POSITION PAPER

ESBG response to the EBA consultation on materiality threshold of credit obligation past due under Article 178 of Regulation (EU) 575/2013

ESBG (European Savings and Retail Banking Group)

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Dear Sir/Madam,

Thank you for the opportunity to comment on the EBA's consultation on *materiality threshold of credit obligation past due under Article 178 of Regulation (EU) 575/2013*.

<u>Question 1:</u> Do you agree with the approach proposed in the draft RTS (option 1) that default should be recognized as soon as one of the components of the threshold (absolute or relative limit) is breached? Or would you rather support the alternative option, i.e. recognition of default after both thresholds are breached (option 2)?

According to ESBG's experience, 'technical defaults' are usually corrected within a few days after they occurred. Thus, they will not last for 90 days or more.

Option 2 is less strict and – as the EBA stated in its draft RTS – better identifies technical defaults than option 1. Therefore, ESBG prefers option 2.

Furthermore, we would like to ask the EBA for a clarification with regard to option 1. According to Art. 2 draft delegated Regulation, which is based on Art. 178 CRR, reference is made to an 'absolute' and a 'relative' component. While the 'absolute' component (Art. 2(2)(a) draft delegated Regulation) is very clearly worded, we have one doubt concerning the 'relative' component (Art 2(2)(b) draft delegated Regulation). ESBG would very much appreciate if the EBA could clarify whether the 90-days (or 180-days) threshold also applies to the 'relative' component. We assume that for both the 'absolute' and the 'relative' components the 90-days (or 180-days) limit needs to be fulfilled in order to consider an obligor as defaulted. However, the EBA's proposal is not very clear in this respect.

<u>Question 2:</u> Do you agree with the proposed maximum levels of the thresholds?

Due to the fact that only very little data is available on this aspect it seems at present hardly possible to us to precisely assess suitable maximum levels of the thresholds.

However, we cannot agree with the proposed maximum level of the thresholds. Several ESBG members have implemented well-calibrated thresholds which are different from the proposed ones. The possible process of implementing the necessary adjustments (data, risk parameters) would be fairly costly, time consuming and not necessarily justified by the benefits. Therefore, ESBG would rather advocate maintaining the existing thresholds (Please see also the answer to question 4).

__Question 3:__* How much time is necessary to implement the threshold set by the competent authority according to this proposed draft RTS? Given current practices, what is the scope of work required to achieve compliance?

First of all, ESBG would like to hold that the start of the implementation period needs to be aligned with the definition of the applicable materiality threshold by respective NCAs, not with the finalisation of the RTS.

In ESBG's opinion, an implementation period of less than two years is not feasible due to the reason that the implementation process is expected to be very complex. In fact, there are several factors relevant to the implementation period which can only be more precisely determined after both the RTS are finalised and the thresholds by the NCAs are adopted.

Re-developing internal models usually takes around four years. Therefore, if adjusting IRB models is required, ESBG would ask for a sequential adjustment of models over a period of four years.

__Question 4:__* Do you agree with the assessment of costs and benefits of these proposed draft RTS?

ESBG agrees with the assessment of costs for IRB institutions, but does not agree with the assessment of benefits.

With regard to the costs, it is our estimation that the implementation of the necessary adjustments will indeed be very costly and time consuming. These costs will be significant and, in our view, not entirely justified by the stated benefits.

In respect of the benefits, we would like to state the following two reflections:

- Greater comparability of own funds requirements: ESBG believes that the reasons of poor comparability of own funds requirements are to be found well beyond the unified definition of the materiality of default. This is also documented by a BCBS study on the 'Regulatory consistency assessment programme (RCAP) – Analysis of risk-weighted assets for credit risk in the banking book' (July 2013). In our opinion, introducing unified thresholds will only marginally improve comparability of own funds requirements for IRB institutions.

- The reduction in administrative and operational burden for cross-border institutions to comply with different regulatory frameworks in different Member States: No benefit can be seen for IRB banks that have already implemented own materiality thresholds and have already borne the costs of the implementation. On the contrary, changing the thresholds would impose significant additional operational burdens. Additionally, the initial intention of the different thresholds was to take into consideration the specific situations in the different markets (e.g. average consumer loan volumes in different Member States). This flexibility should be maintained.

***Question 5:* What is the expected impact of these proposed draft RTS?**

Following option 1 instead of option 2 (see question 1) could lead to a significant increase in defaulted clients, which would not reflect very precisely the (risky) situation of the client or his financial difficulties. As a consequence, the PDs would be increased, the LGD decreased, and the increased cure rate would show that the default rating from those clients was not adequate.

At the same time it is true that, without simulating, it is rather difficult to predict what the effect in the long run will be on the RWA and risk-cost side.

About WSBI-ESBG (European Savings and Retail Banking Group)

ESBG brings together savings and retail banks of the European Union and European Economic Area that believe in a common identity for European policies. ESBG members support the development of a single market for Europe that adheres to the principle of subsidiarity, whereby the European Union only acts when individual Member States cannot sufficiently do so. They believe that pluralism and diversity in the European banking sector safeguard the market against shocks that arise from time to time, whether caused by internal or external forces. Members seek to defend the European social and economic model that combines economic growth with high living standards and good working conditions. To these ends, ESBG members come together to agree on and promote common positions on relevant matters of a regulatory or supervisory nature.

ESBG members represent one of the largest European retail banking networks, comprising of approximately one-third of the retail banking market in Europe, with total assets of over €7,300 billion, non-bank deposits of €3,480 billion and non-bank loans of €3,950 billion (31 December 2012).

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