

**Guidelines on the application of the definition of default under Article 178  
of Regulation (EU) No 575/2013**

**(EBA/GL/2016/07)**

These Guidelines of the European Banking Authority (EBA) are addressed to competent authorities as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation No 1093/2010.

The purpose of the Guidelines is to develop the content of Article 178 of Regulation (EU) No 575/2013 on the default definition, in accordance with the mandate conferred to the EBA in Article 178 (7) of that Regulation. They will apply to institutions that use both the standardised approach and the internal ratings-based approach (IRB) for the calculation of capital requirements for credit risk, establishing specific principles for the first implementation of the latter, given the need for authorisation by the competent authority.

Specifically, these guidelines explain the indicators of unlikelihood to pay and introduce new criteria for both identifying the amounts past due and returning to a non-default situation. In addition, they set out application requirements in the case of retail exposures, as well as in external databases for IRB entities using them. Finally, they include requirements in terms of homogeneity, documentation, internal policies and risk management processes.

These Guidelines have been developed in accordance with article 16 of Regulation (EU) No 1093/2010. The European Banking Authority published the English version of these Guidelines on 28 September 2016 and the Spanish version on 18 January 2017. The Guidelines will apply from 1 January 2021.

Banco de España's Executive Commission, in its role of competent authority for the direct supervision of the less significant credit institutions, adopted these Guidelines as their own on 15 March 2018.

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EBA/GL/2016/07

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18/01/2017

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## Guidelines

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on the application of the definition of  
default under Article 178 of Regulation  
(EU) No 575/2013

# 1. Compliance and reporting obligations

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## Status of these guidelines

1. This document contains guidelines issued pursuant to Article 16 of Regulation (EU) No 1093/2010<sup>1</sup>. In accordance with Article 16(3) of Regulation (EU) No 1093/2010, competent authorities and financial institutions must make every effort to comply with the guidelines.
2. Guidelines set the EBA view of appropriate supervisory practices within the European System of Financial Supervision or of how Union law should be applied in a particular area. Competent authorities as defined in Article 4(2) of Regulation (EU) No 1093/2010 to whom guidelines apply should comply by incorporating them into their practices as appropriate (e.g. by amending their legal framework or their supervisory processes), including where guidelines are directed primarily at institutions.

## Reporting requirements

3. According to Article 16(3) of Regulation (EU) No 1093/2010, competent authorities must notify the EBA as to whether they comply or intend to comply with these guidelines, or otherwise with reasons for non-compliance, by 20.03.2017. In the absence of any notification by this deadline, competent authorities will be considered by the EBA to be non-compliant. Notifications should be sent by submitting the form available on the EBA website to [compliance@eba.europa.eu](mailto:compliance@eba.europa.eu) with the reference 'EBA/GL/2016/07'. Notifications should be submitted by persons with appropriate authority to report compliance on behalf of their competent authorities. Any change in the status of compliance must also be reported to EBA.
4. Notifications will be published on the EBA website, in line with Article 16(3).

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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).

## 2. Subject matter, scope and definitions

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### Subject matter

5. These guidelines specify the requirements on the application of Article 178 of Regulation (EU) No 575/2013 on the definition of default, in accordance with the mandate conferred to the EBA in Article 178(7) of that Regulation.

### Scope of application

6. These guidelines apply in relation to both of the following:
  - (a) the Internal Ratings Based Approach (IRB Approach) in accordance with Part Three, Title II, Chapter 3 of Regulation (EU) No 575/2013;
  - (b) the Standardised Approach for credit risk by virtue of the reference to Article 178 in Article 127 of Regulation (EU) No 575/2013.
7. Institutions that have received permission to use the IRB Approach should apply the requirements set out in these guidelines for the IRB Approach to all exposures. Where those institutions have received prior permission to permanently use the Standardised Approach in accordance with Article 150 of Regulation (EU) No 575/2013, or permission to implement the IRB Approach sequentially in accordance with Article 148 of that Regulation, may apply the requirements set out in these guidelines for the Standardised Approach for the relevant exposures under permanent partial use of the Standardised Approach or included in the sequential implementation plan.

### Addressees

8. These guidelines are addressed to competent authorities as defined in point (i) of Article 4(2) of Regulation (EU) No 1093/2010 and to financial institutions as defined in Article 4(1) of Regulation No 1093/2010.

### Definitions

9. Unless otherwise specified, terms used and defined in Regulation (EU) No 575/2013 and Directive (EU) 36/2013 have the same meaning in these guidelines.

## 3. Implementation

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### Date of application

10. These guidelines apply from 1 January 2021, therefore institutions should incorporate the requirements of these guidelines in their internal procedures and IT systems by that time, but competent authorities may accelerate the timeline of this transition at their discretion.

### First application of the Guidelines by IRB institutions

11. In order to apply these guidelines for the first time, institutions that use the IRB Approach should assess and accordingly adjust, where necessary, their rating systems so that the estimates of risk parameters reflect the new definition of default according to these guidelines by applying the following:
  - (a) where possible, adjust the historical data based on the new definition of default according to these guidelines, including in particular as a result of the materiality thresholds for past due credit obligations referred to in point (d) of Article 178(2) of Regulation (EU) No 575/2013;
  - (b) assess the materiality of impact on all risk parameters and own funds requirements of the new definition of default according to these guidelines and compared to the previous definition, where applicable, after the relevant adjustments in historical data;
  - (c) include an additional margin of conservatism in their rating systems in order to account for the possible distortions of risk estimates resulting from the inconsistent definition of default in the historical data used for modelling purposes.
12. The changes referred to in paragraph 11, which are applied to the rating systems as a result of the application of these guidelines, are required to be verified by the internal validation function and classified according to Commission Delegated Regulation (EU) No 529/2014, and, depending on this classification, they are required to be notified or approved by the relevant competent authority.
13. Institutions that use the IRB Approach, and which need to obtain prior permission from competent authorities in accordance with Article 143 of Regulation (EU) No 575/2013 and Commission Delegated Regulation (EU) No 529/2014<sup>2</sup> in order to incorporate these guidelines by the deadline referred to in paragraph 10, should agree with their competent

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<sup>2</sup> OJ L 148, 20.5.2014, p. 36.

authorities the final deadline for submitting the application for the approval of changes in the definition of default.

14. After IRB institutions have started collecting data according to the new definition of default as provided in these guidelines, in the course of their regular revision of risk estimates referred to in Article 179(1)(c) of Regulation (EU) No 575/2013, those institutions should extend or, where justified, move the window of historical data used for the risk quantification to include new data. Until an adequate time period with homogenous default definition is reached, those IRB institutions, during their regular revisions of the risk parameter estimates, should assess the adequacy of the level of the margin of conservatism referred to in point (b) of paragraph 11.

