EBA/Op/2020/12

31/08/2020

Opinion of the European Banking Authority on the European Commission's amendments relating to the final draft Regulatory Technical Standards on the specification of the nature, severity and duration of an economic downturn under Articles 181(3)(a) and 182(4)(b) of Regulation (EU) No 575/2013

Introduction and legal basis

On 5 November 2018, the EBA submitted the final draft regulatory technical standards (RTS) on the specification of the nature, severity and duration of an economic downturn in accordance with Articles 181(3)(a) and 182(4)(a) of Regulation (EU) No 575/2013 ('CRR'). In its letter of 20 July 2020, the European Commission informed the EBA of its intention to endorse the draft RTS with amendments and submitted to the EBA a modified version of the RTS with its envisaged changes.

Articles 181(3)(a) and 182(4)(a) of the CRR empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA) in accordance with Articles 10 to 14 of Regulation No (EU) 1093/2010, delegated acts specifying the nature, severity and duration of an economic downturn to be taken into account for the estimation of LGD appropriate for an economic downturn and for the estimation of CF appropriate for an economic downturn, where LGDs and CFs are estimated under the IRB Approach.

The EBA's competence to deliver an opinion on the amendments to the RTS proposed by the European Commission is based on the sixth subparagraph of Article 10(1) of Regulation (EU) No 1093/2010[1].

In accordance with Article 14(7) of the Rules of Procedure of the Board of Supervisors[2], the Board of Supervisors has adopted this opinion which is addressed to the European Commission.

General comments

In regard to the first and second substantive change described below, the EBA considers that they alter the agreed policy substantively.

The EBA agrees with the changes summarised in the subsection 'Non- substantive changes', due to their nature as non-substantive and given their usefulness in clarifying the text.

In consideration of the comments raised, the EBA considers that the proposed changes to the Commission's text set out in the accompanying reviewed final RTS on economic downturn in Annex 1, and which are related to the changes discussed below, should be included in the final RTS to be published by the Commission.

In regard to the third substantive change described below the EBA considers that the amendments envisaged by the European Commission do not alter the draft RTS in a significant manner and that the draft RTS, despite this change in Article 3, maintain a good balance between the flexibility and risk sensitivity required for the IRB Approach and the need for a harmonised regulatory framework.

Specific comments

Substantive changes

Substantive change 1– change in the conditionality with regard to combining downturn periods of single indicators into one period (Article 1(4)(b))

EBAs draft RTS contained the following phrase describing how different economic indicators should relate to one downturn period: *"[…] which are significantly correlated so that their peaks or troughs relating to the most severe values identified in accordance with Article 3 are reached simultaneously or shortly after each other"*. Legal redrafting required clarifying the condition versus the implication. The EBA considers that the original drafting implied a double condition: economic indicators have to be significantly correlated and their peaks and troughs (related to the most severe values observed within the applicable time-spans) occurred simultaneously or shortly after each other. The Commission's version of the RTS however allows a grouping of non-correlated indicators into one single downturn period. This could lead to downturn periods that are affected by two different

[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

[2] Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 22 January 2020 (EBA/DC/2020/307).

"types" of economic downturn (e.g. supply and demand shock induced economic cycles) with potentially different impacts on the loss experience of an institution as well as to excessively prolonged downturn periods with potential implications (e.g. on data requirements) on the estimation of LGDs appropriate for an economic downturn in accordance with the GL on downturn LGD estimation[3].

Therefore the EBA suggests to re-insert the condition of significant correlation in Article 1(4)(b), however clarifying that this condition has to be met in conjunction with the occurrence of simultaneous or very close most severe values related to the relevant economic indicators.

Substantive change 2 - proportionality principle for the cost of data

Recital 10 clarifies that the economic factors to be considered relevant should either be publicly available or the costs of acquiring such data should not be disproportionate with respect to the materiality of the type of exposures under consideration.

However, aggregate credit losses may not be available for all jurisdictions and types of exposures. Articles 2(1)(a)(iii) and (iv) emphasize this principle for the externally provided aggregate default rates and externally provided aggregate credit losses respectively.

The EBA considers it inconsistent that the proportionality principle for the cost of data explained in Recital 10 applies to all relevant economic indicators, while it has only been added to Articles 2(1)(a)(iii) and (iv). In this context it should be noted that the limitation to availability in these articles has been included as this data may indeed not be collected and published or sold for a specific type of exposure considered. Hence, the EBA suggests to delete the phrase "without incurring disproportionate costs" in Articles 2(1)(a)(iii) and (iv) and Article 2 (1) (b) (iv).

