relation to small and less complex institutions.

Specifically, the Guidelines require credit institutions to establish NPE reduction strategies and introduce governance and operational requirements to support them. The Guidelines also set out requirements for forbearance granting processes with a focus on the viability of these measures as well as for the processes to identify NPE and forbearance exposures.

The Guidelines introduce a threshold of 5% of gross non-performing loans (NPL) ratio as a trigger for developing NPE reduction strategies and applying associated governance and operational arrangements. This threshold does not indicate an optimal level for NPL and should not be considered as a target to be used in credit institutions' NPE strategies but as a factor that leads to stricter supervisory monitoring to guard against rising levels of NPE.

Finally, the Guidelines outline requirements for competent authorities' assessment of credit institutions' NPE management activities as part of the Supervisory Review and Evaluation Process (SREP).

The EBA has developed these Guidelines in accordance with Article 16 of Regulation (EU) No 1093/2010 and following the conclusions reached by the European Council in July 2017 specifying an Action Plan to tackle NPL in Europe. The EBA published the

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English version of these Guidelines on 31 October 2018 (the Spanish version was released on 3 April 2019). The Guidelines apply from 30 June 2019.

The Executive Commission of the Banco de España, in its role of competent authority for the direct supervision of the less significant credit institutions, adopted these Guidelines as their own on 30 May 2019.

EBA/GL/2018/06

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31 October 2018

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# Final Report

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Guidelines on management of non-performing and forborne exposures

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## Executive summary

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The financial crisis negatively affected the European banking sector and contributed to a build-up of non-performing exposures (NPEs) on many banks' balance sheets. Although the joint efforts of banks, supervisors, regulators and macroprudential authorities have led to a slow improvement in NPE ratios in recent years, the overall level of NPEs remains high by historic standards, especially in some jurisdictions. In July 2017, the European Council concluded an Action Plan<sup>1</sup> to tackle non-performing loans (NPLs) in Europe. The Council stressed that a comprehensive approach consisting of a mix of complementary policy actions, at national and European level, was needed to address the existing stock of NPLs as well as to prevent the emergence and accumulation of new NPEs on banks' balance sheets. In this regard, the EBA, along with other bodies and institutions, was invited by the Council to contribute to this Action Plan in four specific areas: (i) supervisory actions to work with banks to improve strategies to reduce NPEs; (ii) measures to improve the functioning of the secondary market; (iii) structural measures to improve the environment for dealing with NPEs; and (iv) fostering restructuring of the banking system. These guidelines relate to the first area.

The guidelines are aimed primarily at reducing NPEs on banks' balance sheets by providing supervisory guidance to ensure that credit institutions effectively manage NPEs and forborne exposures (FBEs) on their balance sheets. The aim is to achieve a sustainable reduction of NPEs on credit institutions' balance sheets by means of the institutions' own NPE strategies, which would prove beneficial from both micro and macro perspectives. The guidelines are written from a prudential perspective but also taking into account the pressing need to ensure that consumers who have taken out loans are treated fairly at every stage of the loan life cycle. To that end, the guidelines draw attention specifically to provisions under the EU directives and relevant EBA guidelines relating to consumers of which credit institutions need to be cognisant when managing NPEs.

The development and operationalisation of an NPE strategy is the core building block of the guidelines for banks' NPE management. The NPE strategy should be built on an assessment of the operating environment, should set out time-bound, credible yet ambitious reduction targets and should consider all available strategic options to reduce NPEs. The guidelines outline the proportionate approach to the key elements of governance and operations in relation to an NPE workout framework, covering aspects related to steering and decision-making, the NPE operating model, the internal control framework and NPE monitoring processes. Credit institutions with gross NPL ratios at a level of 5% or above should establish an NPE strategy, as part of their overall strategy, and related governance and operational arrangements. Effective governance covers all the responsibilities that banks have, including treating customers fairly.

The guidelines stress that any forbearance measures should be granted only when they aim to restore sustainable repayment by the borrower and are thus in the borrower's interests. These

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<sup>1</sup> <http://www.consilium.europa.eu/en/press/press-releases/2017/07/11/conclusions-non-performing-loans/>

guidelines set out requirements relating to processes for recognising NPEs and FBEs, as well as a forbearance-granting process with a focus on the viability of forbearance measures. Credit institutions are expected to monitor the efficiency and effectiveness of forbearance measures and have in place policies and processes to assess borrowers' financial difficulties and identify NPEs.

The guidelines set out guidance on the estimation of future cash flow resulting from an active workout of the exposure and/or the sale of collateral, and require credit institutions to have in place policies for timely impairments and write-offs. The management of NPEs secured by movable or immovable property collateral requires credit institutions to have in place governance arrangements, procedures, including on methodology and frequency, and controls on the valuation of the collateral.

The guidelines also set out requirements for competent authorities' assessments of credit institutions' NPE management activities.

## Next steps

The guidelines will be translated into the official EU languages and published on the EBA website. The deadline for competent authorities to report whether they comply with the guidelines will be two months after the publication of the translations. The guidelines will apply from 30 June 2019.

## Background and rationale

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1. The financial crisis negatively affected the European banking sector in various ways, and it contributed to the build-up of a large stock of non-performing exposures (NPEs) on banks' balance sheets. The stock of non-performing loans (NPLs) in the EU banking sector amounted to EUR 989 billion at the end of 2016, EUR 815 billion at the end of 2017 and EUR 779 billion in the first quarter of 2018, i.e. 5.4%, 4.1% and 3.9% respectively of the total loan portfolio. The EU average NPE ratio was 3.4% in the first quarter of 2018.<sup>2</sup>
2. The dispersion of the stock of NPEs is uneven across Member States. There are currently 12 Member States experiencing above average NPE ratios, and the scale and the cross-border implications make this an EU-wide problem. The overall level remains high by historic standards, even though the joint efforts of banks, supervisors and macroprudential authorities have led to a slow improvement in NPE ratios over recent years.
3. The EBA's risk analysis, supported by similar research conducted by other international organisations, indicated that high levels of NPEs are a drag on profitability and are strongly correlated with weak lending growth. The effects of high levels of NPEs on banks' balance sheets on, inter alia, funding costs and capital and profitability can seriously jeopardise institutions' ability to run a viable and sustainable business model.
4. NPEs are a problem at multiple levels: at microprudential level, high levels of NPEs are associated with lower profitability and lower efficiency; at macroprudential level, high levels of NPEs are connected with stagnant growth, as capital is tied up in NPEs and there is decreased new lending into the real economy. In addition, high stocks of NPEs negatively affect the resilience of the banking sector to shocks and hence increase systemic risk. Finally, for consumers, an inability to meet the obligations of the credit contract could have a detrimental impact on their financial situation and social circumstances. All of these effects must be tackled in a comprehensive manner.
5. In 2014, in Commission Implementing Regulation (EU) No 680/2014 on supervisory reporting the EBA introduced definitions of NPEs and forborne exposures (FBEs) to facilitate the identification of problematic assets. Despite the decreasing trend in levels of NPEs in most EU Member States, the pace of reduction of NPLs has been slow. This slow pace of reduction is mainly due to the discretion allowed banks' management and supervisors, together with the absence of an effective secondary market for NPEs and challenging legal systems, which have incentivised credit institutions to keep the loans on their balance sheets.

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<sup>2</sup> The EBA Risk Dashboard; data as of Q1 2018: <http://www.eba.europa.eu/risk-analysis-and-data/risk-dashboard>.



6. In July 2017, the European Council concluded an Action Plan<sup>3</sup> to tackle NPLs in Europe. The Council stressed that a comprehensive approach consisting of a mix of complementary policy actions, at national level and at European level where appropriate, was the most effective way to address the existing stock of NPEs, as well as the emergence and accumulation of new NPEs, on banks' balance sheets. The policy actions were to cover the following four policy areas: (i) supervision, (ii) development of secondary markets for distressed assets, (iii) structural reforms of insolvency and debt recovery frameworks and (iv) restructuring of the banking system. These guidelines relate to the first area.

## Objective and structure of the guidelines

7. The main body of the guidelines is structured in six sections, with section 4 introducing the requirements for the NPE strategy, and section 5 providing details on the operationalisation of the strategy and outlines supporting governance and operational arrangements. Section 6 sets out supervisory expectations regarding the use of forbearance, section 7 addresses the recognition of NPEs, section 8 deals with NPE impairments and write-offs, and section 9 specifies supervisory requirements regarding the collateral valuation of movable and immovable property. Furthermore, section 10 provides guidance to the competent authorities on addressing NPEs and FBEs in the supervisory review and evaluation process (SREP).
8. The NPE strategy is the core building block of the guidelines for the banks' NPE management. The strategy sets the basis for the credit institutions' initial and regular assessments of the operating environment and describes the considerations that they should take into account. These include the internal capabilities of the credit institution, external conditions and capital implications. When developing their NPE strategy, credit institutions should also consider all available strategic options and combinations of them. These include hold/forbearance strategies, active portfolio reductions, taking collateral onto the balance sheet and legal options including out-of-court options. Furthermore, implementing the operational plan and embedding the NPE strategy into the institution are both important aspects of the NPE strategy. The guidelines call for regular review of the strategy, monitoring of its operational effectiveness and integration of it into the credit institution's risk management framework.
9. Credit institutions need to address NPEs in an efficient and sustainable way. Therefore, an appropriate governance structure and operational set-up should be in place to facilitate this objective. The guidelines outline the key elements of governance and operations in relation to an NPE workout framework, covering key aspects related to steering and decision-making, the NPE operating model, the internal control framework and NPE monitoring processes.
10. An NPE strategy and its governance and the operational aspects of the strategy are key for the efficient management of NPEs and FBEs. In the implementation of these guidelines, when credit institutions have a gross NPL ratio at 5% or above, they should establish an NPE

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<sup>3</sup> <http://www.consilium.europa.eu/en/press/press-releases/2017/07/11/banking-action-plan-non-performing-loans/#>

strategy and fulfil all related operational and governance aspects in accordance with sections 4 and 5 of these guidelines. This threshold is not intended to indicate any optimal level of NPLs that credit institutions should aim for on their balance sheets and should not be considered an automatic quantitative target to be used in credit institutions' NPE strategies. NPE strategies should target a time-bound reduction of NPEs over a realistic but sufficiently ambitious time horizon. Competent authorities could identify other credit institutions that should develop NPE strategies, governance and operations if they detect signs of deteriorating asset quality.

11. The level of a 5% gross NPL ratio aims to ensure a minimum level of transparency, and to ensure that credit institutions are prepared to prevent NPEs building up and to take action at an early stage to tackle the issue. The rationale behind applying an NPL threshold is that the majority of exposures on credit institutions' balance sheets that have become non-performing are loans; therefore, a calculation that is based on the share of NPLs better depicts the evolution of asset quality overall and is more risk based. Sections 4 and 5, when triggered, would apply to all material NPEs, including debt securities.

12. The computation of the gross NPL ratio is defined in the EBA Risk Dashboard. For the NPL ratio, the gross carrying amount of NPLs and advances is divided by the gross carrying amount of total loans and advances subject to the NPE definition.<sup>4</sup>

13. The NPE strategy, governance and operations should in general cover all exposures but should focus on portfolios with material levels of NPEs and/or FBEs.

## Legal basis and application

14. These guidelines are issued pursuant to Article 16(1) of Regulation (EU) No 1093/2010<sup>5</sup> in order to ensure common, uniform and consistent application of Union law and to establish consistent, efficient and effective supervisory practices within the EU.

15. Article 74 of Directive 2013/36/EU requires institutions to have robust governance arrangements, including a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to and adequate control mechanisms.

16. To further harmonise institutions' internal governance arrangements, processes and mechanisms within the EU, the EBA is mandated by Article 74 of Directive 2013/36/EU to develop guidelines in this area.

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<sup>4</sup> FINREP (from Q1 2018 onwards): F18.00; rows (070+191+221); column 060 / F18.00; rows (070+191+221); column 010.

<sup>5</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p. 12).

17. Article 76 of Directive 2013/36/EU sets out requirements for the involvement of the management body in risk management, the setting up of a risk committee for significant institutions, and the tasks and organisation of the risk management function, and it requires in particular that the management body of a credit institution must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the institution is or might be exposed to.
18. Furthermore, in line with Article 79 of Directive 2013/36/EU, competent authorities should ensure, inter alia, that:
- credit institutions have internal methodologies in place to assess the credit risk of their exposures on an individual and on a portfolio basis,
  - the ongoing administration and monitoring of the various credit risk-bearing portfolios are operated through effective systems, including the identification and management of problem credits, as well as the setting aside of adequate value adjustments and provisions.
19. In accordance with Article 97 of Directive 2013/36/EU, competent authorities should review the arrangements, strategies, processes and mechanisms implemented by credit institutions to determine whether the own funds and liquidity held by them ensure a sound management and coverage of their risk. Competent authorities, when conducting the SREP, must review whether credit institutions observe the provisions of these guidelines. As an outcome of the SREP, and in accordance with Article 104(1)(d) of Directive 2013/36/EU, competent authorities may require an institution to apply a specific provisioning policy, which may – where permitted by accounting rules and regulations – result in an increase in impairments, or the need to hold additional own funds.
20. Article 107 of Directive 2013/36/EU addresses the consistency of supervisory reviews, evaluations and supervisory measures, mandating the EBA to draw up guidelines addressed to the competent authorities to specify, in a manner that is appropriate to the size, the structure and the internal organisation of institutions and the nature, scope and complexity of their activities, the common procedures and methodologies for the SREP referred to in paragraph 1 of Article 107 and in Article 97 and for the assessment of the organisation and treatment of the risks referred to in Articles 76 to 87 of that Directive.
21. Article 109(2) of Directive 2013/36/EU requires parent undertakings and subsidiaries subject to this Directive to meet the governance requirements also on a consolidated or sub-consolidated basis, to ensure that their arrangements, processes and mechanisms are consistent and well-integrated and that any data and information relevant to the purpose of supervision can be produced. In particular, it should be ensured that parent undertakings and subsidiaries subject to Directive 2013/36/EU implement such arrangements, processes and mechanisms in their subsidiaries not subject to this Directive. These arrangements, processes and mechanisms must also be consistent and well-integrated and those

subsidiaries not subject to Directive 2013/36/EU must also be able to produce any data and information relevant to the purpose of supervision.

22. Under Article 123(2) of Directive 2013/36/EU, competent authorities must require institutions to have in place adequate risk management processes and internal control mechanisms, including sound reporting and accounting procedures in order to identify, measure, monitor and control transactions with their parent mixed-activity holding company and its subsidiaries appropriately.
23. The evidence from wide-ranging asset quality reviews conducted by competent authorities in recent years highlights gaps in credit institutions' credit risk assessment and management practices. Therefore, these guidelines respond to a legitimate supervisory need to equip credit institutions with a comprehensive set of requirements that should be considered when devising their NPE management framework.
24. The objective of the guidelines is to increase the convergence of NPE and FBE management practices across EU Member States, by clarifying how credit institutions should effectively manage and ultimately reduce their non-performing and forborne exposures through the establishment and operationalisation of an NPL strategy that is embedded in the credit institution's overall strategy.
25. The guidelines, together with the guidelines on loan origination that the EBA has also been invited to issue by the Council's Action Plan, aim to address the existing stock of NPLs and to prevent the accumulation of NPLs in the future.
26. The provisions of the guidelines should be read in conjunction with and without prejudice to Commission Implementing Regulation (EU) No 680/2014 on supervisory reporting, which provides harmonised NPE and FBE definitions for prudential reporting purposes; these are applied consistently across these guidelines.
27. Credit institutions are expected to apply these guidelines as of 30 June 2019 on the basis of the gross NPL ratios calculated at 31 December 2018. The application of sections 4 and 5 will depend on the credit institutions' NPL ratios in relation to the levels specified in these guidelines and within supervisory dialogue, which will also consider the institutions' own NPE strategies (including any NPL ratio targets set therein).
28. The guidelines should be applied in a proportionate manner and, in particular, organisational aspects of the management of NPEs and FBEs should be applied taking into account the size and complexity of the institution. Large and more complex institutions should have more sophisticated governance arrangements, policies, processes and procedures, while small and less complex institutions may implement simpler governance arrangements, policies, processes and procedures in accordance with the EBA Guidelines on internal governance.
29. The scope of the guidelines is all exposures covered by the definition of NPE or FBE. Credit institutions should focus their actions on portfolios with material NPEs or FBEs. Some parts

of the guidelines may be more relevant for loans and advances than for debt securities or off-balance-sheet exposures and, similarly, some parts are focused on specific counterparty sectors (households, small and medium-sized enterprises, corporates).

30. These guidelines should be read in conjunction with and without prejudice to other relevant EBA products, in particular the EBA Guidelines on internal governance (EBA/GL/2017/11), the EBA Guidelines on common procedures and methodologies for the SREP (EBA/GL/2014/13 and EBA/GL/2018/03), the EBA Guidelines on credit risk management practices and accounting for expected credit losses (EBA/GL/2017/06) and the joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders (EBA/GL/2017/12).
31. Furthermore the guidelines rely on the harmonised definition of default provided by the EBA Guidelines on the application of the definition of default (EBA/GL/2016/07), which cover key aspects such as the days past due criterion for default identification, indications of unlikelihood to pay, conditions for a return to non-defaulted status, the treatment of the definition of default in external data, the application of the default definition in a banking group and specific aspects related to retail exposures. In the context of determining the days past due, these guidelines refer to Commission Delegated Regulation (EU) 2018/171 on the materiality threshold for past due credit obligations, which has been adopted by the European Commission and published in the Official Journal<sup>6</sup>; it sets out the methodology for calculating the days past due.
32. These guidelines should also be read in conjunction with and without prejudice to the Mortgage Credit Directive (MCD) (Directive 2014/17/EU), and in particular Article 7 of the MCD on conduct of business obligations when providing credit to consumers and Article 28 on arrears and foreclosure; the Consumer Credit Directive (Directive 2008/48/EC), and in particular Article 17 of this Directive on the assignment of rights under a consumer credit agreement; and the EBA guidelines under the MCD, and in particular the EBA Guidelines on arrears and foreclosure (EBA/GL/2015/12).

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<sup>6</sup> OJ L 32, 6.2.2018, p. 1–5

# Guidelines

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EBA/GL/2018/06

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31 October 2018

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## Guidelines

# on management of non-performing and forborne exposures

# 1. Compliance and reporting obligations

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## Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010.<sup>7</sup> In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and credit institutions must make every effort to comply with the guidelines.
2. Guidelines set out the EBA's view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to which guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## Reporting requirements

3. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA that they comply or intend to comply with these guidelines, or otherwise give reasons for non-compliance, by ([dd.mm.yyyy]). In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu) with the reference 'EBA/GL/201x/xx'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to the EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3) of Regulation (EU) No 1093/2010.

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<sup>7</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC, (OJ L 331, 15.12.2010, p. 12).

## 2. Subject matter, scope and definitions

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### Subject matter

5. These guidelines specify sound risk management practices for credit institutions for managing non-performing exposures (NPEs), forborne exposures (FBEs) and foreclosed assets.
6. These guidelines also provide competent authorities with guidance on assessing credit institutions' risk management practices, policies, processes and procedures for managing NPEs and FBEs as part of the supervisory review and evaluation process (SREP).

### Scope of application

7. These guidelines apply in relation to Article 74 of Directive 2013/36/EU,<sup>8</sup> which requires institutions to have robust governance arrangements, including a clear organisational structure with well-defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks they are or might be exposed to and adequate control mechanisms.
8. Competent authorities should ensure that credit institutions comply with these guidelines on an individual, sub-consolidated and consolidated basis in accordance with Article 109 of Directive 2013/36/EU.
9. All sections of these guidelines apply to all exposures subject to definitions of non-performing and forbearance as defined in Annex V to Commission Implementing Regulation (EU) No 680/2014.<sup>9</sup>
10. For the purposes of the abovementioned definitions of non-performing and forborne exposures in Annex V to Commission Implementing Regulation (EU) No 680/2014, trading exposures include the exposures in the trading book defined in point 86 of Article 4(1) of Regulation (EU) No 575/2013.
11. Credit institutions with a gross NPL ratio equal to or greater than 5% on consolidated, sub-consolidated or solo level should apply sections 4 and 5 of these guidelines to the entities that have NPL ratios exceeding the set threshold.

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<sup>8</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, (OJ L 176, 27.6.2013, p. 338).

<sup>9</sup> Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council, (OJ L 191, 28.6.2014, p. 1).



12. Where credit institutions have a gross NPL ratio below the 5% level but have a high share or material amount of NPEs in an individual portfolio or individual portfolios with a specific concentration of NPEs in a geographical region, an economic sector or a group of connected clients, competent authorities may require credit institutions to apply sections 4 and 5 at the level of these portfolios.

13. Furthermore, competent authorities may identify credit institutions other than those covered in paragraph 11 that should also apply sections 4 and 5. Competent authorities should require the application of these sections if they identify signs of deteriorating asset quality. Competent authorities should consider the following elements and their interactions when assessing the applicability of sections 4 and 5:

- a) increased inflows of NPEs;
- b) a high or increased level of FBEs;
- c) a high or increased level of foreclosed assets;
- d) low coverage ratios;
- e) breached early warning indicators;
- f) an elevated Texas ratio;
- g) the quality and appropriateness of workout activity.

14. All credit institutions should apply sections 6 to 9.

15. Credit institutions should comply with these guidelines in a manner that is appropriate to their size and internal organisation and the nature, scope and complexity of their activities; in particular, credit institutions may comply with sections 4 and 5 taking into account the proportionality criteria specified in section 4, Title I, of the EBA Guidelines on internal governance.<sup>10</sup> Furthermore, if the credit institution is classified by the competent authorities for SREP purposes as SREP Category 3 or 4 (as assigned in accordance with the EBA Guidelines on common procedures and methodologies for the SREP<sup>11</sup>), then the guidelines should be applied in a proportionate manner. The principle of proportionality in the application of these guidelines will relate in particular to simplified obligations for the operationalisation and governance arrangements supporting the NPE strategies of credit institutions (section 5).

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<sup>10</sup> Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11).

<sup>11</sup> Described in section 2.1.1, 'Categorisation of institutions', of the Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) (EBA/GL/2014/13).

16. Proportionality in terms of the supervisory assessment of the NPE strategy of a SREP Category 3 or 4 institution can be achieved by aligning the assessment with the SREP engagement model, which ensures a risk-based approach to supervision and takes into account the systemic importance of the institution.

## Addressees

17. These guidelines are addressed to competent authorities as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010. The guidelines are also addressed to credit institutions as defined in point 1 of Article 4(1) of Regulation (EU) No 575/2013.

## Definitions

18. Unless otherwise specified, terms used and defined in Directive 2013/36/EU, Regulation (EU) No 575/2013,<sup>12</sup> and Commission Implementing Regulation (EU) No 680/2014, as amended and in force, have the same meaning in the guidelines.

19. In addition and in particular, for the purposes of these guidelines, the following definitions apply.

Cure period	As defined in Part 2, paragraph 231(b), of Annex V to Commission Implementing Regulation (EU) No 680/2014
EBITDA	Earnings before interest, taxes, depreciation and amortisation
Forbearance	Forbearance measures as referred in Annex V to Commission Implementing Regulation (EU) No 680/2014
Forborne exposures (FBEs)	Exposures in respect to which forbearance measures have been applied in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014
Foreclosed assets	Assets obtained by taking possession of collateral and which remain recognised on the balance sheet. Foreclosed assets can be obtained through judicial procedures, through bilateral agreement with the borrower or through other types of collateral transfer from the borrower to the credit institution. Foreclosed assets may include financial and non-financial assets and should include all collateral obtained irrespective of accounting classification
Immovable property	Immovable property as defined in Article 208 of Regulation (EU) No 575/2013
Liquidation cost	Liquidation costs are defined as the cash outflows incurred during collateral execution and the sales process and include:

<sup>12</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

- a) all applicable legal costs;
- b) selling costs, taxes and other expenses;
- c) any additional maintenance costs to be incurred by the credit institution in relation to the repossession and disposal of the collateral;
- d) any cash inflows up to the date of liquidation

Management body	As defined in points 7 and 8 of Article 3(1) of Directive 2013/36/EU
Movable property	Physical property other than immovable property in accordance with Article 210 of Regulation (EU) No 575/2013
Non-performing exposures (NPEs)	Exposures classified as non-performing in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014
Non-performing loans (NPLs)	Loans and advances as defined in Annex V to Commission Implementing Regulation (EU) No 680/2014 that are classified as non-performing in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014
NPL ratio	To calculate the NPL ratio, the gross carrying amount of NPLs and advances is divided by the gross carrying amount of total loans and advances in accordance with the NPE definition
NPE framework	Policies, processes, controls and systems for risk management of NPEs
Portfolio	A group of exposures with similar credit risk characteristics
Probation period	As defined in Annex V to Commission Implementing Regulation (EU) No 680/2014
Risk appetite framework (RAF)	The overall approach, including policies, processes, controls and systems, through which risk appetite is established, communicated and monitored. It includes a risk appetite statement, risk limits and an outline of the roles and responsibilities of those overseeing the implementation and monitoring of the RAF. The RAF should consider material risks to the credit institution, as well as to its reputation with depositors, investors and customers. The RAF aligns with the bank's strategy
Texas ratio	Texas ratio: a ratio comparing the stock of NPLs with a credit institution's equity. NPLs (gross carrying amount) over equity and accumulated impairments

## 3. Implementation

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### Date of application

20. These guidelines apply from 30 June 2019.

21. For the first application of these guidelines, credit institutions should calculate their NPL ratios using the reference date of 31 December 2018.

## 4. NPE strategy

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22. This section sets out the key elements for developing and implementing an NPE strategy. Credit institutions should have in place an adequate framework to identify, measure, manage, monitor and mitigate NPEs, including through workout activities.

23. In the development and implementation of their NPE strategies, credit institutions should take into account relevant consumer protection considerations and requirements, and ensure fair treatment of consumers.

### 4.1 Developing the NPE strategy

24. Credit institutions should establish an NPE strategy to target a time-bound reduction of NPEs over a realistic but sufficiently ambitious time horizon (NPE reduction targets). The NPE strategy should lay out the credit institution's approach and objectives regarding effective management to maximise recoveries and ultimately a reduction in NPE stocks in a clear, credible and feasible manner for each relevant portfolio. When developing and implementing the NPE strategy for retail portfolios, credit institutions should consider provisions aimed at protecting consumers, including Directive 2014/17/EU,<sup>13</sup> Directive 2008/48/EC<sup>14</sup> and the EBA Guidelines on arrears and foreclosure.<sup>15</sup>

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<sup>13</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.2.2014, p. 34).

<sup>14</sup> Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC (OJ L 133, 22.5.2008, p. 66).

<sup>15</sup> Guidelines on arrears and foreclosure (EBA/GL/2015/12).

25. The following steps should form the core building blocks of the development and implementation of the NPE strategy:

- a) assessment of the operating environment and external conditions (see section 4.2);
- b) development of the NPE strategy over short-, medium- and long-term time horizons (see section 4.3);
- c) implementation of the operational plan (see section 4.4);
- d) fully embedding the NPE strategy into the management processes of the credit institution, including regular review and independent monitoring (see section 4.5).