## Repeal

15. Sections 3.3.2.1. and 3.4.4. of the CEBS Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based (IRB) Approaches (GL10) published on 4 April 2006 are repealed with effect from 1 January 2021.

# 4. Past due criterion in the identification of default

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## Counting of days past due

16. For the purposes of the application of point (b) of Article 178(1) of Regulation (EU) No 575/2013, where any amount of principal, interest or fee has not been paid at the date it was due, institutions should recognise this as the credit obligation past due. Where there are modifications of the schedule of credit obligations, as referred to in point (e) of Article 178(2) of Regulation (EU) No 575/2013, the institution's policies should clarify that the counting of days past due should be based on the modified schedule of payments.
17. Where the credit arrangement explicitly allows the obligor to change the schedule, suspend or postpone the payments under certain conditions and the obligor acts within the rights granted in the contract, the changed, suspended or postponed instalments should not be considered past due, but the counting of days past due should be based on the new schedule once it is specified. Nevertheless if the obligor changes the schedule, suspends or postpones the payments, the institutions should analyse the reasons for such a change and assess the possible indications of unlikelihood to pay, in accordance with Articles 178(1) and (3) of Regulation (EU) No 575/2013 and Section 5 of these guidelines.
18. Where the repayment of the obligation is suspended because of a law allowing this option or other legal restrictions, the counting of days past due should also be suspended during that

period. Nevertheless, in such situations, institutions should analyse, where possible, the reasons for exercising the option for such a suspension and should assess the possible indications of unlikeliness to pay, in accordance with Articles 178(1) and (3) of Regulation (EU) No 575/2013 and Section 5 of these guidelines.

19. Where the repayment of the obligation is the subject of a dispute between the obligor and the institution, the counting of days past due may be suspended until the dispute is resolved, where at least one of the following conditions is met:
  - (a) the dispute between the obligor and the institution over the existence or amount of the credit obligation has been introduced to a court or another formal procedure performed by a dedicated external body that results in a binding ruling in accordance with the applicable legal framework in the relevant jurisdiction;
  - (b) in the specific case of leasing, a formal complaint has been directed to the institution about the object of the contract and the merit of the complaint has been confirmed by independent internal audit, internal validation or another comparable independent auditing unit.
20. Where the obligor changes due to an event such as a merger or acquisition of the obligor or any other similar transaction, the counting of days past due should start from the moment a different person or entity becomes obliged to pay the obligation. The counting of days past due is, instead, unaffected by a change in the obligor's name.
21. The calculation of the sum of all amounts past due that are related to any credit obligation of the obligor to the institution, parent undertaking or any of its subsidiaries to this obligor and which institutions are required to calculate for the purpose of comparison with the materiality threshold set by the competent authority in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013 should be performed with a frequency allowing timely identification of default. Institutions should ensure that the information about the days past due and default is up-to-date whenever it's being used for decision making, internal risk management, internal or external reporting and the own funds requirements calculation processes. Where institutions calculate days past due less often than daily, they should ensure that the date of default is identified as the date when the past due criterion has actually been fulfilled.
22. The classification of the obligor to a defaulted status should not be subject to additional expert judgement; once the obligor meets the past due criterion all exposures to that obligor are considered defaulted, unless either of the following conditions is met:
  - (a) the exposures are eligible as retail exposures and the institution applies the default definition at individual credit facility level;
  - (b) a so called 'technical past due situation' is considered to have occurred, in accordance with paragraph 23.

## Technical past due situation

23. A technical past due situation should only be considered to have occurred in any of the following cases:

- (a) where an institution identifies that the defaulted status was a result of data or system error of the institution, including manual errors of standardised processes but excluding wrong credit decisions;
- (b) where an institution identifies that the defaulted status was a result of the non-execution, defective or late execution of the payment transaction ordered by the obligor or where there is evidence that the payment was unsuccessful due to the failure of the payment system;
- (c) where due to the nature of the transaction there is a time lag between the receipt of the payment by an institution and the allocation of that payment to the relevant account, so that the payment was made before the 90 days and the crediting in the client's account took place after the 90 days past due;
- (d) in the specific case of factoring arrangements where the purchased receivables are recorded on the balance sheet of the institution and the materiality threshold set by the competent authority in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013 is breached but none of the receivables to the obligor is past due more than 30 days.

24. Technical past due situations should not be considered as defaults in accordance with Article 178 of Regulation (EU) No 575/2013. All detected errors that led to technical past due situation should be rectified by institutions in the shortest timeframe possible.

In the case of institutions that use the IRB Approach, technical past due situations should be removed from the reference data set of defaulted exposures for the purpose of estimation of risk parameters.

## Exposures to central governments, local authorities and public sector entities

25. Institutions may apply specific treatment for exposures to central governments, local authorities and public sector entities where all of the following conditions are met:

- (a) the contract is related to the supply of goods or services, where the administrative procedures require certain controls related to the execution of the contract before the payment can be made; this applies in particular to factoring exposures or similar types of arrangements but does not apply to instruments such as bonds;

- (b) apart from the delay in payment no other indications of unlikelihood to pay as specified in accordance with Article 178(1)(a) and 178(3) of Regulation (EU) No 575/2013 and these guidelines apply, the financial situation of the obligor is sound and there are no reasonable concerns that the obligation might not be paid in full, including any overdue interest where relevant;
- (c) the obligation is past due not longer than 180 days.

26. Institutions that decide to apply the specific treatment referred to in paragraph 25 should apply all of the following:

- (a) these exposures should not be included in the calculation of the materiality threshold for other exposures to this obligor;
- (b) they should not be considered as defaults in the sense of Article 178 of Regulation (EU) No 575/2013;
- (c) they should be clearly documented as exposures subject to the specific treatment.

## Specific provisions applicable to factoring and purchased receivables

27. Where there are factoring arrangements whereby the ceded receivables are not recognised on the balance sheet of the factor and the factor is liable directly to the client up to a certain agreed percentage, the counting of days past due should commence from when the factoring account is in debit, i.e. from when the advances paid for the receivables exceed the percentage agreed between the factor and the client. For the purpose of determining items of the client of a factor that are past due, institutions should apply both of the following:

- (a) compare the sum of the amount of the factoring account that is in debit and all other past due obligations of the client recorded in the balance sheet of the factor, against the absolute component of the materiality threshold set by the competent authority in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013;
- (b) compare the relation between the sum described in point (a) and the total amount of current value of the factoring account, i.e. the value of advances paid for the receivables and all other on-balance sheet exposures related with the credit obligations of the client, against the relative component of the materiality threshold set by the competent authority in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013.

