Brussels, 22 January 2016

EMF-ECBC Response to the European Banking Authority's Consultation Paper on Guidelines on the Application of the Definition of Default under Article 178 of Regulation (EU) 575/2013

General comments

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC)[1] welcomes the objective of the EBA guidelines to harmonise the definition of default to ensure consistency of its application, transparency and comparability of risk parameters between banks across the Member States. However, the EMF-ECBC would like to highlight the following observations:

Time needed for implementation:
The impact of the proposed definitions on financial institutions will vary depending on the extent to which the current approaches deviate from the proposals.

However, given the envisaged significant impact on substantial part of institutions, it is worth stressing that sufficient time needs to be granted to implement all the different operative procedures and to enable banks customers to become use to the new rules, which in some areas are very strict compared to the current ones. In addition to previous remarks, this is particularly important for those banks which opted for the Internal Ratings Based (IRB) approach. These financial institutions will need to have sufficient time to recalibrate their models and internal systems. The phase-in timeframe will, naturally, also have to factor in the supervisory approval of the banks' internal models.

In order to minimise its impact on financial institutions' operations, it is important to synchronise the implementation of the new definition with the International Financial Reporting Standard 9 (IFRS 9) standard. The new rules on the definition of default should therefore not enter into force before the mandatory application date of IFRS 9, January 2018.

Application method of the new proposals:
It is our understanding that the EBA is aware of the difficulties of applying the proposals retroactively. Adjusting historical data to the proposed application of the default definition will be at best challenging from both a cost and a time perspective if not impossible due to unavailability of the data. There are cases in which the retrospective application of the definition of default would not be entirely correct in principle, e.g. in relation to distressed restructurings and sales of credit obligations. In the counterfactual, had the definition of default been different at the time, other provisions would have been included in the restructuring plan or the sale conditions. By adjusting default statistics backwards, there is therefore a very present risk of distorting other parameters. Thus, for fictitious defaults, not detected in the current procedures and therefore not treated as such, to be included in the probability of default (PD) retrospective will likely prove difficult to exercise in practice. There might also be potentially distortive effects on the loss due to default and the exposure at default with respect to Loss

[1] Established in 1967, the European Mortgage Federation (EMF) is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The EMF provides data and information on European mortgage markets, which were worth over €6.7 trillion at the end of 2013. As of February 2015, the EMF has 18 members across 14 EU Member States as well as a number of observer members. In 2004, the EMF founded the European Covered Bond Council (ECBC), which is a platform that brings together covered bond market participants. The EMF-ECBC is registered in the EU Transparency Register under ID Number 24967486965-09.

EMF ECBC
COVERED BOND & MORTGAGE COUNCIL (CBMC)
(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

Given Default (LGD) and Exposure at default (EAD).

An approach based on generic best estimates that following the implementation of the new rules, doors will be open to a high degree of heterogeneity. At the same time, parallel running is also hardly viable from an operational prospective. In our view therefore the new definition should not be applied retroactively. A discussion should nevertheless take place on how the need for retrospective consideration can be balanced with its intrinsic constraints. The EBA should provide some guidelines on this (following some criterions already issued for external data not compliant with the new definition). The EMF-ECBC therefore encourages the EBA to engage in a collaboration with the Industry in order to determine feasible proposals and rules guarantying a level playing field in the introduction of the new uniform definition of default.

Frequency of Past Due calculation:
It is our understanding that the EBA's objective is to identify the default on the day when it occurs. For some banking products however, such as mortgage loans, the determination of default is carried out on a monthly basis, at month end. A daily determination requirement would, in these cases, be needlessly burdensome for existing systems and procedures. As a consequence, it should be adjusted and simplified.

IFRS 9 considerations:
The new accounting framework IFRS 9 should be taken into account in developing proposals for the definition of default. So the EMF-ECBC underlines the importance of having the implementation of the new default definition not before the go live of IFRS 9 accounting principle. In fact it would be overly burdensome for us from an operational perspective to adapt the new definition of default to current accounting practices and shortly after to the revised IFRS 9 principle.

