



**Single
Rulebook
Q&A**

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Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit risk
Article	500
Paragraph	1
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	Not applicable
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Name of institution / submitter	ECB Banking Supervision
Country of incorporation / residence	Frankfurt
Type of submitter	Competent authority
Subject matter	Adjustment for massive disposals
Question	Regarding the interpretation of Article 500(1) of the Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013 (hereafter “Regulation (EU) No 575/2013 as amended”), do we understand it correctly that:

	<p>a. “the average estimated LGDs for comparable exposures in default that have not been finally liquidated” should be derived by applying the estimation method for incomplete recovery processes, which is required under Article 181(1)(a) Regulation (EU) No 575/2013 and further explained in paragraphs 158 and 159 of EBA/GL/2017/16, to the disposed assets as of the date just before the disposal;</p> <p>b. “the average realised LGDs including on the basis of the losses realised due to the massive disposals” should be the average observed LGD for all disposed exposures based on the economic loss of each exposure, taking into account the disposal price as well as material discount effects and material direct and indirect costs associated with collecting on the instrument in line with Article 5(2) of Regulation (EU) No 575/2013</p> <p>the adjustment based on Article 500 for all disposed exposures cannot lead to an estimate of average losses for the disposed assets that is lower than the estimated LGD calculated under point (a) above?</p>
<p>Background on the question</p>	<p>Article 181(1)(a) of Regulation (EU) No 575/2013 already requires banks to estimate LGDs using all observed defaults. According to our understanding banks need to include also incomplete cases in this calculation and thus they need to incorporate an adjustment for incomplete recovery processes, as also explained in paragraphs 158 and 159 of EBA/GL/2017/16. By definition, exposures in scope of a disposal are incomplete workout cases prior to the disposal, so institutions already need, for the purposes of obtaining the long-run average LGD, to estimate future costs and recoveries for the incomplete recoveries processes based on comparable cases. It should be highlighted that this interpretation significantly simplifies the implementation of this article, as it reduces the implementation to the new use of existing methodologies/approaches already required by other articles of Regulation (EU) No 575/2013.</p>
<p>EBA answer</p>	<p>In accordance with Article 500(1) of the Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876, subject to conditions specified in points (a) to (c) of that article and by way of derogation from Article 181(1)(a), institutions may adjust their LGD estimates “by partly or fully offsetting the effect of massive disposals of defaulted exposures on realised LGDs”. Consequently, in order to derive adjusted LGD estimates, institutions should adjust the realised LGDs on disposed exposures, which were included in the massive disposal plan. Such adjustment should reflect exclusively the impact on the obtained sale price of the assets due to the massive nature of the disposal, which may have led to a larger than usual discount, but it should not affect any other elements; in particular, it should not offset the impact of economic conditions. For this purpose only the cash flows directly related to the massive disposal can be adjusted, and any recoveries, costs or discounting effects realised on these exposures before the sale must remain unchanged.</p>

Institutions should use the method or methods for adjusting realised LGDs, which are the most appropriate for the portfolio subject to the massive disposal, taking into account the principles and objectives described above. Possible methods for LGD adjustment to be considered include inter alia the following two methods:

- Institutions may adjust realised LGDs for exposures subject to massive disposals to the LGDs of the disposed assets as of the date just before the disposal, calculated in accordance with the methods for the treatment of incomplete recovery processes as described in paragraphs 153 to 159 of the EBA Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures (EBA/GL/2017/16). This would be equivalent to the assumption that the exposures subject to massive disposal have not been finally liquidated. Under this approach, institutions should consider the disposed assets as of the date just before the disposal to be the “comparable exposures in default that have not been liquidated”.
- Institutions that sell their portfolios of defaulted exposures on a regular basis may assume that exposures belonging to a portfolio subject to the massive disposal were subject to a normal portfolio sale rather than a massive disposal, but adjust the cash flow from the sale by taking into account the usual discount related to the sale of such exposures and the specific risk characteristics of the exposures disposed in a massive disposal. Under this approach, the comparable exposures in default that have not been liquidated” should be understood as similar defaulted exposures sold in the past on a regular basis.

Different methods may be appropriate for different sales or parts of portfolios subject to the massive disposal.

Disclaimer:

The answers clarify provisions already contained in the applicable legislation. They do not extend in any way the rights and obligations deriving from such legislation nor do they introduce any additional requirements for the concerned operators and competent authorities. The answers are merely intended to assist natural or legal persons, including competent authorities and Union institutions and bodies in clarifying the application or implementation of the relevant legal provisions. Only the Court of Justice of the European Union is competent to authoritatively interpret Union law. The views expressed in the internal Commission Decision cannot prejudice the position that the European Commission might take before the Union and national courts.

Link

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