



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

## Feedback Statement

Responses to the public consultation  
on the draft ECB Regulation on the  
materiality threshold for credit  
obligations past due

BANKENTOEZICHT

November 2018

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This document seeks to provide an overview of the comments that were received during the public consultation on the draft ECB Regulation on the materiality threshold for credit obligations past due, which ran from 3 July to 17 August 2018, and to provide an assessment of those comments. Where applicable, it also explains the amendments that have since been made to the draft Regulation in response to the comments received. However, this document does not prejudge the future interpretation and application of the provisions laid down in the Regulation, since only the Court of Justice of the European Union can provide a legally binding interpretation of the provisions of EU law. Unless otherwise indicated, article numbers referred to in this document relate to the original draft ECB Regulation as submitted for public consultation.

# A Overview and analysis of responses

On 3 July 2018, the European Central Bank (ECB) launched a public consultation on a draft ECB Regulation on the materiality threshold for credit obligations past due (hereinafter “the draft ECB Regulation”). Under Article 178(2)(d) of the Capital Requirements Regulation (hereinafter “the CRR”), the ECB, as a competent authority, is required to define the threshold against which the materiality of a credit obligation past due will be assessed for the purposes of identifying defaults by obligors in relation to obligors’ total obligations or at the level of individual credit facilities. When setting that materiality threshold, competent authorities have to take account of the provisions of Commission Delegated Regulation (EU) 2018/171 with regard to regulatory technical standards for the materiality threshold for credit obligations past due (hereinafter “the RTS”)<sup>1</sup>.

That public consultation was conducted in accordance with Article 4(3) of Council Regulation (EU) No 1024/2013<sup>2</sup> conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions and sought to collect written feedback and comments on the proposed provisions from industry participants and other interested parties. As part of the consultation process, the ECB gave people the opportunity to participate in a live question and answer session on the draft ECB Regulation, which took the form of a public conference call on 31 July 2018 involving senior representatives of the ECB. The public consultation ended on 17 August 2018.

The ECB has given due consideration to all of the comments that were received during the consultation period. Those comments are available [here](#). A total of nine responses were received, comprising 24 individual comments. However, five of those comments were not related to the draft ECB Regulation and have therefore not been considered in this feedback statement. Those respondents ranged from financial institutions and banking associations to individual citizens, as Table 1 shows.

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<sup>1</sup> Commission Delegated Regulation (EU) 2018/171 of 19 October 2017 on supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the materiality threshold for credit obligations past due (OJ L 32, 6.2.2018, p. 1).

<sup>2</sup> Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).

**Table 1****Responses to the public consultation on the draft ECB Regulation**

Type of respondent	Number of respondents	Percentage of total
Credit and financial institutions	3	33%
Market and banking associations	5	56%
Public authorities	-	-
Individuals/others	1	11%
<b>Total</b>	<b>9</b>	<b>100%</b>

This feedback statement presents an assessment of the comments received during the public consultation. Although oral feedback received during the conference call is not reflected in Table 1 above, it was taken into account when preparing this statement. It should also be noted that most of the comments that were made during the conference call were repeated in written submissions.

This document sets out and responds to all relevant comments. Comments relating to specific provisions of the draft ECB Regulation are addressed in Section B, whereas other comments on the draft ECB Regulation are addressed in Section C. In order to avoid duplication, comments have been grouped together on the basis of the arguments made and presented as short summaries (in italics) at the start of each section. In each case, details of those comments are then followed by the ECB's assessment of the issue in question. The amendments that have since been made to the draft ECB Regulation on the basis of the comments received are summarised in Section D.

The final text of this ECB Regulation was adopted by the Governing Council of the ECB on 21 November 2018 and was published on the ECB's website, together with this feedback statement, on 26 November 2018. The ECB Regulation will be published in the Official Journal of the European Union on 26 November 2018.