Indications of unlikeliness to pay:
Major achievements in credit risk management research and practice are based on a clear distinction between default (i.e. an event, therefore objective and observable) and risk (i.e. potential losses coming from possible future default events). This distinction is necessary to build up and validate consistent and transparent risk quantification tools (including capital requirements).

In line with this distinction, the unlikeliness to pay status should gather those positions where a default event has occurred even if it is not observed through the past due/insolvency triggers. Moreover, the principle is also a standard in the capital markets, where rating agencies define "default" in the following ways:

- [S&P's]: An obligation rated 'D' is in default or in breach of an imputed promise. For non-hybrid capital instruments, the 'D' rating category is used when payments on an obligation are not made on the date due, unless Standard & Poor's believes that such payments will be made within five business days in the absence of a stated grace period or within the earlier of the stated grace period or 30 calendar days. The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of similar action and where default on an obligation is a virtual certainty, for example due to automatic stay provisions. An obligation's rating is lowered to 'D' if it is subject to a distressed exchange offer.[2]

- [Moody's]: Four events constitute a debt default under Moody's definition:
  a) a missed or delayed disbursement of a contractually-obligated interest or principal payment (excluding missed payments cured within a contractually allowed grace period), as defined in credit agreements and indentures; b) a bankruptcy filing or legal receivership by the debt issuer

[2] Standard & Poor, *Ratings Definitions*, https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352

COVERED BOND & MORTGAGE COUNCIL (CBMC)
(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

or obligor that will likely cause a miss or delay in future contractually-obligated debt service payments; c) a distressed exchange whereby 1) an obligor offers creditors a new or restructured debt, or a new package of securities, cash or assets that amount to a diminished financial obligation relative to the original obligation and 2) the exchange has the effect of allowing the obligor to avoid a bankruptcy or payment default in the future; or d) a change in the payment terms of a credit agreement or indenture imposed by the sovereign that results in a diminished financial obligation, such as a forced currency re-denomination (imposed by the debtor, himself, or his sovereign) or a forced change in some other aspect of the original promise, such as indexation or maturity.[3]

- [FITCH]: 'D' ratings indicate an issuer that in Fitch Ratings' opinion has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business. Default ratings are not assigned prospectively to entities or their obligations; within this context, non-payment on an instrument that contains a deferral feature or grace period will generally not be considered a default until after the expiration of the deferral or grace period, unless a default is otherwise driven by bankruptcy or other similar circumstance, or by a distressed debt exchange.[4]

The unlikeliness to pay status extends the default definition to events which are normally rated C. Those events relate to cases where default is imminent or inevitable, or the issuer is in standstill. Conditions that are indicative of a 'C' category rating for an issuer include: a) the issuer has entered into a grace or cure period following non-payment of a material financial obligation; b) the issuer has entered into a temporary negotiated waiver or standstill agreement following a payment default on a material financial obligation; orc) Fitch Ratings otherwise believes a condition of 'RD' or 'D' to be imminent or inevitable, including through the formal announcement of a distressed debt exchange [FITCH].[5]

If an extended definition of default (including the C definition) would be acceptable for regulatory purposes, the relevant triggers should in any case exclude different circumstances more related to obligor's financial distress or high vulnerability like those reported in subparagraph a, b and c of paragraph 47 "*Other indications of unlikeliness to pay*", section 5 "*Indications of unlikeliness to pay*" of the EBD draft guidelines. Moreover, subparagraph d of the same paragraph should be limited to default covenants and subparagraph e, f and g should be followed on a case by case analysis and not be applied as general rules.

Materiality threshold:
While materiality threshold has been subjected to a separate consultation, the Quantitative Impact Study (QIS) includes a scenario that assumes application of an absolute limit of EUR 200 for retail exposures and EUR 1000 for non-retail exposures and a 2.5% relative limit for non-retail exposures. This means that, at least for retail exposures, the new proposal is stricter than the previous version which was challenged by the majority of the respondents to the consultation requesting more relaxed rules.

