

PRA
CONSULTATION
PAPER CP17/18

**CREDIT
RISK:
DEFINITION
OF DEFAULT**

INTRODUCTION

On the 27th July 2018, the PRA published a consultation paper on credit risk and the definition of default, proposing an approach to implement the European Banking Authority (EBA) rules and guidelines.

EBA PUBLICATIONS

The EBA recently published two items which relate to the definition of default : the technical standards for the [materiality threshold](#) for credit obligations past due and the [Guidelines](#) on the application of the definition of default.

CRR ARTICLE 178 - DEFINITION OF DEFAULT

- An institution considers that the obligor is unlikely to pay its credit obligations to the institution (or group) without recourse to actions such as realising security and/or
- the obligor is past due more than 90 days on any material credit obligation to the institution (or group)

**THE PRA PROPOSES A NEW
CHAPTER IN THE CREDIT RISK
PART OF THE PRA RULEBOOK IN
RELATION TO MATERIALITY
THRESHOLDS**

0%

RETAIL EXPOSURES

0% relative materiality threshold
and zero absolute materiality

1%

NON RETAIL EXPOSURES

1% relative materiality threshold
and a sterling equivalent of 500
Euros absolute threshold

THE PRA EXPECTS FIRMS TO COMPLY WITH THE EBA GUIDELINES

A credit obligation past due is any amount of principal, interest or fee unpaid at the due date.

Firms may use a lower materiality threshold for non retail exposures if they consider it to be a more relevant indication of default, and if this does not lead to:

- (i) an excessive number of defaults returning to non-defaulted status soon after being recognised as defaults, or :
- (ii) a decrease in capital requirements

PROPOSED IMPLEMENTATION DATE IS 31 DECEMBER
2020

TECHNICAL PAST DUE

Technical past due status may be recognised by firms in the following cases only:

A data or system error of the institution, including manual errors but excluding wrong credit decisions

As a result of the non execution, defective or late execution of the payment transaction ordered by the obligor or due to the failure of the payment system

There has been a time lag between the receipt of the payment by an institution and the allocation of that payment to the relevant account

In the specific case of factoring, where the materiality threshold is breached but none of the receivables to the obligor is past due more than 30 days

INDICATIONS OF UNLIKELINESS TO PAY

Non accrual status

Specific credit risk adjustments

Impairment (Stage 3) under IFRS 9

Sale (including securitisation) at an economic, credit-related loss greater than 5%

Distressed restructuring at an economic loss greater than 1%

Bankruptcy or similar protection arrangements

Recurring income no longer available

Breach of covenant(s)

Significant increase in leverage

Action to enforce collateral

External information (eg credit registers)

Sectoral crisis

INSTITUTIONS MAY APPLY THE DEFINITION OF DEFAULT AT THE LEVEL OF AN INDIVIDUAL CREDIT FACILITY RATHER THAN IN RELATION TO THE TOTAL OBLIGATIONS OF THE BORROWER, WHERE:

- It is justified by internal risk management practices
- It is used consistently over time
- It is specified in their internal policies and procedures
- Other indications of unlikelihood to pay, relating to the obligor, have not been identified and
- The proportion of overall obligations in default is not significant

INSTITUTIONS SHOULD CONSIDER A JOINT CREDIT OBLIGATION AS AN EXPOSURE TO TWO OR MORE OBLIGORS THAT ARE EQUALLY RESPONSIBLE FOR THE REPAYMENT OF THE CREDIT OBLIGATION

This notion does not extend to a credit obligation of an individual obligor secured by another individual or entity in the form of a guarantee or other credit protection.

CREDIT RISK: DEFINITION OF DEFAULT

**KNOWCO IS A SPECIALIST UK BANK
SUPPORT RESOURCE FOR:**

- ICAAP, ILAAP, RRP
- RISK APPETITE STATEMENT
DEVELOPMENT AND
ENHANCEMENT
- CRR COMPLIANT PILLAR 3
STATEMENTS
- STRATEGIC BUSINESS
PLANNING AND MODELLING
- GOVERNANCE
POLICIES, PROCESSES,
ASSURANCE

**OUR INTUITIVE AND TRANSPARENT
SOFTWARE FACILITATES COMPLIANCE WITH
REGULATORY REQUIREMENTS FOR:**

- CREDIT RISK CAPITAL
STRESS TESTING AND
MANAGEMENT
- IRRBB STRESS TESTING AND
MANAGEMENT
- LIQUIDITY RISK STRESS
TESTING AND MANAGEMENT
- FUNDS TRANSFER PRICING
- IFRS 9 COMPLIANCE AND
REPORTING

PLEASE CONTACT

Paul Ashton

paul.ashton@knowco.co.uk

Dr Lise Land

lise.land@knowco.co.uk

www.knowco.co.uk 07799 113535