

Single Rulebook Q&A

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Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Model validation
Article	144
Paragraph	2
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	EBA/GL/2017/16 - Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures
Article/Paragraph	101
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Disclose name of institution / entity	No
Type of submitter	Credit institution
Subject matter	Consistency in the treatment of multiple defaults
Question	<p>On 18/3/2022 the Final Draft Regulatory Technical Standards EBA/RTS/2016/03 were published in the Official Journal of the European Union and became legal regulations that take precedence over technical documents (Delegated Regulation (UE) 2022/439). In the light of that, should Banks adopt the same approach for treatment of multiple defaults (so-called symmetrical approach) consistently for all parameters (PD, CCF, LGD) in line with Art. 49 of the aforementioned Commission Delegated Regulation?</p>
Background on the question	<p>Based on the provisions of Article 49 of Commission Delegated Regulation (EU) 2022/439 on the treatment of multiple defaults, defaults used for estimating PD and CCF should be treated consistently with defaults used for estimating LGD. As is well known, the treatment of multiple defaults impacts the definition of default to be used in the estimation: using different approaches for different parameters leads to inconsistency in the definitions of default and estimation of expected losses. It is therefore evident that, in order to have consistency of defaults, the treatment of multiple defaults should necessarily be adopted in the same way for all parameters. Prior to publication in the Official Journal of the European Union" on 18/3/2022, the best practice for model estimation was to adopt the treatment of multiple</p>

defaults only for LGD models (asymmetrical approach) in line with the requirements of the EBA/GL/2017/16 (par. 74-77,101). It is noted that the two normative documents may lead to misunderstandings on this issue. Clarification would be helpful in order to proceed in future revisions of the models in a manner consistent with the updated regulatory situation.

Final answer

Article 46, paragraph 1, point b, of the [Commission Delegated Regulation \(EU\) 2022/439](#) requires to calculate the numerator of the one-year default rate by including *'obligors or exposures referred to in point (a) that have defaulted within that one year period; multiple defaults for the same obligor or exposure, which have been observed during the one year period relating to the default rate, are considered to be a single default as referred to in Article 49(b) having occurred on the date of the first of those multiple defaults.'*

Therefore, in order to consider multiple defaults to be a single default for the purpose of the calculation of the default rates, the default event of the same obligor, or of the same facility when the definition of default is applied at facility level, must have been observed during the same one-year period related to the default rate of a specific calculation date.

In other words, for the purpose of the calculation of the default rates as further specified in paragraph 101 of the guidelines on PD and LGD estimation, there is the need to distinguish two cases - irrespectively of the treatment for LGD:

1. In the case where multiple default events have been observed during the same one-year observation period when computing the default rate of a specific calculation date, these defaults should be accounted as one default in the numerator of this specific default rate. This is to prevent that *significant errors in risk parameter estimates, because higher default rates would lead to higher PD estimates*, as mentioned in recital 24 of the Commission Delegated Regulation (EU) 2022/439;
2. In the case where multiple default events have been observed during different one-year period related to the computation of default rates of different calculation dates, these defaults should be accounted as one default in the numerator of the default rate of each specific calculation date.

By contrast, Article 49, point b of the Commission Delegated Regulation (EU) 2022/439 specify that - irrespectively of the treatment for PD - any defaults considered as multiple defaults identified within a period of time specified by the institution are considered to be a single default for the purpose of LGD estimation, using the default date of the first observed default as the

	relevant default date, such that, requested in Article 49, point d, defaults used for the purpose of PD and conversion factors estimation are treated consistently with defaults used for the purpose of LGD estimation.
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