

EBA/RTS/2021/12

29 October 2021

Final Report

Draft regulatory technical standards specifying the types of factors to be considered for the assessment of the appropriateness of risk weights under Article 124 (4) of Regulation 575/2013 and the conditions to be taken into account for the assessment of the appropriateness of minimum LGD values under Article 164 (8) of Regulation 575/2013

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1. Executive Summary

Under Articles 124 (4) and 164 (8) of Regulation (EU) No 575/2013 (CRR), the EBA is mandated to develop, in close cooperation with the ESRB, draft regulatory technical standards (RTS) to specify:

- a) the rigorous criteria for the assessment of the mortgage lending value (MLV) referred to in paragraph 1 of Article 124¹ CRR;
- b) the types of factors to be considered for the assessment of the appropriateness of the risk weights referred to in the first subparagraph of paragraph 2 of Article 124 CRR; and
- c) the conditions that the authority designated by the Member State shall take into account when assessing the appropriateness of minimum loss given default (LGD) values as part of the assessment referred to in paragraph 6 of Article 164 CRR.

Given the rather similar nature of the mandates in both abovementioned Articles 124 (4) and 164 (8) CRR, these elements are specified jointly in these draft RTS. Namely, the mandates deal with the assessments of the appropriateness of risk weights for institutions applying the Standardised Approach (SA) or minimum LGD values for institutions applying the Internal Ratings-Based (IRB) Approach.

The draft RTS also take into account other major changes introduced to Article 124 and Article 164 through Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013. Most importantly, the relevant authority as designated by the Member State may set higher risk weights or impose stricter criteria on risk weights, or increase the minimum LGD values when the following two conditions are met:

- a) based on the periodical assessments of risk weights or minimum LGD values, the relevant authority concludes that the risk weights set out in Article 125 (2) or 126 (2) CRR do not adequately reflect the actual risks relating to the exposures secured by mortgages on residential property or commercial immovable property, or that the minimum LGD values referred to in Article 164 (4) CRR are not adequate; and
- b) the relevant authority considers that the identified inadequacy of these risk weights or minimum LGD values could adversely affect current or future financial stability in its Member State.

The scope of the mandate given to the EBA pertains to the first condition. For institutions applying the SA, these draft RTS specify the types of factors to be considered during the appropriateness assessment of risk weights on the basis of the loss experience and forward-looking immovable property market developments. In particular, the draft RTS delineate the types of factors to be taken into account in the determination of the loss expectation.

¹ This element lays down the mandate to develop draft RTS specifying the rigorous criteria for the assessment of MLV. In 2015, the EBA provided an opinion advising the Commission to limit the scope of application of these draft RTS on MLV to the SA, Credit Risk Mitigation framework and Large Exposures. The preparation of these draft RTS awaits the forthcoming revision of the CRR.

For institutions applying the IRB Approach to retail exposures secured by residential or commercial immovable property, these draft RTS provide three conditions to be considered when assessing the appropriateness of minimum LGD values. In particular, the draft RTS emphasise the systemic risk approach of such an appropriateness assessment. This is due to:

- a) the existing approval, validation and close monitoring of rating systems under the IRB Approach by competent authorities; and
- b) the requirements for institutions to use LGD estimates that are appropriate for an economic downturn if these are more conservative than the long-run average LGD, which is further specified in regulatory technical standards and EBA guidelines.

For both assessments, proper coordination and cooperation between the competent and the designated authority are key to strengthening the identification of risks and to avoiding overlaps, double counting of risk and duplicative actions by authorities.