In addition some economic indicators may be easier and therefore cheaper to obtain than others. The EBA considers in particular that following the proposed text of the Commission's version of the draft RTS, the comparably low cost of aggregate default rates could lead to the cost of aggregate credit losses being considered disproportionate. Therefore, the EBA proposes to take the type of indicator (e.g. aggregate default rates or aggregate loss rates) into account as well for the consideration of proportionality, by this clearly separating the proportionality comparison for different economic indicators.

Substantive change 3 – possibility of considering a shorter time series than 20 years for economic indicators relating to an EU member state that joined the union less than 20 years ago

Article 3(1)(b) of the draft RTS submitted by the EBA on 5 November 2018 introduces the possibility for institutions to consider a period shorter than twenty years (for the purpose of identifying an economic downturn) where a considered relevant economic indicator has changed significantly due

[3] https://eba.europa.eu/sites/default/documents/files/documents/10180/2551996/f892da33-5cb2-44f8-ae5d-68251b9bab8f/Final%20Report%20on%20Guidelines%20on%20LGD%20estimates%20under%20downturn%20conditions.pdf?retry=1

to the accession of the country (to which the concerned economic indicator relates) to the European Union. This possibility has been removed in the Commission's version of the RTS. The EBA notes the following implications of this change:

(a) The 20 years' time horizon may not be representative for the economic development in countries which joined the EU in the last twenty years. Therefore, the correct identification of the downturn period might be hampered.

(b) The deletion of the exception requires institutions to "dig deeper" into the data, use older data, and time horizons of 20 years (and potentially longer), that might not be an adequate solution with regard to member states which accessed the EU in the first decade of 21st century and which identified important structural economic changes due to that fact.

(c) The lack of representativeness or unavailability of data for economic indicators before the date of accession of a concerned Member State may lead to an approach which could be deemed insufficiently risk sensitive and where, as a result, the observed or estimated impact (according to Sections 5 and Section 6 of the EBA GL on downturn LGD estimation respectively) may not be available or not be reliable, and where a minimum margin of conservatism (MoC) in accordance with paragraph 36(b) of the EBA GL on downturn LGD estimation might have to be applied for the purposes of the estimation of the LGD appropriate for downturn conditions.

However, the EBA believes that the risk of a wrongly identified downturn period due to the proposed change is limited. Indeed, a brief analysis of public data as regards annual GDP growth[4] (an economic indicator which is considered relevant for all types of exposures according to the draft RTS) confirms that the financial crisis and its implications lead to identification of downturn periods between 2008 and 2013 in all concerned EU Members States. The analysis can be found in Annex 2. Thus, the risk of wrongly omitting a downturn period seems to be low. Vice versa, a downturn period could be identified wrongly due to the structural change in the economy or in reporting (following the accession). The EBA therefore considers that the risk of wrongly identified downturn periods due to the proposed change is very low and can be considered negligible due to the following reasons:

- The policy laid down in the GL on downturn LGD estimation (paragraphs 23) would require an impact assessment of observed impact of the wrongly identified downturn period. As a consequence either such downturn period (identified between the point in time twenty years from applying the policy and the date of accession) would not show any impact (and thus proof that the identified period does not reflect a downturn for the considered type of exposures) or it would show an impact in which case the in-depth analysis of the considered period seems justified.

[4] The COVID19 pandemic might trigger the most severe annual GDP to be observed for 2020 in many EU jurisdictions. Annual GDP for 2020 is however not observable as of today.

- If no impact can be observed for such potentially wrongly identified downturn period, this would not result in downturn LGD estimation according to Section 7 of the EBA GL on downturn LGD estimation (minimum MoC). This is because according to Annex 2 (of this note) there would be at least one other downturn period after accession and according to paragraph 15(a)(iv) in this case the downturn LGD estimates (based on the wrongly identified downturn period) taking into account the minimum MoC may be omitted.

- The data availability to assess the observed impact in accordance with paragraph 23 of the EBA GL on downturn LGD estimation should not be an argument in this context as otherwise this argument would hold as well for downturn periods identified in accordance with Article 3(1)(c) of the draft RTS which remains in the Commission's proposal under Article 3(2).

