THE DIRECTOR GENERAL

Mr José Manuel Campa
Chair European Banking Authority
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EBA Guidelines of the Definition of Default

Dear Chair,

I write to you regarding the threshold for the "diminished financial obligation" in the context of the Guidelines of the Definition of Default.

One of the new elements introduced by the EBA in the so-called "new definition of default" is the application of the Net Present Value variation criterion to decide whether a forbearance measure results in a diminished financial obligation that triggers the classification of the obligor as defaulted. When a bank extends a forbearance measure towards a debtor, facing or about to face difficulties in meeting its financial commitments, the Net Present Value of the cash flows according to the new schedule shall be compared with the Net Present Value of the cash flows according to the original contract. If the Net Present Value is reduced by more than 1%, this is considered a diminished financial obligation that triggers the default of the obligor.

The 1% threshold is very strict and limits the opportunity for banks to work with a solvent business without marking it as forborne. Default status triggers severe consequences for the business concerned with heightened cost of credit, immediate fall of rating/scoring, appearance in bad files and curtailing access to credit from other institutions.

Having done their utmost during the Covid pandemic, European companies have faced the headwinds of the asymmetric shock of the consequences of the war in Ukraine and are still struggling with the rise in costs. There is a need for forbearance measures to address the current challenging economic environment. Consequently, banks should not be constrained by such a very strict threshold.

BusinessEurope believes that a more flexible approach should be adopted. The treatment of forbearance measures extended by banks should not mechanically imply an undue classification in defaulted status as this would severely hamper the recovery perspective of a business experiencing temporary difficulties.
The definition of "diminished financial obligation" needs to be made more flexible to encourage financial institutions to engage in debt restructuring to support obligors.

It is important to highlight that such flexibility is not intended to avoid classification in default status for those businesses where the financial situation is deteriorated, and such classification would be appropriate. Financial institutions would not be exempt from the ordinary rules and assessment of clients.

We hope that you share these concerns and remain at your disposal should you wish to discuss this further.

Yours sincerely,

Markus J. Beyrer