26. When credit institutions develop their NPE strategy, they should also consider policies that aim to ensure the fair treatment of borrowers.

## 4.2 Assessing the operating environment

27. As a first phase in the formulation and execution of an appropriate NPE strategy, credit institutions should complete an assessment of the following elements:

- a) internal capabilities to effectively manage and reduce NPEs;
- b) external conditions and operating environment;
- c) the capital implications of the NPE strategy.

### 4.2.1 Internal capabilities/self-assessment

28. Credit institutions should perform a comprehensive self-assessment to evaluate the actual situation and the steps to be taken internally to address any gaps in the internal capabilities to manage NPEs.

29. Institutions should fully understand and assess:

- a) The magnitude and drivers of their NPEs:
  - i. the size and evolution of NPE portfolios at an appropriate level of granularity, which requires an appropriate grouping of the exposures, as outlined in section 5.2.3;
  - ii. the drivers of NPE inflows and outflows, by portfolio where relevant;
  - iii. other potential correlations and causations.
- b) The outcomes of NPE actions taken by the credit institution in the past:
  - i. the types and nature of actions implemented, including forbearance activities;

- ii. the effectiveness of those activities and related drivers.
- c) Their operational capacities (processes, tools, data quality, IT/automation, staff/expertise, decision-making, internal policies and any other relevant area for the implementation of the strategy) in relation to the various steps involved in the process, including but not limited to:
- i. early identification of NPEs;
  - ii. forbearance activities;
  - iii. impairments and write-offs;
  - iv. collateral valuations;
  - v. recovery, legal process and foreclosure;
  - vi. management of foreclosed assets, where relevant;
  - vii. reporting and monitoring of NPEs and of the effectiveness of NPE workout solutions.

30. Credit institutions should perform a comprehensive self-assessment covering at least the items listed in paragraph 29 on an annual basis to determine strengths, significant gaps and areas of improvement required to reach NPE reduction targets.

31. Credit institutions should report the outcome of the comprehensive self-assessment to the institution's management body and the competent authority.

32. Credit institutions should consider seeking expert views on their operational capabilities to manage NPEs from the institution's risk management and control functions or from external sources on a periodic basis.

#### **4.2.2 External conditions and operating environment**

33. Credit institutions should assess and consider the current and likely future external operating conditions and environment when establishing the NPE strategy and associated NPE reduction targets. The following list of external factors, where appropriate, should be taken into account by credit institutions when setting the NPE strategy:

- a) The macroeconomic conditions, including the dynamics of the real estate market or other relevant sectors, taking into account sector concentrations in NPE portfolios.
- b) Market expectations with regard to acceptable NPE levels and coverage, including but not limited to the views of rating agencies and market analysts, and available research, taking proper account also of the interests of borrowers.

- c) NPE investor demand, including trends in and the dynamics of the domestic and international NPE markets for portfolio sales.
- d) The maturity of the NPE servicing industry and the availability and coverage of specialised servicers.
- e) The regulatory, legal and judicial framework. Credit institutions should have a good understanding of the legal proceedings related to NPE workout for different types of assets and different jurisdictions. In particular, credit institutions should assess the average duration of such proceedings, the average financial outcomes, the rankings of different types of exposures and related implications for outcomes, the influence of the types and rankings of collateral and guarantees on the outcomes, the impact of consumer protection issues on legal decisions, and the average total costs associated with legal proceedings. Legal provisions aimed at protecting consumers, in particular for residential mortgage exposures, should also be considered by credit institutions when setting the NPE strategy.
- f) The national tax implications of impairments and NPE write-offs.

#### **4.2.3 Capital implications of the NPE strategy**

34. Credit institutions should be able to calculate a detailed assessment of the impact of the planned strategy from capital, risk exposure amount, profit or loss, and impairment perspectives for each of the reduction drivers, and they should assess whether the bank has identified a strategic process to resolve any shortfalls under different economic scenarios. The assessment criteria, underlying assumptions and implications should be aligned with the RAF as well as with the internal capital adequacy assessment process (ICAAP).<sup>16</sup>

35. Credit institutions should include suitable actions in their capital planning to ensure that the level of available capital will enable a sustainable reduction of NPEs on the balance sheet.

### **4.3 Development of the NPE strategy**

36. The NPE strategy should encompass, at a minimum, time-bound quantitative NPE targets and foreclosed assets targets, supported, where appropriate, by a corresponding comprehensive operational plan. The development of the NPE strategy should be informed by a self-assessment process and an analysis of the strategic options for the implementation of the NPE strategy. The NPE strategy and operational plan should be defined and approved by the management body and reviewed at least annually.

#### **4.3.1 Strategy implementation options**

37. Credit institutions should consider including a combination of strategies and options in the NPE strategy to achieve their objectives over the short, medium and long term. In order to

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<sup>16</sup> See Guidelines on ICAAP and ILAAP information collected for SREP purposes (EBA/GL/2016/10).

successfully operationalise the NPE strategy, credit institutions should consider at least the following non-mutually exclusive implementation options for different portfolios and under different conditions:

- a) Hold/forbearance strategy: suitable workout strategy and forbearance options. The hold strategy option is strongly linked to the credit institution's operating model, forbearance and borrower assessment expertise, operational NPE management capabilities, outsourcing of servicing and write-off policies.
- b) Active portfolio reductions: sales, securitisation or, in the case of NPEs that are deemed unrecoverable, write-offs. This option is strongly linked to adequacy of impairments, collateral valuations, quality of exposure data and investors' demand for NPEs.
- c) Change of type of exposure or collateral, including foreclosure, debt to equity swapping, debt to asset swapping or collateral substitution.
- d) Legal options: including insolvency proceedings or out-of-court solutions.

38. Credit institutions should identify medium- and long-term strategy options for NPE reductions that may not be achievable immediately, for example due to a lack of immediate NPE investor demand, which might change in the medium to long term. The operational plan may therefore need to allow for such changes and require preparations for them, for example by enhancing the quality of NPE data in order to be ready for future investor transactions.

39. When a credit institution concludes that none of the above options will lead to a sufficient NPE reduction in the medium to long term for certain portfolios or individual exposures, this should be clearly reflected in a timely impairment and write-off approach.

40. Credit institutions aiming to engage in complex processes, such as NPE risk transfer and securitisation transactions, should conduct robust risk analysis and have adequate risk control processes in place.<sup>17</sup>

#### **4.3.2 Targets**

41. Before commencing the short- to medium-term target-setting process, credit institutions should establish a view of reasonable long-term NPE levels, both at portfolio level and at aggregate level. Credit institutions should take into account historic or international benchmarks in order to define reasonable long-term NPE levels.

42. Credit institutions should include, at a minimum, clearly defined realistic yet ambitious quantitative targets in their NPE strategy, including for foreclosed assets, where relevant. These targets should lead to a concrete reduction, gross and net of impairments, in NPEs, at

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<sup>17</sup> As required for securitisation under Article 82(1) of Directive 2013/36/EU.



least in the medium term. While expectations about changes in macroeconomic conditions, when based on solid external forecasts, can play a role in determining target levels, they should not be the sole driver of the NPE reduction targets established.

43. Credit institutions should establish targets as followings:

- a) by time horizons (short-term (indicative one year), medium-term (indicative three years) and possibly long-term);
- b) by main portfolios (e.g. retail mortgage, retail consumer, retail, small and medium-sized enterprises (SMEs), corporate, large corporate, commercial real estate);
- c) by implementation options (e.g. cash recoveries from a hold strategy, collateral repossessions, recoveries from legal proceedings, revenues from sales of NPEs or write-offs).

44. The NPE targets for credit institutions should at a minimum include a projected absolute or relative NPE reduction, both gross and net of impairments, not only on an overall basis but also for the main NPE portfolios. Where foreclosed assets are material, a foreclosed assets strategy should be defined or, at least, foreclosed assets reduction targets should be included in the NPE strategy.

45. The NPE targets should be aligned with the more granular operational targets. Further monitoring indicators can be implemented as additional targets, if deemed appropriate.

### **4.3.3 Operational plan**

46. The NPE strategy of the credit institution should be supported by an operational plan, which should be defined, approved and reviewed by the management body. The operational plan should clearly define how the credit institution will operationally implement its NPE strategy over a time horizon of at least one to three years (depending on the type of operational measures required).

47. The NPE operational plan should contain at least:

- a) clear time-bound objectives and goals;
- b) activities to be carried out on a portfolio basis;
- c) governance arrangements and structures, including responsibilities and reporting mechanisms for activities and outcomes;
- d) quality standards to ensure successful outcomes;
- e) staffing and resource requirements;
- f) required technical infrastructure and an enhancement plan;

- g) granular and consolidated budget requirements for the implementation of the NPE strategy;
- h) plans for communication with internal and external stakeholders (e.g. with regard to sales, servicing, efficiency initiatives).

48. The operational plan should have a specific focus on internal factors that could present impediments to the successful delivery of the NPE strategy.

#### 4.4 Implementing the operational plan

49. The implementation of the NPE strategy operational plan should rely on suitable policies and procedures, clear ownership and appropriate governance structures, including escalation procedures, and the operational plan should incorporate wide-ranging change management measures in order to embed the NPE workout framework as a key element in the corporate culture.

50. Credit institutions should report material deviations from the plan to the management body and to the competent authority in a timely manner, with appropriate remediation actions to be put in place.

#### 4.5 Embedding the NPE strategy

51. As the execution and delivery of the NPE strategy will involve and depend on many different areas within the credit institution, it should be embedded in processes at all levels of the organisation, including strategic and operational, including the risk committee as defined in Article 76(3) of Directive 2013/36/EU.

52. Credit institutions should emphasise to all relevant staff the key components of the NPE strategy in line with the approach taken to the institution's overall strategy and in particular the risk strategy as defined in Article 76 of Directive 2013/36/EU. This is especially important if the implementation of the NPE strategy will involve wide-ranging changes to business procedures.

53. Credit institutions should clearly define and document the roles, responsibilities and formal reporting lines for the implementation of the NPE strategy and operational plan.

54. Staff and management involved in NPE workout activities should be provided with clear individual (or team) goals and incentives geared towards reaching the targets agreed in the NPE strategy and operational plan. Related remuneration policies, career development objectives and performance monitoring frameworks should take the NPE targets into account in order to ensure the full engagement of staff and management with NPE reduction and should also have regard to the fair treatment of consumers. The incentive scheme for staff and managers in the loan origination/business units should also take into account the feedback from the workout activities and the quality of the credit institution's exposures in

order to disincentivise excessive risk taking. With regard to retail exposures, these remuneration policies should be developed in accordance with the EBA Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services.<sup>18</sup>

55. All relevant components of the NPE strategy should be fully aligned with and integrated into the business plan and budget, including all the relevant costs associated with the implementation of the operational plan, and also potential losses stemming from NPE workout activities.

56. The NPE strategy should be fully embedded in the risk management framework. In that context, special attention should be paid to:

- a) ICAAP:<sup>19</sup> all relevant components of the NPE strategy should be fully aligned with and integrated into the ICAAP. Credit institutions should prepare quantitative and qualitative assessments of NPE developments under base and stressed conditions including the impact on capital planning.
- b) RAF:<sup>20</sup> RAF and NPE strategies are closely interlinked. In this regard, there should be clearly defined RAF metrics and limits, approved by the management body, that are in alignment with the core elements and targets forming part of the NPE strategy.
- c) Recovery plan:<sup>21</sup> where NPE-related indicator levels and actions form part of the recovery plan, credit institutions should ensure that they are in alignment with the NPE strategy targets and operational plan.

57. Credit institutions should ensure a high level of monitoring and oversight by the risk management functions in respect of the formulation and implementation of the NPE strategy and operational plan.

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<sup>18</sup> Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services (EBA/GL/2016/06).

<sup>19</sup> As defined in Article 108 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (OJ L 176, 27.6.2013, p. 338).

<sup>20</sup> As described in the Financial Stability Board's 'Principles for an effective risk appetite framework'.

<sup>21</sup> As required by Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

## 5. NPE governance and operations

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58. In order for credit institutions to be able to address their NPE issues in an efficient and sustainable manner, an appropriate governance structure and operational set-up should be in place.

59. This section sets out the key elements of governance and operations in relation to an NPE workout framework, covering aspects related to steering and decision-making, the NPE operating model, the internal control framework and NPE monitoring processes.

60. In the implementation of their NPE governance and operations, credit institutions should take into account relevant consumer protection considerations and requirements, and ensure fair treatment of consumers.

### 5.1 Steering and decision-making

61. The overarching strategy of a credit institution and its implementation should cover the NPE strategy and operational plan, which should therefore be set, approved and reviewed by the management body. In particular, the management body should:

- a) approve annually and regularly review the NPE strategy and operational plan in line with the overall risk strategy;
  - b) oversee the implementation of the NPE strategy;
  - c) define quantitative and qualitative management objectives and incentives for NPE workout activities;
  - d) monitor on a quarterly basis progress made in comparison with the targets defined in the NPE strategy and operational plan;
  - e) define adequate approval processes for NPE workout decisions (for large NPEs, these should involve the approval of the management body);
  - f) approve NPE-related policies (including those listed in Annex 4) and processes, review them at least annually and proceed with any necessary amendments, ensuring that the policies and processes are completely understood by the staff;
  - g) ensure sufficient internal controls on NPE management processes, with a special focus on activities linked to NPE classifications, impairments, write-offs, collateral valuations and the sustainability of forbearance solutions;
  - h) have sufficient knowledge, experience and expertise with regard to the management of NPEs.
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62. The management body and senior management should dedicate an amount of their capacity and devote sufficient time to NPE workout-related matters in line with Article 76 of Directive 2013/36/EU, in proportion to the risks connected to NPEs within the credit institution. Credit institutions should establish and document clearly defined, efficient and consistent decision-making procedures, with adequate second line of defence involvement at all times.

## 5.2 NPE operating model

### 5.2.1 NPE workout units

63. In order to mitigate sufficiently any conflict of interest in managing NPEs, as well as to make good use of dedicated NPE expertise across the organisation, credit institutions should establish dedicated NPE workout units (NPE WUs) that are independent from loan origination activities. This separation of duties approach should encompass not only client relationship activities (e.g. negotiation of forbearance solutions with clients) but also the decision-making process. In this context, credit institutions should consider implementing dedicated decision-making bodies related to NPE workout (e.g. an NPE committee).

64. Where overlaps with the decision-making bodies, managers or experts involved in the loan origination process are unavoidable, the institutional framework and internal controls should ensure that any potential conflicts of interest are sufficiently mitigated.

65. Credit institutions should have arrangements in place to ensure that regular feedback between loan origination units and NPE WUs is established.

66. When designing an appropriate NPE WU structure, credit institutions should take into account the specificities of their main NPE portfolios, including the type of exposure (retail, SME, corporate) and the type of collateral.

67. Credit institutions should consider designing automated processes for NPE WUs for homogeneous retail NPE portfolios. For corporate NPE portfolios, where relevant, and depending on the sectoral concentration of the NPEs, credit institutions should consider a relationship management approach with sectoral specialisation of NPE WU staff. For sole traders and micro-enterprises, a combination of automated elements and a relationship management approach should be considered.

68. Smaller and less complex credit institutions (e.g. those that are classified in SREP Category 3 or 4) may have in place dedicated workout functions proportionate to their size, nature, complexity and risk profile. Credit institutions should ensure that the design of such functions prevents and eliminates conflict of interest in the management of NPEs.

69. For proportionality purposes, smaller and less complex credit institutions (e.g. those that are classified in SREP Category 3 or 4), as an alternative to establishing dedicated decision-

making bodies related to NPE workout, may cover the necessary requirements in their existing credit or risk committees, as long as conflicts of interest are sufficiently mitigated.

### 5.2.2 Alignment with the NPE life cycle

70. NPE WUs should be set up to ensure that NPE workout activities and borrower engagements are tailored to the phases of the NPE life cycle.<sup>22</sup> Credit institutions should set up different NPE WUs for the different phases of the NPE life cycle and also for different portfolios, if appropriate. All applicable workout stages should receive adequate focus and should be equipped with sufficiently specialised staff.

71. Credit institutions should consider the following phases in the NPE life cycle, taking into account also the specificities of the products and the nature of the arrears:

- a) Early arrears (up to 90 days past due):<sup>23</sup> during this phase, the focus should be on initial engagement with the borrower for early recoveries and on collecting information to enable a detailed assessment of the borrower's circumstances (e.g. financial position, status of loan documentation, status of collateral, level of cooperation, etc.). The type of exposure and collateral should ultimately determine the most suitable workout strategy, which may involve forbearance measures with a short-term time horizon, to be applied when necessary (including during this initial period, where appropriate), with the aim of stabilising the financial position of the borrower before establishing a suitable workout strategy. In addition, the credit institution should, where appropriate, seek options to improve its position while taking into account the rights and interests of consumers (e.g. by signing new loan documents, perfecting outstanding collateral, minimising cash leakage, taking additional collateral if available). A dedicated arrears management policy should contain guidance on the overall NPE workout procedures and responsibilities, including handover triggers.
- b) Late arrears/forbearance: credit institutions should implement and formalise forbearance arrangements with borrowers in this phase. Forbearance arrangements should be put into place only where the credit institution is satisfied that the borrower can afford to make the repayments. In considering whether a restructuring option is viable, credit institutions should have regard to Article 28 of Directive 2014/17/EU<sup>24</sup> and other legal provisions aimed at protecting consumers, to the extent applicable. A forbearance arrangement should be monitored for at least one year in line with Commission Implementing Regulation (EU) No 680/2014, given the increased risk, before it can eventually be transferred out of the NPE WUs if no further NPE triggers are observed.

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<sup>22</sup> This also encompasses assets not classified as NPEs – such as early arrears, FBEs and foreclosed assets – that play an essential role in the NPE workout process.

<sup>23</sup> Unlikely to pay exposures could be part of either early arrears or NPE WUs, depending on their complexity.

<sup>24</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.2.2014, p. 34).

c) Liquidation/debt recovery/legal cases/foreclosure: if no viable forbearance solution has been found due to the borrower's financial circumstances or cooperation level, credit institutions should perform a cost-benefit analysis of different liquidation options, including in-court and out-of-court procedures, having regard also to the interests of the borrower. Based on this analysis, credit institutions should speedily proceed with the chosen liquidation option, supported by legal and business liquidation expertise. Credit institutions that are engaged in extensive use of external experts should ensure that sufficient internal control mechanisms are in place to ensure an effective and efficient liquidation process. NPEs that have been categories as such for a long period of time should be given special attention in this regard. A dedicated debt recovery policy should contain guidance on liquidation procedures.

72. Managing foreclosed assets (or other assets stemming from NPEs): collateral repossession generally commences after other attempts by the credit institution to collect the outstanding amounts have failed. The credit institution should have a policy in place that describes the recovery process for foreclosed assets, covering in particular the steps of repossession, valuation of the collateral and realisation of various types of collateral through appropriate means.

### 5.2.3 Grouping exposures

73. The EBA Guidelines on credit risk management practices and accounting for expected credit losses<sup>25</sup> describe the policies for credit institutions of grouping exposures with shared credit risk characteristics. Homogeneous portfolios should be built up in order to tailor treatments specifically to NPEs. Credit institutions should consider designing customised processes for each portfolio, with a dedicated expert team taking ownership of each. NPE portfolios should be analysed with a high degree of granularity, resulting in clearly defined borrower subportfolios. For these analyses, credit institutions should develop appropriate management information systems and sufficiently high data quality.

74. A list of potential selection criteria for grouping retail NPEs into portfolios is contained in Annex 1.

75. For corporate NPE portfolios, grouping by asset class or sector (e.g. commercial real estate, land and development, shipping, trading businesses) should be considered a key driver for NPE WU specialisation. These portfolios should then be further divided in line with the NPE strategy and the level of financial difficulty to ensure that workout activities are sufficiently focused.

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<sup>25</sup> Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses (EBA/GL/2017/06).

## 5.2.4 Human resources

76. Credit institutions should have in place an appropriate organisational framework relative to their business model and taking into account their risks, including risks stemming from NPEs. Credit institutions therefore should devote an appropriate and proportionate amount of management attention and resources to the workout of NPEs and to internal controls on related processes.
77. Sharing management and resources with other parts of the value chain (e.g. loan origination) should be carefully reviewed before implementation in order to avoid conflicts of interest and to ensure sufficient specialisation, as discussed above.
78. Based on the findings of the credit institution's NPE self-assessment on capabilities, as referred to in section 4.2.1, credit institutions should regularly review the adequacy of their internal and external NPE workout resources and address any human resourcing gaps in a timely fashion. As workout activities may place significant demands on resources, credit institutions should consider if it is appropriate to choose to use fixed-term contracts, internal/external outsourcing or joint ventures for NPE workout activities. However, the final responsibility for these activities remains with the credit institution. In the event that outsourcing is used, credit institutions should ensure that such outsourcing is arranged in accordance with the applicable legislation or regulatory requirements.
79. Credit institutions should build up the relevant expertise required for the defined NPE operating model, including the NPE WUs and internal control functions, in line with the provisions of the joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders.<sup>26</sup> Staff allocated to key NPE workout tasks should have specific NPE expertise and experience. Credit institutions should implement adequate and dedicated NPE training, including on consumer protection, and should design staff development plans to build in-house expertise using available talent.
80. Where it is not possible or efficient to build in-house expertise and infrastructure, the NPE WUs should have easy access to qualified independent external resources (e.g. property appraisers, legal advisors, business planners, industry experts) or to dedicated NPE servicing companies.
81. The credit institution, in alignment with the overall NPE strategy and operational plan, should implement an appraisal system tailored to the requirements of the NPE WUs. The appraisal system should be designed in line with the provisions of the EBA Guidelines on sound

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<sup>26</sup> Joint ESMA and EBA Guidelines on the assessment of the suitability of members of the management body and key function holders under Directive 2013/36/EU and Directive 2014/65/EU (EBA/GL/2017/12).



remuneration policies<sup>27</sup> and Article 7 of Directive 2014/17/EU,<sup>28</sup> as well as for retail exposures, those of the EBA Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services.<sup>29</sup> The appraisal system should be mainly linked to the quantitative elements of the credit institution's NPE targets but may also include qualitative elements (level of technical abilities relating to the analysis of financial information and data received, structuring of proposals, quality of recommendations or monitoring of restructured cases, as well as effective negotiation skills). The performance of the NPE WU staff should be regularly monitored and measured against these targets either on an individual basis or at team level, as appropriate.

82. The performance measurement framework for the management body and relevant managers should include specific indicators linked to the targets defined in the credit institution's NPE strategy and operational plan. The weights given to these indicators within the overall performance measurement framework should be proportionate to the severity of the NPE issues faced by the credit institution.

83. Addressing early warnings signals and indicators should be encouraged by credit institutions through the remuneration policy and incentives framework in order to ensure that pre-arrears are efficiently addressed and NPE inflows thus effectively reduced.

#### **5.2.5 Technical resources**

84. In terms of adequate technical infrastructure, credit institutions should ensure that all NPE-related data are centrally stored in robust and secure IT systems and that they are complete and up to date throughout the NPE workout process.

85. An adequate technical infrastructure should enable NPE WUs to:

- a) Access all relevant data and documentation, including:
  - i. current NPE and early arrears borrower information, including automated notifications;
  - ii. exposure, collateral and guarantee information linked to the borrower or connected clients;
  - iii. monitoring tools with the IT capabilities to track forbearance performance and effectiveness;

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<sup>27</sup> Guidelines on sound remuneration policies under Articles 74(3) and 75(2) of Directive 2013/36/EU and disclosures under Article 450 of Regulation (EU) No 575/2013 (EBA/GL/2015/22).

<sup>28</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.2.2014, p. 34).

<sup>29</sup> Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services (EBA/GL/2016/06)

- iv. status of workout activities and borrower interaction, as well as details on forbearance measures agreed;
  - v. foreclosed assets, where relevant;
  - vi. tracked cash flow of the loan and collateral;
  - vii. sources of underlying information and complete underlying documentation;
  - viii. where relevant, access to central credit registers, land registers and other external data sources.
- b) Efficiently process and monitor NPE workout activities, including:
- i. automated workflows throughout the entire NPE life cycle;
  - ii. an automated monitoring process for loan status, ensuring correct flagging of NPEs and FBEs;
  - iii. incorporated warning signals;
  - iv. automated quantitative reporting throughout the NPE workout life cycle as a basis for the analyses to be provided to NPE WU management, the management body and other relevant managers, as well as the regulator;
  - v. performance analyses of workout activities by NPE WUs, sub-teams and experts (e.g. cure/success rate, rollover information, effectiveness of restructuring options offered, cash collection rate, vintage analyses of cure rates, promises kept rate at call centre, etc.);
  - vi. evolution monitoring of portfolios, subportfolios, cohorts and individual borrowers.
- c) Define, analyse and measure NPEs and related borrowers:
- i. recognise NPEs and measure impairments;
  - ii. perform suitable NPE portfolio analyses and store outcomes for each borrower;
  - iii. support the assessment of the borrower's personal data, financial position and repayment ability, at least for non-complex borrowers;
  - iv. conduct calculations of (i) the net present value and (ii) the impact on the capital position of the credit institution for each restructuring option and/or any likely restructuring plan under any relevant legislation (e.g. foreclosure law, insolvency law) for each borrower.

86. The adequacy of the technical infrastructure, including data quality, should be assessed by an independent internal or external audit function on a regular basis.

### 5.3 Control framework

87. The management body should be responsible for establishing and monitoring the adequacy and effectiveness of the internal control framework. In particular, effective and efficient internal control processes should be implemented for the NPE workout framework in order to ensure full alignment between the NPE strategy and operational plan on the one hand and the credit institution's overall business strategy, including the NPE strategy and operational plan, and risk appetite on the other hand.

88. Internal control functions should regularly submit to the management body written reports on NPE management highlighting major identified deficiencies. These reports should include, for each new identified major deficiency, the relevant risks involved, an impact assessment, recommendations and corrective measures to be taken. Where necessary, the heads of internal control functions should be able to have access to and report directly to the management body in its supervisory function to raise concerns and warn the supervisory function, where appropriate, when specific developments affect or may affect the institution. This should not prevent the heads of internal control functions from reporting within regular reporting lines as well.

89. The management body should follow up on the findings of the internal control functions in a timely and effective manner and require adequate remedial actions. A formal follow-up procedure on findings and corrective measures taken should be put in place.

90. The internal control framework should involve all three lines of defence in line with the EBA Guidelines on internal governance.<sup>30</sup> The roles of the different functions involved should be assigned and documented clearly to avoid gaps or overlaps. Key outcomes of second- and third-line activities as well as defined mitigating actions and progress on those needs should be reported to the management body regularly.

91. In the implementation of the control framework, larger and more complex credit institutions should apply all three lines of defence; the second line of defence does not have to be NPE specific and may be performed by the credit risk (control) function.