Non substantive changes

Non- Substantive change 1 – redrafting of requirement to customize economic factors to the geographical areas and sectors

Article 2(2) of the draft RTS requires the economic factors (i.e. economic indicators in the Commission's text) to *"[...] reflect the geographical and, where relevant, the sectorial distribution of the type of exposures under consideration. For this purpose, institutions should ensure that an economic factor is included in the set of factors constituting the nature of an economic downturn once for each jurisdiction, and where relevant once for each sector, which is covered by a material share of the type of exposures under consideration."*

Article 2(2) of the draft RTS amended by the Commission requires the *"[...] economic indicators identified for exposures within a type of exposures in accordance with paragraph 1 shall reflect the geographical distribution and, where applicable, the sectoral distribution of the exposures within that type of exposures.*

For this purpose, an economic indicator shall be included in the relevant indicator set:

(a) once for each jurisdiction or, where appropriate, once for each geographical area within a jurisdiction, covered by a material share of that type of exposures; and

(b) once for each sector, where applicable, covered by a material share of that type of exposures."

Although the wording is different, the Commission's text is consistent in requiring that a relevant economic indicator is included (in the set of relevant economic indicators) once for each jurisdiction (covered by a material share of exposure). The terms geographical area was however not defined in the draft RTS. The use of a slash in Recital 4 of the draft RTS indicated an interchangeable use (of geographical area and jurisdiction).

EBA acknowledges that the Commission aimed at clarifying the term geographical area. However, where the draft RTS **permits** considering a more granular level (than jurisdiction), the redrafting seems to **require it** (if appropriate). In order to ensure that such more granular level only has to be considered where appropriate, it is proposed to delete the term "geographical areas within a jurisdiction in the third sentence of Article 2(2) and to adjust Recital 12 accordingly:

"However, where economic indicators to be included in accordance with the second subparagraph show strong co-movement across the different jurisdictions or, as applicable, different sectors, a common economic indicator may instead be selected to reflect those jurisdictions or sectors overall."

In this context it should be noted that taking into account the EBA GL on downturn LGD estimation it follows that a more granular level (than jurisdiction) for the consideration of an economic indicator seems appropriate if the calibration segments reflect a more granular distribution (of the type of exposure considered) in terms of geographical areas.

In Summary the EBA suggests to take on board the amendments to Article 2(2) as explained above and inserted in the annexed RTS.

Non- Substantive change 2 – Deletion of Article 5 requiring annual and if appropriate ad-hoc review of downturn periods

Article 5 of the draft RTS requires institutions to review their specification of an economic downturn at least annually and update it if a new downturn period has been identified. The content has been moved to Recital 15 as from a legal point of view this requirement is already implied by the CRR and should thus not be repeated in a technical standard.

Other changes

1. Changes in Structure: The revised structure of the articles in the Commission's text no longer follows the CRR wording related to the nature, severity and duration of an economic downturn. The EBA considers that the structure and titles of the Articles were closer to the CRR mandate in the draft RTS. The EBA however considers that the change in structure does not imply a change in policy. Nevertheless, the changes should be duly justified as they may hamper the reader's understanding, especially as the structure now differs from the CRR.

   Redrafting of Article 4: The policy laid down in Article 4 on the specification of the duration of a downturn period is complex and as such the drafting should be very specific. The draft RTS as well as the proposed text clearly indicates that the default duration of a downturn period should be twelve month. However, the policy contains three rules where longer durations of downturn periods should be considered. For two of these rules single economic indicators have to be considered, for the other rule a combination of different economic indicators associated to the same downturn period have to be considered. The draft RTS did not contain any requirement in Articles 4(a) and 4(c) on whether the economic indicator considered should be the only indicator associated to the downturn period under consideration or whether there may be several economic indicators. The text proposed by the Commission clarifies the rules in Article 4 by:

- (i) adjusting the structure such that the first rule in Article 4(a) relates to a combination of different economic indicators within one downturn period, while Articles 4(b) and (c) specify those rules that apply to single economic indicator; and

- (ii) clarifying that for Articles 4(b) and (c) one economic indicator is considered regardless of whether there are more economic indicators associated to the same downturn period under consideration or not.

The EBA considers the changes in structure as meaningful. However, although the changes in drafting of Articles 4(b) and 4(c) result in a more complicated text, where it is in particular less straight forward to understand that for these two provisions only developments on single economic indicators should be considered, the reference to the definition of downturn periods in Article 1 4(b) should be kept.

The EBA considers the amended drafting in Article 4(c) to not reflect the agreed policy correctly. Therefore the EBA proposes to change the drafting of Article 4 (c) to the following to render it more clearly how the policy should be applied. The new drafting of Article 4(c) should thus be:

"in all cases, whether or not falling within Article 1(4)(b), where the economic indicator or indicators show adjacent peaks or troughs to those peaks or troughs related to the most severe 12-month values observed for the economic indicator or indicators in question over the applicable time-span and these adjacent peaks and troughs do not significantly deviate from the most severe 12-month value observed for that indicator or those indicators over that time-span and these adjacent peaks and troughs are related to the same overall economic condition, then the downturn period shall be long enough to reflect the whole prolonged period over which those adjacent peaks or troughs are observed."