28. Where there are factoring arrangements where the purchased receivables are recognised on the balance sheet of the factor and the factor has exposures to the debtors of the client, the counting of days past due should commence when the payment for a single receivable

becomes due. In this situation, for institutions that use the IRB Approach, by virtue of the fact that the ceded receivables are purchased receivables, where they meet the requirements of 154(5) of Regulation (EU) No 575/2013 or in the case of purchased corporate receivables the requirements of Article 153(6) of Regulation (EU) No 575/2013, the default definition may be applied as for retail exposures in accordance with Section 9 of these guidelines.

29. Where the institution recognises events related to dilution risk of purchased receivables as defined in point (53) of Article 4(1) of Regulation (EU) No 575/2013, these events should not be considered as leading to the default of the obligor. Where the amount of receivable has been reduced as a result of events related to dilution risk such as discounts, deductions, netting or credit notes issued by the seller the reduced amount of receivable should be included in the calculation of days past due. Where there is a dispute between the obligor and the seller and such event is recognised as related to dilution risk the counting of days past due should be suspended until the dispute is resolved.
30. Events recognised as related to dilution risk and hence excluded from the identification of default should be included in the calculation of own funds requirements or internal capital for dilution risk. Where institutions recognise significant number of events related to dilution risk, they should analyse and document the reasons for such events and assess the possible indications of unlikelihood to pay, in accordance with Articles 178(1) and (3) of Regulation (EU) No 575/2013 and Section 5 of these guidelines.
31. Where the obligor has not been adequately informed about the cession of the receivable by the factor's client and the institution has evidence that the payment for the receivable has been made to the client, the institution should not consider the receivable to be past due. Where the obligor has been adequately informed about the cession of the receivable but has nevertheless made the payment to the client, the institution should continue counting the days past due according to the conditions of the receivable.
32. In the specific case of undisclosed factoring arrangements, where the obligors are not informed about the cession of the receivables but the purchased receivables are recognised on the balance sheet of the factor, the counting of days past due should commence from the moment agreed with the client when the payments made by the obligors should be transferred from the client to the factor.

## Setting the materiality threshold

33. Competent authorities should notify the EBA of the levels of the materiality thresholds that they set in their respective jurisdiction in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013. After the entry into force of the regulatory technical standards developed in accordance with Article 178(6) of Regulation (EU) No 575/2013, where competent authorities set the relative component of the materiality threshold at a level different than the 1% referred to in those regulatory technical standards, they should provide the justification for this different level of the threshold to the EBA.

34. Institutions should apply the materiality threshold for past due credit obligations set by their competent authorities as referred to in point (d) of Article 178(2) of Regulation (EU) No 575/2013. Institutions may identify defaults on the basis of a lower threshold if they can demonstrate that this lower threshold is a relevant indication of unlikelihood to pay and does not lead to an excessive number of defaults that return to non-defaulted status shortly after being recognised as defaulted or decrease of capital requirements. In this case institutions should record in their databases the information on the trigger of default as an additional specified indication of unlikelihood to pay.

## 5. Indications of unlikelihood to pay

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### Non-accrued status

35. For the purposes of unlikelihood to pay as referred to in point (a) of Article 178(3) of Regulation (EU) No 575/2013, institutions should consider that an obligor is unlikely to pay where interest related to credit obligations is no longer recognised in the income statement of the institution due to the decrease of the credit quality of the obligation.

### Specific credit risk adjustments (SCRA)

36. For the purposes of unlikelihood to pay as referred to in point (b) of Article 178(3) of Regulation (EU) No 575/2013, all of the following specific credit risk adjustments (SCRA) should be considered to be a result of a significant perceived decline in the credit quality of a credit obligation and hence should be treated as an indication of unlikelihood to pay:

- (a) losses recognised in the profit or loss account for instruments measured at fair value that represent credit risk impairment under the applicable accounting framework;
- (b) losses as a result of current or past events affecting a significant individual exposure or exposures that are not individually significant which are individually or collectively assessed.

37. The SCRA that cover the losses for which historical experience, adjusted on the basis of current observable data, indicate that the loss has occurred but the institution is not yet aware which individual exposure has suffered these losses ('incurred but not reported losses'), should not be considered an indication of unlikelihood to pay of a specific obligor.

38. Where the institution treats an exposure as impaired such a situation should be considered an additional indication of unlikelihood to pay and hence the obligor should be considered defaulted regardless of whether there are any SCRA assigned to this exposure. Where in accordance with the applicable accounting framework in the case of incurred but not

reported losses exposures are recognised as impaired, these situations should not be treated as an indication of unlikeliness to pay.

39. Where the institution treats an exposure as credit-impaired under IFRS 9, i.e. assigns it to Stage 3 as defined in IFRS 9 Financial Instruments, published by the IASB in July 2014, such exposure should be considered defaulted, except where the exposure has been considered credit-impaired due to the delay in payment and either or both of the following conditions are met:

- (a) the competent authorities have replaced the 90 days past due with 180 days past due in accordance with point (b) of Article 178(1) of Regulation EU (No) 575/2013 and this longer period is not used for the purpose of recognition of credit-impairment;
- (b) the materiality threshold referred to in Article 178(2)(d) of Regulation (EU) No 575/2013 has not been breached;
- (c) the exposure has been recognised as a technical past due situation in accordance with paragraph 23;
- (d) the exposure meets the conditions of paragraph 25.

40. Where the institution uses both IFRS 9 and another accounting framework it should choose whether to classify exposures as defaulted in accordance with paragraphs 36 to 38 or in accordance with paragraph 39. Once this choice is made it should be applied consistently over time.

## Sale of the credit obligation

41. For the purposes of unlikeliness to pay as referred to in point (c) of Article 178(3) of Regulation (EU) No 575/2013, institutions should take into account both the character and materiality of the loss related to the sale of credit obligations, in accordance with the following paragraphs. Transactions of traditional securitisation with significant risk transfer and any intragroup sales of credit obligations should be considered sale of credit obligations.

42. Institutions should analyse the reasons for the sale of credit obligations and the reasons for any losses recognised thereby. Where the reasons for the sale of credit obligations were not related to credit risk, such as where there is the need to increase the liquidity of the institution or there is a change in business strategy, and the institution does not perceive the credit quality of those obligations as declined, the economic loss related with the sale of those obligations should be considered not credit-related. In that case the sale should not be considered an indication of default even where the loss is material, on condition of the appropriate, documented justification of the treatment of the sale loss as not credit-related. Institutions may, in particular, consider the loss on the sale of credit obligations as non-credit related where the assets subject to the sale are publicly traded assets and measured at fair value.

