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Is your bank ready for new default definition?

2016

September

EBA Guidelines on the application of the default definition

among other, in Chapter 5 covers NPL recognition with the bestpractice examples of UTP events and gives link between regulatory and accounting definitions (including link between NPEs and Forebearance)

2017

March

Guidance to banks on non-performing loans

clarify important elements concerning the past due criterion, the indications of unlikelihood to pay (UTP), the criteria for the exit from default, etc.

2017

July

NBS Guidelines for the Identification of Default

Local version of EBA Guidelines on the application of the default definition. set out in detail the cases in which it is considered that the default status has occurred in accordance with Section 93, paragraphs 5 and 10 of the Decision on Capital Adequacy of Banks

2017

October

RTS on materiality threshold of past due credit obligations

specifies the conditions that competent authorities (CAs) shall apply when setting the materiality threshold for credit obligations

TRANSITION PERIOD

Urgent need for action is needed in the area of Risk Governance and IT systems



Compliance with the new regulation will require adaption of systems and processes for:

- detection of default including identification of unlikelihood to pay
- tracking defaulted clients
- cure period monitoring and healing of defaulted clients
- harmonizing historical data with new default definition
- full validation of models with respect to the introduction of new default definition
- adaptation of internal controls, adjustments of risk strategy and revision of risk governance

2021

January 1st

Date of implementation of the guides



The guidelines will apply from 1 January 2021, but the EBA encourages institutions to implement the changes prior to this date in order to build the necessary time series.



Impact on business

PORTFOLIO QUALITY

PROFITABILITY

EFFICIENCY

DECISION
MAKING

RISK-BASED
PRICING

COLLATERAL
REQUIREMENTS

WORKOUT &
COLLECTION

SCORING/ RATING
MODELS

EXPECTED
CREDIT LOSSES

RWA & CAPITAL
REQUIREMENTS

PROBABILITY OF
DEFAULT

LOSS GIVEN
DEFAULT

EXPOSURE AT
DEFAULT

DEFAULT DEFINITION

What do we offer?

- Powerful tool to support quick new DoD implementation
- Full EBA and local regulatory compliance
- The highest possible level of automation



Indicative project scope

- Gap analysis of internal policies
- Proposal of new Default Definition
- Impact assessment analysis
- Business requirements document
- Functional specifications document
- Software solution for the IT implementation of New Default definition
- Model recalibration

Default solution®

Translation of **complex regulatory requirements** into functional specifications

| Input data (daily) | | Default trigger identification | Supporting tool/process | Default event/status activated | Default status deactivated | Min Cure period and additional conditions | Healing (upgrade to performing rating) | | Output data (daily) | |
|--------------------|-----------------------|---|---|--------------------------------|---|---|---|---|---|--|
| 1 | Client level | ID client Group of connected client ID Basel exposure class | Financial difficulties identified - Credit analysis (strict manual process supported with notifications) | DPD 90+ | No DPD | Min (3 months/3 installments) No DPD above 30 in cure period | Retail (Private individuals and Micro) - cure period successfully completed - new preforming scoring done | Corporate - Manual credit assessment and upgrade decision to be made | Client level: - Default event type - Default event reason - Date of Default event open - Date of Default event closed - Date of Default status open - Date of Default status closed - Exposure in the moment of default open (frozen amount) - Exposure in the moment of default closed (frozen amount) - Default flag | |
| 2 | Account level | Account ID Joint credit obligation Amortization plan Effective interest rate New accrued (suspended) interest | | Write off (above threshold) | | Min 1 year | | | | |
| 3 | Accounting data | Outstanding balance Outstanding off balance Outstanding balance in arrears | | Bankruptcy procedure started | Bankruptcy procedure closed | Min (3 months/3 installments) No DPD above 30 in cure period | | | | |
| 4 | DPD Counter | DPD with threshold DPD without threshold | | Distress forbearance | Distress Forbearance rules to be applied: - cure period - repayments - positive financial development (corporate only) | | | | | |
| 5 | Forbearance history | Forbearance flag on account level Date of forbearance measure | | Other UTP | Hard/soft triggers don't exist anymore | | | | | |
| 6 | EWS system | EWS trigger activated EWS status | | | | | | | | |
| 7 | Rating system | Client rating history | | | | | | | | |
| 8 | IFRS 9 tool | Stage 3 flag Individual assessment | Credit analysis (strict manual process supported with notifications) | Other UTP | Hard/soft triggers don't exist anymore | | | | | |
| 9 | External data | Credit bureau data Bankruptcy (or similar) procedure open Pledge register data Law register data Cadastral data | | | | | | | | |
| 10 | Client financial data | Balance sheet per year P&L per year | | | | | | | | |
| 11 | NPL sale data | Sold accounts (with discount) Discount % | Soft triggers (strict manual process) - ECB Non-performing UTP events (grey) | | | | | | | |

