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Open Review of Management, Banking and Finance

«They say things are happening at the border, but nobody knows which border» (Mark Strand)

The normative framework of non-performing loans: regulatory and accounting issues

by **Andrea Miglionico**

Abstract: *This article examines divergences in the definition of non-performing loans (NPLs) across countries, accounting regimes and firms. Currently no common definition of NPLs exists. From the point of view of setting standards, the divergence is manifested in several ways, not just across jurisdictions, across time and across entities, but also in the different priorities that accountants and regulators have. This article aims to shed light to the accounting and regulatory aspects of loan classification and NPLs, topics that are multifaceted but have not been exhaustively addressed in the literature. Since the 2007-09 global financial crisis, accounting bodies and prudential regulators have focussed on early recognition of credit losses and enhanced disclosure. In this view, a harmonized normative framework for loan classification is needed to address a regulatory gap since there is no consensus how to resolve NPLs across countries, firms or even within firms.*

Summary: *1. Introduction. – 2. The resolution regime for NPLs. – 3. Divergences in the definition of NPLs. – 4. Accounting issues. – 5. The regulatory responses. – 6. The challenge of a harmonized regime for NPLs. – 7. Conclusive remarks.*

1. One of the most important achievements of global financial regulation in the last few decades is that the definition of bank capital has been subject to a substantial degree of harmonization because of work promoted by the Basel Committee on Banking Supervision starting with the Basel I agreement in 1988 [1]. There also has been progress towards a common international understanding of liabilities as a by-product of resolvability assessments, recovery planning and 'bail in' regulation because it has been necessary to establish a hierarchy of debt instruments [2]. But while claims on banks are increasingly comparable internationally, much less traction has been made on standardising the asset side of the balance sheet [3]. Yet, for resolution tools to work in practice, there needs to be a better understanding of what assets are worth in a crisis situation, and therefore of asset quality more generally [4].

This article examines the lack of a common financial language for bank assets, loan classification in general and the definition of non-performing loans (NPLs) in particular. There is divergence in the definition of NPLs across jurisdictions, firms and within firms across time. This matters because it makes meaningful comparison of banks' assets difficult for investors and regulators. The

incommensurability of banks' asset portfolios also has wider socio-economic implications. Bad lending is the root of many banking crises, which in turn are often the source of economic downturns and depressions [5]. In these situations, uncertainty with respect to the quality, and therefore ultimately the value, of banks' assets can prove to be a major stumbling block to bank recapitalisation and economic recovery.

The structure of article proceeds as follows. The first section sets out the reasons why non-performing loans often feature prominently in banking and economic crises. In this section the link between ex-ante loan loss provisioning (LLPs) and bank capitalisation is discussed along with the literature debate. The conventional view—and the rationale for imposing capital requirements on banks—is that LLPs and related capital deductions are meant to help banks deal with *expected losses* from their lending business, while bank capital is meant to provide buffers for *unexpected losses* [6].

While higher ex-ante provisioning against expected loan losses lowers bank profitability in the short term, over the long term the progressive constitution of LLPs in good times reduces the chances of having a situation in crisis times where ex-post NPL losses force a bank to raise capital. Following Borio, Furfine and Lowe [7] and Laeven and Majnoni [8], who have argued that loan loss provisioning needs to be an integral component of banking regulation, these issues are raised because forward-looking provisioning and timely recognition of loss are discussed less often in the academic literature on financial stability than bank capitalisation. The key economic consequence of insufficient loan loss provisioning and the persistence of NPLs on bank balance sheets is the combined threat of a 'capital crunch' and a 'credit crunch'. The Japanese 'lost decades' and the recent global financial crisis (GFC) provide cases in point [9]. The first section of this article reviews some of the challenges that a persistence of NPLs on bank balance sheets has posed post-GFC.