While it is appreciated that some of the Industry's comments in response to the consultation on

[3] Moody's, *Rating-Symbols-and-Definitions*, http://www.moodysanalytics.com/~/media/Brochures/Credit-Research-Risk-Measurement/Quantative-Insight/RDS/Moodys-Rating-Symbols-and-Definitions.ashx
[4] Fitch Ratings, *International Issuer and Credit Rating Scales*,
https://www.fitchratings.com/jsp/general/RatingsDefinitions.faces?context=5&context_ln=5&detail=507&detail_ln=500
[5] Fitch Ratings, *International Issuer and Credit Rating Scales*,
https://www.fitchratings.com/jsp/general/RatingsDefinitions.faces?context=5&context_ln=5&detail=507&detail_ln=500

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(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

materiality threshold have been taken on board (with particular reference to the breach of both absolute and relative thresholds to trigger default calculation), there is reason to believe that the 2.5% relative threshold is still low. In line with previous comments, the EMF-ECBC therefore believes a 4% threshold, both for retail and not- retail, would be more appropriate.

Introducing only an absolute threshold for the retail exposures risks undesirable impact in particular on SMEs portfolios.

In addition, it has been noted that the QIS Part 2: "*Quantitative questionnaire – policy options*", subsection 3.3.1 "*Materiality threshold*", paragraph d says that "*the counting of 90 days (or where relevant 180 days) begins at the moment this amount breaches the threshold*". The wording of this specific section suggests that the counting of days past due starts only at the moment when the amount past due breaches the materiality threshold. The EMF-ECBC therefore invites the EBA to confirm if this interpretation is correct. If this is the case, then an exposure which is materially past due has to be considered defaulted only after 90 days of continuing past due status.

Finally, in our understanding, institutions can maintain thresholds with characteristics similar to those determined in the draft guidelines but more restrictive. Allowing methodological approximations if such can be made more conservative than those established in the RTS would allow a reduction cost of the developments required to implement the RTS, meanwhile maintaining the necessary levels of conservatism and consistency.

Specific treatment for public entities:
Low thresholds such as those proposed by the EBA give rise to concerns about the exposures of institutions to public administration and government institutions that are in some instances obliged to postpone their payments for administrative reasons. The EMF-ECBC therefore believes that the default of a public administration requires further consideration and evaluation.

During the public hearing on the 13th of November 2015, the EBA indicated that it will propose a specific treatment for public institutions on the evaluation of unlikeliness to pay. A similar exceptional treatment should be considered introduced for past due that triggers default. This would be justified given the specificities of the trade debts of public administrations, where payments habits vary amongst Member States. In some, the average past due day exceeds 180 days while the actual risk of losses is very limited. The EBA should consider introduction of a waiver that would allow the institution to suspend the counting of past due days if the debtor (being a public administration) makes a payment on at least one of its past due exposures.

A specific treatment should be envisaged also for cases of factoring with the involvement of public entities. Where the risks and benefits related to the assigned receivables are fully transferred to the factor and the factor has exposures to the debtor (being a public entity) of the client and where the repayment of the obligation is suspended because of a law allowing this option or other legal restrictions, the payment date is not the one formally indicated on the invoice, but instead the one stated by the same debtor after a procedure of credit certification. Moreover, in respect to that date, the public entity usually has 30 more days to make the payment. Such cases would in our view justify specific treatment.

Treatment of missed payments:
The current guidelines ignore the existence of different practices in the treatment of missed payments, i.e. how incoming cash flows after a default situation should be treated in relation to the previous instalments that are in arrears. A FIFO (first in first out) approach or a LIFO (last in first out) approach will influence a return to a non-default status. The harmonisation of a procedure for these cases is very

EMF ECBC
COVERED BOND & MORTGAGE COUNCIL (CBMC)
(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

important and should be included in the EBA's final guidelines.