Traceability and high level of documentation

Strict manual processes
(supported by notifications)

Automated

Phoenix Default tool - proposal

Setup (IT Security, User Management, Configuration Module)

Minimum viable product

Input Data Quality Validation

Process supporting moduls

Input Data Transformation and Load

Additional moduls

Steering tables mngmt

Dimension tables mngmt

Trigger recognition

DPD default calculation

NPV loss test

Financial difficulties

Default recognition

Cure Period

Notification system

Healing

Joint credit obligation

Technical default and manual corrections management

Dashboards

Reporting

BPM (trigger confirmation/-discarding)

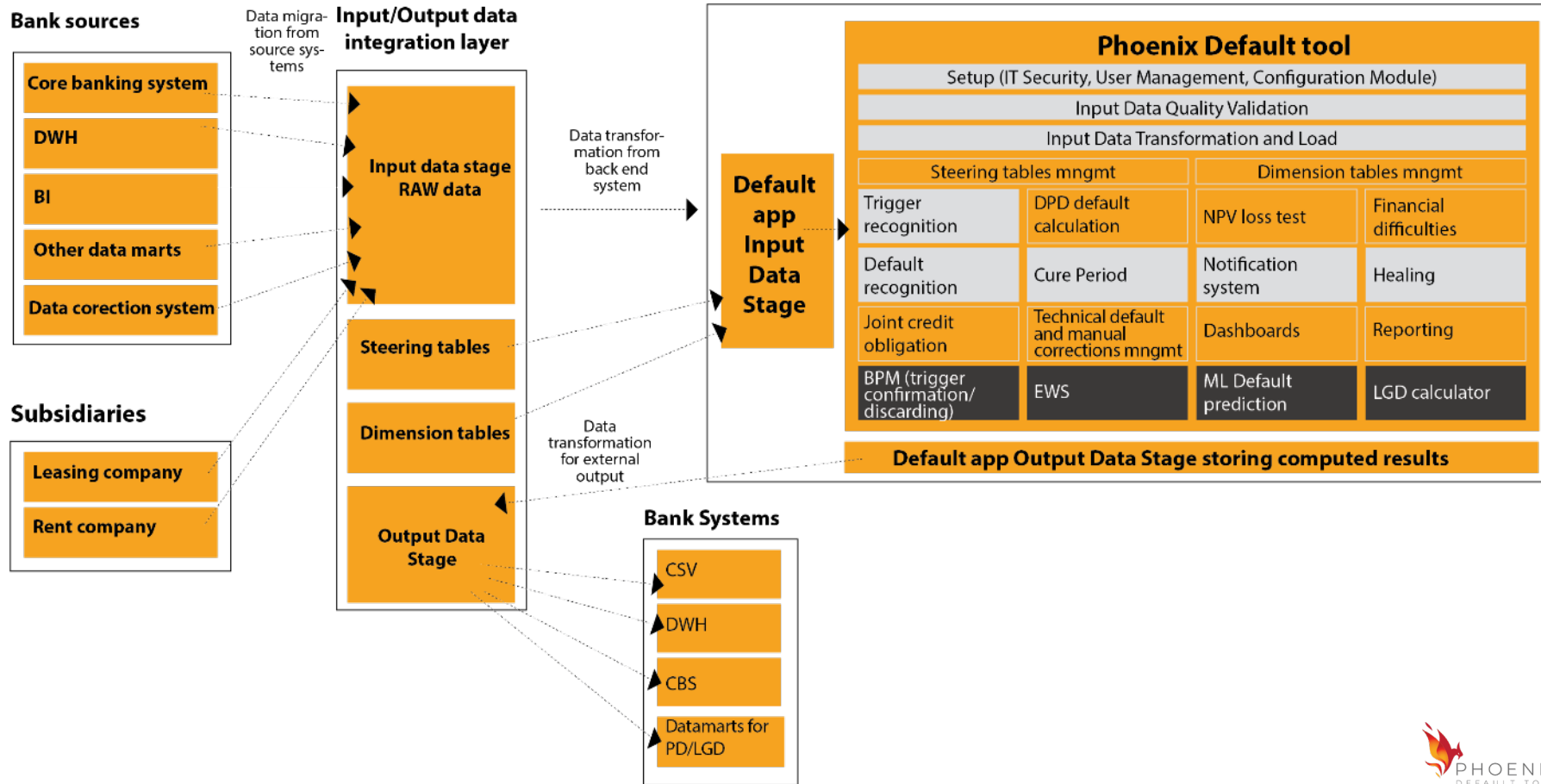
EWS

ML Default prediction

LGD calculator

- The Postgres database (OpenSource) to be used for data storing
- Back end (functionalities) to be developed in PHP programming language
- Front end to be developed in HTML/CSS/Javascript
- The application to run on the Linux environment (Centos 7)
- Reporting in Excel/PPT/PDF