Section two analyses the resolution regime for NPLs. In many jurisdictions and for many firms, an NPL is defined as a sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days. Generally, at some point after the debtor starts making payments again on a NPL, it becomes a re-performing loan, even if the debtor has not caught up on all the missed payments. In a sense, an NPL is either in default or close to being in default [10]. However, this definition is not universal. Section two also examines the heterogeneity of resolving tools for NPLs across jurisdictions. The focus is on current differences between prudential supervisory authorities. But there are also likely differences within jurisdictions across time, and again between jurisdictions in terms of the intensity of prudential enforcement of NPL standards.

Section three discusses the divergences in the definition of NPLs, particularly in the disclosures of NPLs by global systemically important banks (G-SIBs) in their annual reports and accounts, and in widely used commercial data sets. One possible explanation for this divergence is that detailed accounting standards are a relatively recent phenomenon and until recent decades there were no international accounting standards governing comprehensively either how to calculate LLPs or how to classify loans according to credit quality. Even at a national level, there were few standards. In the US, the issue of FAS 5 *Accounting for Contingencies* in 1975 was likely the first formalised accounting standard in this area. Before then, while banks did make provisions against bad loans, these often took the nature of 'hidden reserves' monitored by banks in private but often not disclosed publicly: in some cases, neither the extent of bad loans nor the level of provisions was public information. In the UK, for example, banks

were, through custom and law, exempt from reporting the true nature of their provisions, profits, capital and NPLs until 1970 [11].

Section four deals with the accounting issues for NPLs. The need for accounting standards and enhanced disclosures has increased because the nature of lending has become longer term. For example, in the UK, until the second half of the twentieth century, short-term loans constituted the vast majority of UK bank lending, fewer than 10 percent of banks' loans to businesses between 1910 and 1914 had a contractual term greater than a year [12]. The development of longer-term lending, where the bank assumes more credit risk, increases the importance of having accurate and timely data to monitor asset quality through a loan's long life.

Sections five and six of the article examine the regulatory responses to create new standards for loans. Following the 2007 financial crisis, a number of actors at the Bank for International Settlements (BIS), the Financial Stability Board (FSB), the European Banking Authority (EBA) and the International Monetary Fund (IMF) have in various ways expressed concern with the lack of international comparability and inappropriately late recognition of loss when it comes to the asset side of banks' balance sheets. One specific criticism raised about pre-crisis accounting standards for provisions is that they operated on an incurred loss model [13]. This meant that impairment was only recognised when a loss event occurred. Such a model is inherently reactive and backward-looking. Indeed some critics have argued that it fuelled pro-cyclical lending and asset price bubbles ahead of the GFC because it meant loans were under-provisioned at the onset of the crisis. In its aftermath, there has been a growing chorus calling for a more forward-looking, 'expected loss' model.

The current debate revisits an older difference of opinions between securities and banking regulators about the appropriate allowance for managerial judgement and discretion in the estimation of future losses [14]. Traditionally, banking regulators often have been of the view that early provisioning provides a buffer against potential future losses. On the other hand, securities regulators have been wary of banks raising high provisions and then releasing them as a means of artificially smoothing profits in order to reduce the volatility of their stock market valuations. In fact, the latter concern contributed to the adoption of the 'incurred loss' model that dominated until the GFC. It can be argued that the steps being taken post GFC, to bring in greater forward looking loan loss provisioning, will increasingly integrate the accounting standards on provisioning with information useful to prudential regulators in assessing capital adequacy requirements.

Last section concludes by pointing that even if NPL definitions are standardized internationally, there are likely to remain instances in the future when discretion will be encouraged, and that this has implications for asset quality data. Indeed in the past regulators have sanctioned loan forbearance at a firm or system-wide level during financial crises as a means to stave off their worst depths [15]. While forbearance may be inappropriate if the obligor has no real chance of recovery, as this can hamper the reallocation of resources to other sectors of the economy and weigh down long-term productivity, it may be appropriate if an obligor is suffering just from a temporary cash flow problem, or restructuring or strategically reclassifying the loan gives them time to recover and become economically viable [16].