43. Where, however, the loss on the sale of credit obligations is related to the credit quality of the obligations themselves, in particular where the institution sells the credit obligations due to the decrease in their quality, the institution should analyse the materiality of the economic loss and, where the economic loss is material, this should be considered an indication of default.
44. Institutions should set a threshold for the credit-related economic loss related with the sale of credit obligations to be considered material, which should be calculated according to the following formula, and should not be higher than 5%:

$$L = \frac{E - P}{E}$$

where:

*L* is the economic loss related with the sale of credit obligations;

*E* is the total outstanding amount of the obligations subject to the sale, including interest and fees;

*P* is the price agreed for the sold obligations.

45. In order to assess the materiality of the overall economic loss related with the sale of credit obligations, institutions should calculate the economic loss and compare it to the threshold referred to in paragraph 44. Where the economic loss is higher than this threshold they should consider the credit obligations defaulted.
46. The sale of credit obligations may be performed either before or after the default. In the case of institutions that use the IRB Approach, regardless of the moment of the sale, if the sale was related with a material credit-related economic loss, the information about the loss should be adequately recorded and stored for the purpose of the estimation of risk parameters.
47. If the sale of a credit obligation at a material credit-related economic loss occurred before the identification of default on that exposure, the moment of sale should be considered the moment of default. In the case of a partial sale of the total obligations of an obligor where the sale is associated to a material credit-related economic loss, all the remaining exposures to this obligor should be treated as defaulted, unless the exposures are eligible as retail exposures and the institution applies the default definition at facility level.
48. In the case of a sale of a portfolio of exposures the treatment of individual credit obligations within this portfolio should be determined in accordance with the manner the price for the portfolio was set. Where the price for the total portfolio was determined by specifying the discount on particular credit obligations, the materiality of credit-related economic loss should be assessed individually for each exposure within the portfolio. Where however the price was set only at the portfolio level, the materiality of credit-related economic loss may be assessed at the portfolio level and in that case, if the threshold specified in paragraph 44 is

breached, all credit obligations within this portfolio should be treated as defaulted at the moment of the sale.

## Distressed restructuring

49. For the purposes of unlikeliness to pay as referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013, a distressed restructuring should be considered to have occurred when concessions have been extended towards a debtor facing or about to face difficulties in meeting its financial commitments as specified in paragraphs 163-167 and 172-174 of Annex V Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014<sup>3</sup> as amended by Commission Implementing Regulation (EU) 2015/227<sup>4</sup>.
50. Given that, as referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013, the obligor should be considered defaulted where the distressed restructuring is likely to result in a diminished financial obligation, where considering forbore exposures, the obligor should be classified as defaulted only where the relevant forbearance measures are likely to result in a diminished financial obligation.
51. Institutions should set a threshold for the diminished financial obligation that is considered to be caused by material forgiveness or postponement of principal, interest, or fees, and which should be calculated according to the following formula, and should not be higher than 1%:

$$DO = \frac{NPV_0 - NPV_1}{NPV_0}$$

where:

*DO* is diminished financial obligation;

*NPV<sub>0</sub>* is net present value of cash flows (including unpaid interest and fees) expected under contractual obligations before the changes in terms and conditions of the contract discounted using the customer's original effective interest rate;

*NPV<sub>1</sub>* is net present value of the cash flows expected based on the new arrangement discounted using the customer's original effective interest rate.

52. For the purposes of unlikeliness to pay as referred to in point (d) of Article 178(3) of Regulation (EU) No 575/2013, for each distressed restructuring, institutions should calculate the diminished financial obligation and compare it with the threshold referred to in paragraph 51. Where the diminished financial obligation is higher than this threshold, the exposures should be considered defaulted.

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<sup>3</sup> OJ L 191, 28.6.2014, p. 1.

<sup>4</sup> OJ L 48, 20.2.2015, p. 1.

53. If however the diminished financial obligation is below the specified threshold, and in particular when the net present value of expected cash flows based on the distressed restructuring arrangement is higher than the net present value of expected cash flows before the changes in terms and conditions, institutions should assess such exposures for other possible indications of unlikeliness to pay. Where the institution has reasonable doubts with regard to the likeliness of repayment in full of the obligation according to the new arrangement in a timely manner, the obligor should be considered defaulted. The indicators that may suggest unlikeliness to pay include the following:
- (a) a large lumpsum payment envisaged at the end of the repayment schedule;
  - (b) irregular repayment schedule where significantly lower payments are envisaged at the beginning of repayment schedule;
  - (c) significant grace period at the beginning of the repayment schedule;
  - (d) the exposures to the obligor have been subject to distressed restructuring more than once.
54. Any concession extended to an obligor already in default, should lead to classify the obligor as a distressed restructuring. All exposures classified as forborne non-performing in accordance with Annex V of Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 as amended by Commission Implementing Regulation (EU) 2015/227 should be classified as default and subject to distressed restructuring.
55. Where any of the modifications of the schedule of credit obligations referred to in point (e) of Article 178(2) of Regulation (EU) No 575/2013 is the result of financial difficulties of an obligor, institutions should also assess whether a distressed restructuring has taken place and whether an indication of unlikeliness to pay has occurred.

## Bankruptcy

56. For the purposes of unlikeliness to pay as referred to in point (e) and (f) of Article 178(3) of Regulation (EU) No 575/2013, institutions should clearly specify in their internal policies what type of arrangement is treated as an order or as a protection similar to bankruptcy, taking into account all relevant legal frameworks as well as the following typical characteristics of such protection:
- (a) the protection scheme encompasses all creditors or all creditors with unsecured claims;
  - (b) the terms and conditions of the protection scheme are approved by the court or other relevant public authority;

- (c) the terms and conditions of the protection scheme include a temporary suspension of payments or partial redemption of debt;
- (d) the measures involve some sort of control over the management of the company and its assets;
- (e) if the protection scheme fails, the company is likely to be liquidated.

57. Institutions should treat all arrangements listed in Annex A to Regulation (EU) 2015/848<sup>5</sup> as an order or as a protection similar to bankruptcy.

## Other indications of unlikeliness to pay

58. Institutions should specify in their internal policies and procedures other additional indications of unlikeliness to pay of an obligor, besides those specified in Article 178(3) of Regulation (EU) No 575/2013. Those additional indications should be specified per type of exposures, as defined in point (2) of Article 142(1) of Regulation (EU) No 575/2013, reflecting their specificities, and they should be specified for all business lines, legal entities or geographical locations. The occurrence of an additional indication of unlikeliness to pay should either result in an automatic reclassification to defaulted exposures or trigger a case-by-case assessment and may include indications based on internal or external information.

