

15 July 2016

Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel
SWITZERLAND

Dear Secretariat

BCBS Consultative Document: Guidelines: Prudential treatment of problem assets - definitions of non-performing exposures and forbearance

The Australian Bankers' Association (**ABA**) appreciates the opportunity to provide comments on the Basel Committee on Banking Supervision (**BCBS**) Consultative Document: Guidelines: *Prudential treatment of problem assets – definitions of non-performing exposures and forbearance*.

With the active participation of its members, the ABA provides analysis, advice and advocacy for the banking industry and contributes to the development of public policy on banking and other financial services. The ABA works with government, regulators and other stakeholders to improve public awareness and understanding of the industry's contribution to the economy and to ensure Australia's banking customers continue to benefit from a stable, competitive and accessible banking industry.

The ABA supports the objective of the Committee to harmonise definitions of non-performing exposures and forbearance to ensure consistency of application, transparency and comparability of risk parameters amongst banks. The ABA does not underestimate the challenge that the Committee faces; banks operate in unique environments and different jurisdictional practices have emerged due to individual accounting, regulatory and tax standards, which makes it challenging to achieve harmonisation without unintended consequences.

The ABA has five specific concerns we wish to highlight. We have also provided a number of technical comments grouped under the relevant paragraph taken from the proposed guidelines.

General comments

1. Interaction with accounting standards

It should be clearly acknowledged in the final BCBS guidelines that the accounting standards are distinct and independent from the guidelines, regardless of any convergence. Without such express clarity the guidelines could become a source of significant ongoing confusion in markets should investors attempt to reconcile the relevant accounting frameworks with these prudential guidelines.

Clarity is needed on the interconnectedness of these proposed prudential standards with the International Financial Reporting Standard (**IFRS**) 9. In particular, clarity around the interaction with stage 2 and 3 under IFRS 9 would be welcomed. To avoid any doubt, the ABA believes the final guidelines should clearly state that the IFRS 9 stage 2 should not be considered as an indication of default.



Also, classification of an exposure as forborne should not be automatically considered to be a driver for classification of the exposure to stage 2 under IFRS 9. Under the IFRS 9, the criterion for classification of the exposure to stage 2 will be the “significance of the credit risk increase”.

While exposures in stage 3 under IFRS 9 (exposures where the credit risk of a financial asset increases to the point that it is considered credit impaired) will be defaulted and non-performing (also in the prudential terms), it cannot be automatically assumed that all non-performing and defaulted loans under the prudential framework would be in stage 3 under IFRS 9, although it is expected that the majority will be.

2. Curing/probation period

In Australia, APRA’s prudential standard (APS 220 Credit Quality) specifies a curing period of at least six months or three payment cycles, whichever is longer. The ABA sees no reason for the Committee to extend this period to one year. The ABA’s strong preference is to maintain the current supervisory standard of a minimum of six months.

The requirement of a 'cure period' of minimum payments may not be consistent with the IFRS 9 credit-impaired definition. It would be operationally difficult to implement, and may not be applicable if scheduled minimum payments do not exist (e.g. revolver).

If forbearance results in a non-performing exposure being derecognised, and a new exposure being recognised, the guidelines would require this new exposure to be classified as non-performing. Under IFRS 9, this would require it to be classified as 'originated credit-impaired'. The Committee should consider if this was the intention and whether the definition of originated credit-impaired should also be aligned with the non-performing definition, including the concept that this new exposure would never 'cure' under IFRS 9.

3. Materiality

Paragraph 28 states an exposure is “past due” even when the past due amount is not considered material. The proposed concept of materiality indicates that absolute and relative thresholds should be considered.

Given the above, a common rule on the usage of absolute and/or relative thresholds for retail/non retail segments should be clearly quantified with the type of calculation prescribed (at facility level or at counterparty level) to ensure a level playing field. In relation to the materiality threshold issue, we suggest the Committee should introduce clear guidance on the exclusion of ‘technical defaults’ which should not only cover the errors in data or IT systems, but also all the exposures below the materiality threshold indicated.

4. Pulling effect

In regards to commercial/wholesale exposures, the ABA does not agree with the requirement that all exposures of the counterparty are to be classified as non-performing if just one exposure is non-performing. The pulling effect will lead to higher adjusted gross impaired loan balances, especially since the standard will not permit the setting-off of collateral values against the non-performing exposures.

The ABA believes that non-performing exposures should be at the facility level with elevation to counterparty level dependant on the documentation, level of recourse, cross default clauses etc.