This opinion will be published on the EBA's website.

Done at Paris, 31 August 2020

[Signed]

José Manuel Campa

Chairperson
For the Board of Supervisors

Annex 1 (Revised amended RTS on economic downturn)
Annex 2 (GDP development in the EU)

EUROPEAN
COMMISSION

Brussels, XXX
[…](2018) XXX draft

COMMISSION DELEGATED REGULATION (EU) …/...

of XXX

Supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 with regard to regulatory technical standards on the specification of the nature, severity and duration of an economic downturn in accordance with Articles 181(3)(a) and 182(4)(a) of Regulation (EU) No 575/2013

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[5], and in particular the third subparagraph of Article 181(3) and the third subparagraph of Article 182(4) thereof,

Whereas:

(1) Article 181(1)(b) of Regulation (EU) No 575/2013 requires institutions, in quantifying the risk parameters to be associated with rating grades or pools, to use own-LGD estimates that are appropriate for an economic downturn if those estimates are more conservative than the long-run average. Similarly, Article 182(1)(b) of that Regulation requires institutions to use own-conversion factor ('CF') estimates that are appropriate for an economic downturn if those estimates are more conservative than the long-run average.

[5] OJ L 176, 27.06.2013, p. 1.

(2) Given the specificities of different portfolios, institutions should be required to identify economic downturns separately for each type of exposures, as defined in point (2) of Article 142(1) of Regulation (EU) No 575/2013.

(3) The nature of an economic downturn for a given type of exposures should be specified by reference to the set of economic indicators that are considered to be either explanatory variables for, or indicators of, the economic cycle specific to that type of exposures. The set of economic indicators should include both macro-economic and credit-related indicators. This is to ensure that, for a comparable type of exposures, institutions will, generally speaking, identify the same economic downturn.

(4) Even though the level of realised LGDs and realised CFs may be substantially above the long-run average as a result of an economic downturn, the conditions characterising an economic downturn should not be considered as the equivalent of the conditions used for stress testing. The conditions used for stress testing may be more severe and potentially use more extreme scenarios that are not necessarily based on historical observations. Regulation (EU) No 575/2013, and the delegated acts that supplement it, adequately provide for the carrying out of stress testing in cases where this is required, and the provisions relating to own-LGD and own-CF estimates do not include any such requirement for stress testing. The specification of an economic downturn for the purposes of own-LGD and own-CF estimates should be based instead on historically observed economic conditions.

(5) The severity of an economic downturn should be specified by reference to the most severe 12-month values observed over an appropriate historical time-span for the set of economic indicators characterising the nature of a downturn for the particular type of exposures under consideration. For each economic indicator in the set, the most severe 12-month value should be used because it strikes a balance between stability and identification of the most severe conditions observed in an appropriate time-span. This approach was chosen for simplicity of the 12-month view and also because a longer average could potentially dilute adverse conditions observed on an economic indicator. More frequent values, for example quarterly values, could be subject to seasonal influences. On the other hand less frequent values, for example values representing 36-month averages, could hide severe conditions.

(6) Even for economic indicators reported annually, the 12 months to which indicators relate is not necessarily the same in all cases. For example, some indicators relate to calendar years, others to financial years, others to tax years and so on. For the purposes of identifying economic downturns, it should therefore be possible, in the case of both economic indicators reported annually and indicators reported on a more frequent basis, to use 12-month periods that start at any point in time within the year.

(7) Given that a type of exposures may comprise exposures related to different businesses, sectors or geographical areas, an economic downturn for a type of exposures may comprise either one or several distinct “downturn periods”. A downturn period should be recognised as a period of specified time in which a relevant economic indicator shows its most severe 12-month value. If the peaks or troughs related to the most severe 12-month value observed for two or more economic indicators are reached simultaneously or shortly after each other, those economic indicators should all be attributed to the same “downturn period”. The reason for allowing for the possibility of an economic downturn comprising more than one distinct downturn period is to ensure that each relevant economic indicator is taken into account in specifying non-overlapping downturn periods which are to be analysed in the context of downturn LGD estimation and downturn CCF estimation.

(8) In order to avoid excessive complexity, it is appropriate to establish a list of economic indicators to be taken into account in all cases. However, given the specificities of particular portfolios,

institutions should also be required to take into account additional economic indicators that are explanatory variables for, or indicators of, the economic cycle specific to the particular type of exposures.