Examples of default calculation:
The EMF-ECBC asks to the EBA that in the final draft of the Guideline some examples are introduced in order to better clarify the mechanism regarding the compensation of past due amounts, the counting of days past due and the computation of the sum relevant for the materiality threshold.

1. Do you agree with the proposed definition of technical defaults? Do you believe that other situations should be included in this definition? If yes, please provide detailed proposals on how to address further possible situations.

The EMF-ECBC welcomes the objective of the EBA's guidelines to harmonise the definition of default to ensure consistency of its application, transparency and comparability of risk parameters between banks across the Member States.

However, the EMF-ECBC considers the EBA's proposed definition of technical default to be too narrow. The proposed conceptual scope of technical default as defined in subsection 3.2.2 "*Technical defaults*", section 3 "*Background and rationale*" and paragraph 16-20, section 4 "*Past due criterion in the identification of default*" and letter C. of subsection 5.1.D "Definition of technical default", section 5 "*Accompanying documents*" only considers credit obligations as technically past due when the delay results from data or system errors or lengthy payment allocation processes within the credit institution itself as opposed to including data or system errors caused by counterparties. By doing so the EBA determines that credit obligations with technical circumstances, which are not covered by the proposed definition, are by definition considered defaulted for the purpose of estimation of risk parameters.

This definition becomes problematic in instances where material payments are delayed due to lengthy allocation processes that are not carried out internally within the credit institution. For example, in cases of syndicated facilities to corporate borrowers, it is often observed that it takes time for the agent to forward the instalment payment to each participant in the syndication. This delay routinely exceeds the 90-days regulatory period, with no connection to any counterparty credit deterioration. In the modelling of larger bank customers, it is common that payment delays not caused by financial issues exceed the materiality threshold. If defaults that are a result of data or system errors of the counterpart are not regarded as technical defaults, modelling of PDs for large corporates will turn into a matter of modelling probability of errors in customer data and payment systems. With EBA's narrow definition of technical default, the most relevant risk driver in large corporate portfolios could very well be the size of the company. As a consequence, delayed payments not related to deterioration of the credit quality of the counterparty should not be considered as an indication of default.

Another important example where a specific assessment will be needed is the merging of government entities. An example of this at a municipal level is the Établissement Public de Coopération Intercommunale in France. As a consequence of such mergers, existing loans need to be transferred to the merged entity and technical payment delays occur. Naturally this issue will dissolve with time once the mergers in question have been finalised, but during the implementation period the credit obligations involved should be viewed as merely technical defaulted given the administrative circumstances described. In addition, the low thresholds proposed also give raise to concern about the exposures of institutions to public administration and government institutions that are in some instances obliged to postpone their payments for administrative reasons. The default of a public administration therefore requires further consideration and evaluation.

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Furthermore, paragraph 20 of section "*Past due Criterion in the identification of default*" of the CP states that the classification of the obligor to a defaulted status should not be subject to additional expert judgement. However, expert judgement has an important place within credit risk management and should continue to be used as situations may occur that will result in past due exposure of more than 90 days, however not due to a credit deterioration of the counterparty.

It is often the case that some commercial disputes can last for several months or even years meaning that borrowers, in accordance with the EBA guidelines, would stay in default during the whole period. It is therefore important to avoid capturing defaults related to exposures that are disputed or waived or that are not related to the decrease in the quality of the credit risk.

3. Do you agree with the approach proposed for the treatment of specific credit risk adjustments?

The EMF-ECBC agrees with the proposal and underlines the importance of having a harmonised application of the definition of default and clear rules for the treatment of SCRA.

4. Do you consider the proposed treatment of the sale of credit obligations appropriate for the purpose of identification of default?

The EMF-ECBC sees several possible concerns with the proposed treatment of the sale of credit obligations:

Firstly, whilst a sale of a credit obligation resulting in a loss due to decreased credit quality could be an indication of default, the EBA should consider increasing the proposed threshold of 5% to a minimum threshold of 10%. A 5% threshold is too low given that even a small deterioration in credit rating or changes in interest rate might lead to a 5% drop of the market value of an asset. The EMF-ECBC therefore recommends increasing the minimum threshold to the level of 10%.

