

EBA/Op/2017/17

22 December 2017

# Opinion of the European Banking Authority on the use of the 180 days past due criterion

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## Introduction and legal basis

The EBA competence to deliver an opinion is based on Article 34(1) of Regulation (EU) No 1093/2010<sup>1</sup>, as the appropriateness of the continued application of the 180 days past due criterion relates to the EBA's area of competence.

The EBA is mandated in Article 506 CRR to report to the European Commission, by 31 December 2017, on how replacing 90 days by 180 days past due in Article 178(1) CRR impacts risk-weighted exposure amounts and the appropriateness of the continued application of that provision after 31 December 2019.

The national discretion to replace the 90 days past due (DPD) with 180 DPD is specified in Article 178(1)(b) CRR:

*“Competent authorities may replace the 90 days with 180 days for exposures secured by residential or SME commercial real estate in the retail exposure class, as well as exposures to public sector entities”. The 180 days shall not apply for the purposes of Article 127.”*

Article 178(1)(b) CRR further specifies that this national discretion is limited to the following exposure classes:

- Residential real estate (RRE) in the retail exposure class
- SME commercial real estate (CRE) in the retail exposure class
- Public Sector Entities (PSEs)

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<sup>1</sup> Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

Since Article 178(1) CRR excludes exposures in default under the Standardised Approach (SA) from the application of 180 DPD at national discretion, the scope of this opinion is only the IRB approach.

This Opinion is based on the findings from the EBA report on the 180 days past due criterion<sup>2</sup> which are presented as an annex to this Opinion.

In accordance with Article 14(5) of the Rules of Procedure of the Board of Supervisors<sup>3</sup>, the Board of Supervisors has adopted this opinion.

## Main findings of the report on 180 days past due

Currently, only a number of UK institutions and a French institution make use of the 180 DPD exemption for material exposures. Several jurisdictions where the 180 DPD exemption was allowed in the past already returned to the 90 DPD criterion in all institutions. Furthermore, the SSM issued a regulation (for its SIs) and a GL (for its LSIs), allowing only the 90 DPD criterion.

Analysis of the data submitted by the institutions that still make use of the 180 DPD criterion show that a removal of the 180 DPD criterion would lead to an increase in risk-weighted exposure amount<sup>4</sup> (REA) in two thirds of the institutions. The average expected relative change in REA is +1.61 percent. However a wide variation in these numbers can be observed, reaching a maximum of +23.57 and a minimum of -20.30 percent (relative changes in RW). The increases in REA can mostly be explained by the fact that the increase in PD has a greater (upward) effect than the decrease in LGD has on reducing the REA.

For some institutions, the decrease in the LGD parameter was constrained by the 10 percent floor on retail exposures secured by RRE (Article 164(4) CRR). Without this floor, the increase in REA would naturally have been smaller, since the increase in the PD would have been counterbalanced by a larger decrease in the LGD estimate.

On average, a decrease in own funds of 0.44 percent can be expected, which is driven by the change in the shortfall (i.e. a larger shortfall to be deducted from Tier 1 capital). The decrease in the own funds further aggravates the effect on the capital ratio.

A decrease in the capital ratio can be observed in several institutions. The average expected decrease is 0.37 percentage points with significant variation across institutions. For all institutions, there is however a sufficiently large buffer above the minimum required capital ratio of 8 percent (Article 92(1)(c) CRR).

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<sup>2</sup>See: <https://www.eba.europa.eu/regulation-and-policy/credit-risk/-/topic-documents/dOiiRADKz0PY/more>

<sup>3</sup> Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 27 November 2014 (EBA/DC/2011/01 Rev4).

<sup>4</sup> The concept of REA is defined in Article 92 (3) CRR and described in more detail in paragraph 36. This definition generally aligns with the use of Risk Weighted Assets (RWA), which is the terminology used in the Basel framework.

The largest downward expected effects on the capital ratio can be explained by (i) the wide applicability of the 180 DPD criterion to the institution's REA, (ii) the fact that the expected increase in the PD estimate is not counterbalanced by a decrease in the LGD estimate, and (iii) the increase in the IRB shortfall (i.e. leading to a larger deduction from tier 1 capital).

Considering that the removal of the 180 DPD is expected to lead to an increase in REA in two thirds of the institutions, a relative change of on average 1.61 percent but with a maximum of +23.57 percent and a minimum of -20.30 percent, it is fair to say that the 180 DPD criterion is a source of undue REA variability.

It should also be kept in mind that the IFRS 9 rules will enter into force at the end of 2018. In IFRS 9, there is a rebuttable 90 DPD assumption, which may lead institutions to introduce the 90 DPD criterion for regulatory purposes.

## Recommendation

Due to the wide applicability of the 90 DPD criterion in the EU, the undue RWA variability caused by the 180 DPD criterion and the forthcoming changes in the accounting framework, it is consequently recommend to remove the 180 DPD exemption from Article 178(1) CRR, i.e. to disallow the continued application of the 180 DPD criterion.

However, it must be noted that this recommendation may have a material capital impact on some institutions that currently use the 180 DPD criterion. The latter would justify an appropriate transitional period.

This opinion will be published on the EBA's website.

Done at London, 22 December 2017

[signed]

Andrea Enria

Chairperson

For the Board of Supervisors