## B Comments on specific provisions of the draft ECB Regulation

### B.1 Subsidiary undertakings outside the euro area – Article 1

*One respondent requested confirmation that EU subsidiary undertakings outside the euro area only needed to comply with the ECB Regulation where local competent authorities had not set a materiality threshold. The same respondent also enquired as to whether Paragraph 83 and subsequent paragraphs of the EBA Guidelines on the application of the definition of default under Article 178 of the CRR (EBA/GL/2016/07) (hereinafter “the EBA Guidelines”) were applicable, given the provisions of the draft ECB Regulation.*

*One respondent remarked that the past due criterion would be considered differently by subsidiaries of significant institutions and institutions in non-participating Member States where local competent authorities set materiality thresholds that differed from that set by the ECB, which could impede the level playing field across the EU.*

Article 1(2) of the RTS states that the materiality threshold to be set by a competent authority for credit obligations past due in its jurisdiction should consist of an absolute component and a relative component. The absolute component should be expressed as a maximum amount for the sum of all amounts past due that are owed by an obligor to an institution, the parent undertaking of that institution or any of its subsidiaries. The relative component, meanwhile, should be expressed as a percentage indicating the amount of credit obligations past due in relation to the total amount of on-balance-sheet exposures to that obligor held by the institution, the parent undertaking of that institution or any of its subsidiaries, excluding equity exposures. The above provisions are reflected in Articles 3(1)(a) and 3(1)(b) of the ECB Regulation, which is applicable exclusively to significant institutions, as stated in Article 1 of the Regulation.

In jurisdictions outside the euro area, a materiality threshold which differs from the one set by the ECB may apply under national law. In this case, an institution in a non-participating Member State, for example, should assess the materiality of a credit obligation past due against a threshold defined by the competent authority of that Member State, which could be different from the materiality threshold set out in the ECB Regulation. This means that the materiality thresholds – and, as a result, the definitions of default – applied by an institution in a non-participating Member State and a significant institution could be different, even if both belong to the same banking group. That scenario is one of the situations addressed by Paragraph 83 of the EBA Guidelines, which the ECB will require full compliance with from 1 January 2021. The EBA Guidelines state that institutions, parent undertakings and subsidiaries should use the same definition of default for all exposures of the same type, but that different definitions of default may be used for different types of exposure (e.g. in the case of specific types of legal entity or presences in

geographical locations that are not achieved via a legal entity). However, this should be justified by the application of significantly different internal risk management practices for those different types of exposure or different legal requirements (such as different materiality thresholds set by competent authorities) in the different jurisdictions. Moreover, according to Paragraph 85 of the EBA Guidelines, where institutions use the internal ratings-based (IRB) approach laid down in Part Three, Title II, Chapter 3 of the CRR, the use of different definitions of default has to be adequately reflected in the estimation of risk parameters in the case of rating systems whose scope of application encompasses different default definitions.

While the ECB acknowledges that the entry into force of the Regulation will not solve all of the discrepancies in the identification of defaults that could potentially occur at jurisdiction level – or even at banking group level – it believes that this legislation will contribute to a level playing field across the Single Supervisory Mechanism (SSM) as regards capital requirements.

## B.2 Exchange rate to be used – Article 3(1)

*Two respondents enquired about the exchange rate to be used when comparing the total amount past due with the absolute threshold for exposures held in foreign currency.*

The absolute component of the materiality threshold established by Article 3(1) of the ECB Regulation is expressed in euro. Consequently, significant institutions will need to convert all of the relevant amounts to euro when applying the materiality threshold.

Since Article 3(3) of the ECB Regulation states that a default is deemed to have occurred when both components of the threshold are exceeded for 90 consecutive days, significant institutions should convert those figures to euro every day, using the exchange rate quoted on that day, in order to count the number of days that the threshold is exceeded.

Furthermore, Paragraph 21 of the EBA Guidelines states that significant institutions should ensure that all information about the number of days past due and defaults is up to date whenever it is used for decision-making, internal risk management, internal or external reporting and the calculation of own funds requirements, and that, where significant institutions calculate the number of days past due less often than daily, the date of default is the date when the days past due criterion is fulfilled for the first time.

In practice, a significant institution that calculates the number of days past due less often than daily could adopt an approach whereby, for each day, amounts past due and exposures to obligors are recorded in foreign currency together with the exchange rate quoted for that day, but the conversion to euro is applied less often than daily. In this situation, although the significant institution would be calculating the number of days past due less often than daily, it would still be able to determine

the precise date on which the days past due criterion was fulfilled for the first time using those daily amounts and daily exchange rates.

Irrespective of the approach used, significant institutions should have documented policies in respect of the counting of the number of days past due and the exchange rates used. These policies should, moreover, be in line with the significant institution's internal risk management and decision-making processes.