In addition, an obligor might also want to sell for reasons such as concentration management, country limit management, liquidity management, regulatory capital savings or employment, balance sheet management, country envelope consumption or counterparty exposure management etc. Such reasons for selling, which are not meant to be exhaustive, are normal credit policies and they are not an indication that credit quality of the obligor per se is perceived as being problematic. Selling for the reasons mentioned above, even at a discount, should therefore not lead to the obligor being viewed as defaulted.

Thirdly, with regards to the materiality of economic loss used as an indicator of default, it is important to bear in mind that a discount incurred upon sale of a credit obligation may be justified by reasons that are not obligor specific. For example, recent history has proven that in volatile markets some bonds can be valued at 95% of their par value just because market anticipate future decrease of credit despite the issuer being in good health. In such circumstances, a bank may cease granting facilities to the obligor, thus potentially triggering an actual payment of default. Hence, it may well be inaccurate to attribute the discount incurred upon sale to the credit quality of the obligor and thereby trigger an actual payment default. In addition, disentangling the specific obligor contribution to the discount may itself prove difficult and disputable to apply in practice. It would therefore be worthwhile developing objective criteria to identify sales of credit obligations not related to credit risk.

EMF ECBC
COVERED BOND & MORTGAGE COUNCIL (CBMC)
(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

Lastly, sales of credit obligations 'en bloc' should also be taken into account, as a discount is usually applied compared to a one to one evaluation (in order to conclude the deal earlier) with no link to the real risk of the block.

The EMF-ECBC therefore proposes that the sale of credit obligations is considered as an indication for unlikeliness to pay but should be associated with other indicators and not as a stand-alone criterion. In addition, a clarification from the EBA on whether securitised credits have to be considered within the "sale of credit obligation" category would be welcome.

5. Do you agree that expected cash flows before and after distressed restructuring should be discounted with the customer's original effective interest rate or would you prefer to use the effective interest rate applicable at the moment before signing the restructuring arrangement? Do you consider the specification of the interest rate used for discounting of cash flows sufficiently clear?

The EMF-ECBC would advocate the discounting with the "original effective interest rate", in line with the IFRS 9 (5.4.3).

In section 3.3.3 "*Distressed restructuring*" of the CP the EBA states: "*In order to keep consistency with the supervisory reporting framework it has been specified that distressed restructuring should be considered to have occurred when forbearance measures have been extended towards a debtor as specified in the ITS on forbearance and non-performing exposures. Therefore those forborne exposures, where the forbearance measures are likely to result in a diminished financial obligation should be classified as defaulted.*"

This wording does not differentiate between performing forborne exposures and non performing forborne exposures as otherwise defined in the EBA's Technical Standards on reporting on forbearance and non-performing exposures (see EBA/ITS/2013/03). Performing forborne exposures should not be classified as defaulted. In the case of a renegotiated performing exposure, it is by definition the lender's best guess at the time of renegotiation that the loan is likely to be paid in full according to the post renegotiation schedule. It would therefore be inconsistent to classify the forborne exposure as defaulted.

Considering the 1% threshold for diminished financial obligation in the EBA guidelines, the EMF-ECBC recommends that the relevant measure for recognition of default should be re-examined and set at a level where the new cash flow would no longer be adequate to cover the book value of the obligation, regardless of the decline in Net Present Value (NPV). Moreover, classifying performing forborne exposures as defaulted could also create perverse incentives for banks, as arguably it would make more sense for lenders not to negotiate payment plans with borrowers at all ahead of the default stage.

