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**FRENCH BANKING FEDERATION 2st DRAFT RESPONSE TO EBA CP/2014/32 ON
DRAFT RTS ON MATERIALITY THRESHOLD OF CREDIT OBLIGATION PAST DUE
UNDER ARTICLE 178 OF REGULATION (EU) 575/2013**

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to comment the EBA's Consultation Paper on draft Regulatory Technical Standards on materiality threshold of credit obligation past due.

I- General comments

The RTS is meant for competent authorities who have the responsibility to define adequate materiality thresholds for credit obligation past-due within the limits set by the EBA.

In the context of the discussion on internal models and RWA comparability, the proposals of this RTS do not seem consistent with the trend of harmonization inherent to the Single Rulebook. This paper should also be read in the perspective of the BCBS's recent publications and of international regulatory agenda. This point is significant as the thresholds need to be homogeneous for all jurisdictions associated to a competent authority (the authority is mandated to define single thresholds for all institutions within their jurisdiction).

- With the ECB as supervisor and competent authority for banks in the euro zone, the thresholds should be homogeneous at least for those institutions falling within the ECB's remit, in line with the objectives of increased comparability.
- It is therefore advisable that the rest of the EU adopts the same thresholds. Failing that, a variety of approaches would be implemented across EU institutions, which would further complicate practices for credit risk modelling and further fuel criticism due to lack of comparability on this space.

Final rules must take into consideration expert judgment in the default definition for non-retail counterparties, in particular when it comes to deal with technical defaults that cannot be isolated via the implementation of pure quantitative thresholds. More generally we consider that technical defaults (i.e. not linked to credit events) should be explicitly excluded from the scope. We would gladly support the EBA in drafting a definition of technical defaults.

II- Areas requiring further clarification:

Generally we would like to highlight that a consistent treatment of all characteristics of default should be sought, in order to achieve the desired level playing field and the objectives of comparability and harmonisation of modelling practices. In this context we would expect that the final document on materiality thresholds, as well as the forthcoming EBA Guidelines on default definition, would provide enough details on the following elements:

- Definition of “credit obligation past due” and approach in order to account for days past due:
 - We would like to draw the EBA’s attention to article 178 2. of CRR (Regulation 575/2013) which defines several criteria that may be used to start the count of days past due (rejection by the bank of a drawing above the authorisation, or notification of an unauthorised exposure to the borrower etc...).
 - In terms of defaulted amount, we understand that “credit obligations of the borrower to the institution, the parent undertaking or any of its subsidiaries (‘credit obligation past due’)” referred to in the CP RTS article 2, 2 a) is to be appreciated at the borrower level. Could you confirm this understanding and detail its calculations?
 - Do 90 days past due also include 3 missed instalments?
- Definition of consolidated exposure: several definitions may be contemplated (sum of exposures on several credits within a single institution, or resulting from consolidation of exposures from the various subsidiaries of a banking group). How should partial repayments be considered? (FIFO or LIFO approach, which would have consequences in terms of movements of amounts past due above or under the threshold).
- How will the thresholds interact with the multiple default definition contemplated by EBA (such as the one described in CP36)? Grouping defaulted exposures, or analysis of cured exposures, will be highly dependent of the threshold definition.
- FBE / NPE have not been mentioned in the RTS, neither the contagion aspects which cannot be treated independently from default triggers. The EBA should also bring additional clarifications regarding sales of exposures at a loss (which may currently be considered as defaulted exposures if the loss is higher than a certain NPV threshold).
- There is no link with work underway on IFRS 9. Nonetheless, convergence between accounting and prudential definitions of default may be a desirable outcome of the process.

- In some jurisdictions, borrower status may be updated regularly thanks to connections with credit bureaux, and a default may be triggered automatically as soon as a credit bureau delivers some information on a credit event (for instance in case of tax arrears). How should such information and constraints be handled in the context of a new default definition with a materiality threshold?
- Regarding contagion, the legal framework in some countries may forbid the transfer of specific information on borrower’s default status even between separate legal entities belonging to the same banking group within the same country (see for instance corresponding requirements from the “Commission Nationale Informatique et Libertés”, CNIL, in France). Any consideration around contagion should then take any such legal impediments into account.
- Finally, how should calls for guarantees be considered? In some cases the guarantor may indeed be called before any threshold is hit, and the guaranteed exposure may be considered as defaulted.

III- Answers to the questions

1. Do you agree with the approach proposed in the draft RTS (option 1) that default should be recognized as soon as one of the components of the threshold (absolute or relative limit) is breached? Or would you rather support the alternative option, i.e. recognition of default after both thresholds are breached (option 2)?

We are overall in favour of Option 2 for non-retail clients. Please refer to question 2 for our proposed alternative approach for retail clients and our detailed analysis.