59. The possible indications of unlikeliness to pay that could be considered by institutions on the basis of internal information include the following:

- (a) a borrower's sources of recurring income are no longer available to meet the payments of instalments;
- (b) there are justified concerns about a borrower's future ability to generate stable and sufficient cash flows;
- (c) the borrower's overall leverage level has significantly increased or there are justified expectations of such changes to leverage;
- (d) the borrower has breached the covenants of a credit contract;
- (e) the institution has called any collateral including a guarantee;
- (f) for the exposures to an individual: default of a company fully owned by a single individual where this individual provided the institution with a personal guarantee for all obligations of a company;

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<sup>5</sup> Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (OJ L 141, 5.6.2015, p. 19).

- (g) for retail exposures where the default definition is applied at the level of an individual credit facility, the fact that a significant part of the total obligation of the obligor is in default;
- (h) the reporting of an exposure as non-performing in accordance with Annex V of Commission Implementing Regulation (EU) No 680/2014 of 16 April 2014 as amended by Commission Implementing Regulation (EU) 2015/227, except where competent authorities have replaced the 90 days past due with 180 days past due in accordance with point (b) of Article 178(1) of Regulation EU (No) 575/2013.

60. Institutions should also take into account the information available in external databases, including credit registers, macroeconomic indicators and public information sources, including press articles and financial analyst's reports. The indications of unlikelihood to pay that could be considered by institutions on the basis of external information include the following:

- (a) significant delays in payments to other creditors have been recorded in the relevant credit register;
- (b) a crisis of the sector in which the counterparty operates combined with a weak position of the counterparty in this sector;
- (c) disappearance of an active market for a financial asset because of the financial difficulties of the debtor;
- (d) an institution has information that a third party, in particular another institution, has filed for bankruptcy or similar protection of the obligor.

61. When specifying the criteria for unlikelihood to pay, institutions should take into consideration the relations within the groups of connected clients as defined in point 39 of Article 4(1) of Regulation (EU) No 575/2013. In particular institutions should specify in their internal policies when the default of one obligor within the group of connected clients has a contagious effect on other entities within this group. Such specifications should be in line with the appropriate policies for the assignment of exposures to individual obligor to an obligor grade and to groups of connected clients in accordance with point (d) of Article 172(1) of Regulation (EU) No 575/2013. Where such criteria have not been specified for a non-standard situation, in the case of default of an obligor that is part of a group of connected clients, institutions should assess the potential unlikelihood to pay of all other entities within this group on a case-by-case basis.

62. Where a financial asset was purchased or originated by an institution at a material discount institutions should assess whether that discount reflects the deteriorated credit quality of the obligor and whether there are any indications of default in accordance with these guidelines. The assessment of unlikelihood to pay should refer to the total amount owed by the obligor regardless of the price that the institution has paid for the asset. This assessment may be based on the due diligence performed before the purchase of the asset or on the analysis

performed for the accounting purposes in order to determine whether the asset is credit-impaired.

63. Institutions should have adequate policies and procedures to identify credit frauds. Typically when credit fraud is identified, the exposure is already defaulted on the basis of material delays in payment. However, if the credit fraud is identified before default has been recognised this should be treated as an additional indication of unlikelihood to pay.

## Governance processes regarding unlikelihood to pay

64. Institutions should establish policies regarding the definition of default in order to ensure its consistent and effective application and in particular they should have clear policies and procedures on the application of the criteria for unlikelihood to pay as laid down in Article 178(3) of Regulation (EU) No 575/2013 and all other indications of unlikelihood to pay as specified by the institution, covering all types of exposures as defined in point (2) of Article 142(1) of Regulation (EU) No 575/2013, for all business lines, legal entities and geographical locations.
65. With regard to each indication of unlikelihood to pay institutions should define the adequate methods of their identification, including the sources of information and frequency of monitoring. The sources of information should include both internal and external sources, including in particular relevant external databases and registers.

## 6. Application of the definition of default in external data

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66. Institutions that use the IRB Approach and use external data for the purpose of estimation of risk parameters in accordance with Article 178(4) of Regulation (EU) No 575/2013 should apply the requirements specified in this section.
67. For the purposes of Article 178(4) of Regulation (EU) No 575/2013 institutions should do all of the following:
  - (a) verify whether the definition of default used in the external data is in line with Article 178 of Regulation (EU) 575/2013;
  - (b) verify whether the definition of default used in external data is consistent with the definition of default as implemented by the institution for the relevant portfolio of exposures, including in particular: the counting and number of days past due that triggers default, the structure and level of materiality threshold for past due credit obligations, the definition of distressed restructuring that triggers default, the type

and level of specific credit risk adjustments that triggers default and the criteria to return to non-defaulted status;

- (c) document sources of external data, the default definition used in external data, the performed analysis and all identified differences.

68. For each difference identified in the definition of default resulting from the assessment of paragraph 67, institutions should do all of the following:

- (a) assess whether the adjustment to the internal definition of default would lead to an increased or a decreased default rate or whether it is impossible to determine;

- (b) either perform appropriate adjustments in the external data or be able to demonstrate that the difference is negligible in terms of the impact on all risk parameters and own funds requirements,

69. Regarding the totality of the differences identified in the definition of default resulting from the assessment of paragraph 67 and taking into account the adjustments performed in accordance with point (b) of paragraph 68, institutions should be able to demonstrate to competent authorities that broad equivalence with the internal definition of default has been achieved, including, where possible by comparing the default rate in internal data on a relevant type of exposures with external data.

70. Where the assessment of paragraph 67 identifies differences in the definition of default which the process of paragraph 68 reveals to be non-negligible but not possible to overcome by adjustments in the external data, institutions are required to adopt an appropriate margin of conservatism in the estimation of risk parameters as referred to in Article 179(1)(f) of Regulation (EU) No 575/2013. In that case institutions should ensure that this additional margin of conservatism reflects the materiality of the remaining differences in the definition of default and their possible impact on all risk parameters.

## 7. Criteria for the return to a non-defaulted status

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### Minimum conditions for reclassification to a non-defaulted status

71. For the purposes of the application of Article 178(5) of Regulation (EU) 575/2013, except for situations referred to in paragraph 72, institutions should apply all of the following:

- (a) consider that no trigger of default continues to apply to a previously defaulted exposure, where at least 3 months have passed since the moment that the conditions

referred to in Articles 178(1)(b) and 178(3) of Regulation (EU) No 575/2013 cease to be met;

- (b) take into account the behaviour of the obligor during the period referred to in point (a);
- (c) take into account the financial situation of the obligor during the period referred to in point (a);
- (d) after the period referred to in point (a), perform an assessment, and, where the institution still finds that the obligor is unlikely to pay its obligations in full without recourse to realising security, the exposures should continue to be classified as defaulted until the institution is satisfied that the improvement of the credit quality is factual and permanent;
- (e) the conditions referred to in points (a) to (d) should be met also with regard to new exposures to the obligor, in particular where the previous defaulted exposures to this obligor were sold or written off.

Institutions may apply the period referred to in point (a) to all exposures or apply different periods for different types of exposures.