### B.3 Legal impediments relating to confidentiality – Article 3(1)

*One respondent pointed out that legal impediments relating to confidentiality could interfere with the requirement to consolidate defaults across the various legal entities in a supervised group.*

In the event of legal impediments relating to confidentiality that could hamper the sharing of client data within an institution, the parent undertaking of that institution or any of its subsidiaries, significant institutions should apply the provisions set out in Paragraph 81 of the EBA Guidelines. Thus, they should inform the ECB of the relevant legal impediments and, if they use the IRB approach, they should estimate the materiality of the inconsistencies in the identification of a defaulting obligor and their possible impact on the estimates of risk parameters.

### B.4 Possibility of applying a lower threshold – Article 3(1)

*One respondent remarked that, owing to accounting laws or local requirements, banks could have to classify exposures as having defaulted on the basis of a materiality threshold that was lower than the one set out in the draft ECB Regulation. Although Paragraph 34 of the EBA Guidelines allows institutions to apply a lower threshold as an indication that payment is unlikely, the respondent considered that the application of this additional materiality threshold would result in burdensome monitoring of exposures against two thresholds. Consequently, the respondent proposed amending the draft ECB Regulation by including the following sentence in Article 3(1)(b): "By way of exception, lower materiality threshold could be used in order to respect accounting / local standards, when still using a day-past-due trigger".*

Article 178(2)(d) of the CRR states that the materiality of a credit obligation past due should be assessed against a threshold defined by the competent authority. Articles 1(1) and 2(1) of the RTS require the competent authority to set, for all institutions in its jurisdiction, a **single** materiality threshold for retail exposures and a **single** materiality threshold for non-retail exposures. Consequently, Article 3 of the ECB Regulation sets a single materiality threshold for retail exposures and a single materiality threshold for non-retail exposures.

Without prejudice to the above, Paragraph 34 of the EBA Guidelines does indeed state that significant institutions may identify defaults on the basis of a lower

threshold if they can demonstrate that this lower threshold is an appropriate indication of the unlikelihood of payment being made and does not lead to (i) an excessive number of defaults that return to non-defaulted status shortly after being regarded as having defaulted or (ii) a decline in capital requirements. In this case, significant institutions should record details of the trigger for the default in their databases as an additional specified indication of the unlikelihood of payment being made. In addition, for significant institutions using the IRB approach, information about the trigger for the default could be relevant for the estimation of the loss given default (LGD), since it should be included in the reference dataset pursuant to Paragraph 109(c) of the EBA Guidelines on PD estimation, LGD estimation and treatment of defaulted assets (EBA/GL/2017/16), which the ECB will require full compliance with from 1 January 2021.

## B.5 Adaptation of the absolute component to local jurisdictions – Article 3(1)(a)

*One respondent asked whether it was possible to adapt the absolute component to the particularities of each local jurisdiction, given the differences in economic conditions (including price levels) across jurisdictions.*

Articles 1(1) and 2(1) of the RTS require the competent authority to set, for all institutions in its jurisdiction, a **single** materiality threshold for retail exposures and a **single** materiality threshold for non-retail exposures. Consequently, the ECB, as a competent authority, only has a mandate to set those two materiality thresholds, which must be applied by all significant institutions within the SSM.

This approach ensures a level playing field across significant institutions within the SSM and consistent use of the materiality threshold, thus helping to reduce the burden of compliance for cross-border groups. As regards exposures booked in subsidiaries of significant institutions located in EU Member States outside the SSM, see paragraph B.1 for details of the possibility of using the materiality threshold set by the competent authority of the other Member State.

## B.6 Level of the relative component – Article 3(1)(b)

*With regard to the relative component of the materiality threshold, one respondent requested clarification regarding the identification of breaches on the basis of the proposed level.*

*Two respondents asked that the level of the relative component of the materiality threshold (as stipulated in Article 3(1)(b) of the draft ECB Regulation) be raised, as the proposed level would hamper other positive measures adopted by EU legislators in order to increase and improve the financing of European small and medium-sized enterprises. In particular, one respondent pointed out that in the leasing industry it is common for average monthly instalments/rentals to exceed 1% of contract*



*exposures and asked that the ECB consider adopting a rate of 2.5% for the relative component.*

Article 3(1)(b) of the ECB Regulation states that the relative component of the materiality threshold stands at 1%, and Article 3(3) of the ECB Regulation states that a default is deemed to have occurred when both the absolute and the relative components of the threshold are **exceeded** for 90 consecutive days.