2. Do you agree with the proposed maximum levels of the thresholds?

We propose to set an absolute maximum limit for retail clients. We believe this approach will adequately capture default positions, leaving out “technical defaults” that may bias the modelling framework, and remain operationally feasible. This approach is prudent, represents a pragmatic solution to the challenge of dealing with large pools of retail clients in bank’s retail branches and avoids undue complexity. We remain reluctant to consider a relative threshold here since it would behave in contradiction with current risk management practices. For example let us assume that a borrower draws on his authorization up to a certain amount, and that his credit quality deteriorates: the bank is then likely to decrease his authorization, which will then increase the relative rate of use of the authorization. While the absolute amount at risk for the bank is reduced, a default may be triggered by the relative exposure threshold. Also, please note that the absolute thresholds currently applied are largely lower than the proposed maximum thresholds of 200 € (4€ is an actual threshold for the consumer credit activity for instance).

As far as non-retail clients are concerned, we propose to set the threshold as the max of a 500 € absolute limit and of a relative limit defined as 2% of the total amount of all credit obligations of the borrower (i.e. “option 2”). This approach reflects the wide variety of clients included in the non-retail population, ranging from SME to large corporates to sovereign entities. We believe this approach would provide for a more accurate measurement of risk parameters. We strongly believe that thresholds should be differentiated for non-retail (hence our proposal above to focus on the maximum of a relative threshold and of an absolute amount). On this basis we also believe that expert judgment should remain allowed for triggering defaults for non-retail counterparties in certain instances.

More generally, we believe that while a competent authority sets a certain threshold for its jurisdiction, banks in that jurisdiction should be allowed to trigger defaults internally with lower thresholds to capture material credit quality deteriorations before regulatory thresholds are hit, leveraging on existing internal risk monitoring procedures and specific knowledge of counterparties. We consider this would also be in line with the regulatory definition of default stemming from the concept of “unlikeliness” to pay.

We consider that an absolute threshold should remain both material and significant enough to prevent, as mentioned in the EBA consultation paper, from recognizing too many defaults that will be cured in a short timeframe. Irrespective of the retained target option, more identified defaults imply more recoveries and thus better LGD and an increased PD.

Irrespective of the final choice of options, if entities are not allowed to use only an absolute amount as a threshold, then option 2 would be preferred for the retail exposures as well as for non-retail ones.

3. How much time is necessary to implement the threshold set by the competent authority according to this proposed draft RTS? What is the scope of work required to achieve compliance?

Before implementation of new thresholds into models, institutions need to collect 5 years of historical data according to set levels. In practice, it is not considered as a feasible/reasonable scenario to recalibrate all current historical data taking into account new thresholds.

The draft RTS proposes a transition period of maximum 2 years for institutions to modify their models. A change of default definition that changes the number of defaults has material operational implications and may simply be impossible retroactively –an historical data set ranging from 5 to 7 years may not be adequately corrected, integrated and tested within the risk management system over a 2 year period.

As far as diligences linked to the materiality of changes of a rating system, no approval should be requested by the supervisor subsequent to those, especially if the implementation of different materiality threshold on models has no significant impact. In the latter instance, the competent authorities should thus be notified through ex-ante or ex-post communication. In all instances, we would like to propose one global communication to the supervisor on the change of threshold, as opposed to separate communications model by model.

NCA's should also bear in mind that the definition of retail portfolios is not always homogeneous between banks (owing to historical practices, and to the granularity of internal model approvals granted by supervisors, in connection with the client segmentation then in force within banks). We consider that the thresholds (retail Vs non-retail) should be implemented on the basis of the retail / non retail boundary currently implemented in the bank. Any modification of the perimeter of retail portfolios would entail significant impact over data series and additional operational constraints for banks, overstretching the transitional phase.

We would also like to point out that any discrepancy between regulatory and accounting definitions of default is likely to result in additional operational difficulties. In some jurisdictions convergence may have been achieved across both definitions. In this respect we would simply like to highlight that a coherent framework would help meet regulators' expectations in terms of comparability of models and practices.

4. Do you agree with the assessment of costs and benefits of these proposed draft RTS?

No comment

5. What is the expected impact of these proposed draft RTS?

We would like to emphasise again that no approval should be requested by the supervisor/authorities subsequent to the changes contemplated in the draft RTS on the basis of PDs estimation already including margins of conservatism calibrated to take into account uncertainty in the evolution of default rate.

As a consequence, the impact of the implementation of different materiality thresholds is expected to be significant especially from an IT development perspective.

We urge the EBA to consider jointly the answers and comments submitted to this consultation, and to the consultation paper 36/2014, in so far as numerous subjects are inter-related and evolutions contemplated by EBA in some parts of CP36 will impact banks modelling of default in the context proposed by CP32.