Given that some regulatory and management discretion is likely in crisis situations, standardising a definition of NPLs using only a hard-and-fast threshold based on arrears may be an objective that

misses the ultimate mark. When forecasting future losses and loan performance, judgment inevitably plays a role. The implication of this observation is that, in addition to initiatives to harmonise NPL definition and asset classification for purposes of loan loss provisioning, considerable vigilance is required of the prudential regulator to enhance the quality of the data for the purpose of assessing asset quality to aid that judgment.

2. The problems NPLs create for economic recovery are evident in the period since the start of the global financial crisis in 2007, with the persistence of NPLs being a reason for the delay in the recovery from the GFC [17]. The fundamental problem is that the balance sheet counterpart of NPLs on the assets side is an eventual hit to bank capital on the claims side. Thus one key ratio to track is the proportion of LLPs to NPLs (coverage ratio), constructed and commonly used by credit rating agencies, among others [18].

In general, the goal should be having a level of provisioning commensurate with the initial expectations of recovery on loans (and therefore the pricing of credit) [19]. If this is not so, then the scale of losses may be so large that they cannot be covered by income, bringing a bank's capital below or close to the minima required. At that point, banks might have to recapitalise when they and the wider system may be facing a crisis. Crises, of course, are the worst possible moment for a bank to raise capital, as profits are falling, investors are wary of purchasing new shares, and general economic conditions are poor. So as a general rule, bank recapitalisation during a crisis is a second best solution to higher LLPs before they occur.

However, adequate provisioning for NPLs requires overcoming complex strategic incentives that banks have in either wanting to keep LLPs low, or for not writing NPLs off from their balance sheets. The timing of losses taken as a result of provisions or write offs, and the level of loan loss provisions set aside for future NPLs on the balance sheet, are often part of a bank's strategy to smooth reported earnings and reported capitalisation [20]. For example, current regulatory capital requirements give banks strategic reasons for wanting to keep LLPs low. Specifically, the BIS Common Equity Tier 1 and Tier 1 capital adequacy ratio numerators include common stock and retained earnings. However, since higher LLPs are taken as losses and so reduce retained earnings, this implies a trade-off between reporting higher Common Equity Tier 1 and Tier 1 capital ratios and maintaining adequate LLPs. This trade-off is further complicated by a Basel III Common Equity Tier 1 (CET1) capital requirement of 7% (comprising the minimum CET1 requirement of 4.5% plus a mandatory capital conservation buffer of 2.5%) of risk-weighted assets, with further buffers added to the CET1 requirement in specific cases. LLPs have the effect, generally speaking, of reducing CET1 and therefore the numerator of those ratios [21].

In addition to the above strategic reasons for potential under-provisioning to maintain regulatory capital, provisions may be mis-calibrated simply because the path of future NPLs may differ considerably from historical experience. For example, mortgage delinquencies from the 2007 house price fall in the US far exceeded any previous market downturns, so there was considerable under-provisioning for these losses [22]. In 2005, the US Federal Deposit Insurance Corporation (FDIC) stated that "while historical loss experience provides a reasonable starting point, historical losses, or

even recent trends in losses, are not by themselves, a sufficient basis to determine an adequate level. Management should also consider any factors that are likely to cause estimated losses to differ from historical loss experience".

Since write offs mean that some loans and the provisions against them disappear from the balance sheet, and as some loans tend to have higher provisions raised against them as a proportion of the gross amount of the loan, it follows that a bank that elected to write off relatively more of its highly provisioned problem loans would show lower provisions as a percentage of overall loans. Thus full information about write offs, and further data on when a bank deems that such write offs take place, are critical for users of financial statements to compare overall provision numbers from bank to bank. For example, in their detailed study on why Italian banks have been slow in dealing with NPLs in the recent crisis, Jassaud and Kang note that these banks have delayed writing off highly provisioned loans as this would lower their overall provisioning ratio and possibly their credit rating [23].

