NON-PERFORMING LOANS

The Intesa Sanpaolo Group uses the definitions of the various categories of “non-performing” loans as set out in the Bank of Italy’s Circulars no. 272 (“Credit and financial institutions’ supervisory: Accounting matrix”) and no. 262 (“Banks’ financial statements: layout and preparation”), which adopted the definitions of non-performing exposures (NPEs) included in the Implementing Technical Standards (ITS) published by the EBA on 21 October 2013 and then approved by the European Commission on 9 January 2015. Moreover, starting from November 2019 (July 2019 for the former UBI Banca perimeter), the Group has adopted in advance the New Definition of Default, deriving from the implementation of the “RTS on the materiality threshold for credit obligations past due under Article 178 of the CRR (Delegated Regulation (EU) 2018/171)” and the related “EBA Guidelines on the application of the definition of default under Article 178 of the CRR”. The new regulations – while confirming the bases of default in the concepts of past due payments and unlikeliness to pay – with a view to achieving a higher level of prudence, introduce some significant changes mainly related to:

- “relative” and “absolute” materiality thresholds in the past due exposures for the verification of the default:
    - 1% of the exposure, to be compared to the ratio between the total amount of past due and/or overdrawn exposures and the total amount of all on-balance sheet exposures to the same borrower, as a relative threshold;
    - 100 euro for retail exposures and 500 euro for non-retail exposures, to be compared to the borrower’s total past due and/or overdrawn amount, as absolute thresholds.

  The default is triggered when the two limits are jointly exceeded for 90 consecutive days.
- probation period of three months (starting from when non-performing past due and/or overdrawn exposures or unlikely-to-pay exposures no longer meet the conditions to be classifies as such) before return of the credit to non-defaulted status;
- specific thresholds as triggers of classification as non-performing exposures with respect to:
    - distressed restructuring (default is identified when the loss from renegotiation exceeds 1%);
    - sale at a loss (default is identified when the loss in relation to the deteriorating credit risk of the counterparty exceeds 5%).

The instructions of the Authorities are supplemented by company provisions that establish the criteria and automatic rules for the transfer of loans between the different risk categories. The supervisory provisions of the Bank of Italy are broken down as follows:

- bad loans: on- and off-balance sheet exposures to borrowers in a state of insolvency (even when not recognised in a court of law) or in an essentially similar situation, regardless of any loss forecasts made by the bank, irrespective, therefore, of whether any collateral or guarantees have been established to cover the exposures. Exposures whose anomalous situation may be attributed to “country risk” are excluded from this category;
- unlikely to pay: exposures for which - according to the judgement of the creditor bank - full repayment is unlikely (in terms of capital or interest and without considering recourse to actions such as enforcement of collateral arrangements). This assessment is conducted regardless of the presence of any amounts (or instalments) due and unpaid. As the assessment of unlikelihood of repayment is at the discretion of the bank, it is not necessary to await an explicit symptom of anomaly (non-repayment), when there are elements that imply a risk of non-compliance by the borrower (for example, a crisis in the industrial sector in which the borrower operates). The set of on- and off-balance sheet exposures toward the same borrower in said situation is therefore classified under the category “Unlikely to pay” (unless the conditions for classification of the borrower among bad loans exist). Loans classified as “unlikely to pay” should include exposures to issuers who have not regularly honoured their repayment obligations (in terms of capital or interest) relating to listed debt securities, unless they meet the conditions for classification as bad loans. To this end the “grace period” established by the contract is recognised or, in its absence, the period recognised by the market listing the security.

The Intesa Sanpaolo Group's policy - in addition to what is expressly and specifically indicated by Circular no. 272 - envisages that exposures classified as "unlikely to pay" also include non-performing past due or overdrawn loans renegotiated and which, following restructuring, no longer have past due days [1]. As provided for in the reference regulations, classification in the non-performing category is maintained for twelve months following the signing of restructuring.

- Past due and/or overdrawn exposures: on- and off-balance sheet exposures, other than those classified as bad or unlikely to pay that, as at the reporting date, are past due or overdrawn by over 90 days on a continuous basis. This is irrespective of whether any collateral or guarantees have been established to cover the exposures.

The exposures continue to be disclosed as non-performing loans up to at least three months from when they no longer meet the conditions to be classified as such (probation period). These exposures are maintained in their respective risk categories until conditions are ripe for moving them out of the non-performing status and are assessed in analytical-statistical or analytical-specific modality taking their lower level of risk into account.

The non-performing loans category excludes exposures from the "Financial assets held for trading" portfolio, as well as derivatives, as for these types of financial instruments such disclosure is not required.

The convergence between the concept of "non-performing" and the definition of impaired loans under IFRS 9 – Section 5.5 is confirmed.

The concept of forbearance has also been introduced into supervisory regulations. In this context, the notion of "forborne assets", introduced by European provisions, transversally applies to the loan classification macro-categories (performing and non-performing).
The exposures subject to forbearance are subdivided into:

- non-performing exposures subject to forbearance measures, which correspond to the "Non-performing exposures with forbearance measures" pursuant to the aforementioned ITS. These exposures represent a further element of definition of the customer's credit quality which complements (but not overlaps with) the classifications, depending on the case, of the categories of non-performing exposures; therefore, they do not form their own category of non-performing exposures.
- other exposures subject to forbearance measures, which correspond to the "Forborne performing exposures" pursuant to the ITS.

The definition of "forborne exposures" is directly connected to that of forbearance measures. The latter represent concessions for a borrower that is facing, or is about to face, difficulties in meeting his payment obligations (troubled debt).
The term "forbearance measures" indicates contractual modifications granted to the borrower suffering financial difficulties (modification), as well as the disbursement of a new loan in order to satisfy the pre-existing obligation (refinancing). "Forbearance measures" include contractual modifications, which may be freely requested by a borrower with regard to a contract already signed, but only if the lender believes the borrower to be in financial difficulty ("embedded forbearance clauses").

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[1] Maintenance of the renegotiated exposures in the categories of non-performing loans follows the provisions of the EBA's ITS, according to which a loan that is granted "forbearance measures" must be included under "non-performing" exposures for at least twelve months from the renegotiation. This provision is valid solely for renegotiations with borrowers having "non-performing" status upon restructuring or that become non-performing directly following restructuring.