92. In the implementation of the control framework, smaller and less complex credit institutions (e.g. those that are classified in SREP Category 3 or 4) do not necessarily have to have three fully fledged NPE-specific lines of defence, but they have to ensure that any conflict of interest is sufficiently mitigated.

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<sup>30</sup> Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11).

### 5.3.1 First line of defence controls

93. Credit institutions should ensure that the first line of defence is embedded into the procedures and processes of the operational units, mainly the NPE WUs, that actually own and manage the credit institution's risks in the specific context of NPE workout.

94. In order to ensure that adequate control mechanisms are implemented, credit institutions should have internal policies in place on the NPE workout framework. The managers of the operational units are responsible for ensuring that these internal policies are implemented, including through their incorporation into IT procedures. Annex 4 to these guidelines sets out key elements of NPE framework-related policies that should be implemented in credit institutions.

### 5.3.2 Second line of defence controls

95. Second line of defence functions should perform controls on a continuous basis to check that NPE management in the first line of defence is operating as intended. To adequately perform their control tasks, second-line functions require a strong degree of independence from functions performing business activities, including the NPE WUs, and should have sufficient resources. They should have an adequate number of qualified staff. The qualifications of staff should be reassessed on an ongoing basis, and staff should receive training as necessary.

96. The second line of defence controls the implementation of risk management measures by the NPE WUs and should have a special focus on:

- a) monitoring and measuring of NPE-related risks on a granular and aggregate basis, including in relation to internal/regulatory capital adequacy;
- b) reviewing the performance of the overall NPE operating model, as well as elements of it (e.g. NPE WU management/staff, outsourcing/servicing arrangements, NPE reduction targets and early warning mechanisms);
- c) assuring quality across NPE loan processing, monitoring/reporting (internal and external), forbearance, impairments, write-offs, collateral valuation and NPE reporting (in order to fulfil this role, second-line functions should have sufficient power to intervene ex ante on the implementation of individual workout solutions);
- d) reviewing the alignment of NPE-related processes with internal policy and public guidance, most notably related to NPE classification, provisioning, write-offs, collateral valuations, forbearance and early warning mechanisms.

97. Risk control and compliance functions should also provide guidance on the process of designing and reviewing NPE-related policies and procedures and on the controls being established across NPE WUs. These functions should be involved in the design and review of the policies before they are approved by the management body.

### 5.3.3 Third line of defence controls

98. The third line of defence, the independent internal audit function, should have sufficient NPE workout expertise to perform its periodic control activities on the efficiency and effectiveness of the NPE framework, including the first- and second-line controls.

99. With regard to the NPE framework, the internal audit function should, at least, perform regular assessments to monitor adherence to internal NPE-related policies (see Annex 4) and to this guidance. This should also include random and unannounced inspections and credit file reviews.

100. In determining the frequency, scope and scale of the controls to be carried out, credit institutions should take into account the level of NPEs and whether significant irregularities and weaknesses have been identified by recent audits.

101. Based on the results of its controls, the internal audit function should make recommendations to the management body, bringing possible improvements to their attention.

## 5.4 Monitoring of NPEs and NPE workout activities

102. The monitoring systems should be based on the NPE targets approved in the NPE strategy and related operational plan, which are subsequently cascaded down to the operational targets of the NPE WUs, with feedback loops to pricing of credit risk and provisioning. A related framework of NPE-related key performance indicators (KPIs) should be developed to allow the management body and other relevant managers to measure progress.

103. Credit institutions should define and monitor NPE-related KPIs. The NPE-related KPIs, should include, but not necessarily be limited to (see also Annex 2):

- a) NPE metrics;
- b) borrower engagement and cash collection;
- c) forbearance activities;
- d) liquidation activities;
- e) other (e.g. NPE-related profit and loss items, foreclosed assets, outsourcing activities).

### 5.4.1 NPE metrics

104. Credit institutions should closely monitor the relative and absolute levels of NPEs and FBEs, as well as foreclosed assets (or other assets stemming from NPE activities) and early arrears, in their books.

105. Credit institutions should carry out such monitoring activities at transaction/borrower level, and portfolio or subportfolio levels, as appropriate, considering aspects such as business line, borrower segment, geographical area, products, concentration risk, level of collateralisation and type of collateral provided, and debt-service ability.
106. Credit institutions should monitor the level of impairments of NPEs in order to provide the management body with comprehensive information on coverage. The analysis should include data on the aggregate level as well as the levels for different NPE portfolios. The selection of NPE portfolios should consider aspects such as type of exposure, including secured/unsecured, type of collateral and guarantees, geographical area, number of years since NPE classification, time to recovery, and the use of the going and gone concern approach. Coverage movements should also be monitored and reductions clearly explained.
107. Credit institutions should benchmark indicators related to the NPE ratio and coverage against the available indicators of peers in order to provide the management body with a clear picture of the competitive position and potential shortcomings.
108. Credit institutions should monitor their deviations from the budget, in order for the management body to understand the drivers of significant deviations from the plan.
109. Key figures on NPE inflows and outflows should be included in periodic reporting to the management body, including transfers from/to NPEs, non-performing FBEs, NPEs under probation, performing FBEs and early arrears ( $\leq 90$  days past due).
110. Credit institutions should consider if it would be useful to establish migration matrices to track the flow of exposures into and out of non-performing classification.
111. Credit institutions should estimate the migration rates and the quality of the performing exposures month by month, so that actions can be prioritised and taken promptly to inhibit deterioration of portfolio quality. Migration matrices can be further broken down by exposure type (retail mortgage, consumer, real estate), by business unit or by other subportfolio to identify whether the driver of the flows can be attributed to a specific subportfolio.
112. In their monitoring activities, credit institutions should use internal information (e.g. from internal score systems) and external information (e.g. from rating agencies, credit bureaus, specialised sector research or macroeconomic indicators for specific geographical areas) and should refer to a particular point in time or observation period. Annex 3 includes examples of such internal and external information.

#### **5.4.2 Borrower engagement and cash collection**

113. Once NPE WUs have been established, key operational performance metrics should be implemented to assess the units' or employees' efficiency relative to average performance and/or standard benchmark indicators. If no such indicators exist or are available, key

operational performance should be monitored by measuring the effective results against the targets set in the credit institution's NPE operational plan.

#### **5.4.3 Forbearance activities**

114. To resolve or limit the impact of NPEs, credit institutions should explore the possibilities with regard to granting forbearance measures. Credit institutions should monitor two aspects of the forbearance activities, efficiency and effectiveness. Section 7 specifies the requirements relating to the application of forbearance measures.

115. The main objective of forbearance measures should be the return of the borrower to a sustainable performing repayment status, taking into account the amount due and minimising expected losses. This objectives should take into account the importance of ensuring the fair treatment of consumers and compliance with any consumer protection requirements that may be applicable. The credit institution should monitor the quality of the forbearance activities to make sure that they are not used to delay impairments or an assessment that the exposure is uncollectable. The monitoring should cover forbearance activities in relation to both performing and non-performing exposures.

#### **5.4.4 Liquidation activities**

116. If no sustainable restructuring solution can be reached, credit institutions should still resolve the NPE. Resolution may involve initiating legal procedures, foreclosing assets, debt to asset/equity swap, disposal of credit facilities by sale, transferal to an asset management company or securitisation. Where the price obtained from the foreclosure of immovable property affects the amount owed by a consumer, credit institutions should take into account, when deciding on the liquidation measure and next steps, the provisions of Article 17(5) of Directive 2014/17/EU,<sup>31</sup> to the extent applicable.

117. Liquidation activities should be monitored by the credit institution to help inform strategies and policies. Credit institutions should monitor disposals and monitor realised sales/transfer prices against net carrying amounts.

118. Credit institutions should monitor the volumes and recovery rates of legal and foreclosure cases. Performance in this regard should be measured against set targets, in terms of number of months/years and loss to the institution. In monitoring the actual loss rate, institutions are expected to build historical time series for each loan portfolio to back up the assumptions used for impairment review purposes and stress test exercises.

119. For exposures covered by collateral or another type of guarantee, credit institutions should monitor the time period needed to liquidate the collateral or to enforce a guarantee. Credit institutions should also monitor potential forced sale haircuts upon liquidation and

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<sup>31</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.2.2014, p. 34).

developments in certain markets (e.g. property markets) to obtain an outlook on potential recovery rates.

120. Monitoring the recovery rates from foreclosure and other legal proceedings should help credit institutions to reliably assess whether the decision to foreclose will provide a higher net present value than pursuing a forbearance option. The data regarding the recovery rates from foreclosures should be monitored on an ongoing basis and feed into potential amendments to credit institutions' strategies for handling their debt recovery/legal portfolios.
121. Credit institutions should also monitor the average duration of legal procedures recently completed and the average amounts recovered (including related recovery costs) from these completed procedures.
122. Credit institutions should carefully monitor cases where the debt is swapped with an asset or equity of the borrower, at least by using volume indicators by type of assets, and ensure compliance with any limits set by the relevant national regulations on holdings. The use of this approach as a forbearance measure should be backed by a proper business plan and limited to assets in relation to which the institution has sufficient expertise and the market realistically allows the determined value to be extracted from the asset in the short to medium term. The institution should also make sure that the valuation of the assets is carried out by qualified and experienced appraisers.

#### **5.4.5 Other monitoring items**

123. Credit institutions should monitor and report to their management bodies the amount of interest income stemming from NPEs. In addition, a distinction should be made between the interest payments on NPEs actually received and those not actually received. The evolution of loss allowances and the related drivers should also be monitored.
124. If foreclosure is a part of a credit institution's NPE strategy, it should also monitor the volume, ageing, coverage and flows of foreclosed assets (or other assets stemming from NPEs) at a sufficient level of granularity to take into account material types of assets. The performance of the foreclosed assets vis-a-vis the predefined business plan should be monitored and reported to the management body and other relevant managers on an aggregate level.



## 6. Forbearance

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125. Credit institutions should use the definitions of forbearance measures and FBEs as stated in Annex V to Commission Implementing Regulation (EU) No 680/2014 in their risk management. Forbearance measures should aim to return the borrower to a sustainable performing repayment status, taking into account the amount due and minimising expected losses. When deciding on which steps or forbearance measures to take, credit institutions should take into account the interests of consumers and comply with consumer protection requirements, including those set out in Article 28 of Directive 2014/17/EU<sup>32</sup> and in the EBA Guidelines on arrears and foreclosure.<sup>33</sup> Credit institutions should monitor the efficiency and effectiveness of forbearance activities.

126. This section sets out the key elements of governance and operations in relation to FBEs.

### 6.1 Forbearance measures and their viability

127. Credit institutions should consider using a combination of different forbearance measures, including both short-term and long-term time horizons in line with the nature and maturity of the credit facilities. Credit institutions should consider the list of possible forbearance measures in Annex 5.

128. Credit institutions should use forbearance measures with time horizons shorter than two years (one year in the case of project finance and the construction of commercial property) where such measures do not address the resolution of outstanding arrears, unless such measures are combined with forbearance measures that are longer than two years.

129. Credit institutions should consider forbearance measures with time horizons not greater than two years (and, where appropriate, for other forbearance measures) when the borrower meets the following criteria:

- a) The borrower has experienced an identifiable event that has caused temporary liquidity constraints. Evidence of such an event should be demonstrated in a formal manner with clear evidence showing that the borrower's income will recover fully or mostly in the short term, or on the basis of the credit institution concluding that a long-term forbearance solution was not possible due to temporary financial uncertainty of a general or borrower-specific nature. The form of evidence to be provided for this purpose should be proportionate to the nature, maturity and value of the credit facility in question.

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<sup>32</sup> Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 (OJ L 60, 28.2.2014, p. 34).

<sup>33</sup> Guidelines on arrears and foreclosure (EBA/GL/2015/12).

- b) The borrower had been fulfilling contractual obligations prior to the event.
- c) The borrower has clearly demonstrated willingness to cooperate with the credit institution.

130. The contractual terms for any forbearance measure should ensure that the credit institution has the right to review the agreed forbearance measures if the situation of the borrower improves and more favourable conditions for the credit institution (with regard to the forbearance or the original contractual conditions) can therefore be enforced; to this end, the contract should indicate the specific changes to the forbearance measure to be applied as a consequence of specific improvements in the situation of the borrower. Credit institutions should also consider including strict consequences, such as a requirement for additional collateral, in the contractual terms for borrowers who fail to comply with the forbearance agreement.

#### **6.1.1 Viable versus non-viable forbearance**

131. Credit institutions should distinguish between viable forbearance measures contributing to reducing the borrower's exposure and non-viable forbearance measures.

132. Credit institutions should consider the following factors when assessing the viability of forbearance measures:

- a) The credit institution can demonstrate (based on objectively verifiable evidence) that the borrower can afford the forbearance solution, i.e. full repayment is expected.
- b) The resolution of outstanding arrears is fully or mostly addressed and a significant reduction in the borrower's balance in the medium to long term is expected.
- c) In cases where previous forbearance measures have been granted, including any previous forbearance measures considered in the long run, the credit institution should ensure that additional internal controls are implemented to ensure that this subsequent forbearance treatment meets the viability criteria outlined below. These controls should include, at a minimum, that such cases are explicitly brought to the attention of the risk control function *ex ante*. Furthermore, the explicit approval of the relevant senior decision-making body should be sought.
- d) Forbearance measures with a short-term time horizon are applied temporarily and the credit institution is able to demonstrate, based on objectively verifiable evidence, that the borrower has the ability to repay the original or modified amount on a full principal and interest basis commencing from the expiry date of the short-term temporary arrangement.
- e) The measure does not result in multiple consecutive forbearance measures having been granted to the same exposure.

133. The assessment of viability should be based on the financial characteristics of the borrower and the forbearance measure to be granted at that time. The viability assessment should

take place irrespective of the source of forbearance. Different sources for forbearance measures are, inter alia, the borrower using a forbearance clause embedded in a contract, bilateral negotiation of forbearance between a borrower and a credit institution and a public forbearance scheme extended to all borrowers in a specific situation.

## 6.2 Sound forbearance processes

### 6.2.1 Forbearance policy

134. Credit institutions should develop a policy on their forbearance activities. The policy should cover at least:

- a) the process and procedures for granting forbearance measures, including responsibilities and decision-making;
- b) a description of available forbearance measures, including those embedded in contracts;
- c) information requirements for assessing the viability of forbearance measures;
- d) documentation of forbearance measures granted;
- e) the process and metrics for monitoring the efficiency and effectiveness of forbearance measures.

135. Credit institutions should regularly review their forbearance policies and options based on the collective monitoring of the performance of different forbearance measures, including the examination of potential causes and instances of re-defaults.

### 6.2.2 Efficiency and effectiveness of forbearance activities

136. Credit institutions should monitor the quality of forbearance activities to make sure that they are not used to delay an assessment that the exposure is uncollectable. The monitoring should cover forbearance activities relating to both performing and non-performing exposures and differentiate between types of forbearance measures and portfolios.

137. Credit institutions should measure the efficiency of the process for granting forbearance measures and monitor the duration of the decision-making process and the volumes of forbearance measures at each stage of the granting process.

138. Credit institutions should monitor effectiveness of forbearance measures granted. This monitoring should measure the degree of success of the forbearance measure and whether the modified contractual obligations of the borrower are met and the exposure is performing. The following metrics by portfolio and by type of forbearance measure should be used:

- a) Forbearance cure rate and rate of exposure being reclassified as non-performing: credit institutions should conduct a vintage analysis and monitor the behaviour of FBEs from the date of modification to determine the cure rate. This analysis should be conducted separately for cured exposures with and without forbearance measures.
- b) Cash collection rate: credit institutions should monitor cash collected from FBEs.
- c) Write-off: where granting a forbearance measure leads to a partial write-off, credit institutions should record and monitor these exposures against an approved loss budget. The net present value loss associated with the decision to write off an unrecoverable exposure should be monitored against the cure rate.

139. Credit institutions should monitor indicators relating to forbearance activities using a meaningful breakdown, which could include the type and duration of arrears, the type of exposure, the probability of recovery, the size of the exposures or the total amount of exposures to the same borrower or group of connected clients, and the number of forbearance solutions applied in the past.

### **6.2.3 Assessing the borrower's repayment capacity**

140. Before granting any forbearance measures, credit institutions should assess the borrower's repayment capacity. This should include an adequate assessment of the borrower's financial situation, based on sufficient information and taking into account relevant factors such as the debt-servicing capacity and overall indebtedness of the borrower or the property/project.

### **6.2.4 Standardised forbearance products and decision trees**

141. Credit institutions should have adequate policies and procedures in place with a range of sustainable and effective solutions for the borrower when granting forbearance. The grouping of exposures into portfolios should be reflected in these policies and procedures, to enable credit institutions to adopt different forbearance measures for different segments of borrowers and tailor measures to them.

142. Credit institutions should consider developing decision trees and standardised forbearance measures for portfolios of homogeneous borrowers with less complex exposures. Decision trees may help in determining and implementing appropriate and sustainable forbearance strategies for specific portfolios of borrowers in a consistent manner based on approved criteria.

### **6.2.5 Comparison with other NPE workout options**

143. Credit institutions should use a net present value approach to determine the most suitable and sustainable workout option for borrowers' varied circumstances, having regard to the fair treatment of the consumer, and should compare the net present value of the envisaged forbearance measure with the net present value of repossession and other available

liquidation options. The parameters used in the calculation, such as the assumed liquidation time horizon, discount rate, cost of capital and liquidation cost, should be based on observed empirical data.

### 6.2.6 Forbearance targets and monitoring

144. Forbearance contracts and documentation should include a well-defined borrower target schedule, detailing all necessary targets to be achieved by the borrower in order to repay the exposure over the course of the contract term. These milestones/targets should be credible, be appropriately conservative and take account of any potential deterioration in the borrower's financial situation. The performance of the forborne borrower, including the borrower's compliance with all agreed targets, should be closely monitored by the NPE WU responsible for granting the forbearance, at least for the duration of the probation period.

## 7. NPE recognition

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145. Credit institutions should use the definition of NPE in Annex V to Commission Implementing Regulation (EU) No 680/2014 in their risk management.

146. This section sets out the key elements of governance and operations in relation to NPE recognition.

### 7.1 Past due criterion

147. Credit institutions should recognise exposures as being past due in accordance with section 4 of the EBA Guidelines on the application of the definition of default<sup>34</sup> and Commission Delegated Regulation (EU) 2018/171 on the materiality threshold for credit obligations past due.<sup>35</sup>

### 7.2 Indications of unlikelihood to pay

148. Credit institutions should recognise exposures as unlikely to pay and identify indications of unlikelihood to pay in accordance with section 5 of the EBA Guidelines on the application of the definition of default.

149. Credit institutions should monitor the repayment capacity of borrowers. In the case of corporate borrowers, this should be assessed at least annually and at key reporting dates at

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<sup>34</sup> Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013 (EBA/GL/2016/07).

<sup>35</sup> Commission Delegated Regulation (EU) 2018/171 of 19 October 2017 on supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the materiality threshold for credit obligations past due (OJ L 32, 6.2.2018, p. 1).

which financial data are available. Credit institutions should collect the latest financial information from corporate borrowers in a timely fashion. The non-provision or the unreasonably late provision of information may be seen as a negative sign with regard to the borrower's creditworthiness. In the case of non-corporate borrowers, credit institutions should monitor payment performance and any signs of financial difficulties that may have an impact on repayment capacity. For borrowers on a watch list or with a weak rating, more frequent review processes should be in place, depending on the materiality, the portfolio and the borrower's financial standing. The regular assessment of the borrower's repayment capabilities should also apply to bullet loans, because these loans represent a higher level of risk than a loan subject to regular amortisation and also because continuous payment by the borrower of the interest amounts due is not sufficient reason to assume that the final bullet repayment of the loan will take place.

## 7.3 Forbearance and performing status

### 7.3.1 Forbearance

150. For the purpose of implementing forbearance measures, credit institutions should be able to identify signs of possible future financial difficulties at an early stage. In order to do so, the assessment of the financial situation of the borrower should not be limited to exposures with apparent signs of financial difficulties. An assessment of financial difficulties should also be conducted for exposures with regard to which the borrower does not have apparent financial difficulties but in relation to which market conditions have changed significantly in a way that could impact the borrower's ability to repay (e.g. bullet loans the repayment of which will depend on the sale of immovable property or foreign currency loans).

151. The assessment of any financial difficulties on the part of a borrower should be based on the situation of the borrower only, disregarding collateral or any guarantees provided by third parties. When assessing the financial difficulties of the borrower, credit institutions, in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014, should consider at least the following rebuttable circumstances:

- a) borrower/facility more than 30 days past due during the three months prior to its modification or refinancing;
- b) increase in probability of default (PD) of credit institution's internal rating class during the three months prior to its modification or refinancing;
- c) presence on a watch list during the three months prior to its modification or refinancing.

152. Exposures should not be identified as forborne when concessions are made to borrowers who are not in financial difficulties. Credit institutions should distinguish, based on a detailed financial assessment, between renegotiations or rollovers granted to borrowers not in financial difficulties and forbearance measures such as concessions granted to borrowers in

financial difficulties, in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014.

153. Granting new conditions such as a new interest rate more favourable than the rate borrowers with a similar risk profile could obtain may be considered an indication of such a concession when the credit institution determines that the reason for the new rate is the financial difficulties of the borrower. The provision of more favourable new conditions than those practised by the market should not be considered a prerequisite for the identification of concessions and therefore forbearance. In line with Annex V to Commission Implementing Regulation (EU) No 680/2014, when a borrower is in financial difficulties, a change in conditions in line with what other borrowers with a similar risk profile could get from the credit institution should qualify as a concession, including when borrowers are included in public forbearance schemes that are offered by credit institutions.

154. Borrowers may request modifications in the contractual conditions of their loans without facing or being about to face difficulties in meeting their financial commitments. Credit institutions should perform an assessment of the borrower's financial situation when such modifications to contractual conditions have an impact on payment performance.

### **7.3.2 Classification of FBEs as non-performing**

155. When granting forbearance measures to performing exposures, credit institutions should assess whether these measures lead to a need to reclassify the exposure as non-performing. Granting forbearance measures to NPEs does not clear their non-performing status: the exposures should continue to be identified as non-performing for at least one year of the cure period after the granting of the forbearance measures, as specified in Annex V to Commission Implementing Regulation (EU) No 680/2014 and in section 7.3.3.

156. When assessing if FBEs should be classified as non-performing, credit institutions should assess if exposures:

- a) are supported by inadequate payment plans (either initial or subsequent payment plans, as applicable) that encompass, inter alia, a repeated failure to comply with the payment plan, changes to the payment plan to avoid breaches or the payment plan's resting on expectations that are not supported by macroeconomic forecasts or by credible assumptions on the repayment capability or willingness of the borrower;
- b) include contract terms that delay the time for the regular repayment instalments on the transaction, in such a way that its assessment for a proper classification is hindered, such as when grace periods of more than two years for the repayment of the principal are granted;
- c) include de-recognised amounts that exceed the accumulated credit risk losses for NPEs with a similar risk profile.

### 7.3.3 Cure/exit from non-performing status

157. Credit institutions should reclassify NPEs, including FBEs, as performing in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014. Credit institutions should perform a financial analysis of the borrower to establish the absence of concerns regarding the borrower's ability to pay its credit obligations.

158. Credit institutions' policies for the reclassification of non-performing FBEs should specify practices for dispelling concerns regarding the borrower's ability to comply with the post-forbearance conditions set out in Annex V to Commission Implementing Regulation (EU) No 680/2014. These policies should establish criteria in terms of payments made during the cure period of at least one year and define the borrower's ability to comply with post-forbearance conditions (to the extent that full repayment of the debt is likely) without being reliant on the realisation of collateral at least by demonstrating payments of a not insignificant amount of principal. These policies should require payments of both principal and interest.

159. In addition, where a borrower has other exposures to a credit institution that are not the subject of a forbearance measure, the credit institution should consider the impact and the performance of these exposures in its assessment of the borrower's ability to comply with post-forbearance conditions. The consideration of arrears should not change the level of application of non-performing status, in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014, and only exposures to which forbearance measures have been applied should be identified as FBEs.

160. The existence of contract terms that extend the repayment period, such as grace periods for the principal, should confirm the classification of these FBEs as non-performing until the requirements of Annex V to Commission Implementing Regulation (EU) No 680/2014 have been satisfied. The fact that the one-year cure period has elapsed should not automatically lead to reclassification to performing unless regular payments have been made over these 12 months and an assessment of unlikeliness to pay has been concluded with no indication of unlikeliness to pay.

### 7.3.4 Identification of exposures as performing FBEs

161. Once FBEs are classified as performing, either because they have met the conditions for being reclassified from the non-performing category or because the granting of forbearance measures did not lead to the classification of the exposure as non-performing, they should continue to be identified as forborne until all the conditions for the discontinuation of the classification of exposures as forborne under paragraph 256 of Annex V to Commission Implementing Regulation (EU) No 680/2014 have been met.

162. Credit institutions' policies for identifying performing FBEs should specify practices for dispelling concerns regarding the borrower's financial difficulties. Credit institutions' policies should require the borrower to have settled, by means of regular payments, an amount equal



to all the amounts (principal and interest) that were previously past due or de-recognised at the time of the concession, or to otherwise demonstrate its ability to comply with the post-forbearance conditions under alternative objective criteria that include a repayment of principal.

163. In accordance with paragraph 260 of Annex V to Commission Implementing Regulation (EU) No 680/2014, new forbearance measures granted to performing FBEs that have been reclassified out of the non-performing category will entail the reclassification of these transactions to the non-performing category. The same should apply when these exposures become more than 30 days past due.

## 7.4 Consistent application of definition of non-performing

164. Credit institutions should adopt adequate mechanisms and procedures, in accordance with section 8 of the EBA Guidelines on the definition of default, for the harmonised implementation of the definition in all subsidiaries and branches. This will ensure that the identification of NPEs is consistent at entity and banking group levels.

165. Credit institutions' policies should ensure consistent treatment of individual clients and groups of connected clients as defined in Regulation (EU) No 575/2013, the EBA Guidelines on connected clients<sup>36</sup> and the EBA Guidelines on the definition of default. Credit institutions' policies should also ensure a consistent assessment of the underlying legal relationships between legal entities across a group of connected clients. In view of possible contagion, credit institutions should, whenever feasible, apply a group perspective when assessing the status of a borrower's exposure as non-performing, unless it is affected by isolated disputes that are unrelated to the solvency of the counterparty.

166. In accordance with the EBA Guidelines on the definition of default, credit institutions should keep a register of all classification criteria.

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<sup>36</sup> Guidelines on connected clients under Article 4(1)(39) of Regulation (EU) No 575/2013 (EBA/GL/2017/15).

## 8. NPE impairment and write-offs

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167. Credit institutions should estimate loss allowances for NPEs and FBEs subject to impairment in accordance with the EBA Guidelines on credit risk management practices and accounting for expected credit losses.

168. This section sets out the key elements of governance and operations in relation to NPE impairment measurement and write-offs.