72. For the purposes of the application of Article 178(5) of Regulation (EU) 575/2013, and where distressed restructuring according to paragraph 49 of these guidelines applies to a defaulted exposure, regardless of whether such restructuring was carried out before or after the identification of default, institutions should consider that no trigger of default continues to apply to a previously defaulted exposure, where at least 1 year has passed from the latest between one of the following events:

- (a) the moment of extending the restructuring measures;
- (b) the moment when the exposure has been classified as defaulted;
- (c) the end of the grace period included in the restructuring arrangements.

73. Institutions should reclassify the exposure to a non-defaulted status after at least the one year period referred to in the previous paragraph, where all of the following conditions are met:

- (a) during that period a material payment has been made by the obligor; material payment may be considered to be made where the debtor has paid, via its regular payments in accordance with the restructuring arrangements, a total equal to the amount that was previously past-due (if there were past-due amounts) or that has been written-off (if there were no past-due amounts) under the restructuring measures;

- (b) during that period the payments have been made regularly according to the schedule applicable after the restructuring arrangements;
- (c) there are no past due credit obligations according to the schedule applicable after the restructuring arrangements;
- (d) no indications of unlikelihood to pay as specified in Article 178(3) of Regulation (EU) No 575/2013 or any additional indications of unlikelihood to pay specified by the institution apply;
- (e) the institution does not consider it otherwise unlikely that the obligor will pay its credit obligations in full according to the schedule after the restructuring arrangements without recourse to realising security. In this assessment institutions should examine in particular situations where a large lumpsum payment or significantly larger payments are envisaged at the end of the repayment schedule;
- (f) the conditions referred to in points (a) to (e) should be met also with regard to new exposures to the obligor, in particular where the previous defaulted exposures to this obligor that were subject to distressed restructuring were sold or written off.

74. Where the obligor changes due to an event such as a merger or acquisition of the obligor or any other similar transaction, the institution should not apply paragraph 73(a). Where the obligor's name changes, instead, institutions should apply that paragraph.

## Monitoring of the effectiveness of the policy

75. For the purposes of the application of Article 178(5) of Regulation (EU) 575/2013, an institution should define clear criteria and policies regarding when the obligor can be classified back to non-defaulted status and more in particular, both of the following:

- (a) when it can be considered that the improvement of the financial situation of an obligor is sufficient to allow the full and timely repayment of the credit obligation;
- (b) when the repayment is actually likely to be made even where there is an improvement in the financial situation of an obligor in accordance with point (a).

76. Institutions should monitor on a regular basis the effectiveness of their policies mentioned in paragraph 75, and in particular monitor and analyse:

- (a) the changes of status of the obligors or facilities;
- (b) the impact of the adopted policies on cure rates;
- (c) the impact of adopted policies on multiple defaults.

77. It is expected that the institution would have a limited number of obligors who default soon after returning to a non-defaulted status. In the case of extensive number of multiple defaults the institution should revise its policies with regard to the reclassification of exposures.
78. The analysis of the changes in statuses of the obligors or facilities should in particular be taken into account for the purpose of specifying the periods referred to in paragraphs 71 and 72. Institutions may specify longer periods for the exposures that have been classified as defaulted in the preceding 24 months.

## 8. Consistency in the application of the definition of default

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### Overview

79. Institutions should adopt adequate mechanisms and procedures in order to ensure that the definition of default is implemented and used in a correct manner, and should, in particular, ensure:
- (a) that default of a single obligor is identified consistently across the institution with regard to all exposures to this obligor in all relevant IT systems, including in all the legal entities within the group and in all geographical locations in accordance with paragraphs 80 to 82 or for retail exposures in accordance with paragraphs 92 to 94;
  - (b) that one of the following applies:
    - i. the same definition of default is used consistently by an institution, parent undertaking or any of its subsidiaries and across the types of exposures;
    - ii. where different definitions of default apply either within a group or across the types of exposures, the scope of application of each of the default definitions is clearly specified, in accordance with paragraphs 83 to 85;

### Consistent identification of default of a single obligor

80. For the purposes of point (a) of paragraph 79, institutions should implement adequate procedures and mechanisms to ensure that the default of a single obligor is identified consistently across the institution with regard to all exposures to this obligor in all relevant IT systems, including in all the legal entities within the group and in all geographical locations where it is active in ways other than via a legal entity.
81. Where the exchange of client data among different legal entities within an institution, the parent undertaking or any of its subsidiaries is prohibited by consumer protection regulations,

bank secrecy or other legislation resulting in inconsistencies in the identification of default of an obligor, institutions should inform their competent authorities of these legal impediments and, if they use the IRB Approach they should also estimate the materiality of the inconsistencies in the identification of default of an obligor and their possible impact on the estimates of risk parameters.

82. Further, where the identification of default of an obligor in a manner fully consistent across the institution, the parent undertaking or any of its subsidiaries is very burdensome, requiring development of a centralised database of all clients or implementation of other mechanisms or procedures to verify the status of each client at all entities within the group, institutions need not apply such mechanisms or procedures if they can demonstrate that the effect of non-compliance is immaterial because there are no or very limited number of common clients among the relevant entities within a group and the exposure to these clients is immaterial.

## Consistent use of the definition of default across types of exposures

83. For the purposes of point (b) of paragraph 79, an institution, parent undertaking or any of its subsidiaries should use the same definition of default for a single type of exposures as defined in point (2) of Article 142(1) of Regulation (EU) No 575/2013. They may use different definitions of default for different types of exposures, including for certain legal entities or for presence in geographical locations in ways other than via a legal entity, where this is justified by the application of significantly different internal risk management practices or by different legal requirements applying in different jurisdictions, in particular by reasons such as:
- (a) different materiality thresholds set by competent authorities in their jurisdictions in accordance with point (d) of Article 178(2) of Regulation (EU) No 575/2013;
  - (b) the use of 180 days instead of 90 days past due for certain types of exposures to which the IRB Approach is applied in some jurisdictions in accordance with point (b) of Article 178(1) of Regulation (EU) No 575/2013;
  - (c) the specification of additional indications of unlikelihood to pay specific for certain legal entities, geographical locations or types of exposures.
84. For the purposes of point (b)(ii) of paragraph 79, and where different definitions of default are applied either across types of exposures in accordance with paragraph 83, the institutions' internal procedures relating to the definition of default should ensure both of the following:
- (a) that the scope of application of each definition is clearly specified;
  - (b) that the definition of default specified for a certain type of exposures, legal entity or geographical location is applied consistently to all exposures within the scope of application of each relevant definition of default.

85. Further, for institutions that use the IRB Approach, the use of different default definitions has to be adequately reflected in the estimation of risk parameters in the case of ratings systems which scope of application encompasses different default definitions.