(9) Given the wide geographical and sectoral diversity of portfolios, it is not practicable to prescribe the precise data sources that must be used for each listed indicator in every jurisdiction of the world and every sector. Moreover, institutions are already required under Regulation (EU) No 575/2013 to use reliable data and to have robust systems in place for validating the estimation of all risk parameters. As a result, institutions will in any event be required to demonstrate the accuracy and reliability of the data sources used by them for obtaining indicator values. It is therefore not necessary to lay down specific rules in this Regulation about the precise data sources to be used.

(10) Institutions should use appropriate, reliable data sources, but they should not be required to acquire data for available economic indicators if the costs of doing so are disproportionate, having regard to the type of indicator as well as to the materiality of the type of exposures under consideration relative to the other types of exposures in the portfolio.

(11) The economic indicators are to be considered in levels or in changes of levels as appropriate, taking into account the way in which the economic indicator is commonly reported and the extent to which it is able to reveal cyclicality.

(12) An economic indicator should be included in the set of relevant economic indicators once for each jurisdiction, or smaller geographical area where appropriate, that represents a material share of the type of exposures under consideration. This is to ensure that the set of indicators fairly reflects the geographical mix of the exposures in that type of exposures. A similar rule should apply for each industry sector representing a material share of the type of exposures. Only where different jurisdictions or different industry sectors exhibit strong co-movements in realised values of economic indicators should institutions be allowed to group those jurisdictions or sectors for the purposes of identifying an economic downturn.

(13) The historical time-span over which values for a given economic indicator are to be examined should be specified in this Regulation. A default time-span of 20 years should be set for each economic indicator. This is to ensure that the historical observation period covers at least two economic cycles. However, where those 20 years do not contain sufficiently severe values, institutions should be required to look further back into the data history. Values should be considered “not sufficiently severe” if the variability of the economic indicator over that 20-year observation period is not representative of the likely range of variability of that indicator in the future.

(14) For reasons of simplicity and comparability, a downturn period should have a duration of at least 12 months. In order to ensure greater accuracy in the results, that period of time should be treated as a minimum. Institutions should be required to apply a longer duration where the most severe value(s) for the economic indicator(s) associated with a downturn period imply a longer downturn. The duration of a downturn period should reflect adverse conditions in cyclical behaviours specific to the type of exposures under consideration, rather than structural changes in the economy leading to long-term effects on the values of economic indicators.

(15) The requirements for estimating LGDs and CFs in Regulation (EU) No 575/2013 require institutions to document the design and operational details of their rating systems and to retain evidence to show compliance with the estimation requirements in that Regulation. That obligation will also cover the design of their processes for identifying economic downturns as well as evidence to demonstrate compliance with this Regulation. Regulation (EU) No 575/2013 further requires institutions to review their LGD and CF estimates when new

information comes to light and, in any event, at least annually. In connection with that review obligation, institutions will be required to review their identification of economic downturns at least annually and update it if a new downturn period is identified.

(16) The provisions in this Regulation are closely linked since they deal with the nature, severity and duration of an economic downturn affecting two different risk parameters that are both used for the purposes of applying the Internal Ratings Based (IRB) Approach, namely own-LGD estimates and own-CF estimates. To ensure that the provisions needed for identifying economic downturns for LGD purposes and the provisions needed for identifying economic downturns for CF purposes are consistent and that they enter into force at the same time, and to ensure ready access to those provisions, it is desirable to include the regulatory technical standards required by Article 181(3) and the regulatory technical standards required by Article 182(4) of Regulation (EU) No 575/2013 in a single Regulation.

(17) Given the interplay with other Union acts relevant for own-LGD and own-CF estimation, the date of application of this Regulation should be deferred until 1 January 2021. In particular, institutions will need to comply with the revised materiality threshold set by competent authorities in accordance with Commission Delegated Regulation (EU) 2018/171[6].

(18) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.

(19) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, in accordance with Article 10 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council[7], and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of that Regulation,

HAS ADOPTED THIS REGULATION:

Article 1

Specification of nature, severity and duration of an economic downturn

1. For the purposes of Article 181(1)(b) or 182(1)(b) of Regulation (EU) No 575/2013, an economic downturn shall be identified for each type of exposures, as defined in point (2) of Article 142(1) of that Regulation.

2. In identifying an economic downturn for a given type of exposures, the following specification rules shall apply:

(a) the nature of an economic downturn is characterised by a set of economic indicators that are classified as relevant for exposures within that type of exposures in accordance with the rules laid down in Article 2 (‘the relevant indicator set’);

(b) in terms of severity, an economic downturn is indicated by the most severe value relating to a 12-month period (‘the most severe 12-month value’) that is observed, for each economic indicator in the relevant indicator set, over a historical time-span determined for that economic indicator in accordance with Article 3 (‘the applicable time-span’);

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[6] Commission Delegated Regulation (EU) 2018/171 of 19 October 2017 on supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for the materiality threshold for credit obligations past due (OJ L 32, 6.2.2018, p. 1).

