NEW DEFINITION OF DEFAULT

A fresh take on risk and valuation

The new Default Definition will be a significant implementation challenge for Financial Institutions, particularly for those that employ an IRB Approach

CHANGES TO THE DEFINITION OF DEFAULT

IMPLEMENTATION CONSIDERATIONS

IMPACT ON CAPITAL REQUIREMENTS

The EBA Guidelines on the Definition of Default become applicable on 1 January 2021. These guidelines aim to unify different approaches towards the default definition used by different institutions within the EU. They include four main topics:

1. Past due criterion in identification of defaults
2. Indicators of unlikeliness to pay
3. Conditions for a return to non-default status
4. The definition of default in the external data

The new definition of default is going to affect both the institutions that use IRB and those who use a Standardised Approach, though the former disproportionately more. The cost of redeveloping or reviewing the internal models is likely to be significant, not even to mention the operational challenge to solve in the data infrastructure of each financial institution.

For more information, visit www.finalyse.com/new-definition-of-default

Benefits

- Lower model redevelopment costs and smooth implementation of the New Default Definition
- Adjust the historical data based on the New Default Definition
- Diminish possible distortions that may arise from the inconsistent default definition in the historical data
- Get compliant with revised EBA guidelines

Motivation

The guidelines will apply as from January 2021, but the EBA encourages Financial Institutions to begin preparing for compliance with the New Default Definition before then. Finalyse has considerable experience in Credit Risk, Credit Data Management and Credit Internal Models. This expertise allows us to conduct a gap analysis, review and redevelop models as well as implement data related aspects into your processes.

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