### 8.1 NPE write-offs

169. In accordance with the EBA Guidelines on credit risk management practices and accounting for expected credit losses,<sup>37</sup> uncollectability should be recognised in the appropriate period through loss allowances or write-offs. When the credit institution has no reasonable expectation of recovering contractual cash flow of the exposure it should lead to a partial or full write-off of the exposure (IFRS 9.B3.2.16.r).

170. A write-off may be done before legal actions against the borrower to recover the debt have been concluded in full. A write-off should not be considered to mean that the credit institution has forfeited the legal right to recover the debt; a credit institution's decision to forfeit the legal claim on the debt is debt forgiveness.

171. Write-offs constitute a de-recognition event (IFRS 9.5.4.4). If cash or other assets are eventually collected, these collections should be directly recognised as income in the statement of profit or loss.

172. Credit institutions should maintain detailed records of all NPE write-offs performed on a portfolio-level basis.

### 8.2 NPE impairment and write-offs

173. Credit institutions should include in their internal policies guidance on the timeliness of impairments and write-offs, acknowledging external circumstances and factors such as ongoing judicial procedures. In particular for exposures or parts of exposures that are not covered by collateral, credit institutions should consider suitable maximum periods for full impairment, coverage and write-off. For parts of exposures covered by collateral, the establishment of a minimum impairment level should take the type of collateral into account. Empirical evidence should be applied when calibrating the impairment and write-off periods referred to above. When assessing the recoverability of NPEs and in determining internal

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<sup>37</sup> Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses (EBA/GL/2017/06).

NPE write-off approaches, credit institutions should pay particular attention to the cohorts listed below, as they may have higher levels of permanent uncollectability.

- a) Exposures with prolonged arrears: different thresholds may be appropriate for different portfolios. Credit institutions should assess the recoverability of NPEs if the borrower has been in arrears for a prolonged period of time. If, following this assessment, it is concluded that there is no reasonable expectation of recovering an exposure or part of an exposure, a full or partial write-off should be performed.
- b) Exposures under an insolvency procedure: where the collateralisation of the exposure is low, legal expenses often absorb a significant portion of the proceeds from the bankruptcy procedure, and therefore estimated recoveries can be expected to be very low.
- c) A partial write-off may be justified when there is evidence that the borrower is unable to repay the amount of the exposure in full, meaning that there is a reasonable expectation of recovering a part of the exposure.

### 8.3 Impairment and write-off procedures

174. Credit institutions should adopt, document and adhere to sound policies, procedures and controls for assessing and measuring loss allowances and write-off on NPEs in accordance with the EBA Guidelines on credit risk management practices and accounting for expected credit losses. Credit institutions should back-test their loss allowance estimations against actual losses.

175. These methodologies should also include policies and procedures on write-offs and recoveries as defined in the EBA Guidelines on credit risk management practices and accounting for expected credit losses. The policy on write-offs should include indicators used to assess expectations of recovery and detailed information on those exposures that have been written off but are still subject to enforcement activity.

176. In accordance with the EBA Guidelines on credit risk management practices and accounting for expected credit losses, credit institutions should have in place common processes, systems, tools and data.

177. A credit institution's internal audit function should verify the methodologies used in accordance with the EBA Guidelines on internal governance.<sup>38</sup>

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<sup>38</sup> Guidelines on internal governance under Directive 2013/36/EU (EBA/GL/2017/11).

## 9. Collateral valuation of immovable and movable property

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178. This section sets out the key elements for collateral valuation of immovable and movable property pledged for NPEs.

### 9.1 Governance, procedures and controls

#### 9.1.1 General policy and procedures

179. A credit institution should have in place a written policy and procedures governing the valuation of property collateral. The policy and procedures should be fully aligned with the credit institution's RAF.

180. The policy and procedures should cover the valuation of all immovable and movable property collateral irrespective of its eligibility for prudential purposes in accordance with the requirements of Article 208 and Article 210 of Regulation (EU) No 575/2013.

181. The policy and procedures should be approved by the management body and should be reviewed at least on an annual basis.

#### 9.1.2 Monitoring and controls

182. Credit institutions should monitor and review the valuations performed by internal or external appraisers on a regular basis as set out in this section.

183. Credit institutions should develop and implement a robust internal quality assurance policy and procedures for valuations conducted internally and externally, considering the following:

- a) The quality assurance process should be carried out by a function that is independent from the function conducting the initial valuation, loan processing, loan monitoring and the underwriting process.
- b) The independence of the external appraiser selection process should be tested on a regular basis as part of the quality assurance process.
- c) An appropriate, similar sample of internal and external valuations should be compared with market observations on a regular basis.
- d) Back-testing of both internal and external valuations should be carried out on a regular basis.
- e) The quality assurance process should be based on an appropriate sample size.

184. In addition, the internal audit function should regularly review the consistency and quality of the valuation policy and procedures, the independence of the appraiser selection process and the appropriateness of the valuations carried out by both external and internal appraisers.

### **9.1.3 Individual valuation of immovable property and use of indexation**

185. Credit institutions should monitor the value of immovable property collateral on a frequent basis and at a minimum as specified in Article 208(3) of Regulation (EU) No 575/2013.

186. Indexation or similar methods may be used to monitor the value of a collateral and identify the collaterals requiring revaluation. This should be in line with the institution's policy and provided that the collateral to be assessed is susceptible to accurate assessment by such methods.

187. Indices used to carry out this indexation may be internal or external as long as they are:

- a) reviewed regularly, with the results of this review being documented and readily available, and with the review cycle and governance requirements being clearly defined in a policy document approved by the management body;
- b) sufficiently granular, with the methodology being adequate and appropriate for the type of collateral in question;
- c) based on a sufficient time series of observed empirical evidence of actual property transactions.

188. Valuations and revaluations of immovable property collateral should be performed on an individual and a property-specific basis. Valuations and revaluations of immovable property collateral should not be carried out using a statistical model as the sole means of undertaking the review of the property valuation.

189. Competent authorities should define a common threshold for the individual valuation and revaluation of the collaterals used for NPEs by an independent appraiser. This threshold should be applicable to all credit institutions in the authority's jurisdiction and should be publicly disclosed.

### **9.1.4 Appraisers**

190. All valuations of immovable property, including updated valuations, should be performed by an independent and qualified appraiser, internal or external, who possesses the necessary qualifications, ability and experience to execute a valuation, as specified in Article 208(3)(b) and Article 229 of Regulation (EU) No 575/2013.

191. For the purposes of external appraisals, credit institutions should establish a panel of independent and qualified appraisers, based on the criteria set out below. The appraisers'

performance should be assessed on an ongoing basis and a decision should be made about whether each appraiser should remain in the panel or not.

192. Credit institutions should ensure that external appraisers on the panel have adequate and valid professional indemnity insurance.

193. The credit institution should ensure that each qualified appraiser on the panel:

- a) is professionally competent and has at least the minimum educational level that meets any national requirements for carrying out such valuations;
- b) has appropriate technical skills and experience to perform the assignment;
- c) is familiar with, and able to demonstrate ability to comply with, any laws, regulations and property valuation standards that apply to the appraiser and the assignment;
- d) has the necessary knowledge of the subject of the valuation, the relevant property market and the purpose of the valuation.

194. A panel of appraisers should contain expertise in various areas of the property sector appropriate to the lending business of the credit institution and the location of lending.

195. In order to mitigate any conflict of interest sufficiently, credit institutions should ensure that all internal and external appraisers who are going to carry out the actual appraisal of a given property and their first-degree relatives meet the following requirements:

- a) They are not involved in the loan processing, loan decision or credit underwriting process.
- b) They are not guided or influenced by the borrower's creditworthiness.
- c) They do not have an actual or potential, current or prospective conflict of interest regarding the result of the valuation.
- d) They do not have an interest in the property.
- e) They are not a connected person to either the buyer or the seller of the property.
- f) They provide an impartial, clear, transparent and objective valuation report.
- g) The fee they receive is not linked to the result of the valuation.

196. Credit institutions should ensure adequate rotation of appraisers, i.e. two sequential individual valuations of the immovable property by the same appraiser should result in the rotation of the appraiser, resulting in the appointment of either a different internal appraiser or a different external appraisal provider.

## 9.2 Frequency of valuations

197. For prudential purposes, credit institutions should update valuations of all secured exposures in accordance with the requirements of Article 208(3) and Article 210(c) of Regulation (EU) No 575/2013.
198. The group of collaterals that are subject to individual valuations and revaluations on a regular basis should be updated at the time when the exposure is classified as non-performing and at least annually while it continues to be classified as such. Credit institutions should make sure that, for the collateral subject to indexation or other similar methods, the indexation is updated at least annually.
199. For properties with an updated individual valuation that has taken place within the past 12 months (in line with all the applicable principles and requirements as set out in this section), the property value may be indexed up to the period of the impairment review.
200. Credit institutions should carry out more frequent monitoring 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.
201. Therefore, credit institutions should define criteria in their collateral valuation policy and procedures for determining if a significant decline in collateral value has taken place. Where possible, these will include quantitative thresholds for each type of collateral, based on the observed empirical data and any relevant qualitative credit institution experience, bearing in mind relevant factors such as market price trends or the opinion of independent appraisers.
202. Credit institutions should have appropriate processes and systems in place to flag outdated valuations and to trigger valuation reports.

## 9.3 Valuation methodology

### 9.3.1 General considerations

203. Credit institutions should have defined collateral valuation approaches for each collateral product type; these should be adequate and appropriate for the type of collateral in question.
204. All immovable property collateral should be valued on the basis of market value or mortgage lending value, as specified under Article 229 of Regulation (EU) No 575/2013. Movable property should be valued at its market value.
205. For movable property, credit institutions should, in accordance with the requirements of Article 199(6) of Regulation (EU) No 575/2013, periodically assess the liquidity of the property. If there is material volatility in the market prices, the institution should demonstrate that the valuation of the collateral is sufficiently conservative.

206. For movable property, credit institutions should, in accordance with the requirements of Article 210 of Regulation (EU) No 575/2013, conduct a sufficient legal review confirming the enforceability of the collateral, including an assessment of the legal right to enforce and liquidate the collateral in the event of default, within a reasonable timeframe.

207. Overall valuations based only on the discounted replacement cost should not be used. For income-generating properties, a market-comparable or discounted cash flow approach can be used.

208. Property collateral should be valued in accordance with applicable international, European and national standards.<sup>39</sup>

### 9.3.2 Expected future cash flow

209. Credit institutions should estimate discounted cash flow in a prudential manner and in line with applicable accounting standards.

210. Calculation of discounted cash flow should take into account cases where:

- a) the operating cash flow of the borrower continues and can be used to repay the financial debt, and collateral may be exercised to the extent that it does not influence operating cash flow; and
- b) the operating cash flow of the borrower ceases and collateral is exercised.

211. When the estimation is based on the assumption that the operating cash flow of the borrower will continue, including cash flow being received from the collateral, updated and reliable information on cash flow is required.

212. When the estimation is based on the assumption that the operating cash flow of the borrower will cease, the future sale proceeds from collateral execution should be adjusted to take into account the appropriate liquidation costs and market price discount.

213. In addition to the above liquidation costs, a market price discount, if appropriate, should be applied to the updated valuation as outlined below.

214. The property price at the time of liquidation should take into account current and expected market conditions.

215. Time-to-sale considerations in connection with the disposal of mortgaged properties should also be included, based on debt enforcement practices and experiences from judicial proceedings at national level and on empirical evidence, and back-tested accordingly. These

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<sup>39</sup> These include the European Valuation Standards EVS-2016 (the Blue Book) and the Royal Institute of Chartered Surveyors (RICS) standards.



considerations should include any operational costs or capital expenditures to be incurred before the time of sale.

216. The execution of collateral may include both consensual and non-consensual (forced) liquidation strategies.
217. The liquidation cost discount should reflect the manner of collateral execution, i.e. whether it is consensual or non-consensual.
218. The market price discount should reflect the liquidity of the market and the liquidation strategy. It should not reflect fire sale conditions unless the anticipated liquidation strategy actually involves a fire sale.
219. Credit institutions should apply adequate market price discounts for the purposes of IFRS 9, for the calculation of regulatory capital and for risk control purposes. A market price discount may be close to zero only for highly liquid and non-distressed collateral types that are not affected by any significant correlation risks.
220. All credit institutions should develop their own liquidation cost and market price discount assumptions based on observed empirical evidence. If insufficient empirical evidence is available, discount assumptions should be based on, at a minimum, liquidity, passage of time, and the quality/ageing of the appraisal. If a credit institution faces the situation of a frozen property market and only a small number of properties have been sold or the sales history has to be considered insufficient, a more conservative market price discount should apply.

## 9.4 Further considerations on estimating cash flow from property collateral liquidation

221. In estimating cash flow from property collateral liquidation, credit institutions should use appropriate and credible assumptions. In addition, credit institutions should pay attention to the requirements for valuing cash flow under IFRS 13 on fair value measurements. In particular, financial institutions should comply with the following requirements:
- a) They must determine the assumed time of disposal taking into account current and expected market conditions as well as the underlying national legal framework regarding the disposal of mortgaged properties.
  - b) They must ensure that the property price used to determine the estimated market value of property collateral at the point of liquidation is not based on macroeconomic projections/assumptions that are more optimistic than the projections produced by the relevant authorities and organisations such as International Monetary Fund (IMF) and the European System of Central Banks (ESCB)/ the European Systemic Risk Board (ESRB), and therefore does not assume an improvement on the current market conditions.

- c) They must ensure that income from property collateral is not assumed to increase from the current levels unless there is an existing contractual arrangement for such an increase. Moreover, current income from property should be adjusted when calculating cash flow in order to reflect the expected economic conditions. Credit institutions should consider whether it is appropriate to project a flat income in a recessionary environment in which vacant properties are increasing and/or demand for transportation is decreasing, putting downwards pressure on income.
- d) A hold strategy on property collateral is not acceptable. A hold strategy is defined as holding the asset at above market value assuming that the asset will be sold after the market recovers.

222. When using the value of collateral in assessing the recoverable amount of the exposure, at least the following should be documented:

- a) how the value was determined, including the use of appraisals, valuation assumptions and calculations;
- b) the supporting rationale for adjustments to appraised values, if any;
- c) the determination of selling costs, if applicable;
- d) the assumed timeline to recover;
- e) the expertise and independence of the appraiser.

223. When the observable market price is used to assess the recoverable amount of the exposure, the amount, source and date of the observable market price should also be documented.

224. Credit institutions should be able to substantiate the assumptions used when assessing the recoverable amount by providing to the competent authority, if requested, details on the property market value, the market price discount, legal and selling expenses applied, and the term used for the time to liquidation. Credit institutions should be able to fully justify their assumptions, both qualitatively and quantitatively, and explain the drivers of their expectations, taking past and current experience into account.

## 9.5 Back-testing

225. Credit institutions should demonstrate via sound back-testing that the assumptions used when assessing the recoverable amount were reasonable and grounded in observed experience. In this context, credit institutions should regularly back-test their valuation history (last valuation before the exposure was classified as non-performing) against their sales history (net sales price of collateral). Depending on the size and business model of the credit institution, it should differentiate by collateral type, valuation model/approach, type

of sale (voluntary/forced) and region for its back-testing process. The back-testing results should be used to determine haircuts on collateral valuations supporting exposures remaining on the balance sheet.

226. Alternatively, credit institutions using the advanced internal ratings based (A-IRB) approach may use secured loss given default (LGD) to determine haircuts.

## 9.6 IT database requirements in respect of collateral

227. Credit institutions should have databases of transactions to enable the proper assessment, monitoring and control of credit risk, to respond to requests from management and supervisors, and to enable the provision of information in periodic reports and other timely and comprehensive documentation. In particular, databases should comply with the following requirements:

- a) sufficient depth and breadth, in that they cover all the significant risk factors;
- b) accuracy, integrity, reliability and timeliness of data;
- c) consistency – they should be based on common sources of information and uniform definitions of the concepts used for credit risk control;
- d) traceability, such that the source of information can be identified.

228. These databases should include all the relevant information on properties and other collateral for the credit institutions' transactions and on the links between collateral and specific transactions.

## 9.7 Valuation of foreclosed assets

229. Credit institutions should strongly consider classifying foreclosed assets as non-current assets held for sale under IFRS 5. This accounting treatment implies that the asset must be available for immediate sale in its present condition (IFRS 5.7), that the management body should approve an individual plan to sell the asset within a short timeframe (normally one year) and that an active sales policy should be pursued (IFRS 5.8); thus, it favours recoveries.

230. Foreclosed assets received should be valued at the lower of:

- a) the amount of the financial assets applied, treating the asset foreclosed or received in payment of debt as collateral;
- b) the fair value of the repossessed asset, less selling costs.

231. When fair value is not obtained by reference to an active market but is based on a valuation technique (either level 2 or level 3), some adjustments are necessary, in particular as a result of two factors:

- a) The condition or location of the assets. Risk and uncertainty regarding the asset should be incorporated in the fair value estimation.
- b) The volume or level of activity of the markets in relation to these assets. The credit institution's previous experience of the entity in realisations and of the differences between amounts arrived at using the valuation technique and the final amounts obtained in realisations should be incorporated into the calculation. The assumptions made in order to measure this adjustment may be documented, and should be available to the supervisor on request. Illiquidity discounts may be considered.

232. When credit institutions' foreclosed assets are still under construction and it is decided to complete construction before selling the asset, they should demonstrate the merits of such a strategy and the cost should not exceed the fair value less costs to complete and sell the asset taking into account an appropriate illiquidity discount as described above.

233. When a foreclosed asset has exceeded the average holding period for similar assets for which active sales policies are in place, credit institutions should revise the illiquidity discount applied in the valuation process described above, increase it accordingly. In these circumstances, the credit institution should refrain from recognising write-backs/reversals of existing accumulated impairment on the asset, as its prolonged presence on the balance sheet provides evidence that the credit institution is unable to sell the asset at an increased valuation.

234. The frequency of valuation of foreclosed assets and the applicable procedures should follow the treatment of immovable property as set out in sections 9.1.2 and 9.2.

## 10. Supervisory evaluation of management of NPEs and FBEs

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235. As part of their ongoing engagement with credit institutions under the SREP, competent authorities should monitor the application of these guidelines by the credit institutions, in particular the development and implementation of NPE strategies and related governance and operational frameworks as described in sections 4 and 5. Competent authorities' assessments should include, but not be limited to, whether the credit institution's NPE strategy:

- a) is embedded into the credit institution's overall strategy and is subject to appropriate NPE governance, including a risk management and control framework;
- b) relies on a credible self-assessment of the credit institution's internal capabilities;
- c) adequately takes into account the credit institution's operating environment, external conditions and capital situation;
- d) covers not only a short-term time horizon but also a medium- and/or long-term time horizon;
- e) includes time-bound, realistic yet ambitious quantitative NPE targets and foreclosed assets targets where appropriate and is supported by an operational plan.

236. If the competent authority concludes that the NPE strategy of a credit institution clearly lacks one or more of the elements listed in points (a) to (e) of paragraph 235, it should be considered a serious shortcoming of the NPE strategy. In this case, competent authorities should require the immediate revision of the NPE strategy.

237. If the outcome of the competent authority's assessment is that the requirements of point (a) to (e) of paragraph 236 are broadly fulfilled by the NPE strategy, but some deficiencies are identified, the competent authority should ensure that credit institutions present an action plan on how to address the deficiencies and establish an effective and timely NPE management framework.

238. Competent authorities should apply supervisory evaluation proportionately, taking into account the specificities of the institutions (e.g. in terms of size, nature and complexity). In their SREP assessments of NPE strategies and the supporting governance and operational arrangements, the competent authorities should consider also the business models of the institutions, in particular when the sole business of the institution is the purchase and sale of NPEs.

239. Proportionality in terms of the supervisory assessment of the NPE strategy of a smaller and less complex credit institution (e.g. an SREP Category 3 or 4 institution<sup>40</sup>) can be achieved by aligning the assessment with the SREP engagement model, which ensures a risk-based approach to supervision and takes into account the systemic importance of global and domestic institutions.

240. Competent authorities should challenge credit institutions’:

- a) Operational plan and organisational arrangements if any of the following criteria is met:
  - i. The framework for identifying, measuring, managing, monitoring and mitigating NPEs and FBEs, including for early recognition of NPEs and appropriate workout activities, is deemed inadequate by the competent authorities considering the size and complexity of the NPE problem at the credit institution.
  - ii. It does not allocate or does not foresee the future allocation of the necessary human and technical resources as well as providing for appropriate coverage by the internal control functions.
  - iii. It does not adequately describe the operationalisation of the monitoring process for NPEs.
- b) NPE strategy, if the combination of strategic options for the different portfolios and segments, including foreclosed assets, where applicable, does not result, in the authority’s view, in the most effective and efficient strategy for NPE reduction.
- c) Capital plan, if it does not appropriately set out the planned reduction of NPEs from the balance sheet as per the NPE strategy and does not include suitable actions to ensure that a sufficient amount of capital and capital buffers are available, as well as envisaging timely and adequate impairments and write-offs.
- d) Performance appraisal system, if the incentives for the management body and relevant managers and staff lack specific quantitative elements linked to the NPE reduction targets defined in the credit institution’s NPE strategy.

241. Considering the importance of early detection and prevention of deteriorating credit quality, competent authorities should assess whether the early warning mechanisms are implemented in the credit institutions’ internal procedures.

242. Competent authorities should assess if credit institutions:

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<sup>40</sup> Described in section 2.1.1, ‘Categorisation of institutions’, in the EBA Guidelines on SREP (EBA/GL/2014/13).

- a) have in place a forbearance policy and related processes to assess the viability of forbearance measures and monitor the efficiency and effectiveness of forbearance measures;
- b) recognise and classify NPEs and FBEs, including entry and exit criteria, consistently across the group and based on the definitions in Annex V to Commission Implementing Regulation (EU) No 680/2014;
- c) have in place policies and methodologies to ensure the measurement of impairments and write-offs for timely recognition of impairments and write-offs.

243. Competent authorities should ensure that credit institutions have appropriate written policies and procedures in place regarding the valuation of property, as described in section 9. In particular, competent authorities should verify that these policies cover all immovable and movable property types that are used to secure credit exposures, the criteria for the application of individual versus indexed valuation and the requirements with regard to eligible appraisers.

244. If credit institutions report material deviations from the operational plan in accordance with section 4.4, competent authorities should assess whether the proposed remediation actions are sufficient to eliminate the deviation from the plan. The competent authority should require further actions of the credit institution if it is concerned about the effectiveness of the proposed actions.

245. The requirements set out above regarding the supervisory evaluation of the management of NPEs and FBEs supplement and further specify the assessment of NPEs and FBEs as part of credit risk management put forward in the EBA Guidelines on common procedures and methodologies for the SREP. The findings of this supervisory evaluation would feed into the assessment of credit risk under Title 6.2 of the EBA Guidelines on common procedures and methodologies for the SREP and would inform credit risk scores.

# Annex 1 – Sample criteria for grouping retail NPEs

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1. Natural or legal person:
  - a) retail borrower
  - b) sole trader
  - c) small business or group of professionals
  - d) SME (overlaps with corporates).
2. Arrears bucket/days past due (dpd) (the higher the level of arrears the narrower the range of possible solutions):
  - a) early arrears (> 1 dpd and ≤ 90 dpd)
  - b) late arrears (> 90 dpd and < 180 dpd)
  - c) debt recovery unit (> 180 dpd, including also legal cases (borrowers in relation to whom legal actions have taken place or are in progress)).
3. Re-restructured cases (restructured loans with arrears, indicative of persistent repayment problems and/or failure of restructuring solution offered):
  - a) number of previous restructurings.
4. Exposure balance:
  - a) high value
  - b) low value
  - c) multiple exposures.
5. Level of risk (based on credit institution's assessment/behaviour scoring/internal behaviour data/transaction history/credit rating). Clients with better payment histories are more likely to respond positively to restructuring offers:
  - a) very high
  - b) high



c) medium

d) low.

6. Based on borrower's behaviour:

a) seasonal repayments

b) cooperative versus non-cooperative.

7. Purpose of credit facility (by product):

a) principal private residence loan

b) secondary home/holiday home loan

c) investment property loan/buy-to-let loan

d) personal loan

e) overdraft account

f) leased asset

g) credit card

h) sole trader, micro-enterprise or SME loan:

i. for the set-up of the business (premises; infrastructure or machinery; renovations)

ii. working capital.

8. Loan currency.

9. Loan interest rate (interest rate reduction consideration for loans burdened by high interest rates, if possible).

10. Borrower outlook (borrower's age, health, employment type and history, employment prospects, professional skills, industry).

11. Country of residence/incorporation:

a) residents

b) non-residents.

12. Location of the underlying collateral:

- a) rural versus urban
- b) prime location, city centre, outskirts, etc.

13. Type of underlying collateral:

- a) land:
  - i. building plot
  - ii. agricultural land
- b) building:
  - i. house
  - ii. shop
  - iii. factory.

14. Based on the loan-to-value (LTV) ratio:

- a) for low LTV loans, sale of underlying collateral may be the preferred option, unlike for high LTV loans.

15. Hardship cases (e.g. health problems, separation, divorce).

16. Borrower's creditworthiness assessment:

- a) can afford loan repayment versus cannot afford it;
- b) income less expenditure versus reasonable living expenses versus loan instalment.

