



TOPICS:

Credit Risk

SOURCE:

European Banking Authority

The EBA Amends Guidelines on the Definition of Default

- The EBA's Final Report **updates the Guidelines on the application of the definition of default** under Article 178 of the Capital Requirements Regulation (CRR3). The amendments primarily address how banks should classify exposures subject to **debt restructuring** and **forbearance measures**, while also introducing targeted changes for **factoring arrangements**.
- A central issue reviewed was whether the existing **1% net present value (NPV) loss threshold** used to identify "diminished financial obligations" should be relaxed to provide banks with greater flexibility in restructuring distressed loans. After consultation and technical assessment, the EBA decided to retain the 1% threshold. The EBA argues that the current framework already incorporates sufficient flexibility because default classification only applies where borrowers are experiencing or are likely to experience financial difficulty and where concessions would not otherwise have been granted.
- The report further analyses the **prudential and operational implications of default classification**,

including impacts on IFRS 9 provisioning, risk-weighted exposure amounts, Internal Ratings-Based (IRB) models, operational processes and borrower access to financing. While the EBA acknowledged concerns that default status may discourage proactive restructuring, it concluded that timely recognition of economically distressed exposures remains essential for financial stability and for preventing the accumulation of non-performing loans.

- Regarding **exit criteria from default status**, the EBA considered shortening the one-year probation period for certain forbore exposures but ultimately rejected the change because it would conflict with the CRR non-performing exposure framework.
- The guidelines also amend the treatment of **factoring arrangements** by extending the technical past-due exception from 30 to 90 days at invoice level, reflecting the operational realities of purchased receivables and reducing inappropriate default classifications.