[7] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

(c) an economic downturn is comprised of one or more distinct downturn periods covering the peaks and troughs related to the most-severe 12-month values for the economic indicators in the relevant indicator set, each such period being of a duration determined in accordance with Article 4 ('the duration of a downturn period').

3. For the purposes of point (b) of paragraph 2, the 12-month periods to which values for an economic indicator relate may start at any point in time within the applicable time-span.

4. For the purposes of point (c) of paragraph 2:

(a) a downturn period is a period in which an economic indicator reaches its most severe 12-month value;

(b) where, for different, significantly correlated economic indicators, the peaks or troughs related to the most severe 12-month values are reached simultaneously or shortly after each other, the downturn periods in which those indicators reach their most severe 12-month value are to be treated as one single downturn period covering the most severe 12-month values for all those indicators.

Article 2

The relevant indicator set

1. The following economic indicators shall be classified as relevant for exposures within a given type of exposures:

(a) for all types of exposures:

(i) gross domestic product (GDP);
(ii) unemployment rate;
(iii) externally provided aggregate default rates, where available ;
(iv) externally provided aggregate credit losses, where available ;

(b) in addition to the economic indicators listed in point (a):

(i) for exposures to corporates or to retail small and medium-sized enterprises (SMEs): sector- or industry-specific indices;
(ii) for residential property exposures to corporates or to retail obligors: house prices or house price indices;
(iii) for commercial immovable property exposures to corporates or to SME retail obligors: commercial immovable property prices or commercial immovable property price indices, and commercial immovable property rental prices or commercial immovable property rental price indices;
(iv) for retail exposures other than those falling within point (i), (ii) or (iii): total household debt and disposable personal income, in each case where available;
(v) for specialised lending exposures:

- in the case of immovable property: immovable property prices or immovable property price indices, immovable property rental prices or immovable property rental price indices, for residential, commercial or industrial property as applicable;

- in the case of project finance: prices for the underlying products supplied;

- in the case of object finance: indices for the relevant type or types of collateral;

- in the case of commodity finance: prices or price indices for the relevant type of commodity;

(vi) for exposures to institutions: financial credit indices;

(c) in addition to the economic indicators listed in points (a) and (b), any other economic indicators that are explanatory variables for, or indicators of, the economic cycle specific to exposures in the type of exposures under consideration.

2. The economic indicators identified for exposures within a type of exposures in accordance with paragraph 1 shall reflect the geographical distribution and, where applicable, the sectoral distribution of the exposures within that type of exposures. For this purpose, an economic indicator shall be included in the relevant indicator set:

(a) once for each jurisdiction or, where appropriate, once for each geographical area within a jurisdiction, covered by a material share of that type of exposures; and

(b) once for each sector, where applicable, covered by a material share of that type of exposures.

However, where economic indicators to be included in accordance with the second subparagraph show strong co-movement across the different jurisdictions or, as applicable, different sectors, a common economic indicator may instead be selected to reflect those jurisdictions or sectors overall.

Article 3 Determining the applicable time-span

1. For the purposes of Article 1(2)(b), the historical time-span applicable to an economic indicator shall be the period of 20 years ending at the point in time at which the institution identifies the economic downturn in accordance with this Regulation.

2. However, where the variability of an economic indicator over that 20-year period is not representative of the likely range of variability of that indicator in the future, the historical time-span applicable to that indicator shall be of such longer length as is sufficient to provide values that are representative of that likely range of variability.

Article 4

Duration of a downturn period

For the purposes of Article 1(2)(c), the duration of a downturn period shall be determined as follows:

(a) in a case falling within Article 1(4)(b), the single downturn period shall be such period that is long enough to cover all the peaks or troughs related to the most severe 12-month values observed for the different economic indicators associated with that single downturn period;

(b) in all cases, whether or not falling within Article 1(4)(b), where the various 12-month values observed for the economic indicator or indicators in question over the applicable time-span do not significantly deviate from their most severe 12-month value over a specific, continuous period of time within the applicable time-span, the downturn period shall be long enough to reflect the prolonged severity observed for the economic indicator or indicators in question;

(c) in all cases, whether or not falling within Article 1(4)(b), where the economic indicator or indicators show adjacent peaks or troughs to those peaks or troughs related to the most severe 12-month values observed for the economic indicator or indicators in question over the applicable time-span and these adjacent peaks and troughs do not significantly deviate from the most severe 12-month value observed for that indicator or those indicators over that time-span and these adjacent peaks and troughs are related to the same overall economic condition, then the downturn period shall be long enough to reflect the whole prolonged period over which those adjacent peaks or troughs are observed.