## Annex 2 – Benchmarks for NPE monitoring metrics

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### Benchmarks for NPE monitoring metrics

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#### NPE metrics

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<b>NPE level and flows</b>	<p>NPE stock / total volume of exposures</p> <p><math>\frac{\text{NPE stock} + \text{foreclosed assets} + \text{performing forborne}}{\text{total volume of exposures} + \text{foreclosed assets}}</math></p> <p>Quarterly flow of NPEs (+/-) / total NPE stock</p> <p>Quarterly flow from performing exposure (PE) to NPE</p> <p>Quarterly flow from performing FBE to NPE</p> <p>Quarterly flow from NPE to PE</p> <p>Quarterly flow from NPE to performing FBE</p> <p>Quarterly flow from performing FBE to PE</p> <p>Quarterly flow from PE to performing FBE</p>
<b>Impairments</b>	<p>Quarterly increase in stock of loss allowances</p> <p>Quarterly level of reversal of impairments</p> <p>Quarterly change in stock of loss allowances(+/-) / total NPE stock</p> <p>Accumulated total provisions/total NPE stock</p> <p>By cohort (e.g. number of years since NPE classification, secured/unsecured)</p>
<b>Loss budget</b>	<p>Total loss as a result of forbearance activity</p> <p>Total loss versus budget</p>

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#### Collection activities

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<b>Staff activity</b>	<p>Number of borrower engagements per quarter versus plan</p> <p>Number of borrower engagements leading to forbearance agreement</p> <p>Number of borrower engagements leading to cash recovery</p> <p>Quarterly cash recovery from NPEs / total NPE stock</p> <p>Quarterly cash recovery from interest on NPEs / total NPE stock</p>
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## Benchmarks for NPE monitoring metrics

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	Quarterly cash recovery from capital and fees on NPEs / total NPE stock
<b>Cash recovery</b>	Quarterly cash recovery from property-related liquidations, also as a percentage of total NPE stock
	Quarterly cash recovery from non-property-related liquidations, also as a percentage of total NPE stock
	Quarterly cash recovery from sales of NPEs, also as a percentage of total NPE stock
	Quarterly cash recovery from NPEs, also as a percentage of total NPE stock

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## Forbearance activities

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<b>Debt forgiveness</b>	Quarterly debt forgiveness
	Quarterly debt forgiveness / specific assigned provisions
	Quarterly debt forgiveness / total NPE stock
	Quarterly accounting write-offs (full and partial)
	Quarterly accounting write-offs (full and partial) / individually assessed stock of loss allowances
<b>Accounting write-offs</b>	Quarterly accounting write-offs (full and partial) / total NPE stock
	Value of NPEs currently in forbearance
	Value of recently agreed forbearance solutions by characteristics (e.g. payment holiday > 12 months)
	Value of loans currently in forbearance / total NPE stock
<b>Forbearance activity</b>	Value of PEs currently in forbearance
	Quarterly non-performing FBEs / total NPE stock
	Total non-performing FBEs / total NPE stock
	Value of non-performing FBEs currently experiencing financial difficulties
	Cure rate
	Cash collection rate
<b>Re-default rate</b>	Re-default rate on non-performing FBEs
	Re-default rate on performing FBEs
<b>Debt/asset swap</b>	Quarterly debt to equity swaps, also as a percentage of total NPE stock
	Quarterly debt to asset swaps, also as a percentage of total NPE stock

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### Benchmarks for NPE monitoring metrics

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#### Legal activities

- Value and number of loans currently in legal activity
  - Value and number of assets recently foreclosed
  - Quarterly value and number of loans newly entering legal activity
  - Quarterly value and number of loans exiting legal activity
  - Average duration of legal procedures recently closed
  - Average amounts recovered from legal procedures recently closed (including total costs)
  - Loss rate on loans exiting legal activity
- 

#### Profits and loss (P&L) items stemming from NPEs

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#### Interest from NPEs

- Interest payments recognised on NPEs in the P&L
  - Percentage of recognised interest payments from NPEs actually received
-

## Annex 3 – Other monitoring metrics

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### Borrower-level information from external sources

<b>External sources</b>	<ul style="list-style-type: none"> <li>Debt and collateral increase in other credit institutions</li> <li>Past due or other non-performing classifications in other credit institutions</li> <li>Guarantor default</li> <li>Debt in private central register (if any)</li> <li>Legal proceedings</li> <li>Bankruptcy</li> <li>Changes in company structure (e.g. merger, capital reduction)</li> <li>External rating assigned and trend therein</li> <li>Other negative information regarding major borrowers/counterparties of the borrower/suppliers</li> </ul>
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### Borrower-level information from internal sources

<b>Corporates</b>	<ul style="list-style-type: none"> <li>Negative trend in internal rating</li> <li>Unpaid cheques</li> <li>Significant change in liquidity profile</li> <li>Liabilities (leverage) (e.g. equity/total &lt; 5% or &lt; 10%)</li> <li>Number of days past due</li> <li>Number of months with any overdraft/overdraft exceeded</li> <li>Profit before taxes/revenue (e.g. ratio &lt; -1%)</li> <li>Continued losses</li> <li>Continued excess in commercial paper discount</li> <li>Negative own funds</li> <li>Payment delays</li> <li>Decrease in turnover</li> <li>Reduction in credit lines related to trade receivables (e.g. year-on-year variation, 3 million average/1 year average)</li> <li>Unexpected reduction in undrawn credit lines (e.g. undrawn amount/total credit line)</li> </ul>
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<b>Individuals</b>	Negative trend in behavioural scoring
	Negative trend in PD and/or internal rating
	Mortgage loan instalment > x credit balance
	Mortgage and consumer credit days past due
	Decrease in the credit balance > 95% in the last 6 months
	Average total credit balance < 0.05% of total debt balance
	Forborne
	Related historic loss rates
	Decrease in payroll in the past 3 months
	Unemployment
	Early arrears (e.g. 5–30 days past due, depending on portfolio/borrower types)
	Reduction in bank transfers in current accounts
	Increase in loan instalment over the payroll ratio
	Number of months with any overdraft exceeded
Negative trend in behavioural scoring	
Negative trend in PD and/or internal rating	
<hr/>	
<b>Portfolio-level information</b>	
<hr/>	
<b>Portfolio distribution</b>	Size distribution and concentration level
	Top x (e.g. 10) groups of connected clients and related risk indicators
	Asset class distribution
<b>Risk parameters</b>	Breakdown by industry, sector, collateral type, country, maturity, etc.
	PD/LGD evolution (overall and per portfolio)
	PD/LGD forecasts and projections
	Overall expected losses
	Default exposure
<b>Stock of loss allowances</b>	Stocks and flows of loss allowances (overall and per portfolio)
	Volumes of and trends in significant risk provisions at individual level
<b>NPE/forbearance status/foreclosure</b>	NPE volume by category (> 90 days past due, loss allowances, etc.)

Forbearance volume and grouping of exposures (restructuring, workout, forced prolongation, other modifications, deferrals, > 90days past due, loan loss provisions)

Foreclosed assets on total exposures

NPE ratio without foreclosed assets

NPE ratio with foreclosed assets

NPE coverage (loss allowances, collateral, other guarantees)

### **Specific type of borrower/sector**

#### **Legal activities**

Value and number of loans currently in legal activity

Value and number of assets recently foreclosed

Quarterly value and number of loans newly entering legal activity

Quarterly value and number of loans exiting legal activity

Average duration of legal procedures recently closed

Average amounts recovered from legal procedures recently closed (including total costs)

Loss rate on loans exiting legal activity



## Annex 4 – Common NPE-related policies

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Credit institutions should develop, regularly review and monitor their adherence to policies related to the NPE management framework.

The following policies should be established, taking into account the principle of proportionality, aiming to achieve the implementation of the strategy of the credit institution (including its NPL strategy and operational plan where relevant).

### Arrears management policy

This policy should set out the credit institution's NPE operating model (see section 5.2), including at least the following elements:

- the structure and responsibilities of the NPE WUs, with clear handover triggers and a link to the grouping of exposures (see section 5.2.3);
- the procedure to be followed by the functions involved, to include at a minimum:
  - the procedure and handover criteria to be followed for each stage of arrears, early arrears and late arrears;
  - the procedure to be followed where a borrower is classified as non-cooperating and/or non-viable, and the criteria for the borrower to be classified as such;
  - the communication with the borrower at each step, which should be aligned with the legislative framework of the country of operation (e.g. code of conduct);
  - monitoring tools and methods to be applied;
- the human and technical resource requirements;
- the reports to be produced internally for monitoring purposes and for regular updates to the management body.

Credit institutions, when developing their arrears management policy, should take into account Article 28 of Directive 2014/17/EU and in particular the provisions of the EBA Guidelines on arrears and foreclosure.

### Forbearance policy

The forbearance policy described in section 6.2.1 should set out at least:

- The necessary financial and non-financial documentation to be requested and provided by the different types of borrowers in order for the responsible credit officer to demonstrate repayment capacity on a principal and interest basis.
- The minimum key financial repayment capacity metrics and ratios to be applied by the credit officer, detailed on a portfolio-/product-/sector-specific basis, in order to fully assess the borrower's repayment capacity; sector-specific guidelines for establishing key financial metrics and ratios on a sector-specific basis (SMEs and corporates).
- The process for determining and implementing the most appropriate forbearance solution for a borrower:
  - For retail customers, decision trees are to be used. The process for retail customers should be in line with the provisions of the EBA Guidelines on arrears and foreclosure. For non-retail borrowers, if a decision tree approach is not appropriate, then the policy should provide clear instructions to the credit officer on how to assess the suitability of a forbearance treatment.
  - In the case of borrowers for whom no solution can be reached (non-viable and/or non-cooperating borrowers), a time-bound process and procedure should be established for the transfer of these borrowers to the NPE WUs responsible for liquidation.
- A toolkit of forbearance measures with short-term and long-term time horizons, as outlined in section 6.
- Clear instructions to the credit officer regarding the requirements for revaluation of collateral in line with section 9.
- The decision-making process, approval levels and procedures for each type of forbearance measure and size of exposure.
- The process and procedure for the monitoring of the forbearance solutions granted and borrower performance following the completion of a restructuring, including frequency of the review of the borrower, the re-default definition, the process for reassessment and requirements for reporting of re-defaults.
- The pricing policy for each forbearance measure and type of borrower.

#### Debt recovery/enforcement policy

The NPE WUs responsible for debt recovery should take the most appropriate actions in a timely manner to effectively reduce NPEs over a defined time horizon. The debt recovery policy, in accordance with the NPL strategy, should address, at a minimum:

- The range of available options for each collateral type. Indicatively, the following could be considered (not in any particular order):
  - voluntary asset sale (borrower re-engages and agrees to sell the asset);
  - forced asset sale via receivers/court proceedings (assets are not held on the balance sheet of the credit institution);
  - foreclosure of asset (assets are held on the balance sheet of the credit institution);
  - debt collection (internal or external);
  - debt to asset/equity swap;
  - sale of loan/loan portfolio to a third party.
- The procedure to be followed to select the most appropriate recovery option and the team of internal and external experts to be involved in taking the decision.
- The recovery option should take into account the existence of collateral, type of legal documentation, type of borrower, local market conditions and macroeconomic outlook, the legislative framework in place, and potential historical recovery rates for each option versus the costs involved for each option.
- A clear definition of non-cooperating borrowers or a link to related policies including such a definition.
- A clearly defined approval process for each stage of the debt recovery process for the different recovery options available to the credit institution.
- The role of risk control and internal audit departments in the procedure and in the monitoring process.

With respect to the liquidation of collateral, the following should be defined in the policy:

- The valuation approach to be followed in respect of the asset (in line with section 9.7) including the liquidation costs to be applied. The liquidation costs should be in line with requirements set out in section 9.3.3
- Involvement of internal or external experts.
- Limits
  - to the amount of assets that can be held by the credit institution at any point of time, taking into account the large exposure limits specified in the CRD and industry concentration risk, for example in the real estate sector;

- to the amount of repossessed or foreclosed assets that can be acquired by the credit institution within a certain time period.
- The procedure to be followed post repossession or foreclosure to develop and implement a sale strategy, and the unit within the credit institution responsible for undertaking the management of the assets concerned (this may also be defined in a separate foreclosed/repossessed asset policy).

Credit institutions should consider the interaction with other creditors for NPE borrowers with multiple creditors, usually corporate borrowers. Therefore, credit institutions should put in place a clear procedure for negotiating and interacting with other financial institutions (or other third parties) to whom the borrower is indebted.

#### Collateral policies

Given the importance of credit risk mitigation in the NPE workout process, credit institutions should develop clear and consistent collateral policies, including policies for foreclosed assets. These policies should comprehensively cover the management, valuation and reporting of all collateral types. Given the complexity and specialisation of some types of collateral, credit institutions should seek external expertise in drafting and reviewing these policies. Credit institutions should ensure a consistent approach to managing and valuing similar collateral across the portfolio, as per section 9.

#### NPE monitoring policy

A dedicated policy should be established specifying, inter alia:

- the types of actions required in response to the different types of findings;
- escalation procedures;
- key elements, frequency and recipients of the reporting;
- handover criteria/a link to NPL procedures.

#### Outsourcing/NPL servicing policy

A dedicated policy should be established for the outsourcing of services to third parties if this is relevant. This needs to include the required procedures for the selection of outsourcing partners, the required legal contract content and the decision-making process for outsourcing agreements, as well as the monitoring of those agreements.

## Annex 5 – Possible forbearance measures

Forbearance measure	Description	Viability and other important considerations
1. Interest only	During a defined short-term period, only interest is paid on credit facilities and no principal repayment is made. The principal amount thus remains unchanged and the terms for the repayment structure are reassessed at the end of the interest-only period, subject to the assessed repayment ability.	<p>This measure should be considered viable only if the credit institution can demonstrate (based on reasonable documented financial information) that the financial difficulties experienced by the borrower are of a temporary nature and that after the defined interest-only period the borrower will be able to service the loan at least to the extent of the previous repayment ability.</p> <p>The measure should generally not exceed a period of 24 months and, in the case of construction of commercial property and project finance, 12 months.</p> <p>Once the defined period of this forbearance measure is over, institutions should reassess the borrower's debt-servicing capacity in order to proceed with a revised repayment schedule that is able to account for the unpaid capital element during this interest-only period.</p> <p>In most cases, this measure will be offered in combination with other measures of a longer-term nature to compensate for the temporary lower repayments (e.g. extension of maturity).</p>
2. Reduced payments	Decrease in the amount of repayment instalments over a defined short-term period in order to accommodate the borrower's affected cash flow situation, before continuing with the repayments on the basis of projected repayment ability. The interest remains to be paid in full.	<p>See '1. Interest only'.</p> <p>If the amount of the payment reduction is moderate and all other conditions mentioned above are met, this measure could be applied for a period longer than 24 months.</p>
3. Grace period/payment moratorium	An agreement allowing the borrower a defined delay in fulfilling the repayment	See '1. Interest only.'

Forbearance measure	Description	Viability and other important considerations
4. Arrears/interest capitalisation	<p>obligations, usually with regard to the principal and interest.</p> <p>Forbearance of arrears and/or accrued interest arrears by the addition of those unpaid amounts to the outstanding principal balance for repayment under a sustainable rescheduled programme.</p>	<p>The measure should be granted/considered viable only where the institution has assessed that the borrower's verified income/expenditure levels (based on reasonable documented financial information) and the proposed revised repayments are sufficient to enable the borrower to service the revised loan repayment on a principal and interest basis for the duration of the revised repayment schedule, and where the institution has formally sought confirmation that the borrower understands and accepts the capitalisation conditions.</p> <p>Arrears capitalisation should be provided only selectively in cases where the recovery of historical arrears or payments due under the contract is not possible and capitalisation is the only option realistically available.</p> <p>Institutions should generally avoid offering this measure to a borrower more than once, and the measure should be applied only to arrears that do not exceed a predefined size relative to the overall principal (which should be defined in the credit institution's forbearance policy).</p> <p>The institution should assess the percentage of arrears being capitalised compared with the principal and interest repayments as adequate and appropriate for the borrower.</p>
5. Interest rate reduction	<p>Permanent (or temporary) reduction in interest rate (fixed or variable) to a fair and sustainable rate.</p>	<p>Exposures with high interest rates are one of the common causes of financial distress. The financial difficulties of a borrower may partly derive from the fact that the interest rates are excessively high compared with the income of the borrower or from the fact that the evolution of interest rates, as opposed to a fixed rate, has resulted in the borrower receiving finance at an exorbitant cost, compared with prevailing market conditions. In such cases, an interest rate reduction could be considered.</p>

Forbearance measure	Description	Viability and other important considerations
		<p>If affordability can be achieved only at below-risk or below- cost rates, this should be clearly flagged.</p> <p>This measure could be applied also as a short-term measure.</p>
6. Extension of maturity/term	Extension of the maturity of the loan (i.e. of the last contractual loan instalment date), which allows a reduction in instalment amounts by spreading the repayments over a longer period.	<p>If the borrower is subject to a compulsory retirement age, term extension should be considered viable only where the institution has assessed and can demonstrate that the borrower can, through a pension or other sources of verified income, service the revised loan repayments on an affordable basis.</p> <p>Term extension should be considered viable only where it is in line with the life cycle of existing collaterals or proper substitution of the existing collaterals occurs.</p>
7. Additional collateral	Additional liens on unencumbered assets are obtained as additional collateral from the borrower in order to compensate for the higher risk exposure and as part of the restructuring process.	<p>This measure is not a viable standalone forbearance measure as it does not in itself resolve the presence of arrears on a loan. It usually aims to improve or cure LTV ratio covenants.</p> <p>Additional collateral may take many forms, such as a pledge on a cash deposit, assignment of receivables or a new/additional mortgage on immovable property.</p> <p>Institutions should value second and third liens on assets as well as personal guarantees with care.</p>
8. Sale by agreement/assisted sale	The credit institution and the borrower agree to voluntarily dispose of the secured asset(s) to partially or fully repay the debt.	<p>Credit institutions should restructure any residual debt post the assisted sale with an appropriate repayment schedule in line with the borrower’s reassessed repayment ability.</p> <p>For forbearance measures that may require the sale of the property at the end of the term, credit institutions should conservatively consider the future approach to any shortfall that could remain after the sale of the property and address it as early as possible.</p> <p>For exposures that are repaid by repossession of collateral at a predefined moment, the repossession does not</p>

<b>Forbearance measure</b>	<b>Description</b>	<b>Viability and other important considerations</b>
		constitute a forbearance measure unless it is exercised ahead of the predefined moment due to financial difficulties.
9. Rescheduled payments	The existing contractual repayment schedule is adjusted to a new sustainable repayment programme based on a credible, current and forecasted assessment of the borrower's cash flow	<p>Different repayment options may include:</p> <p>i. Partial repayment: when a payment is made against the exposure, for example from a sale of assets that is lower than the outstanding balance. This option is applied to significantly reduce the exposure at risk and to enable a sustainable repayment programme for the remaining outstanding amount. This option should be preferred to the bullet and step-up options described below.</p> <p>ii. Balloon or bullet payments: when the rescheduled repayment ensures a large payment of the principal at a later date before loan maturity. This option should be used/considered viable only in exceptional circumstances and when the institution can duly demonstrate future cash flow availability by the borrower to meet the balloon or bullet payment.</p> <p>iii. Step-up payments: credit institutions should consider a solution including this option viable only when they can ensure, and are able to demonstrate, that there is good reason to expect that future increases in payments can be met by the borrower.</p>
10. Conversion of currency	When the currency of the exposure is aligned with the currency of the cash flow.	Credit institutions should explain fully to borrowers the risks of foreign exchange and should also refer to currency conversion insurance.
11. Other alteration of contract conditions/covenants	When the credit institution discharges the borrower of covenants or conditions included in a loan agreement not listed above.	
12. Refinancing/new credit facilities	Providing new financing arrangements in order to support the recovery of a distressed borrower.	This is usually not a viable standalone forbearance measure; it should be combined with other forbearance measures addressing existing arrears. It should be applied only in exceptional cases.



Forbearance measure	Description	Viability and other important considerations
13. Debt consolidation	Combining multiple exposures into a single exposure or a limited number of exposures.	<p>New credit facilities may be granted that may entail the pledging of additional collateral. In the case of inter-creditor arrangements, the introduction of covenants may be necessary to compensate for the additional risk incurred by the credit institution.</p> <p>This measure may be more suitable for corporate exposures; a thorough assessment of the borrower's ability to pay should be performed, including sufficient involvement of independent sectoral experts to judge the viability of business plans and cash flow projections provided. This measure should be considered viable only when the thorough affordability assessment demonstrates repayment capacity in full.</p>
14. Partial or total debt forgiveness	The credit institution forfeits the right to legally recover part or the whole of the amount of the debt outstanding from the borrower.	<p>This is usually not a viable standalone forbearance measure; it should be combined with other forbearance measures addressing existing arrears.</p> <p>This measure is particularly beneficial in situations where combining collateral and secured cash flow provides greater overall collateral coverage for the entire debt, for example, by minimising cash leaks or by facilitating reallocation of cash flow surplus between exposures.</p> <p>This measure should be used where the credit institution agrees to a 'reduced payment in full and final settlement' whereby the credit institution will forgive all of the remaining debt if the borrower repays the reduced amount of the principal balance within an agreed timeframe.</p> <p>Credit institutions should apply debt forgiveness options carefully, since the possibility of forgiveness can give rise to moral hazard and thus might encourage 'strategic defaults'. Therefore, institutions should define specific forgiveness policies and procedures to ensure strong controls are in place.</p>

# Accompanying documents

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## Impact assessment

The ‘Council conclusions on Action plan to tackle NPLs in Europe’ require the EBA to issue, by summer 2018, general guidelines on NPL management and internal governance, consistent with the Single Supervisory Mechanism (SSM) guidance for significant institutions, i.e. its ‘Guidance to banks on Non-Performing Loans’ (SSM guidance).<sup>41</sup> More precisely, the Council requests that one of the (preferred) policy options presented in the Report of the Financial Services Committee (FSC) Subgroup on Non-Performing Loans.<sup>42</sup> As a result, this section uses the latter as a baseline for the analysis.

As per Article 16(2) of the EBA Regulation (Regulation (EU) No 1093/2010 of the European Parliament and of the Council), any guidelines developed by the EBA must be accompanied by an impact assessment (IA) that analyses ‘the potential related costs and benefits’. This IA must provide the reader with an overview of the findings as regards the problem identification, the options identified to remove the problem and their potential impacts.

This annex presents the IA with a cost–benefit analysis of the provisions included in the guidelines put forward in this Consultation Paper. Given the nature of the study, the IA is high level and qualitative in nature.

### A. Problem identification

The main (specific) problem that the current guidelines aim to address is the limitations on the scope of implementation of the SSM guidance. The SSM guidance covers a set of microprudential measures and supervisory tools for monitoring and assessing the performance of significant institutions under the SSM’s direct supervision regarding their strategy, governance and operations in relation to NPL management. In other words, the current scope of the policy implementation on NPL management is limited to significant institutions (and to their national, European and international subsidiaries) and does not cover other (less significant) institutions and banks outside the Banking Union. Yet there may be some other banks that are not subject to the SSM guidance that continue to have high levels of NPLs.

Overall, the exclusion of the banks that fall outside the scope of the SSM’s direct supervision from NPE management rules prevents the achievement of the ultimate policy objectives of tackling the high NPE levels in the EU.<sup>43</sup> This could lead to:

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<sup>41</sup> Press Release 459/17 (11/07/2017).

<sup>42</sup> Report of the FSC Subgroup on Non-Performing Loans (9854/17); see ‘Policy Option A.1’ (p. 55).

<sup>43</sup> Report of the FSC Subgroup on Non-Performing Loans (9854/17); see ‘Policy Option A.1’ (p. 55).

- a lack of necessary monitoring and assessment tools to enable supervisors to oversee the management of NPEs;
- a lack of timely recognition and intervention to tackle problems related to high levels of NPEs;
- obstacles to achieving supervisory convergence in the treatment of NPLs and to implementing a proactive NPE management strategy;
- obstacles to fostering and monitoring sound credit management and internal governance to prevent the emergence of excessive levels of NPEs.

The current practice not only leaves a large number of EU banks outside the scope of NPE monitoring and assessment but may also have a negative effect on the level-playing field and supervisory convergence in the EU banking sector.

## B. Policy objectives

The general objectives of the guidelines are to (i) provide supervisors with the necessary and effective tools to oversee the management of NPEs by banks and ensure their timely recognition and provisioning, (ii) promote supervisory convergence in the treatment of NPEs across EU banks, (iii) ensure that all relevant high NPE banks implement a proactive NPL management strategy, and (iv) foster and monitor sound credit originating standards, risk management and internal governance, to prevent the (re-)emergence of excessive levels of NPEs.

The specific objective of the guidelines for these purposes is to extend the scope of the supervisory monitoring and assessment of banks' NPE management to the entire EU banking sector to (i) ensure an effective supervisory framework to tackle NPE-related problems, (ii) promote supervisory convergence across EU banks and (iii) ensure a level-playing field in the EU banking sector.

## C. Baseline scenario

In March 2017, the SSM adopted its 'Guidance to banks on Non-Performing Loans'. The objective of the SSM guidance is for banks to define and implement quantitative policies and targets to address high levels of NPLs.

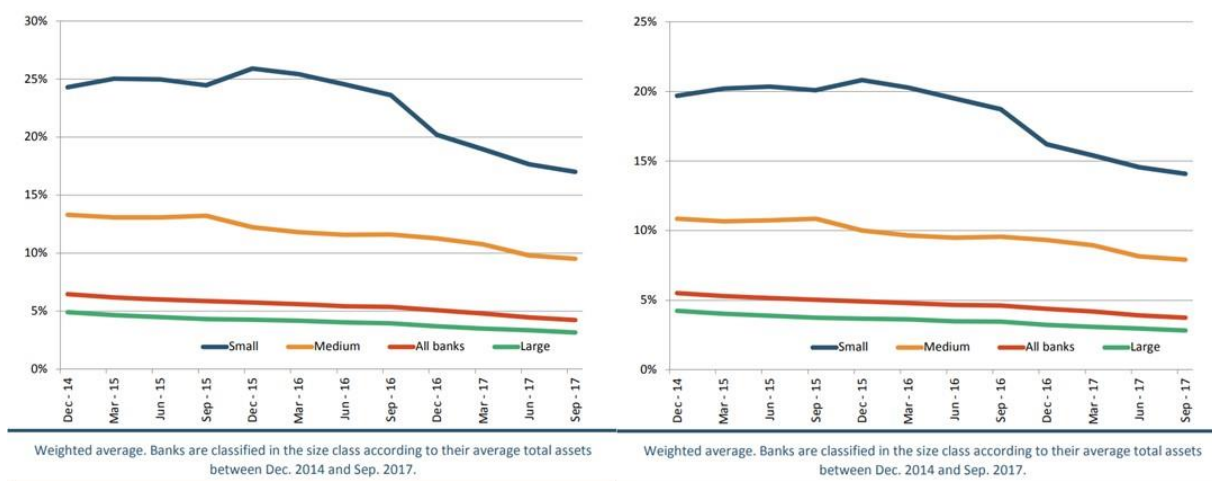
A total of 119 banks fall within the scope of the SSM guidance; the current rules do not cover over 6 000 other institutions that are operating in the EU. Furthermore, significant banks are mostly large banks that have relatively low levels of NPL/NPE ratios, while medium and small banks, in terms of their volume of total assets and level of cross-border activities, on average, have higher levels of NPL/NPE ratios. The EBA collects supervisory data from a sample of EU banks.<sup>44</sup> These

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<sup>44</sup> See the EBA Decision on reporting by competent authorities and the list of reporting institutions: <http://www.eba.europa.eu/risk-analysis-and-data;jsessionid=22757A060AF21D5FD05EE81F270578EC>.