In addition, article 178 (3)(d) of the CRR considers "*material forgiveness…., of principal, interest or, where relevant fees*" an element to be taken as an indication of unlikeliness to pay. In this respect, the proposed threshold is arguably not consistent with the above mentioned materiality criterion, and should therefore be re-examined in order to be consistent with a (common) higher level or restructuring arrangements. Likewise, it seems unnecessary to specify additional indicators regarding the identification of default, if the net present value of expected cash flows on the distressed restructuring arrangement is higher that the net present value of expected cash flows modifications.

Concerning the formula for calculation of the diminished financial obligation (DO) in paragraph 40 "*Distressed restructuring*", section 5 "*Indications of unlikeliness to pay*" of the CP, it is not clear whether

COVERED BOND & MORTGAGE COUNCIL (CBMC)
(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

the cash flows include the expectation of recovery. If account recovery expectation is not taken into account, the threshold would not make much sense as the new restructured loan could include a reinforcement of the collateral value which might mitigate (partially or totally) the diminished financial obligation measured with the proposed formula. The formula arguably also provides the possibility of hiding a distressed situation by sufficiently extending maturity and maintaining an equivalent NPV of cash flows. Likewise, it is not clear if the two NPV parameters only include the future contractual cash flows or also PD and LGD associated with those cash flows in each moment. In the case of latter, the approach would suffer from a circularity problem. Moreover, some restructuring would not be considered as defaulted under the proposed formula. For instance, when a credit obligation is turned into a payment in kind loan (PIK loan) with capitalized interest during the period the proposed formula's output is an economic loss of zero.

Lastly, it is worth underlining that the concept of distressed restructuring does not apply in case a revision of the conditions is allowed by the contract (e.g. embedded clauses) or by specific laws (e.g. moratoria issued by banking association/government) or to commercial renegotiations (e.g. change of interest rate for commercial purposes or alignment with current market practices).

6. Do you agree that the purchase or origination of a financial asset at a material discount should be treated as an indication of unlikeliness to pay?

The EMF-ECBC agrees if the consultation paper wording (paragraph 46 and paragraph 47, letter g) is in accordance with the IFRS 9, Appendix A "Defined terms" that states "Evidence that a financial asset is credit-impaired include observable data about the following events: (…) f) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses".

If not we disagree. A material discount can be the result of other criteria than financial distress, e.g. general changes to market conditions, or the result of negotiations for example when settling other transactions etc. It therefore seems unreasonable that the discount as such should be an indicator of unlikeliness to pay. Such an assessment is normally part of the due diligence of the asset to be bought in order to be able to establish a relevant value/price of the asset.

By introducing rules that links indications of default to the price of purchased (or sold) assets the EBA could in effect disincentives banks from purchasing/selling assets at discount to avoid putting their client in default (if a bank already has an exposure to the issuer). This would arguably have a negative effect on banks in their role as intermediaries on the financial markets. For example, purchased receivables management is an integral part of the banking sector's activities and could be perceived as less attractive with the proposed EBA guidelines.

In the view of the EMF-ECBC, default should only be triggered for reasons that are directly linked to the credit risk of the counterparty.

7. What probation periods before the return from default to non-defaulted status would you consider appropriate for different exposure classes and for distressed restructuring and all other indications of default?

The EMF-ECBC considers that institutions are best placed to recognise when a customer is no longer in default and sees the proposed set of common probation periods as unnecessary. The proposed

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Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

probation period from default to non-default status is inconsistent with Article 178(5) of the CRR which states that: *"If the institution considers that a previously defaulted exposure is such that no trigger of default continues to apply, the institution shall rate the obligor or facility as they would for a non-defaulted exposure."*

In addition, IFRS 9 states that favourable changes in credit risk should be recognised alongside unfavourable changes in credit risk (IFRS 9 BC 5.210).[6] By applying a probation period, financial instruments would arguably move into default status quicker than back to non-defaulted status. This might result in exposures being classified as defaulted but not credit impaired under IFRS 9 (bucket 2 exposures) or the exposure being potentially classified as defaulted and credit impaired (in bucket 3) but with no loan loss allowance, which is counterintuitive.