(d) where neither point (a), nor point (b) or point (c) apply, the downturn period shall be the 12-month period to which the most severe 12-month value relates, as determined in accordance with Article 1(3).

Article 5

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall apply from 1 January 2021.

This Regulation shall be binding in its entirety and directly applicable in all Member States.
Done at Brussels,
For the Commission
The President On behalf of the President [Position]

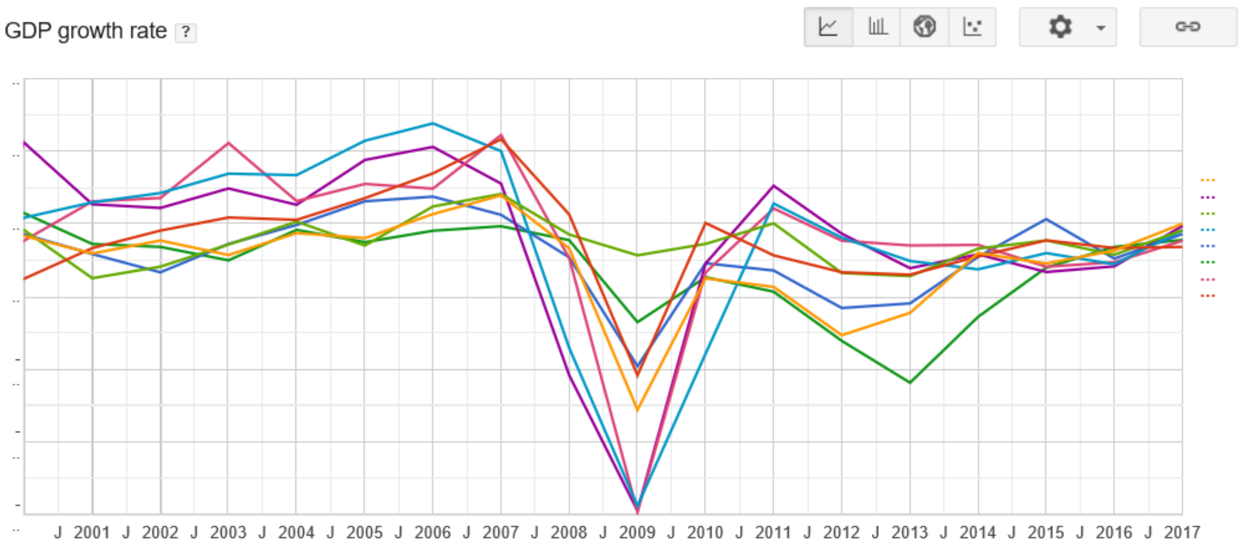
Annex 2 (GDP development in the EU)

Annex 2

It is impossible to analyse ad-hoc all economic indicators for all business sectors served by the banks in the EU. However, a quick analysis of the parameter GDP Growth over the last 20 years for those countries, which entered the EU less than 20 years ago shows that in no case GDP Growth would have wrongly indicated a downturn at the time of accession.

Country	EU Accession
Bulgaria	January 1, 2007
Croatia	July 1, 2013
Cyprus	May 1, 2004
Czechia	May 1, 2004
Estonia	May 1, 2004
Hungary	May 1, 2004
Latvia	May 1, 2004
Lithuania	May 1, 2004
Malta	May 1, 2004
Poland	May 1, 2004
Romania	January 1, 2007
Slovakia	May 1, 2004
Slovenia	May 1, 2004

