

## **Chapter 2**

# **Commission Delegated Regulation (EU) 2018/171**

Preamble

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, and in particular the third subparagraph of Article 178(6) thereof,

01/01/2021

Whereas:

(1) Since the market and economic conditions within the same jurisdiction are similar, the competent authorities should set one single threshold for the assessment of materiality of a credit obligation as referred to in Article 178(1)(b) of Regulation (EU) No 575/2013 for all institutions in their respective jurisdictions. Such a materiality threshold, that should remain consistent over time, brings the added benefit of increased comparability of capital requirements among institutions in the same jurisdiction.

(2) On the one hand, the amount that can be considered material depends on the level of the overall credit obligation. On the other hand, institutions tend to consider all amounts below a certain level as immaterial, regardless of their relation to the overall credit obligation. Therefore, the materiality threshold should consist of two components; an absolute component (an absolute amount) and a relative component (the percentage of the overall credit obligation that the amount past due represents). The past due credit obligation should, as a consequence, be considered material when both the limit expressed as an absolute amount and the limit expressed as a percentage are exceeded.

(3) Between various obligors, there are significant differences in average income and average amounts of credit obligations. Therefore, the materiality thresholds should be differentiated accordingly, with separate absolute components of the threshold for retail exposures and for other exposures.

(4) The materiality threshold should be adapted to the local particularities of each jurisdiction. The differences in economic conditions, including the different price levels in jurisdictions, justify that the absolute component of the materiality threshold can vary from jurisdiction to jurisdiction. Such differentiation, however, is rarely justified with regard to the relative component. As a result, the relative component should in principle

be the same in all jurisdictions, while some flexibility should be allowed for the absolute component. This will enable the competent authorities to set the materiality threshold at an appropriate level, up to a specified maximum, taking into account the specific conditions in their respective jurisdictions.

(5) Even though the conditions for setting the materiality threshold across the different jurisdictions in the Union should be harmonised, some differences in the levels of the thresholds applicable in the different jurisdictions should be allowed to remain, reflecting different levels of risk that are perceived as reasonable by relevant competent authorities under national market specificities. The appropriate level of the materiality threshold might therefore have to be discussed in the framework of the different colleges of supervisors.

(6) The materiality threshold can have a significant impact on the calculation of capital requirements and expected losses for all institutions in the relevant jurisdiction, irrespective of the method used for such calculation. For those reasons, when defining the materiality threshold, the competent authorities should take into account a variety of factors, including the specific risk characteristics of retail exposures. The specific risk characteristics for retail exposures and exposures other than retail exposures should be considered separately

(7) The materiality threshold set by a competent authority of a particular jurisdiction might also have to be applied by institutions operating on a cross-border basis. The level of a threshold set by the competent authority of another jurisdiction might therefore be an important factor when a competent authority is assessing whether the level of risk reflected by a certain threshold is reasonable. Therefore, materiality thresholds defined by the competent authorities should be transparent and should be notified to the European Banking Authority (EBA) so that they can be made public.

(8) The competent authorities should set the materiality threshold at a level that corresponds to the level of risk they consider reasonable. As that level of risk depends on the way the materiality threshold is applied in the default identification process, it is necessary for competent authorities when setting the threshold to make certain assumptions about how the amounts and ratios which will be compared with the absolute and relative component of the materiality threshold will be calculated and at which stage of the default identification process the materiality threshold applies. In that context, the threshold should be set in such a way that institutions are able to identify obligors that pose significantly higher risks because of partial or irregular but systematically late payments, and to identify a material credit obligation past due in a timely manner.

(9) The materiality of past due credit obligations forms part of the definition of default in Article 178(1)(b) of Regulation (EU) No 575/2013. For institutions that use the Internal Ratings Based Approach ("IRB Approach"), any change of that definition leads to material changes in the rating systems that are used for calculating own funds requirements for credit risk. Therefore, a competent authority should not change the materiality threshold unless it is inadequate due to changed market or economic conditions leading to significant distortions in the default identification processes

(10) The competent authorities should be allowed to defer the application of the materiality thresholds for institutions that are required to perform material changes to their IRB models and for institutions for which the implementation of such thresholds is burdensome because their previous approach for determining the materiality of past due exposures is significantly different from those thresholds. Furthermore, for institutions using the IRB Approach but applying the Standardised Approach to part of their exposures

on the basis of Article 148 or 150 of Regulation (EU) No 575/2013, the date of application of the new materiality thresholds should be aligned for all exposures of those institutions. However, to prevent excessive delays in the application of thresholds across the Union, such longer periods should be limited.

(11) The competent authorities should be allowed sufficient time to perform the comprehensive analysis necessary for setting the materiality threshold at a reasonable level.

(12) This Regulation is based on the draft regulatory technical standards submitted by the EBA to the Commission

(13) The EBA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council,

HAS ADOPTED THIS REGULATION: