

<b>Question ID</b>	2019_4680
<b>Status</b>	Final Q&A
<b>Legal act</b>	Regulation (EU) No 575/2013 as amended by Regulation (EU) 2019/876 (CRR2)
<b>Topic</b>	Credit risk
<b>Article</b>	164
<b>Paragraph</b>	4
<b>Subparagraph</b>	Not applicable
<b>COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations</b>	Not applicable
<b>Article/Paragraph</b>	Not applicable
<b>Date of submission</b>	24/04/2019
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<b>Disclose name of institution / entity</b>	No
<b>Type of submitter</b>	Individual
<b>Subject matter</b>	Application of the LGD floor
<b>Question</b>	<p>Are there any specific requirements regarding the adjustment for the LGD floor? More specifically, is it a sufficient condition to ensure (may be on a daily basis) that the exposure weighted average LGD just needs to meet the floor on a portfolio level and the respective adjustments on the facility level are at the discretion of the bank?</p>
<b>Background on the question</b>	<p>Article 164(4) of the CRR requires that the exposure weighted average LGD for all retail exposures secured by residential or commercial property shall not be lower than 10%, respectively 15% (referred as “the floor” in the following). Given a portfolio of retail exposures secured by residential property (a similar example can be made for commercial property) and given a set of approved LGDs that fulfill, at the facility level, the requirements laid in Article 181 CRR, three cases can occur: 1) All LGDs assigned to the portfolio’s individual exposures are above the floor; 2) All LGDs assigned to the portfolio’s individual exposures are below the floor; 3) Some LGDs assigned to the portfolio’s individual exposures are above and some are below the floor. In the case 1 (all above the floor) and 2 (all below the floor) the resulting exposure</p>

	<p>weighted LGD for the portfolio will respectively always (case 1) and never (case 2) meet the article 164(4) CRR requirement. In the case 3, depending on the exposure distribution of the portfolio the article 164(4) may or may not be met. We understand that, in the case 2, the institutions shall adjust (increase) the LGD values assigned to individual exposures in order to meet the Article 164(4) CRR requirement. In case 3, such an adjustment may be revised on a daily basis due to an evolving exposure distribution of the portfolio. As a matter of fact when applying weighted averages, some LGDs on the individual exposure level may be below and some individual LGDs may be above the floor (required on portfolio level) even though on a portfolio level, the weighted average LGDs for all associated exposures may be above the floor. In the latter case, it unclear whether there is any requirement for an adjustment. In General, for the case 2) and especially for the case 3) above, are there any specific requirements regarding such adjustments (i.e. allocation of the difference between the weighted averaged LGDs of a portfolio vs. the floor to the underlying individual LGDs)? In our understanding, across different countries and different banks (even within these countries), Article 164 (4) of the CRR is applied in different ways. Some banks apply the floor on facility level, some other banks apply it on portfolio level. In our view, we would apply the floor on portfolio level, but whatever my understanding is, it may further contribute to a divergent application of Article 164 (4). Indeed, you may regard it as misinterpretation if banks apply the floor on facility level and not as an inconsistency, but it would also contribute to an inconsistent application across Europe.</p>
<p><b>EBA answer</b></p>	<p>The wording of Article 164(4) CRR2 refers to “the exposure weighted average LGD for all retail exposures secured by residential [commercial] property and not benefiting from guarantees from central governments”, thus this does not apply to each of these exposures separately but applies to the set of all these exposures in total.</p> <p>Article 164(4) CRR2 does not prescribe in which way an institution adjusts the LGDs for meeting the respective floor for the exposure weighted average LGD of 10% or 15%, as applicable. In any case, the LGD ranking of the facilities between before and after the application of the add-on should be maintained.</p>
<p><b>Link</b></p>	<p><a href="https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2019_4680">https://eba.europa.eu/single-rule-book-qa/-/qna/view/publicId/2019_4680</a></p>