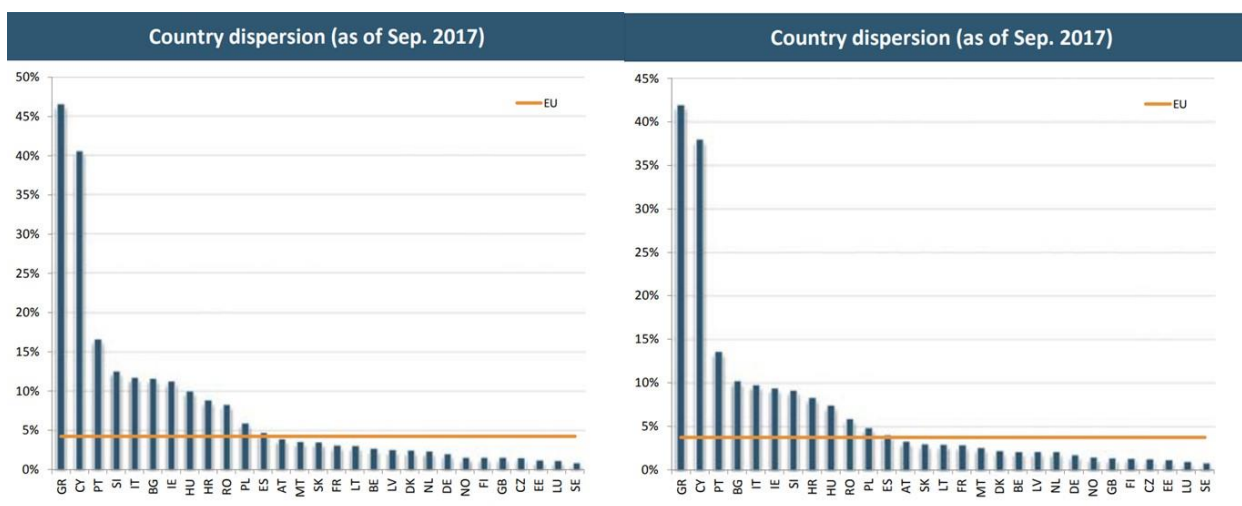
banking data show similar trends in NPL and NPE ratios (Figure 1). If no policy intervention takes place, the current problems related to high NPL/NPE levels are expected to persist.

Figure 1 Evolution of NPL ratios (left-hand panel) and NPE ratios (right-hand panel) by size of EU bank – EBA Risk Dashboard data as of Q3 2017



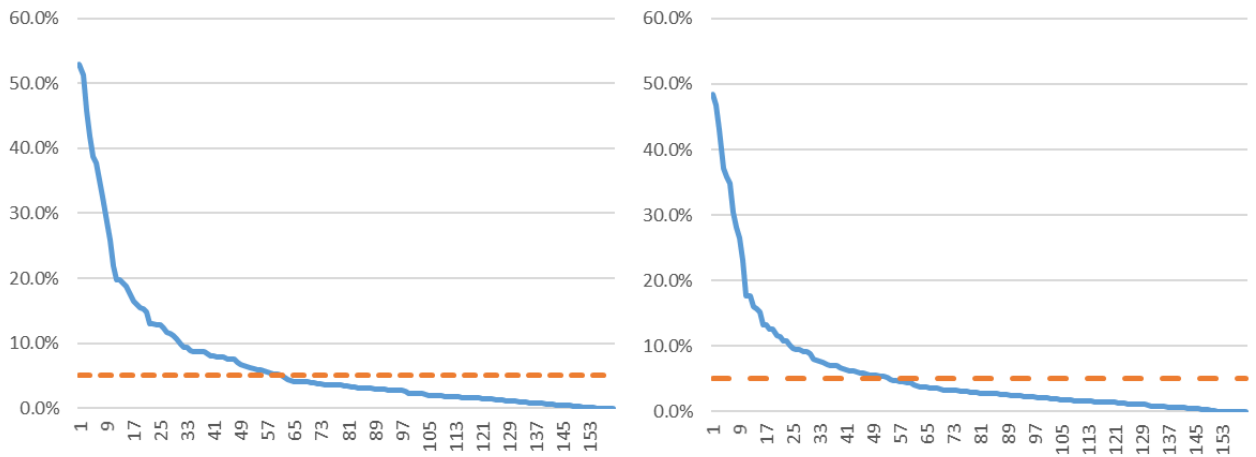
A further analysis indicates that there are no country-specific patterns in the NPL/NPE risk status of banks in relation to their eurozone membership. Countries with NPL/NPE ratios above the EU averages include both eurozone and non-eurozone countries (Figure 2).

Figure 2 Country dispersion in NPL ratios (left-hand panel) and NPE ratios (right-hand panel) – EBA Risk Dashboard data as of Q3 2017



The EBA’s supervisory data as of end September 2017 show that the (weighted) average NPL ratio is 4.2% and the median value is 3.4%, while the (weighted) average NPE ratio is 3.7% and the median value is 2.8% for EU banks. Figure 3 shows the distribution of NPL and NPE ratios across EU banks.

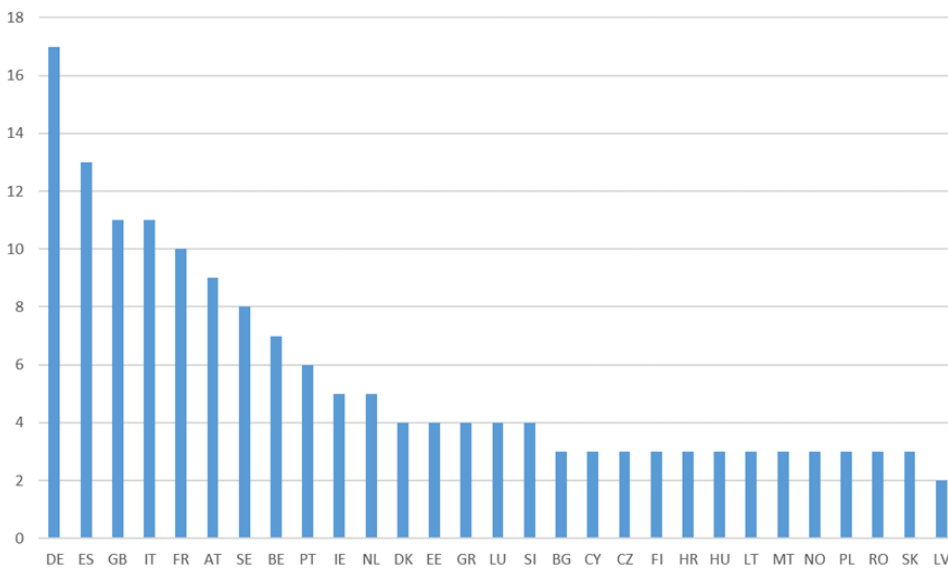
Figure 3 Individual bank-level distribution of NPL ratios (left-hand panel) and NPE ratios (right-hand panel) – EBA FINREP data as of Q3 2017



According to this distribution, among 160 banks included in the analysis, 64 banks (40% of the sample) have an NPL ratio above the average ratio and 65 banks (41% of the sample) have an NPE ratio above the average ratio.

In terms of cost and benefits, it is expected that the current guidelines will have an impact only on the banks in the EU banking sector that fall outside the scope of the SSM’s direct supervision, as currently significant banks are subject to the SSM guidance and they bear the costs and receive the benefits of the NPL management rules.<sup>45</sup>

Figure 4 Sample used for the analysis by Member State – EBA FINREP data as of Q3 2017



<sup>45</sup> This statement does not take into account any positive externalities that may be generated by the policy intervention as a result of the implementation of the rules by the systemic institutions that are already subject to the SSM guidance.

## D. Options considered

### Scope of implementation

- a) Option 1a: Guidelines to cover loans to specific sectors only
- b) Option 1b: Guidelines to cover all exposures

### Proportionality

- a) Option 2a: Application of proportionality in terms of institution-specific characteristics
- b) Option 2b: No application of proportionality in terms of institution-specific characteristics

### Introduction of a threshold

- a) Option 3a: Introduction of a threshold for the implementation of NPE strategy, governance and operations
  - i. Option 3a (i): Variable threshold
  - ii. Option 3a (ii): Static threshold
- b) Option 3b: No threshold for the implementation of NPE strategy, governance and operations

## E. Assessment of the options and cost–benefit analysis

### Scope of implementation

The assessment looked at the loans and exposure categories of banks to be included in the scope of the guidelines. Supervisory data show that NPLs, NPEs to households and NPEs to non-financial corporates (NFCs) are the major categories in which banks have critical risk ratios. Option 1a proposes including these categories. Option 1b suggests that, regardless of the current dynamics in the risk profiles of banks in relation to any loan or exposure category, the scope of implementation should cover the entire non-performing and forbearance scope of definition.

The EBA selected option 1b because it is expected to be more prudential and forward looking, i.e. although currently data do not indicate any major risk in exposure classes other than loans, households and NFCs, this may not be the case in the future. Therefore, the guidelines apply to all instruments and sectors – to exposures that meet the definition of NPEs or FBEs in Annex V to Commission Implementing Regulation (EU) No 680/2014.

In addition, it is expected that the additional cost of expanding the scope of implementation beyond loans, exposures to households and NFCs would not increase the operational cost and

administrative cost to banks or supervisors and that the expected benefits are greater. If critical values appear for other sectors and instruments in the future, the guidelines will not need to be revised to include them in their scope.

### Proportionality

The options require an assessment of whether the current guidelines introduce a balance between the policy requirements and the characteristics of the institutions, i.e. whether the policy requirements for the institutions are appropriate and fair given a set of criteria.

The application of the proportionality principle (option 2a) is intended to introduce a framework that requires that institutions comply with the NPE strategy, governance and operational requirements in proportion to their characteristics.

More precisely, it aims to avoid disproportionately large (administrative and operational) costs for institutions in relation to their characteristics, such as their size, internal organisation, and the nature, scope and complexity of their activities.

For example, the implementation of separate and dedicated NPE WUs might be disproportionately costly for a small institution with less complex and more local business activities than for a large international institution with a more complex set of portfolios. Therefore, the guidelines introduce simplified requirements for some banks. These banks, meeting certain proportionality criteria, may not need to or be able to set out a separate WU but need only to separate certain tasks. In addition, for small banks that do not have internal models, it would be costly to meet requirements for advanced back-testing. Therefore, guidelines introduce simplified requirements for small banks that do not use internal models. This application of proportionality applies also in other technical areas, such as the definition of borrower subportfolios.

However, the recognition and accounting aspects presented in sections 6, 7 and 8 of the guidelines do not justify differing treatment among banks and apply to all institutions regardless of the proportionality assessment criteria.

The application of the proportionality principle does not refer to the risk profiles of the institutions (which depend in this case on the NPL/NPE indicators); rather, it is based on the (non-risk) indicators that are published in section 4 of the EBA Guidelines on internal governance under Directive 2013/36/EU.

Due to its implications for cost-effectiveness, option 2a is the preferred option.

### Introduction of a threshold

The objective of setting a threshold is to link the requirements of the current guidelines (as presented in sections 4 and 5) to the risk profiles of the institutions. This should ensure greater efficiency in supervision and increase the cost-effectiveness of the policy measures.

An NPL/NPE ratio level to be applied at individual institution level would indicate a systemic threshold above which the institutions would be subject to more prudential rules under the scope of the guidelines.

Such a threshold would not be a clear cut-off point; competent authorities would have discretionary power not to wait for institutions to reach this threshold and to apply certain (precautionary) rules when the NPL/NPE ratio of an institution was below the set threshold but showed a somewhat signalling trend. Such a threshold would be a risk-based metric and would apply to all banks.

Option 3b (not introducing a threshold) would not remove the potential problems related to NPEs and would not achieve the policy objectives, for example comparability and consistency across banks and jurisdictions. The preferred option is option 3a.

The left-hand panel in Figure 3 shows the distribution of NPL ratios across EU banks, with the horizontal dashed line indicating the hypothetical 5% threshold.

The numbers of banks with an NPL ratio below 5% (and below 10%) were calculated to take into account the potential binding effect of the threshold. If a 5% threshold were introduced, about 38% of the banks in the sample would remain above this threshold. If this threshold were introduced at a (more relaxed) 10% level, the number of banks that would remain above the critical value would fall to 19%. One limitation of this analysis is that the EBA sample includes mostly large banks, while the baseline scenario shows that problems related to NPEs/NPLs across the EU are greater among small and medium-sized banks.

Similarly, as of end September 2017, the EBA data show that 33% of banks have an NPE ratio above the hypothetical 5% level, while this figure goes down to 15% for a hypothetical threshold of 10%.

Another question is whether the threshold should be static or varying depending on other microeconomic and macroeconomic conditions. A varying threshold applicable at the industry level is not justified on microeconomic grounds (current risk profile of banks in relation to NPL/NPE ratios) or macroeconomic grounds (dynamics of macroeconomic conditions). Indeed, the average NPL/NPE ratio for all banks has been fairly stable, albeit following a decreasing trend, over recent years (see Figure 1). The objectives of the guidelines are to ensure an early warning system and to establish preventive measures against critical NPEs/NPLs. A static threshold is expected to be an effective measure in this regard, while a varying threshold accounting for the tendency of NPEs/NPLs to fluctuate during the economic cycle is not expected to achieve these objectives. In other words, the justification for a decrease in the threshold would be related to more stable (long-term) average risk performance on the part of banks and not necessarily the (short- or medium-term) economic conditions that a varying threshold would capture. The EBA guidelines introduce a static threshold (option 3a(ii)).



## Feedback on the public consultation

The EBA publicly consulted on the proposed guidelines contained in this paper.

The consultation period lasted for three months and ended on 8 June 2018. In the consultation period, the EBA received 26 responses including two confidential responses. The EBA published the 24 non-confidential responses on its website.<sup>46</sup> The EBA did not receive feedback from the Banking Stakeholder Group (BSG).

This paper presents a summary of the key points and other comments arising from the consultation, the analysis and discussion triggered by these comments, and the actions taken to address them if deemed necessary.

In many cases, several industry bodies made similar comments or the same body repeated its comments in response to different questions. In such cases, the comments and the EBA's analysis are included in the section of this paper where the EBA considers them most appropriate.

Changes to the guidelines have been incorporated as a result of the responses received during the public consultation. The feedback table below presents in detail the comments received from stakeholders, the EBA's analysis of these comments and any action taken.

### Summary of key issues and the EBA's response

Stakeholders had **general comments** on various issues such as the prescriptiveness of the requirements and in relation to the application of the principle of proportionality throughout the guidelines. Some comments presented a detailed list of requirements that the stakeholders considered particularly prescriptive. Where possible and appropriate, the EBA changed the language accordingly to avoid any unintended consequences of the prudential regulation, such as an unnecessary regulatory burden on institutions.

In terms of the application of the proportionality principle, in the guidelines the EBA provided some examples and included considerations for institutions and competent authorities in order to indicate how the principle of proportionality should be applied in practice. These considerations include, for example, references to four distinct SREP categories and considerations in relation to NPE governance and operational aspects.

Following the comments received from the stakeholders in relation to the **scope of the guidelines**, the EBA clarified the treatment of trading book assets. While the scope of NPEs is already aligned with Annex V to Commission Implementing Regulation (EU) No 680/2014, i.e. from an accounting perspective, it is clarified that trading book assets are excluded from the scope also from a prudential perspective. Following stakeholder comments, the EBA also included a provision

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<sup>46</sup><http://www.eba.europa.eu/regulation-and-policy/credit-risk/guidelines-on-management-of-non-performing-and-forborne-exposures>

requiring competent authorities to consider in their supervisory evolution the specificities of institutions whose sole business is the purchase and servicing of NPEs.

In relation to the **5% NPL level for the implementation of sections 4 and 5 of the guidelines**, while some stakeholders commented that one standard threshold was undesirable, others commented on the calibration of the threshold. A majority of stakeholders asked for further clarification on the level of implementation. As explained below, the EBA is of the view that an easy-to-understand and easy-to-implement threshold has many benefits, in line with the objectives of these guidelines (i.e. the effective management and reduction of NPLs), but also in terms of transparency and supervisory convergence. The EBA did not change the calibration of the 5% NPL level. The EBA clarified the level of implementation and allowed supervisory discretion regarding when institutions should apply sections 4 and 5 of the guidelines on the basis of portfolio assessment.

Some stakeholders commented on the potential workload imposed by complying with the guidelines and argued that either a delay in the implementation date or a transitional period was needed. Similarly, few stakeholders asked the EBA to clarify the entry and exit criteria for the application of sections 4 and 5 of the guidelines. As explained below, the EBA amended the implementation period to 30 June 2019 with no additional transitional period. Accordingly, to clarify the entry criterion, credit institutions are expected to calculate their NPL ratios using data as of 31 December 2018 and to start implementing the guidelines from 30 June 2019. Regarding the exit criterion, the EBA clarified that this will depend on institutions' NPE strategies and should be decided as part of supervisory dialogue.

Following stakeholder comments, the EBA also clarified and stressed that credit institutions should **account for consumer protection issues and have regard for fair treatment of consumers** not only when they apply sections 4 and 5 of the guidelines but also when they consider forbearance measures as part of their NPE management and reduction strategies.

With regard to the section on **NPE impairment measurement and write-offs**, the EBA received various comments asking for clarification on the requirements. In order to avoid a potential lack of clarity or conflict between these guidelines and accounting rules, the EBA removed some of the sections and clarified the issues relating to the remaining part of the section. When addressing these comments in the feedback table below, the EBA has ensured consistency of language between the guidelines and the accounting rules.

The EBA also received several comments in relation to the **EUR 300 000 set threshold for the gross carrying amount of collateral** above which credit institutions are not allowed to use indexed valuation. Most stakeholders argued that there were many factors (e.g. location of the property, purchasing power, economic environment, etc.) to be considered for collateral valuation and that this threshold would not be feasible given significant differences in these factors not only across jurisdictions but also within countries. The EBA acknowledges the difficulty of introducing one single threshold and, as explained in the feedback table, has changed the requirements so that the competent authorities are expected to set thresholds in their jurisdictions.

Finally, the EBA, in line with the comments received from the stakeholders, streamlined the language, clarified the definitions of and references to certain concepts used in the guidelines and fine-tuned the overall content where necessary.

## Summary of responses to the consultation and the EBA's analysis

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<b>General comments</b>			
Level of details and prescriptiveness	Two stakeholders commented that the guidelines were overly prescriptive, that the EBA should follow a more principle-based approach and that some requirements should be introduced as suggestions or examples.	The objective of these guidelines is to create greater convergence of supervisory practices and promote a structured approach to managing and ultimately reducing NPEs. The EBA is of the view that the framework and requirements set out in these guidelines are proportionate to these objectives and reflect the existing best practices in the area as employed by various competent authorities across the EU.	Where applicable, the EBA has reviewed the wording used throughout the guidelines to ensure that the requirements are proportionate and in line with the objectives of the guidelines.
Level of prescriptiveness	<p>A stakeholder stated that some of the defined criteria were too narrow and were not fully comprehensible. Unless the guidelines introduce a more principle-based approach, they need to clarify the following points:</p> <ul style="list-style-type: none"> <li>• short-term period for project finance (paragraph 131a)</li> <li>• 'formal manner via written documentation ... concluding that a long-term ... was not possible' (paragraph 131a)</li> <li>• 'good financial relationship' (paragraph 131b)</li> </ul>	The EBA acknowledges the comment and has revised the text accordingly.	The EBA has amended section 6.1 of the guidelines.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Addressees of the guidelines	Two stakeholders commented that the draft guidelines should be addressed exclusively to competent authorities and should not include binding requirements for credit institutions.	The guidelines are addressed to both competent authorities and credit institutions, as it is for the latter to set out NPE strategies, where required, and for the former to assess these strategies as part of ongoing supervisory engagement in the SREP. Addressing the guidelines to institutions also contributes to the convergence of supervisory practices, as it ex ante spells out the requirements for the NPE strategies and governance arrangements to be implemented by the affected institutions and thus reduces the risk of different treatment of similar institutions due to supervisory discretion.	The EBA did not make any amendments to the guidelines on this point.
Interaction between EBA guidelines and ECB guidance	A number of stakeholders requested further clarification on the relationship between the EBA Guidelines and the ECB's 'Guidance to banks on non-performing loans' (ECB guidance), for example whether compliance with the EBA guidelines can be supposed if the ECB guidance has been implemented as intended by banks.	<p>Article 16(1) of the EBA Regulation provides that the EBA 'shall, with a view to establishing consistent, efficient and effective supervisory practices within the ESFS, and to ensuring the common, uniform and consistent application of Union law, issue guidelines and recommendations addressed to competent authorities or financial institutions.'</p> <p>The current guidelines specify, in the context of relevant provisions of the CRD, sound risk management practices for credit institutions for managing NPEs, FBEs and foreclosed assets. The guidelines also provide competent authorities with guidance on evaluating credit institutions' risk management practices, policies, processes and procedures for managing NPEs and FBEs.</p> <p>The guidelines are addressed to competent authorities as defined in point 40 of Article 4(1) of</p>	The EBA did not make any amendments to the guidelines on this point.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>Regulation (EU) No 575/2013, including the European Central Bank with regard to matters relating to the tasks conferred on it by Regulation (EU) No 1024/2013, and to credit institutions as defined in point 1 of Article 4(1) of Regulation No 575/2013.</p> <p>Article 4(3) of the SSM Regulation provides, inter alia, 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. It shall in particular be subject to binding regulatory and implementing technical standards developed by EBA and adopted by the Commission in accordance with Article 10 to 15 of Regulation (EU) No 1093/2010, to Article 16 of that Regulation, and to the provisions of that Regulation on the European supervisory handbook developed by EBA in accordance with that Regulation.’</p> <p>Article 16(3) of the EBA Regulation provides that ‘the competent authorities and financial institutions shall make every effort to comply with those guidelines and recommendations. Within 2 months of the issuance of a guideline or recommendation, each competent authority shall confirm whether it complies or intends to comply with that guideline or recommendation. In the event that a competent authority does not comply or does not intend to comply, it shall inform the EBA, stating its reasons. The EBA shall publish the fact that a competent</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>authority does not comply or does not intend to comply with that guideline or recommendation.’</p> <p>Thus, in the case that the ECB complies with the EBA guidelines, it is expected that the ECB guidance will be in line with the EBA guidelines.</p> <p>Financial institutions will then be expected to comply with the EBA guidelines also having regard to the ECB guidance, which should be considered to set out the supervisory practice on the basis of which the ECB complies with the EBA guidelines.</p> <p>More generally, where a competent authority declares compliance with EBA guidelines, financial institutions to which those guidelines are addressed are expected to comply with the guidelines, both on the basis of the soft or hard legal instrument by which the EBA guidelines have been ‘internalised’ within the pertinent supervisory practice of the competent authority and on the basis of their directly applicable obligation referred to in Article 16 of the EBA Regulation, i.e. the obligation on the financial institutions to make every effort to comply with EBA guidelines.</p> <p>Where a competent authority has declared that it will not comply with EBA guidelines, there is a tension between the aforementioned directly applicable Union obligation on the relevant financial institutions to make every effort to comply with EBA guidelines and the fact that their competent authority has explained that it cannot comply. This tension can be settled only on an ad hoc basis, primarily having</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Interaction between EBA guidelines and ECB guidance	Some stakeholders commented on potential conflicts and legal uncertainties for banks if the requirements in the EBA guidelines and the ECB guidance are not streamlined.	<p>regard to the explanation that has been provided by the competent authority for non-compliance.</p> <p>To conclude, if the ECB declares compliance with the EBA Guidelines, institutions, to which the ECB Guidance is addressed, following that Guidance, should be seen as also complying with the EBA Guidelines and vice versa, without prejudice to possible additional elements discussed below.</p> <p>Where the ECB Guidance or any supervisory practice of a competent authority for that matter provides for additional elements, provisions or conditions, which do not contradict the EBA Guidelines, in areas where the EBA Guidelines remain silent or can be further specified by competent authorities, financial institutions should also separately consider those additional elements, provisions or conditions.</p>	
		<p>The EBA does not see any particular reason for conflicts or legal uncertainties. With regard to how the EBA guidelines interact with the ECB guidance, see above.</p> <p>The EBA took into account the Council's political conclusions to issue guidelines in line with the ECB guidance.</p> <p>The EBA had, however, regard also to the fact that the Council's decision to assign to the EBA the task of regulating by means of the soft legal instruments referred to in Article 16 of the EBA Regulation the key topic of NPEs and FBEs consciously pre-supposed the inevitable recourse to the efficient and transparent</p>	