Jassaud and Kang also observe a lack of tax rebates on losses in Italy, and also that the current accounting standard in Europe (IAS 39) is not explicit on exactly when and how to write off uncollectible loans. In this case, and in all situations, the more LLPs and related accounting policy decisions such as write-offs are left to management discretion, the more difficult it becomes to compare cross-firm and cross-border NPL and LLP figures.

3. While the negative economic consequences of NPLs are well understood, the actual meaning of non-performing loans is less so. In fact, there are divergences in NPL definitions across jurisdictions. Barisitz provides an overview of the general drivers behind these differences [24] finding that a majority of countries in his study classify loans as non-performing when principal or interest is 90 days or more past due and there is "well-defined weakness of loan or borrower" [25]. But two issues complicate matters. First, the definition of "well-defined weakness" remains unspecified within and across jurisdictions. In other words, different firms and regulators have different data and different interpretations of data they use to estimate obligors' ability to repay and whether it has deteriorated.

Second, there are other dimensions besides time (since last repayment) that matter in certain jurisdictions. These include whether collateral, guarantees or other forms of security are factored into the credit classification process; whether the full outstanding value or only part of a loan is reported as non-performing; and how to treat restructured loans.

Convergence around the global statistical definition of NPLs is established by the UN System of National Accounts and followed by all countries adhering to IMF or European reporting standards: "a loan is non-performing when payments of interest or principal are past due by 90 days or more, or interest payments equal to 90 days or more have been capitalized, refinanced, or delayed by agreement, or payments are less than 90 days overdue, but there are other good reasons (such as a debtor filing for bankruptcy) to doubt that payments will be made in full" [26]. Loan quality classification schemes range from three to nine categories in some jurisdictions. Furthermore, like the UN statistical definition, which comes with the proviso that the UN "definition of a non-performing loan is to be interpreted flexibly", the drafting of these definitions leaves scope for firm discretion because the meaning of phrases like "objective evidence of impairment" are not precisely defined. In the past, there have been

efforts by some international bodies to establish firmer guidelines in assessing credit risk for regulatory purposes. For example, under the Basel II capital framework first published by Basel Committee on Banking Supervision (BCBS) in 2004, a system of credit risk calibration based on banks' own internal risk models was introduced. For those portfolios where banks elected to develop systems to follow this approach, the IRB methodology required firms to provide own estimates of probability of default, loss given default and exposure at default [27].

In particular, default is defined as where an obligor is 90 days past due, or is unlikely to pay its credit obligations to the banking group in full, without recourse by the bank to actions such as realising security. Indicators of unlikeliness to pay include the following: (1) the bank puts the credit obligation on non-accrued status; (2) the bank makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure; (3) the bank sells the credit obligation at a material credit-related economic loss; (4) the bank consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees; (5) the bank has filed for the obligor's bankruptcy or a similar order in respect of the obligor's credit obligation to the banking group; and (6) the obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of the credit obligation to the banking group [28]. In 2006 BCBS issued guidance that specifically mentioned loan classification [29]. It recommended banks to have a credit classification system on the basis of credit risk but stopped short of spelling out the classification scheme [30]. While some bodies, such as the Institute of International Finance have established such systems, these lack the force of international law.

4. One area where one might expect the meaning of non-performing loans to be reasonably well defined is in accounting. However, neither International Financial Reporting Standards (IFRS) nor US Generally Accepted Accounting Principles (GAAP), treat the topic of non-performing loans as such. Rather, the focus is on impaired loans and note disclosures on credit risk. On the eve of the financial crisis, both the IFRS and the US GAAP accounting standards that governed impairment of financial assets (also known as 'provisioning') operated under a model known as 'incurred loss'. This meant that impairment was only recognised when a loss event had occurred. Within IFRS, the standard IAS 39 is specific that "losses expected as a result of future events, no matter how likely, are not recognised". Nevertheless, additional information on asset quality could be discerned through further analysis of the accounts prepared by banks reporting under IFRS.