## 9. Application of the definition of default for retail exposures

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### Level of application of the default definition for retail exposures

86. According to the second sub-paragraph of Article 178(1) of Regulation (EU) No 575/2013, in the case of retail exposures, institutions may apply the definition of default at the level of an individual credit facility rather than in relation to the total obligations of a borrower. Therefore, institutions that use the IRB Approach, in particular, may apply the definition of default at the level of the individual facility for retail exposures as defined in Article 147(5) of Regulation (EU) 575/2013. Institutions that use the Standardised Approach, instead may apply the definition of default at the level of an individual credit facility for all exposures that meet the criteria specified in Article 123 of Regulation (EU) 575/2013, even where some of those exposures have been assigned to a different exposure class for the purpose of assigning a risk weight, such as exposures secured by mortgages on immovable property.
87. Institutions should choose the level of application of the definition of default between obligor and facility for all retail exposures in a way that reflects their internal risk management practices.
88. Institutions may apply the definition of default at the level of an obligor for some types of retail exposures and at the level of a credit facility for others, where this is well justified by internal risk management practices, for instance due to a different business model of a subsidiary, and where there is evidence that the number of situations where the same clients are subject to different definitions of default at different levels of application is kept to a strict minimum.
89. Where institutions decide to use different levels of application of the definition of default for different types of retail exposures, according to paragraph 88, they should ensure that the scope of application of each definition of default is clearly specified and that it is used consistently over time for different types of retail exposures. In the case of institutions that use the IRB Approach the risk estimates should correctly reflect the definition of default applied to each type of exposures.
90. Where institutions use different levels of application of the default definition with regard to certain retail portfolios, the treatment of common clients across such portfolios should be specified in their internal policies and procedures. In particular, where the exposure to which

the definition of default at the obligor level applies fulfils either or both of the conditions of points (a) or (b) of Article 178(1) of Regulation (EU) No 575/2013, then all exposures to that obligor should be considered defaulted, including those subject to the application of the definition of default at individual credit facility level. Where the exposure subject to the application of the definition of default at individual credit facility level meets those conditions, the other exposures to the obligor should not be automatically reclassified to default status. Institutions, however, may classify those other exposures as defaulted on the basis of other unlikelihood to pay considerations, as provided further in paragraphs 92 to 94.

91. The same rule should apply to the obligors treated under the Standardised Approach, where some exposures to an obligor fulfil the requirements of Article 123 of Regulation (EU) 575/2013 while other exposures to the same obligor are in the form of securities and therefore do not qualify as retail. Where an exposure in the form of a security fulfils either or both of the conditions of points (a) or (b) of Article 178(1) of Regulation (EU) No 575/2013, all exposures to that obligor should be considered defaulted. Where the exposure that fulfils the requirements of Article 123 of Regulation (EU) 575/2013 meets those conditions and the institution applies the definition of default at the individual credit facility level, the other exposures to the obligor should not be automatically reclassified to default status. Institutions, however, may classify those other exposures as defaulted on the basis of other unlikelihood to pay considerations, as provided further in paragraphs 92 to 94.

## Application of the definition of default for retail exposures at the facility level

92. Where, in accordance with the second sub-paragraph of Article 178(1) of Regulation (EU) No 575/2013, the definition of default has been applied at the level of an individual credit facility with regard to retail exposures, institutions should not consider automatically the different exposures to the same obligor defaulted at the same time. Nevertheless institutions should take into account that some indications of default are related with the condition of the obligor rather than the status of a particular exposure. This refers in particular to the indications of unlikelihood to pay related with the bankruptcy of the obligor as specified in points (e) and (f) of Article 178(3) of Regulation (EU) No 575/2013. Where such indication of default occurs, institutions should treat all exposures to the same obligor as defaulted regardless of the level of application of the definition of default.
93. Institutions should consider also other indications of unlikelihood to pay and specify, in line with their internal policies and procedures, which indications of unlikelihood to pay reflect the overall situation of an obligor rather than that of the exposure. Where such other indications of unlikelihood to pay occur, all exposures to the obligor should be considered defaulted regardless of the level of application of the definition of default.
94. Additionally, where a significant part of the exposures to the obligor is in default, institutions may consider it unlikely that the other obligations of that obligor will be paid in full without recourse to actions such as realising security and treat them as defaulted as well.

## Application of the definition of default for retail exposures at the obligor level

95. The application of the definition of default for retail exposures at the obligor level implies that, where any credit obligation of the obligor meets the conditions of points (a) or (b) or both of Article 178(1) of Regulation (EU) No 575/2013, then all exposures to that obligor should be considered defaulted. Institutions that decide to apply the definition of default for retail exposures at the obligor level should specify detailed rules for the treatment of joint credit obligations and default contagion between exposures in their internal policies and procedures.
96. 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.
97. Where the conditions of points (a) or (b) or both of Article 178(1) of Regulation (EU) No 575/2013 are met with regard to a joint credit obligation of two or more obligors, institutions should consider all other joint credit obligations of the same set of obligors and all individual exposures to those obligors as defaulted, unless they can justify that the recognition of default on individual exposures is not appropriate because at least one of the following conditions apply:
- (a) the delay in payment of a joint credit obligation results from a dispute between the individual obligors participating in the joint credit obligation that has been introduced to a court or another formal procedure performed by a dedicated external body that results in a binding ruling in accordance with the applicable legal framework in the relevant jurisdiction, and there is no concern about the financial situation of the individual obligors;
  - (b) a joint credit obligation is an immaterial part of the total obligations of an individual obligor.
98. The default of a joint credit obligation should not cause the default of other joint credit obligations of individual obligors with other individuals or entities, which are not involved in the credit obligation that has initially been defaulted; however, institutions should assess whether the default of the joint credit obligation at hand constitutes an indication of unlikelihood to pay with regard to the other joint credit obligations.
99. Where the conditions of points (a) or (b) or both of Article 178(1) of Regulation (EU) No 575/2013 are met with regard to the credit obligation of an individual obligor, the contagious effect of this default should not automatically spread to any joint credit obligations of that obligor; nevertheless, institutions should assess such joint credit obligations for possible indications of unlikelihood to pay related with the default of one of the obligors. In any case,

where all individual obligors have a defaulted status, their joint credit obligation should automatically also be considered defaulted.