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<p>rule-making procedure envisaged in Article 16 of the EBA Regulation, according to which the EBA ‘shall, where appropriate, conduct open public consultations regarding the guidelines and recommendations and analyse the related potential costs and benefits. Such consultations and analyses shall be proportionate in relation to the scope, nature and impact of the guidelines or recommendations. The Authority shall, where appropriate, also request opinions or advice from the Banking Stakeholder Group referred to in Article 37.’</p>			
<p><b>Responses to questions in Consultation Paper EBA/CP/2018/01</b></p>			
<p><b>Question 1. What are the respondents’ views on the scope of application of the guidelines?</b></p>			
<p>Treatment of trading book assets</p>	<p>The guidelines define non-performing and forborne exposures in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014.</p> <p>This definition excludes trading book assets from an accounting perspective. Since the intention of the draft guidelines is to exclude trading book assets from the scope of application, for greater clarity, a number of stakeholders requested an explicit reference to Article 4(1)(86) of the CRR to carve out trading book assets also in regulatory terms.</p>	<p>The EBA agrees with the comment.</p>	<p>The EBA has amended the scope of application and included an explicit reference to Article 4(1)(86) of the CRR in the final text.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Definition and perimeter of movable property	For the valuation of collateralised movable property, some stakeholders requested greater clarity on the definition and perimeter of movable property.	The EBA agrees with the comment and suggests a reference to Article 210 of the CRR on requirements for other physical collateral.	The EBA has amended the definitions section of the guidelines.
Proportionality	<p>Some stakeholders commented that the wording regarding the application of the proportionality principle (i.e. paragraph 14) was not clear and potentially did not allow sufficient flexibility to achieve a meaningful and feasible implementation of the guidelines to smaller institutions or institutions with an evidently low risk profile.</p> <p>Stakeholders argued that the application of the proportionality principle should be clarified in the text (and should apply to all aspects of the guidelines).</p>	The EBA agrees with the comment. The application of the principle of proportionality should be linked to the relevance and magnitude of NPEs and the size and complexity of institutions as explained in the Guidelines on common procedures and methodologies for the SREP. In particular, it should relate to SREP categorisation, i.e. four categories based on the institution's size, structure and internal organisation, and the nature, scope and complexity of its activities.	The EBA has amended the sections on scope of application, proportionality and the corresponding requirements in section 5.
Treatment of purchased NPLs	<p>Some stakeholders commented on the treatment of purchased NPLs. They stated that there are credit institutions that act as investors in NPL secondary markets and that the current requirements of the draft guidelines might have unintended consequences, i.e. they could discourage credit institutions from investing in NPL secondary markets, which would also contradict the EBA's initiatives promoting secondary markets for NPLs.</p> <p>The stakeholders therefore invited the EBA to consider the exclusion of purchased NPLs from both the scope of application and the definition of the NPL ratio for the purposes of these guidelines.</p>	<p>The EBA does not agree with excluding purchased NPLs outright from the calculation of the NPL ratio and from the scope of these guidelines, as any purchased NPL will contribute to the stock of existing NPLs and associated activities, including workout, servicing, monitoring, etc.</p> <p>Furthermore, exclusion of purchased NPLs from the calculation of the NPL ratio could create a secondary definition departing from the harmonised standards of the industry.</p> <p>The EBA agrees, however, that there may be specialised credit institutions whose sole activity is purchasing and servicing of NPEs. Therefore, in</p>	The EBA has amended the relevant section accordingly.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		supervisory evaluations and in implementing the principle of proportionality, competent authorities should consider the specificities of these institutions.	
<b>Question 2. What are the respondents' views on the proposed threshold of a 5% NPL ratio?</b>			
Introduction and implementation of a standard NPL threshold	<p data-bbox="535 571 925 595"><b><i>Introduction of a standard NPL ratio</i></b></p> <p data-bbox="535 643 1693 746">Most stakeholders were of the view that the proposed level for the threshold was low, in particular, and, in general, that introducing a standard NPL threshold for the purposes of setting the NPE strategy (section 4) and introducing NPE governance and operations measures (section 5) was not desirable for several reasons:</p>	<ol data-bbox="584 786 1693 1361" style="list-style-type: none"> <li data-bbox="584 786 1693 850">1. One standard NPL threshold does not account for the different product mixes on banks' balance sheets and does not reflect differences in the portfolios and risk profiles of credit institutions.</li> <li data-bbox="584 898 1693 994">2. It fails to allow for a holistic view of the situation as part of an institution's overall risk management, recognising recent improvements in terms of NPL reduction and recognising firms' individual risk appetites and stress testing frameworks.</li> <li data-bbox="584 1042 1693 1217">3. It does not account for the different business models of institutions, for example banks with a focus on consumer credit, an area in which NPL ratios are structurally higher, or banks with a focus on leasing, where the collateral, unlike in traditional secured lending, remains on the balance sheet of the lender and can be liquidated quickly at market value. Other examples include banks with a focus on consumer credit, including social housing, which targets low-income households.</li> <li data-bbox="584 1265 1693 1361">4. It does not consider the significant differences between the jurisdictions in which institutions operate, including market and national legal characteristics, for example differing regimes concerning restructuring and extrajudicial collateral enforcement procedures.</li> </ol>	<p data-bbox="1722 555 1921 707">The EBA did not make any amendments to the level of the threshold.</p> <p data-bbox="1722 738 1921 1090">The EBA has amended the scope of application of the threshold and clarified the level of application of the threshold, as well as specifying the possible application of the guidelines at portfolio level.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>5. It does not account for other relevant risk metrics such as broad coverage ratios (provisions, impairment, collaterals, etc.).</p> <p>6. It does not consider varying levels of NPL ratios over time, from one institution to another, depending on the arbitration between profitability and cost of risk, from one type of credit to another (consumer credit, mortgage credit, etc.), and also throughout business cycles, and therefore may have a negative impact on efforts to implement an anti-cyclical economic policy in the EU.</p>	<p>Similarly to points 3 and 5 above, stakeholders commented that some type of activities, such as loan restructuring, consumer finance and social housing, have by definition high rates of gross NPLs without necessarily bearing high losses. In some cases, gross NPL can be 5% but, taking into account other factors, that may indicate that the actual losses experienced are low.</p>	
		<p>In addition, the application of a gross NPL ratio to such portfolios could be counterintuitive: since the expected loss is low, margins are also relatively low, and operating an NPL portfolio in accordance with the principles described would put additional pressure on the operational margins of institutions.</p>	
		<p><b><i>Level of application</i></b></p>	
		<p>Some stakeholders argued that the level of application of the threshold in relation to the application of sections 4 and 5 was not clear and therefore left room for interpretation.</p>	
		<p>First, it was not clear if the guidelines required the application of the threshold first at consolidated level, sub-consolidated or solo level and second at portfolio level. The guidelines stated that ‘Credit institutions with a NPL ratio below 5% but with a high share or material amount of NPEs in an individual portfolio or with a specific concentration of NPEs towards a geographic region, an economic sector or group of connected</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>clients, should apply sections 4 and 5 on these portfolios’. Some stakeholders requested further clarification of this statement in relation to the definitions of ‘high share’ and ‘material amount’.</p>	<p><b><i>Suggestion on application</i></b></p>	
	<p>Some stakeholders commented that the 5% NPL threshold should be indicative. It should not be an automatic trigger for the implementation of sections 4 and 5 but trigger supervisory dialogue between the competent authority and the institution. Supervisory dialogue remains essential and credit institutions should have the opportunity to provide explanations to competent authorities as regards their having an elevated level of NPLs.</p>	<p><b>The EBA’s position:</b> for the purposes of these guidelines, the EBA supports the introduction of a simple-to-understand static threshold at a level of 5% gross NPL ratio for the application of sections 4 and 5. This will ensure consistency and clarity for credit institutions in the application of the guidelines, and convergence of supervisory practices. This is an important and effective harmonised strategy to achieve NPL reductions in line with the Council’s Action Plan. This threshold does not aim to set internal limits for credit institutions; rather, it sets a prudential framework for stricter supervisory monitoring for timely prevention of the emergence of NPLs at higher levels.</p>	
	<p>The central objective of the guidelines is to reduce the levels of NPEs/NPLs, rather than only to promote prudent provisioning. As a result, the EBA is of the view that the gross NPL ratio meets the objective and is a more accurate and fit-for-purpose indicator than the net NPL ratio, which would focus more on potential additional losses rather than the overall magnitude of the NPE issue. Furthermore, the EBA believes that the threshold would need to be lower if the net NPL ratio were introduced. The net NPL ratio is an important indicator and should be part of the SREP assessment together with other risk indicators, for example CET1.</p>		
	<p>For the purposes of transparency and simplicity in the application of these guidelines, the threshold is introduced as a static value calibrated with the NPL ratios observed in 2016–2017; a detailed analysis of the calibration is provided in the impact assessment. Any recalibration of the threshold in the light of the</p>		

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>feedback received was not deemed necessary, as this would conflict with the policy objectives of the guidelines.</p> <p>In terms of the level of application, the EBA has clarified in the guidelines that the threshold will be applicable at consolidated, sub-consolidated and solo levels and will require the application of sections 4 and 5 where NPL ratios at any of these levels is equal to or greater than 5%. For example, where a credit institution has an NPL ratio below 5% at consolidated level but a subsidiary of this institution has an NPL ratio above 5%, according to the guidelines, the subsidiary in question should follow the provisions of sections 4 and 5.</p> <p>Furthermore, the EBA clarifies that the guidelines do not set any NPL threshold at portfolio level and leave it to competent authorities' discretion to apply the requirements based on banks' portfolios. Competent authorities are expected to assess the materiality of a given portfolio (e.g. the nature and size of the portfolio in terms of total exposures) and of the NPEs, including their number, size and concentration, associated with that portfolio. It is then up to competent authorities to decide, following the materiality assessment, whether affected credit institutions are subject to the provisions of sections 4 and 5 of the guidelines at portfolio level.</p>		
Entry/exit criteria	One stakeholder requested further clarification on the entry/exit criteria and the obligation to comply with the requirements included in sections 4 and 5.	The entry criteria are linked to the first application of these guidelines: institutions are expected to apply these guidelines as of 30 June 2019 using the NPL ratios calculated as at 31 December 2018. The exit criteria will depend on the institution's NPE strategy (including any NPL ratio targets set out there) and supervisory assessment and dialogue around this strategy.	The EBA has clarified the entry and exit criteria in the section on the implementation of the guidelines.
<b>Question 3. Do you see any significant obstacles to the implementation date and, if so, what are they?</b>			

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Operational and IT adjustments	<p>Stakeholders criticised the planned implementation date of the guidelines (1 January 2019) and argued that it was highly demanding and burdensome for institutions for several reasons. In order to comply with the standards, institutions would need to:</p> <ul style="list-style-type: none"> <li>• adjust their operational and IT systems to comply with the guidelines, especially with respect to the data requirements in the annexes;</li> <li>• adjust their routines and processes to fulfil NPE and FBE requirements, for example to classify FBEs as short-term/long-term, viable/non-viable;</li> <li>• prepare a thorough gap analysis and a detailed implementation plan (in the case of institutions with NPL ratios above the threshold) under the NPE strategy.</li> </ul> <p>These processes may require time to implement; for example, the requirement to develop an NPE strategy, which should be part of the institution’s risk management framework and the corresponding operational plan, would require the approval of the management body and possibly also of the supervisory body of the institution.</p> <p>Accordingly, some stakeholders requested a delay in the implementation of the EBA guidelines until January 2020 and some stakeholders requested a transitional period.</p>	<p>The EBA acknowledges the concerns raised by the stakeholders. The EBA proposes delaying the date of application by 6 months to 30 June 2018. The EBA does not propose to introduce any transitional arrangements.</p> <p>Credit institutions are expected to apply the guidelines as from 30 June 2019, and for the first application of these guidelines the reference date for the calculation of the NPL ratios is 31 December 2018.</p>	<p>The EBA has amended the guidelines and clarified this point on the date of application.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>Some stakeholders commented that the focus should also be on the costs entailed by applying the recovery strategies (included in the ICAAP, RAF and Recovery Plan) from as early as 2019 and by financing the unplanned investments necessary in 2018 to meet all the operational requirements set out in the section on governance (particularly with regard to technical resources). Consequently, one stakeholder asked for the gradual introduction of the operational requirements.</p>		
<p>Interplay with other EBA products</p>	<p>Some stakeholders commented that there might be a misalignment regarding the implementation date of the guidelines because the EBA guidelines referred to two other EBA products for the application of the definition of default (EBA/GL/2016/07) and the materiality threshold (Commission Implementing Regulation (EU) 2018/171 of 19 October 2017). These products will apply from 1 January 2021 and not later than 31 December 2020, respectively.</p> <p>Therefore, some stakeholders suggested delaying the implementation date until 2021.</p>	<p>The EBA acknowledges the remark and the fact that until the application date of EBA/GL/2016/07 institutions or competent authorities may use definitions of default that may vary from the EBA common definition. This, however, cannot be considered a practical obstacle to the implementation of these guidelines.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>
<p>Cut-off date</p>	<p>One stakeholder commented on uncertainty as regards the cut-off date, i.e. the point of time for applying the threshold to define which credit institutions are subject to the application of sections 4 and 5 of the guidelines.</p>	<p>The EBA agrees with the remark and has suggested for the first application of these guidelines the reference date of 31 December 2018 for the calculation of the NPL ratios.</p>	<p>The EBA has amended the guidelines and clarified this point in the section on date of application.</p>



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<b>Question 4. Does section 4.3.2 capture all relevant options available for credit institutions to implement their NPE strategy?</b>			
Definition of the management body	<p>The draft guidelines state that ‘the NPE strategy and the operational plan should be defined and approved by the management body and reviewed at least annually.’</p> <p>Two stakeholders commented that it would be unreasonable to consider that this always implied the bank’s management board. The management board of an internationally active bank is not the appropriate body to approve lower-level policy documents; policies are better delegated, understood and monitored by lower-level policy committees that are closer to the details.</p> <p>Therefore, the stakeholder stated, the definition of the ‘management body’ is unclear and the EBA should clarify expectations around the definition of ‘management body’, adopting a proportionate approach, especially for internationally active banks.</p>	<p>Management body is defined in accordance with points 7 and 8 of Article 3(1) of Directive 2013/36/EU.</p> <p>The NPE strategy, where relevant, cannot be considered a solely technical policy document that is outside the scope of managerial activities. The NPE strategy should form part of the overall strategy. The roles and responsibilities of the supervisory and management functions of the management body should be appropriately defined in accordance with the EBA Guidelines on internal governance.</p>	<p>The EBA has amended the definitions section to clarify the point.</p>
Securitisation/CRM	<p>Two stakeholders requested that the EBA clarify that the requirements under section 4.3.2 do not and are not intended to supplement or amend the relevant securitisation/credit risk mitigation regulations currently set out in the CRR (in particular but not only in Article 119(5) of the CRR and Articles 243 and 244 of the CRR) and in the Securitisation Regulation.</p>	<p>The requirements do not and are not intended to supplement or amend the relevant securitisation/credit risk mitigation regulations currently set out in the CRR (in particular but not only in Article 119(5) of the CRR and Articles 243 and 244 of the CRR) and in the Securitisation Regulation.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Differentiation between past due and unlikely to pay criteria	<p>Two stakeholders invited the EBA to differentiate between NPEs based on past due and those based on unlikeliness to pay.</p> <p>Stakeholders argued that some of the criteria for the unlikely to pay NPEs may not be sustained from a contractual, legal or judicial execution point of view, which could constitute an effective impediment to NPE reduction.</p>	<p>In the comment, the EBA does not see any obstacle to implementing the NPE strategy as specified in the guidelines for past due and unlikely to pay NPEs. Given the definition of NPEs in accordance with Annex V to Commission Implementing Regulation (EU) No 680/2014, the EBA does not consider differentiation of the treatment of NPEs and of NPE strategies on the basis of the past due criterion and the unlikeliness to pay criterion necessary.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>
Additional option in the strategy implementation options	<p>An additional relevant option that one respondent had seen successfully executed in the market was deconsolidation by the constitution of joint venture companies with international investors or real estate developers (in the case of real estate assets). As part of an active portfolio reduction strategy, banks have come up with this strategy by which significant risk is transferred (usually from 51% to 80%) while allocating the business management to specialised professional partners. Thus, banks have been able to enter into larger transactions, at the expense of a lower price but retaining potential upside.</p>	<p>Such a strategy may be carried out as a combination of two or more options listed in the guidelines. Such a strategy may require thorough ad hoc supervision to assess the risk associated with the strategy and with respect to the objectives of the guidelines.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>
Strategy implementation options	<p>One stakeholder suggested that, while not intended to be exhaustive, the list provided under section 4.3.2 captured the most common options evaluated by banks when developing NPE strategies. It is worth noting that the consideration of all those options depends heavily on the markets in which the institution operates. While in some</p>	<p>The references to ‘overall’ and ‘overarching’ strategies are related to the general risk management of the credit institutions. NPE strategies are expected to be part of the general strategies and risk management strategies of banks. The guidelines acknowledge obligor-based variations that credit institutions may adopt to tackle high NPE levels.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>developed markets the full range of options should be considered, that may not be the case for less developed markets, in which the number of available and/or viable options is limited.</p> <p>The respondent also wished to make two additional comments on sections 4 and 5. It believed that, most importantly, NPE strategies should be developed, approved and monitored at the right level to be meaningful. While the guidelines refer to the ‘overall’ or ‘overarching’ NPE strategy, industry practices are more likely to take the form of adopting strategies that are tailored to each top non-performing obligor based on the relevant context. As mentioned above, the jurisdiction in which the NPE strategy will be implemented is critical in determining which options are available and most effective. Similarly, it is unlikely that the analytical steps listed under sections 4.1 and 4.2 to develop the NPE strategy and assess the operating environment would lead to a one size fits all strategy. The respondent argued that the guidelines should explicitly recognise this reality to avoid unintended consequences.</p>	<p>Developing an NPE strategy requires an assessment of the operating environment, and internal and external conditions. Furthermore, the competent authorities will assess the NPE strategies and will engage in an appropriate dialogue with an institution as part of the SREP process, in which specific aspects of the strategies can be considered in the context of the overall SREP assessment.</p>	
Proportionality	<p>One stakeholder commented that, while it welcomed the comprehensive and thorough approach described in sections 4 and 5, it highlighted the need to apply the guidelines’ recommendations in a proportional manner based on the specific NPE profile of each institution and the results of internal and external audit reviews. In</p>	<p>The guidelines introduce requirements to achieve NPE reductions on the basis of credit institutions’ risk profiles and in proportion to these institutions’ characteristics.</p> <p>The former is taken into account through the application of the 5% threshold (as clarified above). Thus, the supervisory assessment identifies</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>this regard, it was concerned about the assumption expressed in paragraph 15, in the ‘Objective and structure of the guidelines’ section, that the size and complexity of an institution were primary indicators for setting supervisory expectations on ‘organisational aspects of management of NPEs and FBEs’. According to the stakeholder, it should be made clearer that the additional guidance in the guidelines is primarily targeted at institutions for which asset quality, the adequacy of the existing governance and the NPE strategy are not deemed satisfactory, regardless of size and complexity. In other words, alignment with those guidelines should not disproportionately impact large and complex institutions if key stakeholders are satisfied with their current NPL levels and management of non-performing and forborne exposures.</p>	<p>potentially risky profiles in terms of their NPE levels and increases the intensity of supervision and assistance to prevent an increase in NPEs before they reach unsustainable levels.</p> <p>Furthermore, the guidelines aim to apply the requirements in a proportionate manner. They aim to avoid any unnecessary burdens on the basis of institutions’ size and complexity. In other words, whenever possible, the guidelines apply simplified requirements when a small and less complex institution has a high NPL ratio and hence is subject to sections 4 and 5 of the guidelines, for example regarding the requirements for the WUs.</p>	
<b>Question 5. Do you see any significant obstacles to the operationalisation of the NPE strategy as described in chapter 5?</b>			
Proportionality	<p>Stakeholders highlighted that the three lines of defence concept might not necessarily reflect the organisational structure of institutions, and could take different forms that would be proportionate to the resources dedicated to NPE management.</p> <p>With reference to paragraph 15 of the ‘Background and rationale’ section also, the guidelines should not automatically assume that large and complex institutions will have the most developed NPE management organisational structure; rather, the organisational aspects of the management of NPEs</p>	<p>The EBA acknowledges the specific challenges of implementing a comprehensive three lines of defence for the purposes of NPE management and workout functions for smaller and less complex institutions (but also for large institutions). The EBA has introduced specific proportionality criteria for SREP Category 1, 2, 3 and 4 institutions, in particular by introducing simplified obligations for Category 3 and 4 institutions, for example with regard to the application of WUs.</p>	<p>The EBA has amended the sections on scope of application and proportionality and the corresponding requirements in section 5.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Review frequency	<p>should be commensurate with the size and complexity of the NPEs of an institution.</p> <p>One stakeholder commented that an annual review of the whole NPE strategy would be too burdensome. This review should, rather, be aligned with the medium-term plan of the institution.</p>	<p>The EBA believes that annual frequency for the review of strategic and policy documents is considered good practice.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>
Central credit register	<p>One stakeholder commented that the draft guidelines stated that the access to central credit registers, land registers and other relevant external data sources would take place where technically possible.</p> <p>According to the stakeholder, the EBA acknowledged that access to credit data collected on a regular basis by credit registers and credit bureaus can help an institution to manage its NPEs, including where an institution needs to check the overall indebtedness of a borrower/project before granting any forbearance measures (paragraph 142).</p> <p>The draft guidelines also state that NPE WUs should be linked with loan origination units by means of a feedback mechanism (paragraph 61).</p> <p>The stakeholder added that NPE WUs access to credit register and credit bureau data and documentation would have benefits for the financial system as a whole, i.e. it could help in detecting a potential build-up of risks from a</p>	<p>The EBA agrees with the comment. The wording ‘technically possible’ has been removed from the text.</p>	<p>The EBA has amended the text in section 5.2.5.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>systemic financial stability perspective and could help supervisors to ascertain the magnitude and relevance of NPLs, changes and recent trends.</p> <p>Analysis of credit data can help in defining and setting indicative thresholds to guide policy decisions on when a preventive intervention on the part of the authorities responsible for financial stability becomes necessary.</p> <p>Therefore, the stakeholder suggested that the EBA delete the wording ‘where technically possible’.</p>		
Credit bureaus	<p>One stakeholder suggested that the EBA mention ‘credit bureaus’ in paragraph 121, in the context of the external information on the basis of which early warning indicators should be set. This would also help to better address the retail dimension of NPEs, which is also considered in the guidelines.</p>	The EBA agrees with the comment.	The EBA has amended the text in section 5.5.
Sectorial specialisation	<p>The draft guidelines require that ‘Credit institutions should consider designing automated processes for NPE WUs for homogenous retail NPE portfolios, while for those for corporate NPE portfolios a relationship management approach should be used with a strong sectorial specialisation of NPE WU staff’.</p> <p>Some stakeholders stated that sectorial specialisation in NPE WUs would not be feasible in some cases, especially if the critical mass of NPEs is not reached. In this regard, more detailed expert or</p>	The EBA agrees with the comment and has changed the wording to apply proportionality depending on the risk profile of the portfolios.	The EBA has amended the text in section 5.2.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Three lines of defence	<p>legal knowledge may be necessary when the loan gets closer to bankruptcy proceeding.</p> <p>Two stakeholders argued that the implementation of a second line of defence was not feasible either. This would unnecessarily slow down the workout process and result in additional costs. If a bank has a fully fledged approval process in place, including the four-eyes principle and third party participation for large exposures, then a second line of defence is not necessary.</p> <p>Similarly, one stakeholder commented that NPE WU set-ups varied significantly between institutions, and that, in many cases, the three lines of defence framework described in section 5.3 might not necessarily be embedded into the organisational structure. The assessment of the adequacy of the control framework should focus on the independence of the control functions rather than on the organisational structure. Independence of controls is often achieved through oversight by governance committees.</p>	<p>The EBA agrees with the comment and proposes the following structure with a link to SREP categorisation of institutions:</p> <ul style="list-style-type: none"> <li>• Credit institutions that fall into SREP Category 1 or 2 should apply three lines of defence, where the second line of defence does not have to be NPE specific and may be performed by the credit risk (control) function.</li> <li>• Credit institutions that are in SREP Category 3 or 4 do not necessarily have to have three fully fledged NPE-specific lines of defence, but they have to ensure that conflict of interest is eliminated and prevented.</li> </ul>	<p>The EBA has amended the text in section 5.3.</p>
NPE committee	<p>One stakeholder commented that in its experience the best operating models adequately balance control and recovery objectives. Cooperation and sharing of information between the first line and the second line are critical to achieve the best outcomes. Referring to paragraph 59 in section 5.2, for instance, the stakeholder argued that the creation of an NPE committee could lead to sub-</p>	<p>The guidelines expect affected institutions to consider implementing dedicated decision-making bodies related to NPE workout, which can be achieved by establishing a dedicated NPE committee or by any other means, as long as conflict of interest in decision-making is eliminated and prevented. An NPE committee is mentioned as an example of such an arrangement.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Organisation of WUs	<p data-bbox="535 360 1093 416">optimal results by interrupting the information flow for decision-making.</p> <p data-bbox="535 459 1093 547">One stakeholder commented on the effectiveness of the requirements relating to the organisation of the WUs.</p> <p data-bbox="535 571 1093 826">The stakeholder stated that an organisation based on centralised WUs is not necessarily the best organisation to manage high NPL volumes, given differing local market conditions (some with currencies other than euros), differing current organisations (centralised or decentralised), differing business models (holding financial assets or selling financial assets), etc.</p> <p data-bbox="535 850 1093 975">On the contrary, many organisation types other than centralised WUs have, during periods with high NPL volumes, proven to be more successful when adapted to geographical and individual conditions.</p> <p data-bbox="535 999 1093 1222">The stakeholder commented that, from a systemic risk perspective, credit institutions should decide themselves the most appropriate organisation and then, if needed, competent authorities should evaluate the organisational arrangements and apply pressure to ensure that they fulfil the regulatory requirements.</p> <p data-bbox="535 1246 1093 1398">Consequently, the stakeholder requested that the EBA consider an alternative regulatory choice in section 2 of the guidelines ('Subject matter, scope and definitions'), allowing credit institutions to decide the best organisation to manage NPL</p>	<p data-bbox="1122 459 1697 647">The guidelines do not introduce requirements to establish one centralised WU for a given institution. The guidelines allow credit institutions to design and establish the most appropriate WUs in line with the purposes and the requirements of the guidelines, including the level of application of sections 4 and 5.</p>	<p data-bbox="1722 459 1957 616">The EBA did not make any amendments to the guidelines on this point.</p>



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>volumes, based on best practice and geographical conditions. If the credit institution, after an assessment made by the competent authority, failed to demonstrate an efficient organisation, the competent authority would have a mandate to demand necessary adjustments. If, after the adjustments made by the credit institution, it still did not meet the requirements of the competent authority, the form of organisation suggested in the guidelines would be implemented.</p> <p>This amendment would help the guidelines to ensure a faster reduction in NPL volumes by allowing them to be adapted to geographical differences within the EU and to individual institutions without losing the ability to apply pressure when and where it is needed.</p>		
Consumer protection issues	Paragraph 56 on the NPE strategy refers to the setting of incentives for NPE workout activities. It should be noted that the utmost caution is required in the setting of individual incentives so as to not drive inappropriate behaviours and/or poor treatment of customers. The stakeholder believes that treating customers fairly should take precedence over prudential aspects of managing NPLs.	The EBA shares the view of the stakeholder and agrees to include a statement related to the potential implications of the requirements in relation to consumer aspects.	The EBA has amended the relevant text in sections 4 and 5.
Clarification on the scope of WUs	One stakeholder commented that it should be made clear in section 5.2.1, paragraph 58, that NPE WUs are a specific requirement only for the management of NPEs, and that asset disposals for	WUs are dedicated and separate organisational units within the credit institution solely occupied with NPL workout processes; those units can also undertake	The EBA did not make any amendments to the