US accounting rules in this area differ from IFRS, and the absence of common, cross-border accounting standards for judging when loans are impaired makes like-for-like comparisons between banks difficult for users of their financial statements [31]. In the lead up to the GFC, banks often did not disclose the level of write-offs: situations where both a loan and the related provision are derecognised from the balance sheet because there is no realistic prospect of recovery. The assessment of whether a write-off is required inevitably involves judgement on the part of the bank, and so it follows that one bank might elect to write off an asset where another bank would not, even when the underlying economics are broadly similar. In sum, in terms of asset quality, provisions, and write-offs, bank reporting practice is

diverse and divergent. While there is convergence towards the definition of an NPL as being loans 90 days or more past due, there are also differences along quantitative and qualitative dimensions.

5. The period that immediately followed the GFC saw intense criticism of the 'incurred loss' model, and multiple initiatives in the area of loan loss provisioning and related disclosures, both from accounting standard-setters and from prudential regulators. Starting in 2009, the G20 called for accounting standard setters to "strengthen accounting recognition of loan-loss provisions by incorporating a broader range of credit information" [32]. In the same year, the Financial Stability Board (FSB) encouraged accounting standard-setters to agree standards that "will incorporate a broader range of available credit information than existing provisioning requirements, so as to recognise credit losses in loan portfolios at an earlier stage" [33]. The IASB and FASB models require provisions to be based on forward-looking expectations and so mark a clean conceptual break from the methodology of incurred loss. The IASB has also jettisoned the classifications based on past due status that previously formed part of the disclosure framework around it. Unlike the 2009 draft, the term 'non-performing' does not appear in the accounting standard. One reason for this may be that a definition of a set number of days past due is arguably of less relevance in a standard where provisions are calculated on a forward-looking basis [34].

Under the IASB approach, the forward-looking provision is set at 12 months of expected loss for all loans, and full expected loss over the lifetime of a loan where 'significant increase in credit risk' has occurred. When determining whether such credit deterioration has taken place, the accounting guidance makes reference to an internal credit downgrade as an indicator, thus assuming that an internal credit classification might exist. Although firms are required to disclose how they determine whether a significant increase in credit risk has occurred, the criteria used in internal classifications more generally are often opaque so users of financial statements may not be able to understand the full context in which a loan is reclassified, or to what extent loans have not been determined to have undergone a significant increase in credit risk even where some deterioration has occurred. A more comprehensive classification of asset quality, showing how credit quality changes from one period to the next, arguably provides further colour in understanding how the bank goes about applying the three-stage classification in practice.

The FASB intends to issue a standard that requires provisioning based on expected credit loss over the lifetime of a loan for all loans. Discretion over bank loan loss provisioning can have beneficial or negative consequences depending specifically on how managers exploit their discretion to shape loan loss provisions [35]. While management discretion to use loan loss provisions as a means to smooth profits is objectionable, better provisioning in anticipation of future deterioration is not [36]. Meanwhile, the European Securities and Markets Authority (ESMA) has noted that disclosures about forbearance practices in the financial statements diverged significantly and were often limited in the amount of information provided and vague as to content [37]. The European Banking Authority in 2014 published technical standards for the reporting of non-performing loans and forbearance. The EBA document provides the definition of "exposure", "non-performing exposures" and "forborne exposures" [38]. The EBA standard centres the definition of non-performing on the notion of either 90 days past due, or where the debtor is assessed as unlikely to pay its credit obligations in full without realisation of

collateral. Further disaggregated reporting is required for forborne assets, and those defined as performing but nonetheless past due by 30 or 60 days.

6. In the wake of the GFC, one area where the lack of an internationally harmonized accounting concept of impairment was suspected of giving an especially incomplete picture of the health of the financial system was with respect to forbearance, that is, the restructuring of troubled loans. While IAS 39 is clear that restructuring is a credit event that might lead to impairment, and impairments have to be calculated based on the difference between the original and modified conditions, the standard does not rule out cases of restructuring where there is no impairment and there is ambiguity about whether once restructured, an exposure needs to continue being identified as impaired. Consequently, lenders choose to extend or otherwise modify the terms of loans that show evidence of financial stress, these loans might avoid arrears and as such might not be identified as impaired (or non-performing), despite underlying credit deterioration of the borrower [39].