In any case, the suggested 3 months' probation period is too long in relation to both large corporate exposures and retail consumers in particular when applied together with the strict definition of the technical default as proposed in the EBA Consultation Paper (CP). In cases of retail and SME customers, payments are not always fully automatized by systematic debit of the customer's account. In such circumstances, a delay does not necessarily indicate a deterioration of the credit quality of the borrower especially if the cure period is short (less than 30 days). As also discussed previously in question 1, delays in payments of large corporates may be caused by systems or data errors, without necessarily indicating a deterioration of the credit quality of the borrower. This is especially true if the cure period is short (less than 30 days). In such cases, customers should be returned to non-default status as soon as the obligation is paid. The three months' probation period should therefore be eliminated as a mandatory provision or at least take other default triggers into account such as past due.

With regards to distressed restructuring, the criteria upon which an exposure can return to a non-defaulted status should be selected on the basis of the expert's assessment and judgement of whether the obligor will remain unlikely to pay. Not using a minimum probation period. Following this line of thought, should a defaulted bank client be bought by another client of the same bank that is not in default, the exposures of the client B should not be considered defaulted if there is no decrease in the credit quality of purchasing client (due to the acquisition). The remaining unlikeliness to pay should be the decisive criteria. Depending on the portfolio specific characteristics, there might also be different or no probation periods.

8. Do you agree with the proposed approach as regards the level of application of the definition of default for retail exposures?

To summarise our understanding of the proposed guidance:

The guideline confirms that for retail exposure, the financial institution in accordance with second sub-paragraph of Article 178 of the CRR may apply the definition of default at the individual credit facility level rather than at the obligor level. Furthermore the choice should reflect the financial institution's internal risk management practice. This may imply that a financial institution in general applies the definition of default at obligor level, but for some specific types of exposure applies it at facility level.

Under IRB the financial institution is required to ensure that the risk estimates correctly reflect the definition of default applied to each type of exposures.

[6] International Financial Reporting Standard, *Basis for Conclusions on IFRS 9 Financial Instruments*, http://parker-fitzgerald.com/wp-content/uploads/2014/07/IFRS9_July-2014_Basis-for-Conclusions.pdf

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The EMF-ECBC agrees that credit institutions should be allowed to choose between the definition of default between obligor and facility, and how to apply the definition at the level of an obligor for some types of retail exposures and at the level of a credit facility for others.

9. Do you consider that where the obligor is defaulted on a significant part of its exposures this indicated the unlikeliness to pay of the remaining credit obligations of this obligor?

In the view of the EMF-ECBC, a default pulling effect could be considered useful with regards to an obligor if part of the obligor's exposures have already defaulted due to related credit risks.

10. Do you agree with the approach proposed for the application of materiality threshold to joint credit obligations?

The EMF-ECBC disagrees with the joint credit obligation proposals and suggests that credit institution conducts assessments on a case by case basis.

If a joint obligation defaults, the individuals taking part in the joint obligations (and their individual obligations respectively) should not be automatically considered as defaulted. Such an approach is even more difficult to justify economically when applied to joint obligations consisting of a large number of individuals, as all the individuals involved in a defaulted joint obligation would automatically be considered defaulted without investigating their financial state any further.

Moreover, the EBA should also consider that the identification of joint fully liability of retail obligors (e.g. married couple) would expose institutions to an unmanageable workload especially when this implies ongoing updates of dynamic information (the marital status) which are difficult to obtain. The EMF-ECBC therefore recommends the deletion of paragraph 85 "*Application of the definition of default for retail exposures at the obligor level*", section 9 "*Application of the definition of default for retail exposures*".

11. Do you agree with the requirements on internal governance for banks that use the IRB Approach?

The EMF-ECBC agrees with the requirements on internal governance for the use of the IRB approach. The requirements appear to be in line with CRD IV requirements. However, it should be ensured that there is also an alignment with the final Basel Committee Guidelines on credit risk management processes to be applied in accounting for expected credit losses.

COVERED BOND & MORTGAGE COUNCIL (CBMC)
(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org