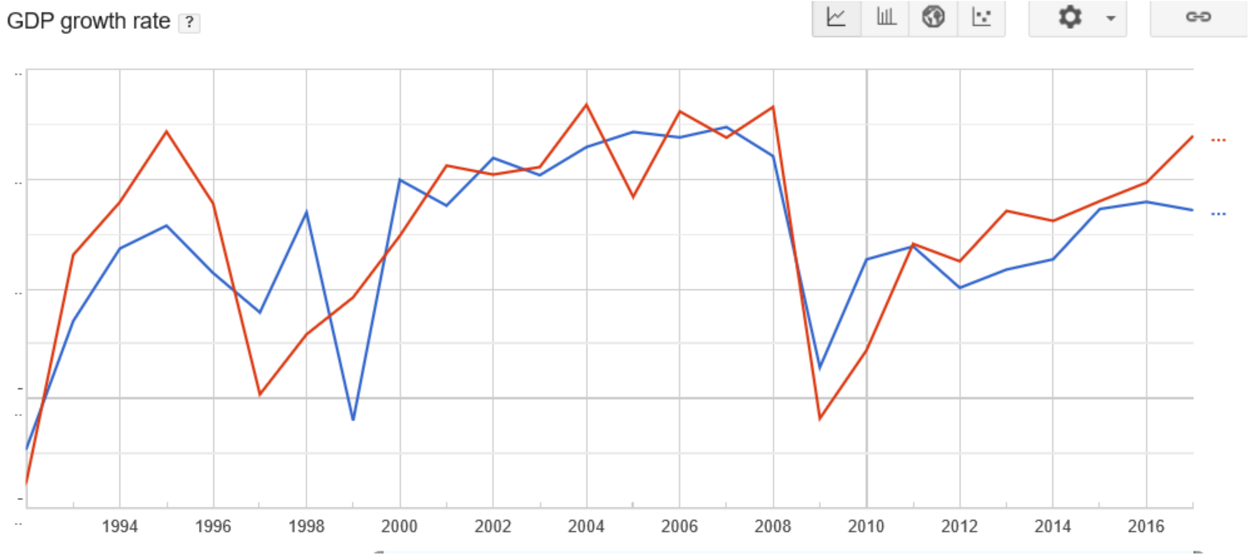
Countries entering 2004 (except Malta and Hungary)



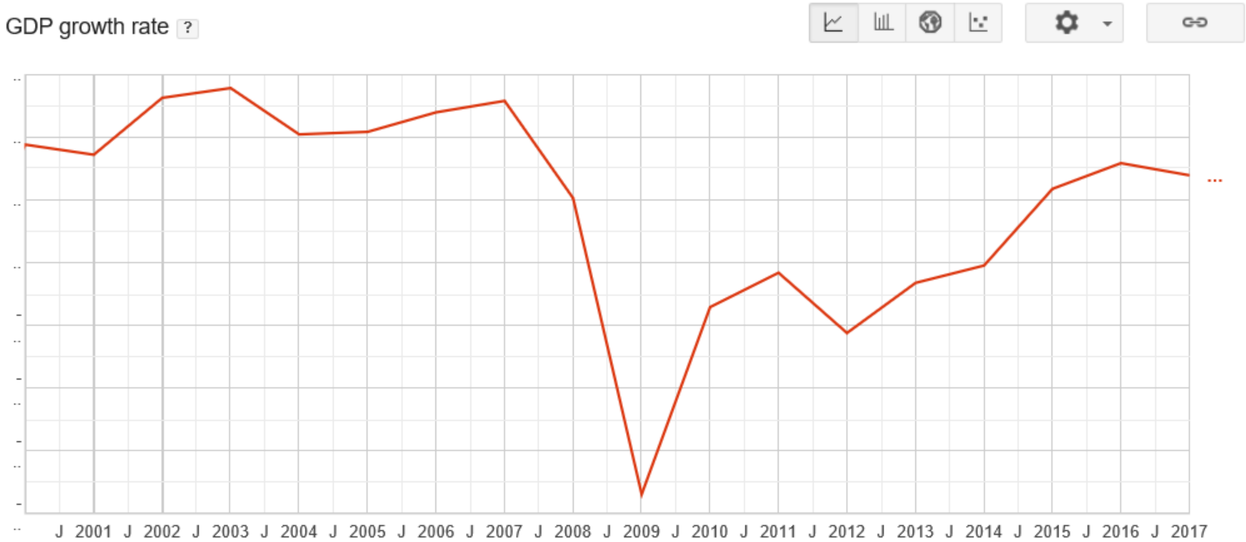
Source: Data from World Bank, Last updated: Jul 6, 2018

Annex 2 (GDP development in the EU)

Countries entering (2007 – red: Romania, blue: Bulgaria)



Croatia (2013)



However, in case another relevant economic indicator would wrongly indicate another downturn period due to EU accession, then there would most probably be no impact on the downturn LGD. This is because of paragraph 15 in the GL, which requires banks to analyze the impact of all downturn periods separately. If a downturn period would be identified incorrectly then there should be no impact visible on empirical loss data (paragraph 23 and24 of the GL) and the downturn period identified by the GDP Growth might turn out the relevant one. However if, by chance, historical loss data would peak at the time of the wrongly identified downturn period then this peak would most probably influence the reference value and the bank would have to analyse and explain if there was indeed no downturn. Summarizing, there is a change in the RTS simplifying the policy. In the light of the policy laid down in the GL on downturn LGD estimation there is however no significant change as regards the impact on downturn LGD estimation.