100. Institutions should identify, on the basis of the analysis of relevant legal provisions in a jurisdiction, and provide in their internal policies and procedures for the identification of the obligors that are legally fully liable for certain obligations jointly and severally with other obligors, therefore being fully liable for the entire amount of those obligations, but excluding credit obligations of an individual obligor secured by another individual or entity in the form of a guarantee or other credit protection. A typical example would be a married couple where, based on specific legal provisions applicable in the relevant jurisdiction, division of marital property (system of separate estates) does not apply. In the case of full mutual liability for all obligations, default of one of such obligors should be considered an indication of potential unlikelihood to pay of the other obligor and therefore institutions should assess whether the individual and joint credit obligations of these obligors should be considered defaulted. Where one of the joint and several obligors that are legally fully liable for all obligations, has a joint credit obligation with another client, the institution should assess whether indications of unlikelihood to pay occur also on the other joint credit obligations with third parties.
101. Institutions should also analyse the forms of legal entities in relevant jurisdictions and the extent of liability of the owners, partners, shareholders or managers for the obligations of a company depending on the legal form of the entity. Where an individual is fully liable for the obligations of a company, default of that company should result in that individual being considered defaulted as well. Where such full liability for the obligations of a company does not exist, owners, partners or significant shareholders of a defaulted company should be assessed by the institution for possible indications of unlikelihood to pay with regard to their individual obligations.
102. Additionally, in the specific case of an individual entrepreneur where an individual is fully liable for both private and commercial obligations with both private and commercial assets the default of any of the private or commercial obligations should cause all private and commercial obligations of such individual to be considered as defaulted as well.
103. Where the definition of default is applied at the level of an obligor for retail exposures, the materiality threshold should also be applied at the level of an obligor. Institutions should clearly specify in their internal policies and procedures the treatment of joint credit obligations in the application of the materiality threshold.
104. A joint obligor, i.e. a specific set of individual obligors that have a joint obligation towards an institution, should be treated as a different obligor from each of the individual obligors. In the case the delay in payment occurs on a joint credit obligation, the materiality of such delay should be assessed by applying the materiality threshold referred to in point (d) of Article 178(2) of Regulation (EU) No 575/2013 to all joint credit obligations granted to this specific set of obligors. For this purpose the individual exposures to obligors participating in a joint

credit obligation or to any other subsets of such obligors should not be taken into account. However, where the materiality threshold for a joint obligor calculated in this way is breached, all joint credit obligations of this set of obligors and all individual exposures to the obligors participating in a joint credit obligation should be considered defaulted unless any of the conditions specified in paragraph 97 is met.

105. When delay in payment occurs on an individual credit obligation, the materiality of such delay should be assessed by applying the materiality threshold referred to in point (d) of Article 178(2) of Regulation (EU) No 575/2013 to all individual credit obligations of this obligor, without taking into account any joint credit obligations of that obligor with other individuals or entities. Where the materiality threshold calculated in this way is breached, all individual exposures to this obligor should be considered defaulted.

## 10. Documentation, internal policies and risk management processes

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### Timeliness of the identification of default

106. Institutions should have effective processes that allow them to obtain the relevant information in order to identify defaults in a timely manner, and to channel the relevant information in the shortest possible time and, where possible, in an automated manner, to the personnel that is responsible for taking credit decisions, and more in particular:
- (a) where they apply automatic processes, such as counting of days past due, the identification of indications of default should be performed on a daily basis;
  - (b) where they implement manual processes, such as checking external sources and databases, analysis of watch lists, analysis of the lists of forborne exposures, identification of SCRA, the information should be updated with a frequency that guarantees the timely identification of default.
107. Institutions should verify on a regular basis that all forborne non-performing exposures are classified as default and subject to distressed restructuring. Institutions should also analyse on a regular basis the forborne performing exposures in order to determine whether any of them fulfils the indication of unlikeliness to pay as specified in Article 178(3)(d) of Regulation (EU) No 575/2013 and in paragraphs 49 to 55.
108. Control mechanisms should ensure that the relevant information is used in the default identification process immediately after being obtained. All exposures to a defaulted obligor or all relevant exposures in case of the application of the definition of default at the facility level for retail exposures should be marked as defaulted in all relevant IT systems without

undue delay. If delays occur in the recording of the default, such delays should not lead to errors or inconsistencies in risk management, risk reporting, the own funds requirements calculation or the use of data in risk quantification. In particular it should be ensured that the internal and external reporting figures reflect a situation where all exposures are correctly classified.

## Documentation

109. Institutions should document their policies regarding the definition of default including all triggers for identification of default and the exit criteria as well as clear identification of the scope of application of the definition of default and, more in particular they should:
- (a) document the operationalisation of all indications of default;
  - (b) document the operationalisation of the criteria for reclassification of a defaulted obligor to a non-defaulted status;
  - (c) keep an updated register of all definitions of default.
110. For the purposes of point (a) of paragraph 109, institutions should document the application of the definition of default in a detailed manner by including the operationalization of all indications of default, including the process, sources of information and responsibilities for the identification of particular indications of default.
111. For the purposes of point (b) of paragraph 109, institutions should document the operationalization of the criteria for reclassification of a defaulted obligor to a non-defaulted status, including the processes, sources of information and responsibilities assigned to relevant personnel.
112. For the purposes of paragraphs 110 and 111, the documentation should include description of all automatic mechanisms and manual processes, and where qualitative indications of default or criteria for the return to non-defaulted status are applied manually the description should be sufficiently detailed to facilitate common understanding and consistent application by all responsible personnel.
113. For the purposes of point (c) of paragraph 109, institutions should keep an updated register of all current and past versions of the default definition at least starting from the date of application of these guidelines. This register should include at least the following information:
- (a) the scope of application of the default definition, if there is more than one default definition used within the institution, the parent undertaking or any of its subsidiaries;

- (b) the body approving the definition or definitions of default and date of approval for each of those definitions of default;
- (c) the date of implementation of each definition of default;
- (d) brief description of all changes performed relatively to the last version;
- (e) in the case of institutions that have permission to use the IRB Approach, the change category assigned, the date of submission to the competent authorities and, if applicable, the date of approval by the competent authorities.

## Internal governance requirements for institutions applying the IRB Approach

114. Institutions that use the IRB Approach should adopt adequate mechanisms and procedures in order to ensure that the definition of default is implemented and used in a correct manner, and should in particular ensure that:

- (a) the definition of default and the scope of its application is what is required to be approved by the management body, or by a committee designated by it, and by senior management in accordance with Article 189(1) of Regulation (EU) 575/2013;
- (b) the definition of default is used consistently for the purpose of the own funds requirements calculation and plays a meaningful role in the internal risk management processes by being used at least in the area of monitoring of exposures and in the internal reporting to senior management and management body;
- (c) the internal audit unit or another comparable independent auditing unit reviews regularly the robustness and effectiveness of the process used by the institution for the identification of default, taking into account in particular the timeliness of the identification of default referred to in paragraphs 106 to 108; and ensuring that the conclusions of the internal audit's review and respective recommendations, as well as the measures taken to remedy the identified weaknesses are communicated directly to the management body or the committee designated by it.