Illustrative integration to a bank's environment



Standard modules and functionalities

Setup module

- Roles
- Identity/Access Policy and User rights management

Data input & data validation

- Data migration from the Bank Data Mart and transformation to pre-defined format
- Technical data validations
- Business logic validations
- Data correction system

Web based GUI

- Admin dashboard
- User dashboard
- Client view/action on client
- Upgrade ready clients
- Steering tables mngmt
- Reports
- Technical default mngmt

Notifications system

- E mail notifications for tasks (open trigger review or client ready client)

Trigger recognition

- Automated trigger – sent through input
- Manual trigger – entered by user
- Trigger list – manageable through GUI
- Soft (with confirmation) triggers
- Hard (not confirmation needed) triggers

Event activation/deactivation

- Different processes regarding events activation/deactivation
 - DPD
 - Distress Restructuring
 - Credit loss
 - Bankruptcy
 - Non-accrued status
 - Other UTP

Cure period

- Different duration for different events
- Additional criteria for forbearance

Healing

- Automated upgrade for Retail based on successfully completed cure period and available performing rating
- Manual upgrade process for Corporate

Dimension/Steering tables

- Parametrization and management different dimensions used in process
- Drop-down menu lists
- Rating scales
- Business lines
-

Output data marts

- PD data mart
- LGD data mart

External databases

- Credit bureau data
- Bankruptcy register data
- Pledge register data
- Law register data
- Cadastra data

Default DPD counter

- Default DPD counter on client level with thresholds based Basel exposures classes

Calculation workflow

Phase 1 - Input data preparation

Client data

Account data

Rating data

Write off data

...

...

Phase 2 - Input data validation and load

Technical data validations

Business logic validations

Data load

Data correction system

Phase 3a - New (automatic) triggers identification and default event activations for hard triggers

T1 DPD 90+

T2 write-off

T3 specific LLP/ECL

T4 stop charging of interest

T5 bankruptcy or insolvency

T9 distressed restructuring

T8 Fraud

T10 DTI/DSCR

T11 unemployment

T12 death of the customer

...

...

Phase 3b - New (manually entered) triggers identification and default event activations for hard triggers

T6 procedures similar to bankruptcy

T18 claim sold with loss which is credit-related

T15 loss of major customer or tenant

T35 restricted or qualified opinion of external auditor

T50 other member of connected group is defaulted

...

Phase 4 – Soft trigger confirmations and default event activations

Check if there are new confirmed soft triggers

Phase 5 – Check of active default events and default event deactivations

Check if cause triggers still exists

Phase 6 – Cure period start/check/re-start/fail/closing

Cure period start

Cure period check/re-start/fail

Cure period completion

Phase 7 – Upgrade/healing of the clients

Check if all cure periods are completed

Automated upgrade in Retail

Refresh ready for upgrade list





















Phase 8 – Data output

Data output file creation

Data marts updates

Create New

VIEW ALL TRIGGERS

| NAME | DESCRIPTION | TYPE | INPUT TYPE | CONFIGURATION FOR DEFAULT ▾ | CURE EVENT TYPE | CURE PERIOD DURATION | STATUS | ACTIONS |
|------|---|------|------------|-----------------------------|-----------------|----------------------|-------------------------------------|---|
| T1 | days past due 90+ | hard | automatic | Yes | E1 | 90 | <input checked="" type="checkbox"/> |   |
| T2 | direct write-off/write-off against provi... | hard | automatic | Yes | E3 | 90 | <input checked="" type="checkbox"/> |   |
| T3 | value adjustment (specific loan loss pro... | hard | automatic | No | E3 | 90 | <input checked="" type="checkbox"/> |   |
| T4 | credit institution stops charging of int... | hard | automatic | No | E5 | 90 | <input checked="" type="checkbox"/> |   |
| T5 | obligor has filed for bankruptcy or inso... | hard | automatic | No | E4 | 90 | <input checked="" type="checkbox"/> |   |
| T6 | out-of-court negotiations for settlement... | hard | manual | No | E4 | 90 | <input checked="" type="checkbox"/> |   |
| T7 | third party has started bankruptcy or in... | soft | manual | No | E4 | 90 | <input checked="" type="checkbox"/> |   |
| T8 | fraud case - credit fraud identified bef... | soft | automatic | No | E6 | 90 | <input checked="" type="checkbox"/> |   |
| T9 | multiple restructurings on one exposure ... | hard | automatic | No | E2 | 90 | <input checked="" type="checkbox"/> |   |
| T10 | a borrower's sources of recurring income... | hard | manual | No | E6 | 90 | <input checked="" type="checkbox"/> |   |

Displaying rows 1 - 10 of 50



Performing status

Triggers recognized

Events active

Cure period started

Upgrade ready

Account Name

Meg Jeremic

Bl

Privat

Manual Trigger Input

Trigger Name

T7 (manual | soft)

T38 (manual | hard)

Approve Default Manual Triggers

No default manual triggers to approve...