The level of the materiality threshold set out in the ECB Regulation (including the rate of 1% for its relative component) was based on a comprehensive cost-benefit analysis. In the course of that analysis, a variety of different threshold levels were analysed. That cost-benefit analysis showed that the level set out in the ECB Regulation represents a reasonable level of risk within the meaning of Article 3 of the RTS because it does not lead to the recognition of an excessive number of defaults that are due to circumstances other than the financial difficulties of obligors or significant delays in the recognition of defaults.

Given that, under Article 1(2) of the RTS, the ECB can only set the relative component at a level other than the baseline rate of 1% if it considers that this does not reflect a reasonable level of risk, the request to raise the level of the relative component of the materiality threshold cannot be considered.

## **B.7 Application of the past due criterion – Article 3(3)**

*One respondent suggested that the past due criterion should trigger the default of an obligor where the obligor has past due exposures exceeding the materiality threshold for 90 consecutive days and, at the same time, one of its exposures, considered alone, is more than 90 days past due.*

The ECB Regulation reflects the threshold structure and the mechanism for counting the number of days past due that are demanded by the RTS. These may, in some cases, lead to a default being identified despite no individual exposure being more than 90 days past due. For instance, this could happen where an obligor repays some material past due exposures, but the number of days past due keeps increasing – instead of being reset – because there are other material exposures that are just a few days past due. In that case, a default will be triggered when the counter reaches 90 days, in line with Article 3(3) of the ECB Regulation, but on that day the remaining material exposures could be less than 90 days past due.

## **B.8 Interaction between Paragraphs 25 and 26 of the EBA Guidelines and the draft ECB Regulation – Article 3(3)**

*One respondent requested clarification as to whether the specific treatment of exposures to central government, local authorities and public sector entities that was outlined in Paragraphs 25 and 26 of the EBA Guidelines remained valid in light of the ECB Regulation.*

Given that the ECB will require full compliance with the EBA Guidelines from 1 January 2021, the specific treatment of exposures to central government, local authorities and public sector entities that is outlined in Paragraphs 25 and 26 of the EBA Guidelines will remain applicable under the ECB Regulation.

It should be noted that the specific treatment set out in the EBA Guidelines has to be applied **after** the calculation of the materiality threshold. It can be applied to exposures that have been materially past due for 90 consecutive days, but **only** where all conditions specified in Paragraph 25 of the EBA Guidelines are met. If the credit obligation past due is immaterial under the ECB Regulation or it has been material for less than 90 days, the specific treatment is not relevant.

Where exposures have been materially past due for 90 consecutive days in accordance with the ECB Regulation and all conditions specified in Paragraph 25 of the EBA Guidelines are met, the specific treatment may be applied. This means that, in accordance with Paragraph 26 of the EBA Guidelines, those exposures are not treated as having defaulted within the meaning of Article 178 of the CRR and, from the time of the application of that specific treatment, those exposures have to be excluded from the calculation of the materiality threshold for all other exposures of the obligor. Importantly, the exposures that are subject to that specific treatment need to be clearly documented.

It goes without saying that if, after the application of that specific treatment, the materiality threshold is still exceeded on account of other exposures past due which are not covered by Paragraphs 25 and 26 of the EBA Guidelines, the obligor in question, and all of its exposures, are immediately regarded as having defaulted, since the obligor has still been materially past due for more than 90 consecutive days.

## B.9 Application of the draft ECB Regulation – Article 4(2)

*One respondent emphasised the need for a transition period in cases where the competent authority's current approach was significantly different from that set out in the draft ECB Regulation.*

*Two respondents requested clarification as to whether the draft ECB Regulation could be applied prior to the application date stipulated in Article 4(2). According to those respondents, the current application date (31 December 2020) did not give significant institutions using an IRB approach enough time to identify defaults in line with the provisions of the draft ECB Regulation and take them into account when making changes to their internal models – changes that, according to the EBA, needed to be finalised by the end of 2020.*

The ECB acknowledges significant institutions' efforts to implement the materiality threshold, especially where competent authorities' current requirements differ significantly from those set out in the ECB Regulation.

