Draft RTS on materiality threshold for past due credit obligations

Public Hearing 16 January 2015

Background

Currently various approaches are used with regard to the application of the materiality threshold:

- In some countries the thresholds have been set by competent authorities – either as caps or floors or obligatory levels to be used by the institutions.
- These thresholds have been defined in absolute or relative terms, or as a combination of the two.
- In some countries a case-by-case approach is used that leads to further discrepancies between institutions. The levels of the thresholds used by the institutions for non-retail exposures range from around 100 EUR to even 10.000 EUR.
- There are various practices with regard to the reference amounts that are compared with the thresholds – these may be defined in particular as all amounts past due, amounts past due more than 90 days or the whole credit obligation.
- The threshold may be checked separately for each facility of the obligor or for the aggregate of all credit obligations of the obligor.

Background – examples of supervisory requirements

Retail (EUR)	Non-retail (EUR)	Relative (%)	Reference amount	Type of obligation
250	250	2.50%	All amounts past due, days past due counted after materiality threshold is breached	Obligatory
100	1000	NA	All amounts past due, days past due counted after materiality threshold is breached	Adopted as a cap
100	100	2.50%	All amounts past due, days past due counted after materiality threshold is breached, both drawn and undrawn amounts taken into account	Obligatory
130	1300	NA	As specified by the institution	Adopted as a floor
50	50	NA	All amounts past due, days past due counted after materiality threshold is breached	Obligatory, but exceptions possible
30	30	NA	Past due amount	Obligatory, but exceptions possible
100	500	2%	Past due amount	Obligatory
200	200	2% (backstop: 50000 EUR)	All amounts past due, days past due counted after materiality threshold is breached	Obligatory
230	230	2.50%	All amounts past due, days past due counted after materiality threshold is breached	Obligatory, but exceptions possible
NA	NA	5%	Not specified	
monthly min. wage	1000	2%	Total past due amount	Obligatory

Background

- This CP puts forward draft RTS as required by Article 178(6) of the CRR to specify the conditions according to which competent authorities shall set the materiality threshold for a credit obligation past due.
- The threshold will be used for the purpose of identification of default for the exposures that are past due more than 90 days to determine whether the credit obligation past due is material.
- The threshold set by a competent authority should reflect the level of risk that the competent authority considers to be reasonable.
- These RTS will be applicable for the purpose of IRB Approach according to Chapter 3 of Title II in Part three of the CRR as well as for the Standardised Approach in line with Article 127 of the CRR.

Background

- These RTS is a part of more fundamental review of the application of the definition of default. The EBA is also working on the Guidelines on the application of definition of default on the basis of the mandate included in Article 178(7) of the CRR. The Guidelines will provide clarification on other aspects of the default definition.
- The work on the draft RTS is slightly delayed as it should have been submitted to the Commission by 31 December 2014. However, in order to facilitate the implementation of the changes, the EBA might consider aligning the time of entry into force of the RTS and Guidelines. Therefore some further delays in the publication of the RTS might be necessary.
- Comments to this consultation can be sent to the EBA by 31 January 2015.

Objectives

Objectives of the RTS

- Harmonisation of practices in order to enhance consistency of the risk parameters and capital requirements across institutions and jurisdictions
- Ensuring level playing field for institutions across EU
- Facilitating the operations of cross-boarder institutions by aligning supervisory requirements

Objectives of the materiality threshold

- Efficient elimination of cases where the past due exposure is not a result of materialisation of credit risk but occurs due to other circumstances
- Reasonable numbers of cure cases
- Effective and timely identification of real, material defaults
- More accurate estimates of risk parameters

Main policy decisions

The reference amount to be compared with the threshold

- For default definition at the obligor level – the sum of all amounts owed by the obligor that are past due more than 90 days (or 180 days if competent authority decided to replace the 90 days with 180 days in accordance with Article 178(1)(b) of the CRR) related to the credit obligations of the borrower
- For default definition at the facility level – the sum of all amounts of the credit obligation of the borrower that result from a single credit facility and that are past due more than 90 days (or 180 days if competent authority decided to replace the 90 days with 180 days in accordance with Article 178(1)(b) of the CRR)

Main policy decisions

Structure of the threshold

- Combination of an absolute and relative threshold
- For default definition at the obligor level – the relative threshold set as a percentage of the sum of all credit obligations of the borrower
- For default definition at the facility level – the relative threshold set as a percentage of the single credit obligation of a borrower
- The obligor or transaction should be considered defaulted whenever either of the components of the threshold, i.e. absolute or relative limit, is breached.

Main policy decisions

Level of the threshold

- Competent authorities may set different levels of thresholds for retail exposures and all other exposures.
- Additionally, the level of the threshold may be differentiated for the obligor and transaction level of the definition of default.
- For retail exposures – the absolute threshold cannot be higher than 200 EUR.
- For non-retail exposures – the absolute threshold cannot be higher than 500 EUR.
- The relative threshold cannot be higher than 2%.

Main policy decisions

Application of the threshold

- Competent authority will set the threshold during 90 days after the publication of the RTS in the Official Journal of the EU.
- Subsequently competent authorities will define the timelines for the institutions to implement the threshold.
- The timelines may be differentiated across institutions depending in particular on:
    - the method used to calculate capital requirements
    - the number and complexity of rating systems used by the institution
    - the materiality thresholds used currently by the institutions

Impact assessment

- It is difficult at this point to assess the impact of the draft RTS on EL and capital requirements of the institutions because:
  - It will influence not only the classification of exposures as defaulted or non-defaulted but also the estimates of risk parameters based on internal models of the institutions;
  - the RTS only specify the criteria for setting the threshold but the levels that the competent authorities will set according to these RTS are still unknown.
- The change of the concept of materiality threshold may have significant impact on the operations of the institutions, especially when they use IRB Approach and developed numerous rating systems.
- The impact on national supervisors will stem from the necessity to set the thresholds and to assess the applications for material changes of rating systems submitted by the IRB banks.

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