FlexFinance NPL Servicing

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1. Summary of NPL Servicing by FlexFinance

The European Banking Authority (EBA) has set out guidelines for integrating measures for processing problem loans into banking procedures. These focus on concessions to borrowers with regard to repayment methods when borrowers start to show signs of financial difficulties.

The "Guidance to banks on non-performing loans" (NPL) published by the European Central Bank in March 2017 provides for an operational model for NPLs based on specialised NPL workout units (WUs) which are to take over activities in all stages of non-performing loans.

The focus here is particularly on loans for which viable restructuring options are identified and implemented after a review of basic debt servicing capacity. Following the conclusion of a restructuring/forbearance agreement, a borrower must be monitored continuously during a recovery period.

These specifications result in operational requirements for organisational processes, risk classification as well as risk provisioning.

FERNBACH provides modules for "NPL Servicing" with the following range of functions:

- Evaluation and documentation of forbearance measures
- Classification of NPEs
- Monitoring of recovery processes
- Risk provisioning under IFRS 9

2. Modules for processing problem loans

With the help of the module 'Problem Loan Processing', the FlexFinance product range supports the integration of forbearance measures into banking processes.

Depending on the functions required, the module's scope of services covers business transactions ranging from changes in loan instalments, interest rate adjustment to the shifting of payment dates, forbearance, debt forgiveness and the sale of receivables.
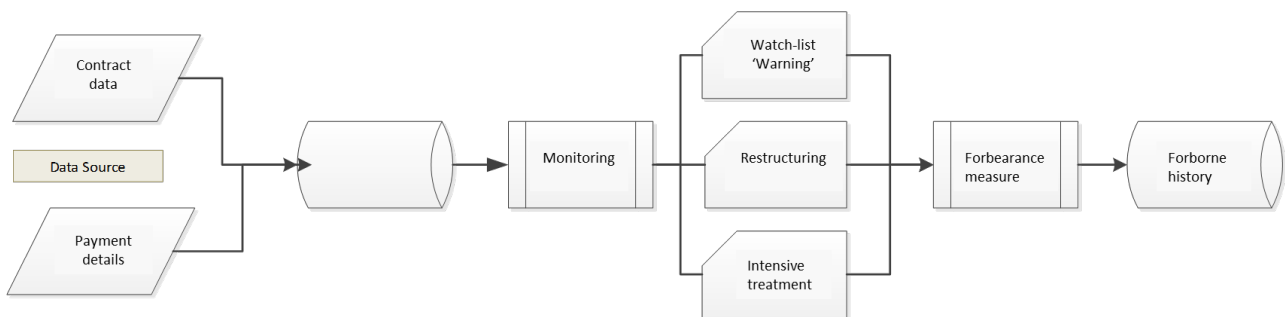
A forbearance measure can be defined for crisis-related restructuring and can comprise a single business transaction or a combination of several business transactions.