Group of connected clients

2339

Add Manual Trigger

Status

Approved

View

Approved

View

Add Default Manual Trigger

Select Manual Trigger

T10 (manual | hard)

Comment

Debt to income above 80%

Add

[Admin dashboard](#)[User dashboard](#)[Client view](#)[Action on client](#)[Upgrade ready clients](#)[Active Events](#)[Other](#)

VIEW ALL UPGRADE READY CLIENTS

| CLIENT ID | CLIENT NAME | BUSINESS LINE | RATING | OUTSTANDING BALANCE ON OPEN | OUTSTANDING OFF BALANCE ON OPEN | UPGRADE READY | UPGRADE READY PROPOSAL | PROPOSED BY | REVIEWED BY |
|-----------|----------------------|---------------------|--------|--------------------------------|------------------------------------|---------------|------------------------|-------------|-------------|
| 10001057 | Matthias Nedeljkovic | Private individuals | N1 | 318000 | 89040 | 25.05.2020. | | | |

[Proposal](#)

Displaying rows 1 - 1 of 1

[Previous](#) [1](#) [Next](#)

Q Client search (2054671)

Performing status > Triggers recognized > **Events active** > Cure period started > Upgrade ready

| | | | | | |
|--------------|-----------------|-----------------|----------------|-----------------|----------------------------|
| Account name | Business line | Account Manager | Risk Manager | Workout Manager | Group of connected clients |
| Phoenix doo | Large Corporate | Milos Milosevic | Petar Petrovic | Lazar Lazarevic | 1021 |

| | | | | | | | |
|-----------------|--------|--------------------|------------------|--------------------------|--------------|------------|--------------------|
| Default status | Rating | Activated triggers | Activated events | Credit relevant products | IFRS 9 stage | EWS status | Forbearance status |
| Active 01/02/18 | P2 | 3 | 3 | 4 | 3 POCI | N/A | Active 05/06/18 |

| | | | |
|---------------------|----------------------|---------------------|------|
| On balance exposure | Off balance exposure | Exposure in arrears | DPDs |
| EUR 1,754,000 | EUR 500,000 | EUR 1,754,000 | 702 |

| | | | | | | |
|--------------|------|----------|-------------|---------------------|------|-----|
| Equity Ratio | DSCR | EBITDA | Quick Ratio | Turnover decr y-o-y | LTV | DTI |
| 11.5% | 0,61 | Negative | 0,33 | 27% | 574% | N/A |

| | | | | |
|--------------------------|---|---------------------------|------------------|--------------------|
| Legal proceeding started | Collection transfered to external agent | Interest charging stopped | Collected amount | Written off amount |
| Yes | Advokatska kancelarija Popovic | Yes 05/06/18 | EUR 370,000 | EUR 700,000 |

Rating history



| Performing status | | Triggers recognized | | Events active | Cure period started | Upgrade ready |
|-------------------|---------------|---------------------|----------------|-----------------|----------------------------|---------------|
| Account name | Business line | Account Manager | Risk Manager | Workout Manager | Group of connected clients | |
| Parrot doo | SME | Vlada Milosevic | Milos Petrovic | Lazar Petkovic | 7451 | |

Manual trigger input

| Select from the drop-down menu | Hard/Soft: | Entered by: | Comment: | Status: |
|---------------------------------------|------------|--------------------------|--|--------------------------|
| T16 material decrease of turnover ... | Soft | Petar Petrovic 15/01/20 | Trigger identified within regular re-rating... | Waiting for confirmation |
| T34 connected customer has filed ... | Soft | Milos Veljkovic 10/02/19 | Trigger identified through EWS process | Trigger discarded |

Triggers to be confirmed/discarded

| Open triggers | Confirm/Discard | Entered by: | Comment: |
|--------------------------------------|-----------------|-------------|----------|
| T16 material decrease of turnover... | ... | ... | ... |

Technical default management

| Open triggers | Open events | Turn off reason | Action | Entered by: | Confirmed by: | Approved by: |
|---------------|-------------|-----------------|--------|-------------|---------------|--------------|
| ... | ... | ... | ... | ... | ... | ... |

Ibis Phoenix Default Team



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Ibis References



Telecommunications



Finance



Government & Enterprise

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