5. Implementation timeframes

The ABA requests the Committee facilitates reasonable implementation deadlines that will allow the industry sufficient time to implement any required new systems and data collection processes.



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The cumulative lead times of vendors (where applicable) and subsequent work by banks to implement the revisions will take substantial time to complete. In light of this, the ABA requests the Committee considers accommodative implementation timeframes. Such flexibility would be most welcome given the existing significant program of other interconnected and concurrent regulatory reforms already scheduled for implementation.

Specific comments on the guidance

For ease, we have grouped our comments under the relevant paragraph taken from the proposed guidelines.

Paragraph 19

The ABA would welcome guidance on the Committee's reasoning behind a *counterparty* view for non-retail versus *facility* view for non-retail. Is the retail versus non-retail view to be formed on a counterparty classification as opposed to a product classification? For retail and connected counterparty exposures that are performing (i.e. < 90 days past due) should their performing exposures be considered non-performing if they are assessed such that full repayment relies on the realisation of collateral (see 24(iii)(b))?

The ABA would suggest greater clarity in the wording of paragraph 19 which uses the words "can" and "should" which introduces an unnecessary ambiguity.

Paragraph 27

The proposed definition states, "... except in rare circumstances where this information is not available." This sentence appears inconsistent with the statement that retail exposures should be classified on a facility rather than counterparty basis. The ABA would also welcome further guidance on what is meant by "rare circumstances".

Paragraph 28

The ABA would welcome further clarity regarding 'materiality'.

Paragraphs 24 and 28 appear to conflict with each other. Paragraph 24 (iii) defines non-performing loans as "all other exposures that are not defaulted or impaired but nevertheless are (a) material exposures that are more than 90 days past due"

Paragraph 28 (under the explanation of the term "Past due") states that "An exposure should be considered past due even when the amount of the exposure or the past due amount, as applicable, is not considered material."

The "material" definition also suggests that bank supervisors should set both a relative and absolute materiality threshold. This will not ensure consistency between jurisdictions as it doesn't sit with any one approach. It may also introduce additional data, technology and reporting requirements that cannot be fully assessed without a common approach and definition.

The ABA recommends that the final guidelines include direction on the use of absolute and/or relative thresholds. The guidance should also cover whether materiality should be applied at a transactional or counterparty level. For consistency and ease of reporting, the preference is the use of one measure only, either absolute or relative, but not both or either.

The ABA would also encourage the introduction of clear guidance on the exclusion of 'technical defaults' (e.g. data or system errors).



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The explanation of the term “Unlikely full repayment” under Paragraph 28 states, “The likelihood of repayment could also be assessed through a comprehensive analysis of the financial situation of the counterparty, using all inputs available, including” This statement may ultimately prove to be restrictive for retail counterparties, e.g. will the use of ‘could’ allow for a materiality threshold here for small retail exposures such as credit cards? The ABA believes that guidance to facilitate decisions on reclassification should allow some scalability.

Paragraph 37

This paragraph states, “... the initial contract allows the counterparty (debtor) to change the terms of the contract in their favour (embedded forbearance clauses) due to financial difficulty.” The ABA would welcome clarification as to whether this statement means that a facility with equity cure rights must be classified as ‘forbearance’ if triggered.

Paragraph 38

Regarding the treatment of cure rights, pre-agreed cure rights generally trigger when a counterparty is facing financial difficulties. Exercise of such rights would normally result in the transaction continuing under what was agreed to be market acceptable terms. Clarification is sought from the Committee that in exercising these clauses, which ultimately maintains the facility on market acceptable terms, there will be no requirement for the exposure to be classified as ‘forbearance’.

Paragraph 41

As stated earlier, in Australia, the APRA prudential standard (APS 220 Credit Quality) specifies a curing period of at least six months or three payment cycles, whichever is longer. The ABA sees no reason to extend this to one year (which is the minimum probation period for reporting as specified in the BCBS guidelines). The ABA’s preference is to maintain the current supervisory standard of a minimum of six months.

More clarity around the starting date of the probation period is also required. For example, were a bank to agree to a three month period of reduced repayments, and then after that period the customer returns to the original repayments, does the bank look to the start or the end of the three month period? Is the probation period from the date in which original repayments start again or from the date of the concession’s effect?

Paragraph 41(ii) refers to a counterparty that has “solved” its financial difficulties. The ABA considers that the term “solved” should be defined to be consistent with not qualifying as a non-performing exposure.

Thank you for taking our comments into consideration.

Yours faithfully

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