In 2011 the UK Financial Services Authority (FSA) issued a guidance document on loan forbearance, noting that "we have concerns that certain accounting practices can have the effect of concealing the full effect of impairment and forbearance and thus may not present the true nature of credit risk within retail portfolios" [40]. Similar concerns were raised the same year in the US when the accounting standard-setter clarified its guidance around the definition of troubled debt restructurings (incidentally a term used only in US accounting), with the aim of developing more consistent standards in determining whether a modification of a loan receivable constitutes a concession to a borrower that is experiencing financial difficulty.

In this light, the Central Bank of Ireland in 2013 produced comprehensive guidance on accounting practice for loans and related disclosure. This document included standardised definitions of terms such as 'performing loan', 'non-performing loan', 'cured loan', 'foreclosed loan' and 'forbearance' [41]. Meanwhile, in the south of the European Continent, the European Bank Coordination 'Vienna Initiative'— a private-public sector platform which brings together key international financial institutions, international organisations, public authorities and private banks— has called for an action plan to address NPLs in CESEE countries.

The main purpose is to establish a central forum for dialogue to create the right conditions for Western banks to remain engaged in emerging Europe. This means enhancing enforcement measures, improving consistency in the definition of NPLs and removing legal obstacles and execution issues in distressed transactions. In particular, the 'Vienna Initiative' is trying to establish an effective coordination mechanism for dealing with distressed assets. NPLs are considered a serious impediment to recovery from the financial crisis in certain CESEE countries because they impair banks' ability to resume lending and weigh down overextended borrowers [42]. This can have macroeconomic consequences, as the burden of debt felt by some results in their decreasing spending, with reduced income down the line for others, including even those not indebted [43]. As a result, it has been claimed that "NPL resolution has moved to the top of policy makers' agenda in central and eastern Europe" [44].

Looking across all of these post-crisis developments in the regulatory and accounting treatment of NPLs, a wide variety of approaches continue to be employed [45]. Within accounting standards,

differences between US and IFRS approaches, as well as discretion allowed to banks in determining many credit quality metrics, means that banks still can diverge significantly from each other in their approach to asset quality classification. Within the regulatory sphere, forward-looking judgment can give rise to quite different estimates. Arguably more than ever, users of financial information are in need of meaningful and comparable information indicators against which to assess the asset quality of banks.

7. The current Eurozone crisis is a stark reminder of the dangers posed to economic and financial stability by over-indebtedness, under-provisioning and NPLs [46]. Besides being precursors to the current crisis, however, earlier episodes also evidence that 'creative accounting' has played a role in previous crises' resolutions. Consider the Latin American debt crisis in the 1980s. In August 1982 "the total risk to the nine money-centre banks in New York was estimated at more than three times the capital of those banks. The regulators did not force the banks to value those loans at the fire-sale prices of the moment, helping to avert a disaster in the banking system [47]. In other words, the nine biggest banks were all insolvent in the 1980s" [48]. The accounting treatment of non-performing loans encouraged regulators to effectively delay the recognition of any losses until banks had had the time to build up loan loss reserves [49].

If there is a place for forbearance as a resolution or macro-prudential tool in certain circumstances to prevent the worst of economic catastrophes, then this suggests that the search for a single, deterministic definition of non-performing loans is misconstrued. If so, then the focus of regulators should not be on establishing a global standard NPL definition because context often matters. Instead the focus perhaps should be on getting banks, regulators, investors and other stakeholders the right data to monitor asset quality in a more timely and transparent way. *Ex ante*, at origination, lenders collect lots of information about obligors. *Ex post*, in liquidation procedures, courts collect lots of information about defaulted obligors. But in the interval in between, in the absence of market prices for non-traded loans, there is a need for continual monitoring of asset quality by looking at the overall solvency of obligors, the progress of projects the loans are financing, and any other key risks that are evolving that are obligor-specific and macro-economic.