A cost-benefit analysis is carried out for forbearance measures. In this case, the payment plan is simulated for the period following a forbearance measure but before it is implemented and compared with alternative restructuring options.
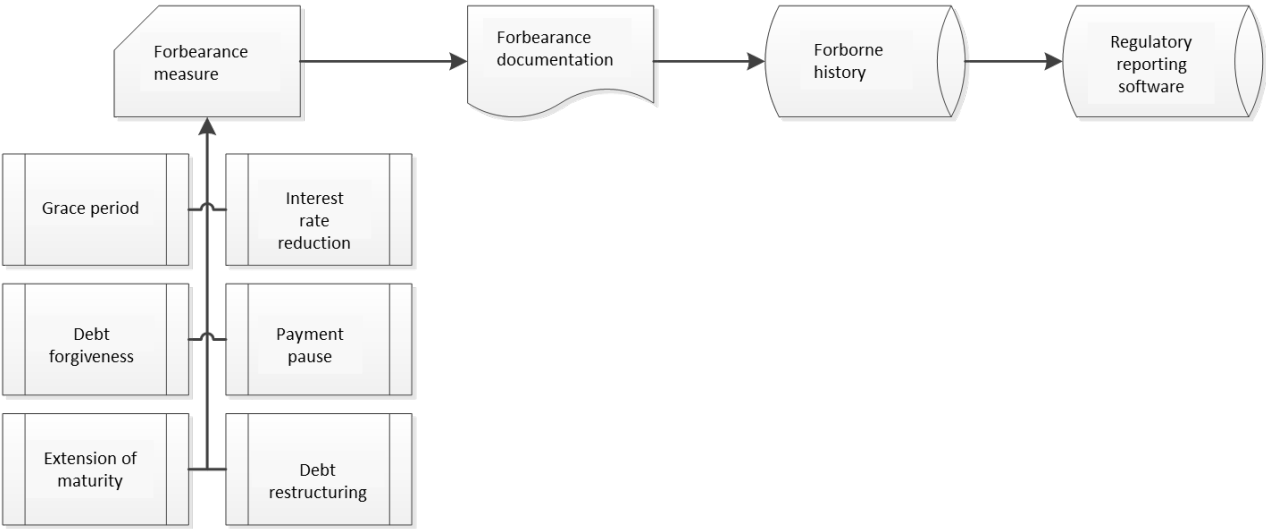
In the course of crisis-related restructuring, the extended data set is maintained. In addition to the reason for restructuring, this includes information on the benefits, significance, the expected recoverability of receivables after implementation of the measure as well as documentation.

In this way, data for classifying forborne exposures or NPE (non-performing exposures) and for monitoring the recovery process are provided at the forbearance measure.

3. The NPE module

The NPE module includes the identification of individual loans as non-performing engagements, taking into account the EBA definitions. This includes both the initial classification as 'NPE' and the monitoring of recovery.
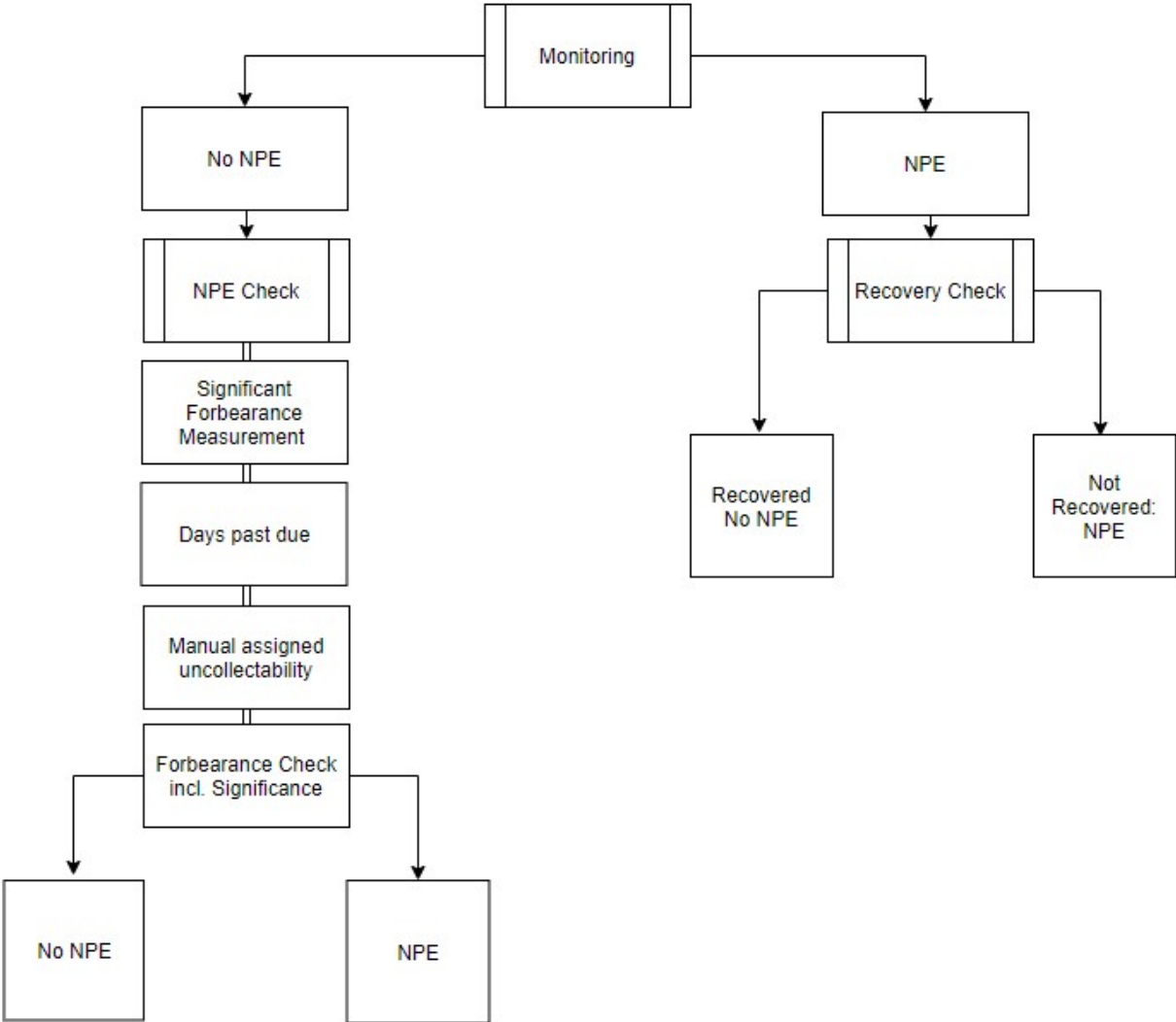
For loans that are currently not in the NPE status, a check is made, along with other criteria, of whether a significant forbearance measure has been carried out since the last NPE check. In principle, loans for which no forbearance measure has been carried out in the past can also be classified as NPE.