The ECB agrees that, where significant institutions are using the IRB approach laid down in Part Three, Title II, Chapter 3 of the CRR, it would be beneficial to implement the materiality threshold prior to 31 December 2020 in order to be able to finalise changes to internal models by that date. By way of clarification, that date should therefore be regarded as the last possible date for achieving compliance with the provisions of the ECB Regulation.

In fact, the ECB has sent individual letters to significant institutions using an IRB approach, inviting them to voluntarily adhere to a new supervisory strategy – the Two-Step Approach – set up by the ECB in order to address the EBA roadmap for the review of the IRB approach and, in particular, the implementation of new provisions on the definition of default. Under that supervisory strategy, significant institutions have been invited to start making the necessary preparations and request ECB approval for early implementation of the new provisions on the definition of default, which would allow them to start collecting real default data using the new materiality threshold before 31 December 2020. Those real default data could then, subject to the ECB's approval, be used by those significant institutions to adjust their rating systems prior to 31 December 2020.

With the aim of addressing the respondents' comments regarding the application date, the ECB has decided to amend the Regulation, allowing all credit institutions to determine, by means of a notification letter to the ECB, the date of their application of the ECB Regulation (which must, however, be no later than 31 December 2020). That notification letter should be sent to the ECB by 1 June 2019 at the latest. Those amendments to the ECB Regulation will also allow the implementation of the Two-Step Approach, if credit institutions voluntarily decide to adhere thereto.

## C Other comments on the draft ECB Regulation

### C.1 Level of harmonisation

*Two respondents welcomed the draft ECB Regulation on the basis that it increased the harmonisation of the definition of default across the Member States participating in the SSM and fostered consistent application, transparency and comparability across significant institutions.*

The ECB agrees that the application of the new materiality threshold will lead to greater harmonisation of the past due criterion of the definition of default across the Member States participating in the SSM. The ECB Regulation fosters consistent application of the past due criterion, helping to enhance both the transparency of the default recognition process and the comparability of defaulted exposures and risk-weighted asset amounts across significant institutions.

### C.2 Operational cost of implementing the proposed materiality threshold

*One respondent remarked that the operational cost of implementing the proposed materiality threshold would be very high.*

The ECB acknowledges the operational costs that significant institutions will incur in implementing this new materiality threshold, particularly where the current materiality threshold is significantly different from the requirements set out in the ECB Regulation. However, the ECB believes that the adoption of the proposed materiality threshold will help to harmonise the identification of defaults across the EU and will eventually simplify processes for significant institutions (especially for those involved in cross-border activities).

## D Amendments to the draft ECB Regulation

**Table 2**  
Amendments to the draft ECB Regulation

Provision in the ECB Regulation	Former provision in the draft ECB Regulation	Headings	Amendment
<b>Recital 9</b>	Recital 9	-	<i>"With regard to the legitimate expectations of supervised credit institutions, the ECB acknowledges the need to allow for transitional periods where its exercise of discretions significantly departs from the approach taken by the national competent authorities prior to the entry into force of this Regulation. In this respect, both credit institutions applying the Standardised Approach and the Internal Ratings Based Approach should have an appropriate transitional period. Therefore, credit institutions must apply the threshold for the assessment of the materiality of a credit obligation past due set by this Regulation not later than 31 December 2020 and must notify the ECB, before 1 June 2019, of the exact date on which they will commence applying such threshold."</i>
<b>Article 1</b>	Article 1	Subject matter and scope	<i>"The ECB hereby exercises the discretion conferred on competent authorities under Article 178(2)(d) of Regulation (EU) No 575/2013 in relation to the threshold for assessing the materiality of credit obligations past due. This Regulation shall apply exclusively with regard to credit institutions classified as significant in accordance with Article 6(4) of Regulation (EU) No 1024/2013 and Part IV and Article 147(1) of Regulation (EU) No 468/2014 (ECB/2014/17) and irrespective of the method used for the calculation of their risk-weighted exposure amounts."</i>
<b>Article 4</b>	Article 4	Date of application of the materiality threshold	<i>"Credit institutions shall apply the threshold for the assessment of the materiality of a credit obligation past due set by this Regulation not later than 31 December 2020. They shall notify the ECB, before 1 June 2019, of the exact date on which they will commence applying such threshold."</i>
<b>Article 5</b>	Article 4	Entry into force	<i>"This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.</i>  <i>This Regulation shall be binding in its entirety and directly applicable in the Member States in accordance with the Treaties."</i>