As regulatory and accounting standards shift from incurred to expected loss models, it is desirable that the debate will focus on harmonizing NPL definitions internationally and on global co-ordination to better collect and disclose asset quality data [50].

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[6] This terminology from the Basel framework (see for instance paragraphs 12, 13 and 17 in the Basel II agreement) holds true regardless of the methodology of computation of LLPs: current accounting under IFRS and US GAAP requires LLPs to reflect incurred loses, that is loses that a bank estimates it has already suffered on a loan, instead of the future losses it expects to suffer.

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[13] At the time of writing, these standards are still in force under US GAAP and IFRS, but both standard-setters have committed to change. As this section concerns itself with initial reactions to the financial crisis, the past tense is used.

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[19] For example, for collateralised lending, provisions under US GAAP and IFRS are net of the recoveries on liquidating collateral. So when the provisions are compared to the gross amount of the non-performing loan, they can be adequate even if less than 100% if there is adequate collateral.

[20] Beck, Paul J., and Ganapathi S. Narayanamoorthy. "Did the SEC impact banks' loan loss reserve policies and their informativeness?" *Journal of Accounting and Economics* 56, No. 2 (2013) 42-65; Hasan, Iftekhar, and Larry D. Wall. "Determinants of the Loan Loss Allowance: Some Cross-Country Comparisons", *Financial review* 39, No. 1 (2004) 129-152.

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[26] United Nations System of National Accounts 2008.

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[28] In view of the passage of time since this wording was issued, two things are noticeable with regard to these criteria. The first is that it is not very different from later definitions of 'non-performing' issued by the EBA. The second is that the first of the indicators listed above makes reference to an accounting concept (non-accrual loans) that does not exist under the newer international accounting standards (IFRS) used in most jurisdictions but does exist under US Generally Accepted Accounting Principles (US GAAP).

[29] Basel Committee on Banking Supervision, *Sound credit risk assessment and valuation for loans*, Basel Committee on Banking Supervision Paper (2006).

[30] In a further Consultative Document issued in December 2014 on revisions to the standardised approach for credit risk, the BCBS for the first time suggests a definition of non-performing, whose threshold includes (amongst other criteria) 90 days past due for loans, and 30 days past due for securities. The purpose of these criteria is to calculate a 'non-performing asset' (NPA) ratio when assessing exposures to other banks. At the time of issue, the proposals in this consultation were described by the BCBS as "at an early stage of development".

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[32] G20 Research Group. "*Declaration on Strengthening the Financial System*", Global Plan Annex 2009.

[33] Note 3.

[34] Although a rebuttable presumption exists in IFRS 9 that a significant increase in credit risk has occurred when a loan is already 30 days past due, the conceptual basis of the standard is based on expectations of future loss, and so is forward-looking.

[35] Basel Committee on Banking Supervision. "Basel 3: A global regulatory framework for more resilient banks and banking systems", Basel Committee on Banking Supervision Paper (2011).

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[37] ESMA, "Treatment of Forbearance Practices in IFRS Financial Statements of Financial Institutions", ESMA no. /2012/853 (2012).

[38] The focus of the EBA document is on non performing exposures (NPEs) broader than NPLs. Paragraph 149 of the EBA document states that for the purpose of template 18, "exposures" include all debt instruments (loans, advances and debt securities) and off-balance sheet exposures (loan commitments, financial guarantees and other revocable and irrevocable commitments) excluding trading exposures and off balance sheet exposures except held for trading exposures. European Banking Authority, "Final implementing technical standards (ITS) on supervisory reporting on forbearance and non performing exposures under Article 99(4) of Regulation (EU)". Official Journal of the European Union Volume 58, 2015.

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[47] In a crisis situation, such 'fire sale' prices may reflect much higher expectations of credit loss, or a further discount due to the illiquidity of the loan market.

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