If only a non-significant forbearance measure has been carried out, a check is also made to determine whether the risk position is significant.

Overall, the following criteria are checked for the risk positions currently not marked with the attribute 'NPE':

- Number of days past due
- Significance of a forbearance measure
- A bank's expectations regarding the recovery of the debt after implementation of the measure
- Relevance of the risk position
- Product type
- Recovery

The product type is, among other things, relevant for the analysis of whether the risk position can be attributed to retail business and consequently whether there is an option to assess only a specific risk position as an 'NPE'.

Otherwise, the following applies: If several risk positions are assigned to a borrower, the status 'NPE' is to be assigned to all risk positions if this status has been determined for at least one risk position. However, this is also the case, irrespective of retail business, if the reason for the forbearance measure suggests that default on all risk positions is to be expected.

For risk positions that are already classified as 'NPE', a periodic check is carried out to determine whether there has been a 'recovery' and the status can be set to 'not NPE anymore'. In addition to the number of days past due, it is relevant whether a forbearance measure has been carried out in the credit history. Depending on this, different checklists are used. The EBA status 'Non-Performing Engagement' will continue to be awarded for risk positions currently classified in the EBA status 'NPE' if at least one test criterion is not met.

4. The risk provisioning module

FlexFinance problem loan processing is directly connected to the Impairment Workbench. The Customer Impairment Workbench provides a fully automated risk provisioning process for significant and non-significant deals.

- Calculation of lifetime expected credit losses (ECL) at individual deal level.
- Lump-sum specific impairment based on loss rates
  - Specific impairment including the liquidation proceeds from and the liquidation costs of collateral as well as other expected incoming payments
  - Generation of credit/debit entries to account for risk provisioning in the balance sheet and profit and loss account
- Analysis and reporting of the calculation principles and results of risk provisioning

5. Publisher's details

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