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	any underlying security/collateral of the loans are not covered in this paragraph.	activities in relation to early arrears (i.e. exposures not yet classified as NPLs) and foreclosed assets.	guidelines on this point.
Clarification: avoidance of foreclosure	One stakeholder commented that care should be taken in the wording of Section 5.4.3, paragraph 107, as the concept of ‘avoidance of foreclosure’ is not generally included in the language of risk participation/credit risk hedging transactions, and this requirement in the guidelines might introduce unwanted accounting implications. The stakeholder recommends clarifying that minimising expected losses is the overriding principle in this article and that ‘avoidance of foreclosure’ is relevant only insofar as it is legally required (in the case of consumer protection rules, for example) or as a secondary consideration to minimisation of expected losses.	The EBA agrees with the comment that the objective is to minimise expected losses. One way for the credit institution to do so may be foreclosure. However, this option should be exercised taking account of the relevant consumer protection rules.	The EBA has amended the relevant text in section 5.4.
Operationalising and monitoring the NPE strategy	Some issues that may be encountered when operationalising and monitoring the NPE strategy are outlined below: <ul style="list-style-type: none"> <li>• Different authorities may have different views on what constitutes an ‘ambitious but realistic target’; this may result in credit institutions being held to different standards across jurisdictions.</li> <li>• The guidelines allow for an annual review of targets by credit institutions. In order to avoid significant reductions of the targets, it may be worth including some guidance on what revisions are acceptable.</li> </ul>	The EBA refrains from providing specific guidance on ‘ambitious but realistic’ targets, as these may differ across jurisdictions and institutions and would need to be assessed in the context of actual NPE strategies and discussed with the institutions as part of supervisory dialogues under SREP. The competent authorities are responsible for monitoring and assessing these targets in the NPE strategies. <p>In applying these guidelines, in addition to the requirements set in the guidelines, competent authorities may use other indicators and supervisory judgement to assess the performance of the credit</p>	The EBA did not make any amendments to the guidelines on this point.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<ul style="list-style-type: none"> <li>• The guidelines may also benefit from additional detail on how compliance with the set target is to be monitored and enforced. For example, if increases in loan portfolios exceed forecasts but reductions in NPEs fall short, is this considered compliant? To ensure that the credit institution is indeed tackling existing NPL stock in an active manner, at a national level the competent authority could use a static denominator when calculating the NPL ratio for the purpose of monitoring the implementation of the plan.</li> <li>• Some issues may also arise in terms of the duration of legal proceedings. In certain jurisdictions, the duration of legal proceedings may well exceed the three-year medium-term horizon outlined in the guidelines. Would these NPEs be considered ‘resolved’ for the purpose of monitoring the reduction of NPEs, even though the final outcome would still be pending?</li> </ul>	<p>institutions vis-à-vis their set strategies and targets and considering the overall SREP assessment.</p> <p>With respect to legal proceedings, credit institutions are expected to monitor legal proceedings and should not consider them ‘resolved’ for the purposes of these guidelines until the actual outcomes of the proceedings are known. Annex 2 lists a set of monitoring metrics for legal activity.</p>	
<b>Question 6. Does the viability assessment of forbearance measures capture all relevant aspects?</b>			
Viability criteria: corporate clients	Some stakeholders commented that forbearance solutions are very context specific and that one size fits all viability criteria might lead to limited ability to extend forbearance measures. The proposed viability assessment could be difficult to implement in the case of corporate clients. Although there are standard procedures, given the peculiarities of each case, it could be difficult to have an automatic viability assessment in place.	The measures and requirements aim to set prudential measures for tackling NPEs, and the section provides some flexibility. The guidelines state that the assessment of viability should be based on the financial characteristics of the borrower and the forbearance measure to be granted at that time. The viability assessment should take place irrespective of the source of forbearance. Different sources for forbearance measures are, inter alia, borrower using	The EBA did not make any amendments to the guidelines on this point.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Contradiction with national legal frameworks	<p>The draft guidelines state that ‘The contractual terms for any forbearance measure should ensure that the credit institution has the right to review the agreed forbearance measures if the situation of the borrower improves and more favourable conditions for the credit institution (ranging from the forbearance to the original contractual conditions) could therefore be enforced. Credit institutions should also consider including strict consequences, like a requirement for additional collateral, in the contractual terms for borrowers who fail to comply with the forbearance agreement.’</p> <p>Some stakeholders commented that this provision might not be compatible with national legislation. For example, in Spain banks cannot ask for additional guarantees, while in Italy the concession of an ‘additional security’ as a standalone measure is subject to some legal constraints. Therefore, this measure can be implemented only in combination with other FBE measures.</p>	<p>forbearance clauses embedded in a contract, bilateral negotiation of forbearance between a borrower and a credit institution and a public forbearance scheme extended to all borrowers in a specific situation.</p> <p>The legal effect of the paragraph in question is that credit institutions should consider whether they should include in forbearance agreements strict consequences for borrowers who fail to comply with those agreements; one such strict consequence could be to require additional collateral.</p> <p>The EBA is of the view that, with that content, this provision cannot actually conflict with any national law applicable. This is because the guidance provided is that credit institutions ‘should consider including’ rather than ‘should include’ strict consequences, while the ‘requirement for additional collateral’ is one possibility. In considering such measures, credit institutions naturally have to take into account not only the business specificities of each case but also the legal regime applicable.</p> <p>If strict(er) consequences are already provided for by law (e.g. if the law requires that execution should be initiated), then these might be seen as an appropriately strict consequences that could be included in the agreement by means of cross-reference to the (national) law applicable.</p> <p>Conversely, if strict consequences (included asking for additional collateral) are excluded due to the legal</p>	The EBA did not make any amendments to the guidelines on this point.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Contradiction with national legal frameworks	Some stakeholders commented that, according to section 6 on forbearance, before granting any forbearance measures, banks should assess the borrower's creditworthiness or in general the borrower's ability to pay in the future (at the end of the forbearance measures). In some countries (e.g. Italy), laws issued by government or agreements signed with associations of consumers or enterprises provide for mandatory forbearance measures (e.g. a moratorium on payment of instalments) by banks in the case of specific events regarding the borrower (e.g. loss of job, death, earthquake). In the case of a law, regulation or institutional agreement whereby forbearance measures are mandatory, banks should be exempt from the requirements of section 6.	<p>regime applicable in a particular case, then obviously the credit institution's decision on if such clauses should be included in the agreement will be negative.</p> <p>The wording of the guidelines has explicitly taken into account the possibility of different national regimes and that is why the provision only recommends that credit institutions should consider the possibility mentioned.</p> <p>Thus, the EBA does not see any need to amend the wording of said paragraph of the guidelines.</p>	The EBA did not make any amendments to the guidelines on this point.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>Where forbearance is to be granted on the basis of other arrangements (i.e. agreements with consumers), the institution should assess, also having regard to the relevant competent authority's compliance with these guidelines, whether the provisions of those other arrangements prevail over the institution's obligation to make every effort to comply with the guidelines.</p>	
<p>Contradiction with national legal frameworks</p>	<p>One stakeholder commented that the requirement that a detailed assessment of the borrower's financial position be made before granting forbearance measures contradicted other rules (e.g. in the context of the Mortgage Credit Directive, with reference to section 505a(3) of the German Civil Code).</p>	<p>The EBA does not see any contradiction with the regulation cited.</p> <p>The ultimate goal of (viable) forbearance is to support the borrower and to take measures to retransfer an exposure to performing (best case). The assessment of the borrower's financial situation is a central element for the assessment of the viability and adequacy of a forbearance measure. From a practical point of view, a forbearance measure cannot be granted without analysing the borrower's individual situation. This practical requirement is a prudential measure and a supervisory expectation.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>
<p>Refinancing (paragraph 132)</p>	<p>Two stakeholders requested the rewording of the statement in paragraph 132 and invited the EBA to consider including not only 'modification of the terms and conditions' but also 'refinancing' among the short-term measures.</p>	<p>The EBA made amendments to the wording of the section to remove the distinction between short-term and long-term measures.</p>	<p>The EBA has amended the relevant text in section 6 and Annex 5.</p>
<p>Retail mortgages</p>	<p>One stakeholder commented that the overall approach outlined in section 6 seemed to be aimed at corporate/commercial loans rather than retail</p>	<p>The forbearance principles outlined in these guidelines apply to both retail and corporate loans and the EBA does not see any contradiction with</p>	<p>The EBA did not make any amendments to the</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>mortgages. Forbearance practices for retail loans in some jurisdictions are already well regulated, so there is a risk that the EBA guidelines will cut across or conflict with such rules and cause confusion and operational uncertainties.</p>	<p>regulations on retail loans. Nevertheless, in the implementation of these guidelines, competent authorities should comply with the applicable national legislation.</p>	<p>guidelines on this point.</p>
Regulatory burden	<p>One stakeholder argued that the requirement to demonstrate via written documentation the event that caused temporary constraints to the borrower is cumbersome to implement, particularly in the case of short-term forbearance measures. Alternatively, guidelines should specify these as best practice, to only the institutions apply them when possible.</p>	<p>The EBA acknowledges the concern raised by the stakeholder and is going to amend the language so to provide flexibility in the requirements.</p>	<p>The EBA has amended the relevant text in section 6.</p>
Further clarification on the viability assessment and consideration of a combined approach	<p>One stakeholder suggested a set of points for further clarification to improve the viability assessment.</p> <p>Paragraph 134a(iii) states that long-term measures should be considered viable where ‘reasonable documented financial information’ is available. In order to establish a level playing field, the respondent suggests elaborating on or giving examples of the type of financial information that will be deemed viable.</p>	<p>As explained later in the same section of the guidelines (section 6.2.3):</p> <p>17. ‘Before granting any forbearance measures, credit institutions should assess borrower’s creditworthiness. This should include an assessment of the borrower’s financial situation taking into account all relevant factors and, in particular, the debt-servicing capacity and overall indebtedness of the borrower or the property/project. This assessment should be based on documented current and verified financial information as described in [future EBA guidelines on loan origination, monitoring and internal governance].’</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Further clarification on the viability assessment and consideration of a combined approach	In paragraph 129, it is mentioned that financial institutions should consider using not only short-term or long-term forbearance measures but a mix of the two. In the viability assessment in paragraph 134, the respondent believes that the option of a forbearance measure using both long-term and short-term measures should be considered. It therefore suggests amending paragraph 134.	The EBA acknowledges the comment. The EBA has removed the distinction between short-term and long-term measures.	The EBA has amended the relevant text in section 6.
Monitoring forbearance measures for commercial lending portfolios	<p>Section 6.2.2 describes specific monitoring of forbearance measures. However, this anticipates the measures being standard and comparable across a portfolio of obligors, which is not considered appropriate for a commercial lending portfolio, where each case is considered individually.</p> <p>Section 6.2.2 describes the risk that an impairment may be masked, but, again, this does not reflect how a non-portfolio exposure would be managed.</p> <p>Furthermore, it is not clear to the respondent that portfolio-level metrics on forbearance would be at all helpful where exposures are considered individually.</p> <p>The respondent notes that section 6.2.4 recognises that there are differences between homogeneous borrowers and more complex ones, but this is not reflected throughout the guidance.</p>	The EBA is of the view that portfolio-level analysis/monitoring assumes, by definition, common aspects of different obligors, and relies on standard and comparable measures across them. This should also be the case for commercial lending portfolios.	The EBA did not make any amendments to the guidelines on this point.



Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<b>Question 7. What are the respondents' views on the proposed requirements for recognition of non-performing and performing/non-performing forbore exposures?</b>			
Excessive burden	<p>administrative</p> <p>One stakeholder commented that the draft guidelines required credit institutions to systematically collect documented financial information from customers in order to justify the measures undertaken.</p> <p>For consumer credit activity (low duration, small amounts, exclusively individuals), for instance, such requirements are disproportionate. They are likely to complicate and hinder forbearance processes. Although forbearance processes are favourable for customers and carried out at their request, these excess requirements could result in the exclusion of some customers from these processes.</p>	<p>The EBA agrees with the comment and clarifies the distinction in the requirements between corporate borrowers and natural persons. It also clarifies the distinction between the treatment of NPEs and that of FBEs.</p>	<p>The EBA has modified the text in section 7 accordingly.</p>
Short-term/long-term measures	<p>The distinction between short-term and long-term measures seems unsuitable, as the probation period that determines the duration of the forbearance measure is already regulated. Forbearance measures generally extend the duration of the credit.</p>	<p>These requirements are from a prudential perspective for to ensure that credit institutions adopt viable forbearance measures and are not related to the probation period defined in Annex V to Commission Implementing Regulation (EU) No 680/2014.</p>	<p>The EBA did not make any amendments to the guidelines on this point.</p>
Retail credit: creditworthiness assessments of repayment capacities	<p>One stakeholder commented that regular individual creditworthiness assessments of repayment capacities (paragraph 151) for retail borrowers who are fully meeting their contractual payments in a timely manner would be both unnecessary and impractical. Moreover, equivalent but more useful aggregate-level assessments of such portfolios are</p>	<p>The EBA agrees with the comment and clarifies in the requirements the distinction between corporate borrowers and retail borrowers.</p>	<p>The EBA has modified the text in section 7 accordingly.</p>

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	already carried out through various stress tests. Policy duplications should be avoided.		
Reference to Annex V to Commission Implementing Regulation (EU) No 680/2014	One stakeholder highlighted that, although the NPE guidelines make explicit reference to the EBA Guidelines on the application of the definition of default and Commission Delegated Regulation (EU) 2018/71 on the materiality threshold in relation to certain criteria used for the identification of default (paragraph 149 ('Past due criterion'), paragraph 150 ('Indications of unlikeliness to pay') and paragraph 166 ('Consistent application of definition of non-performing'), it does not require explicit alignment regarding other criteria that should be applied (paragraph 159 ('Exit from non-performing status') and paragraphs 152 to 158 ('Forbearance and performing status')).	Paragraph 159 on the reclassification of NPEs including FBEs as performing makes explicit reference to Annex V to Commission Implementing Regulation (EU) No 680/2014.  For greater clarity, the relevant paragraphs of the guidelines include references to Annex V to Commission Implementing Regulation EU No 680/2014.	The EBA has modified the text in section 7.3.1 accordingly.
List for the assessment of financial difficulties	One stakeholder recommended that the EBA set the list included in paragraph 153 as indicators of financial difficulties. However, the guidelines do not note that they are rebuttable (i.e. as per Annex V to Commission Implementing Regulation EU No 680/2014, Part 2, paragraph 254). A statement that the indicators are rebuttable is required to demonstrate that the list is a guide.	The EBA agrees with the comment and added the word 'rebuttable' in line with paragraph 254 of Annex V to Commission Implementing Regulation (EU) No 680/2014.	The EBA has modified the text in section 7.3.1 accordingly.
Treatment of arrears	One stakeholder commented that, in paragraph 161, the sentence 'the consideration of arrears should not change the level of application of non-performing status in accordance with of Annex V of Regulation (EU) No 680/2014' should be	The EBA agrees with the comment.	The EBA has modified the text in section 7.3.3 accordingly.

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	<p>amended to ‘The consideration of arrears should not change the level of application of non-performing status in accordance with of Annex V of Regulation (EU) No 680/2014, and only exposures to which forbearance measures have been applied should be identified as forborne exposures’. This would ensure that the guidelines were aligned with the requirements set out in Annex V to Commission Implementing Regulation (EU) No 680/2014.</p>		
<p><b>Question 8. What are respondents’ views on the requirements on timeliness of impairments and write-offs of NPEs?</b></p>			
<p>The EBA received several comments regarding potential contradictions and duplications of accounting standards (e.g. IFRS 9) or other EBA guidelines (e.g. on expected loss) and asking for further clarification on the requirements in the guidelines in relation to prudential standards.</p>			
<p>In order to avoid any risk of contradiction or duplication, the EBA removed some of the subsections. The feedback table does not present the comments put forward by the stakeholders and the EBA’s analysis of these comments in relation to these subsections.</p>			
Flexibility	<p>Two stakeholders commented that the provisions needed more flexibility. For example, in the case of non-EU subsidiaries, in some countries partial write-offs are common, while in others this is not the case.</p> <p>In addition, one stakeholder added that there were circumstances in which the timing of write-offs is subject to events outside the control of banks. The stakeholder suggested that the guidelines should acknowledge those situations and include additional flexibility in the language accordingly.</p>	<p>Paragraph 185 states that credit institutions should include in their internal policies clear guidance on the timeliness of impairments and write-offs.</p> <p>The EBA acknowledges that write-off and partial write-off decisions may depend on circumstances outside the control of the institutions, for example court cases, depending on the probability of winning/losing the case. In some circumstances, it is therefore difficult to indicate when the write-off option should be triggered.</p>	The EBA has amended the text accordingly.

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Clarification: paragraph 182	<p>One stakeholder requested further clarification on paragraph 182, which reads in part: ‘A write-off should not be considered as the credit institution forfeiting the legal right to recover the debt’.</p> <p>The stakeholder expressed concerns, stating that this statement was either factually incorrect or misleading. Some jurisdictions treat partial or full write-off of an exposure as a decision to forfeit the legal claim on the debt, or debt forgiveness.</p>	The EBA is of the view that the requirement is in line with the accounting rules, namely IFRS 9.	The EBA did not make any change on this point.
Section 8.5, ‘NPE impairment and write-offs’	<p>Paragraphs 185(a) and (c) refer to write-offs when an exposure is deemed unrecoverable or there is reasonable financial evidence that the borrower is unable to repay the full amount. This terminology differs from the criterion under IFRS 9 (i.e. no reasonable expectation of recovering the contractual cash flow on a financial asset in its entirety or a portion thereof). The respondent recommended that this paragraph be amended to conform with IFRS 9.</p>	<p>Loss allowance is the expectation of credit loss and write-off is when there is no reasonable expectation of recovery (IFRS 9, 5.4.4).</p> <p>The EBA acknowledges the potential inconsistency that the draft wording might cause.</p>	The EBA has amended the text accordingly.
Paragraph 181	Paragraph 181 should refer to IFRS 9.B3.2.16r (not B3.3.16r).	The EBA agrees with the comment.	The EBA has amended the text.
<b>Question 9. Do you have any significant objection against the proposed threshold for property-specific valuation (EUR 300 000)?</b>			
Threshold for property-specific valuation	<b><i>Introduction of a threshold</i></b>		The EBA has amended the section accordingly.

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>Most stakeholders criticised both the level and the frequency of assessment of the property-specific valuation threshold of EUR 300 000. The stakeholders argued that:</p> <ol style="list-style-type: none"> <li>1. The threshold is very conservative and would result in excessive costs, since it would increase fixed NPL management costs without modifying recovery capacity, especially for the leasing industry.</li> <li>2. The threshold does not account for the diversity of the European property markets and in particular the location of the property. The threshold is too low and in particular for large cities.</li> <li>3. The threshold does not account for foreign exchange rate changes for non-euro-denominated properties (although this could be easily mitigated by adding 'or equivalent' to the text of the guidelines).</li> <li>4. It is neither feasible nor necessary to complete physical valuations of all NPE properties; given the volume, even introducing a threshold of EUR 300 000 would result in significant volumes of physical valuations.</li> <li>5. The proposed frequency of the valuation is high.</li> <li>6. The additional cost of more frequent and physical valuations would increase the cost of managing NPEs and the cost to the customer, which could lead to an unnecessary erosion of equity.</li> <li>7. Regarding the frequency of valuation of non-residential immovable property, one year is considered too infrequent, given that the sale process can take longer than this. It is recommended that only in the event of a sale not being in progress (i.e. no offer one year after repossession) would a further annual assessment be made (it is worth noting also that, while it is unlikely that, following repossession of a residential property, a sale would not be complete within three years, the 'sale in progress' exclusion would also be recommended in this situation).</li> </ol>		

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	<p>As a result, while some stakeholders suggested setting the threshold at EUR 1 000 000, others commented that there should not be a fixed threshold and that the threshold should be based on the price level of such immovable properties in a given country/region.</p> <p><b><i>Scope of the threshold and valuation</i></b></p> <p>Many FBEs are only in short-term financial difficulty, so some stakeholders consider it unnecessary to include these in a physical evaluation. For long-term FBEs, it is argued that there is in general strong rehabilitation performance, and that therefore imposing a requirement for physical valuation of these collaterals may not be necessary.</p> <p>In order to manage these potential issues, physical valuations should be limited to collateral that is in repossession only, as these exposures are more likely be the result of no contact with a customer and/or their inability to engage in a repayment plan.</p> <div style="border: 1px solid black; padding: 10px;"> <p><b>The EBA's position:</b> the EBA acknowledges the variations in property values across jurisdictions and among different geographical areas (e.g. cities) in a jurisdiction. The EBA also understands there are several parameters reflecting local characteristics that the valuation should account for.</p> <p>It is also true that valuation for collateralised NPLs should be accurate and reflect local realities.</p> <p>The EBA is, however, of the view that there should be a strong distinction in these guidelines between situations in which index valuation should be used and those in which expert appraisals are required. The EBA is of the view that this distinction can be achieved by allowing competent authorities to define thresholds in their own jurisdictions.</p> </div>		

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Further clarification	One stakeholder requested clarification regarding paragraph 215: it sets out requirements for annual revaluation of collaterals for NPEs but refers to language in paragraph 203, which is a paragraph only applicable to immovable property collateral. Therefore, it is unclear whether the annual revaluation requirements are meant to apply only to immovable property collateral or also to other types of collateral.	The EBA confirms that the frequency of valuation as defined in section 9.2 applies to both immovable and movable properties.	The EBA did not make any amendments to the guidelines on this point.
Further clarification	One stakeholder proposed the following clarification regarding external appraisers: '[The appraisers] must be engaged by the credit institution and may not have been engaged in the preceding two years by or on behalf of the borrower to perform a valuation of the property.'	The EBA believes that the list of requirements already proposed in the guidelines ensures a framework that would guarantee an independent, fair and objective valuation for the parties.	The EBA did not make any amendments to the guidelines on this point.
Further clarification	Paragraph 199: quality assurance of internal appraisals should be implemented in particular by means of a dual-control principle in the valuation unit, and by an internal plausibility check in the case of external appraisals. Can it be presumed that these requirements can be implemented directly in the appraisal unit?	The guidelines require that internal appraisals be subject to quality assurance by an independent function and by means of a dual-control principle.	Section 9.1.2 has been amended accordingly.
Further clarification	Paragraph 200: one stakeholder suggested making the organisational embedding for this process more flexible in order to ensure that it is located where the best possible knowledge and experience of carrying out these reviews is present.	The EBA believes that collateral valuation should be subject to the standard three lines of defence model whereby the internal audit function has a role in the quality assurance process.	The EBA did not make any amendments to the guidelines on this point.

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Rotation between the appraisers for immovable property	One respondent understands the term ‘appraiser’ in paragraph 201 to refer to an individual valuer within a valuation firm rather than the valuation firm itself, which may have one or many valuers. It believes that the valuer rotation proposed in paragraph 201 is too prescriptive. In many cases, there is merit in maintaining the valuer, as they have historic details and local knowledge, enabling them to assess any deterioration in condition. Furthermore, there may also be cost implications for the customer. The competitive impact of this amendment on smaller valuation firms should also be considered, as banks would probably move their business to larger multi-valuer firms to meet these valuation/revaluation requirements. Therefore, a uniform rule on this is not considered appropriate and lenders should be free to make judgements in this area, linked to the specifics of the customer situation, the level of risk, and the required expertise of the valuer.	The EBA confirms that the reference to ‘appraiser’ is a reference to a qualified individual professional. Rotation of experts, such as appraisers or external auditors, is a good risk management practice to ensure the accuracy and independence of valuations and reduce the risk of fraud or collusion.	The EBA did not make any amendments to the guidelines on this point.
Further clarification in relation to national law	Paragraph 224: it is common practice in Germany to value single and two-family homes using the ‘Sachwertverfahren’, which is a specifically German form of modified cost approach. To confuse matters, the discounted replacement cost approach is often mistranslated into German as Sachwertverfahren, although there are methodological differences between the two approaches. This requirement could result in the non-recognition of all valuations of single- and two-family homes using the Sachwertverfahren, which	The EBA does not see a conflict with the existing German valuation practice of the Sachwertverfahren (Beleihungswertermittlungsverordnung, § 14ff).  The Sachwertverfahren is one of three valuation methods provided for by German valuation law. The others are the discounted cash flow method and the comparison method.  This type of valuation practice is typically applied to the non-rented real estate market (e.g. owner-	The EBA did not make any amendments to the guidelines on this point.



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	<p>would thus negate longstanding valuation practice in Germany. The respondent therefore proposes the deletion of this requirement. As an alternative, the requirement could be expanded to specify that an exclusively cost-based approach within a valuation methodology will not be accepted. The Sachwertverfahren combines the cost and market approaches by including the land value – generally derived from comparative values – and applying a market adjustment if necessary.</p>	<p>occupied homes). The background to this is the fact that the value of property cannot be determined by net income. Traditionally, this property value procedure for owner-occupied properties such as condominiums is also used for one- and two-family houses.</p> <p>A value determined by the Sachwertverfahren is calculated as follows:</p> <ol style="list-style-type: none"> <li>1) the land value ('Bodenwert'): the land value is determined by a comparison value method.</li> <li>2) the costs of building the property (which are undiscounted):           <p>The production costs are calculated by extrapolating the construction costs of a specific base year via the construction cost index and adjusted by the age reduction. Construction costs are taken into account by a surcharge. The impairment due to construction defects and building damage is taken into account by deductions. The outdoor facilities must also be taken into account if they are of particular importance.</p> </li> <li>3) Depreciation: other factors influencing value (e.g. economic ageing or above-average state of preservation) must also be taken into account.</li> <li>4) Finally, a haircut of at least 10% on the calculated value is subtracted.</li> </ol>	

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		<p>In terms of the replacement cost, this is the price that an entity would pay to replace an existing asset at current market prices (with similar characteristics). If the asset has been damaged, then the replacement cost relates to the pre-damaged condition of the asset. The replacement cost also includes demolition costs.</p> <p>The EBA is of the view that the Sachwertverfahren is a valuation method that is in line with the proposed regulation.</p> <p>Therefore, being mindful of potential translation issues in the future, no change is required.</p>	
<b>Question 10. Do the requirements for valuation of movable property collateral capture all relevant aspects?</b>			
Further clarification	The independence requirements (paragraph 199) seem too broad, in particular with regard to process-related separation and testing requirements for life insurance policies (e.g. back-testing for life insurance policies and seized deposits does not correspond to current requirements).	<p>The independence requirement aims to ensure that each separate step of the loan life cycle is carried out reliably to achieve its individual purpose and that the steps are free from any conflict of interest, intervention or bias.</p> <p>The testing requirements aim to ensure that the valuations carried out are accurate. This is expected to contribute to the implementation of a robust internal quality assurance policy and procedures.</p>	The EBA did not make any amendments to the guidelines on this point.
Further clarification: independent appraiser for movable property	The reference in paragraph 207 to Article 229 of the CRR creates some uncertainty on the application of the requirements: i.e. is the framework to be	The EBA confirms that the requirement to use an independent appraiser applies only to the valuation of immovable property.	Section 9.1.4 has been amended accordingly.

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	understood as before (only immovable property has to be valued by independent appraisers) or does the EBA mean that all collateral would now have to be valued by independent appraisers?		
Further clarification: scope of section 9	One stakeholder noted that section 9, ‘Collateral valuation of immovable and movable property’, is fully dedicated to non-performing and forborne exposures. Nevertheless, with respect to immovable properties the section’s proposed wording leaves room for interpretation regarding whether or not the proposed requirements will impact all exposures (both in collateralised and non-collateralised formats), not just non-performing and forborne exposures. Therefore, the stakeholder sought further clarification within the section. As part of this further clarification, it would be important to make clear that the proposed threshold (Question 9) applies only to non-performing and forborne exposures.	The EBA confirms that the first paragraph of section 9 states: ‘This section sets out the key elements for collateral valuation of immovable and movable property pledged for NPEs.’	The EBA did not make any amendments to the guidelines on this point.
Monitoring and controls: disproportionate requirements	One stakeholder expressed concerns about some of the recommendations on monitoring and controls in section 9.1.2.  The stakeholder was of the view that several of those recommendations were unnecessary and believed that monitoring and controls must be specific to the type of collateral and market in which the collateral is held. For instance, paragraph 199 sets the expectation that institutions should systematically challenge valuations conducted	The EBA reiterates that the guidelines aim to ensure that credit institutions have the necessary tools to monitor, review and assess valuations carried out both internally and externally. This is an important aspect of the prudential regulation.  Robust checks to challenge valuations conducted internally and externally are expected to be carried out to the best capacity of the institution and are expected to be in the best interests of the credit institution.	Section 9.1.2 has been amended accordingly.

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	<p>externally. The stakeholder believes that external specialist appraisers are best placed to provide an accurate and reliable valuation, and that it is unclear on what basis institutions would be expected to challenge those experts. The value of residential or commercial buildings is often driven by very local attributes, which local valuation experts, rather than international banks, are best placed to assess. Similarly, the value of very specific types of collateral (e.g. oil fields, coal mines) would be best appraised by appropriate experts external to the institutions. It would be disproportionate to expect institutions to house this level of expertise simply to be able to challenge external valuations on an ad hoc/infrequent basis. Seeking additional external valuations as benchmarks would be costly and in some cases not an available option.</p>	<p>The EBA also acknowledges the concerns raised by the stakeholder and has adjusted the wording accordingly.</p>	