2. Background and rationale

1. Article 124 (2) and Article 164 (6) of Regulation (EU) No 575/2013 (hereinafter CRR1) as applicable before the date of entry into force of Regulation (EU) 2019/876 (hereinafter CRR2) required competent authorities to assess periodically, and at least annually, whether risk weights under Articles 125 and 126 of the CRR or the minimum average loss given default (LGD) values under Article 164 of the CRR1 reflected the actual risk of exposures secured by mortgages on immovable property or were appropriate for retail exposures secured by immovable property, respectively. These articles share common characteristics because both deal with adjustments to input parameters for the determination of own funds requirements for exposures secured by immovable property, although they cover two different approaches when calculating own funds requirements: the SA and IRB Approaches.
2. However, CRR2 introduced a series of changes (including new features) to these two articles. First, whereas originally in CRR1 the competent authority had the responsibility for the assessments and the decisions on setting higher risk weights or imposing stricter criteria than those set out in Article 125 (2) and 126 (2) or on setting other minimum average exposure-weighted LGD values (hereinafter referred as “minimum LGD values”), Member States shall designate an authority responsible for the application of these provisions. Pursuant to CRR2, that authority shall be the competent authority or the designated authority (hereinafter the “relevant authority”).
3. Second, regardless of the choice made by the Member State (see paragraph 2), both authorities shall cooperate closely and share all information that needed for the adequate performance of their duties, when these provisions are used in accordance with Article 124 (1a) and Article 164 (5) of the CRR2.
4. Third, and most importantly, to strengthen the macroprudential purpose of increasing risk weights or minimum LGD values, CRR2 requires the fulfilment of two conditions before the relevant authority may set higher risk weights or higher minimum LGD values:
 - a) based on the periodical assessments of risk weights or minimum LGD values², the relevant authority concludes that the risk weights and/or the current minimum LGD values do not, in the case of risk weights, adequately reflect the actual risks relating to the exposures secured by mortgages on residential property or commercial immovable property, or, in the case of minimum LGD values, are not adequate (in both cases, if deemed relevant, also by decomposition of immovable property segments and/or territory);

² In a similar way to CRR1, the relevant authority is required to assess whether the risk weights for exposures fully and completely secured by immovable property set out under the SA (i.e. 35% for exposures secured by residential property and 50% for exposures secured by commercial immovable property) are appropriate based on the loss experience of exposures secured by immovable property and the forward-looking market developments in the real estate markets. A similar assessment is also required for the appropriateness of the current minimum average LGD values for retail exposures secured by immovable property (i.e. a 10% floor for retail exposures secured by residential property and a 15% floor for retail exposures secured by commercial immovable property).

- b) the relevant authority considers that the identified inadequacy of the current risk weights and/or minimum LGD values could adversely affect the current or future financial stability of the Member State.
5. Fourth, CRR2 splits the mandate, originally given to the EBA in CRR1, into two parts and shares the responsibility between the EBA and the ESRB. On the one hand, the EBA is entrusted, in close cooperation with the ESRB, to develop draft RTS specifying the following:
- a) the rigorous criteria for the assessment of the mortgage lending value (MLV);
 - b) the types of factors to be considered for the assessment of the appropriateness of the risk weights under the SA;
 - c) the conditions to be considered for the assessment of the appropriateness of minimum LGD values under the IRB Approach.
6. The first element above lays down the mandate to develop draft RTS specifying the rigorous criteria for the assessment of MLV. Nevertheless, in 2015 the EBA provided an opinion advising the Commission to limit the scope of application of these RTS (concerning MLV) to the SA, Credit Risk Mitigation framework and Large Exposures.³ Therefore, the preparation of these draft RTS (concerning MLV) awaits the forthcoming revision of Regulation (EU) No 575/2013.
7. The ESRB may, in close cooperation with the EBA, issue a recommendation giving guidance to the relevant authorities on the factors which could adversely affect the current or future financial stability of the activating Member State, and on indicative benchmarks that the relevant authority has to take into account when determining higher risk weights or minimum LGD values.
8. Fifth, CRR2 allows for the setting of higher risk weights and minimum LGD values for selected exposures located in one or more parts of the territory of the Member State as well as at the level of one or more immovable property segments.
9. Compared to the previous mandates given in CRR1, the scope of the current mandates given to the EBA in CRR2 is narrowed down to specifying the types of factors to be considered for the appropriateness assessment of risk weights or the conditions to be taken into account when assessing the appropriateness of minimum LGD values. Therefore, the draft RTS specified in this document determine solely the types of factors or the conditions that relevant authorities shall consider in their assessments in light of the developments in their respective national real estate markets. For these reasons, these draft RTS do not include considerations on financial stability or details on indicative benchmarks for the calibration of any increases in risk weights or minimum LGD values.
10. The key elements of these draft RTS for the assessment of the appropriateness of risk weights under the SA are the loss experience and the loss expectation relating to exposures secured by immovable property within the respective Member State. The loss expectation, as the forward-looking perspective of the assessment, is defined as the relevant authority's best estimate of losses to be realised during a forward-looking horizon of at least one year and up to three years. This loss

³ <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/983359/37076e22-e8b2-42e4-979d-0edcfce810c1/EBA-Op-2015-17%20Opinion%20on%20mortgage%20lending%20value.pdf?retry=1>

expectation should be determined by adjusting the loss experience on the basis of types of factors including the immovable property market developments (i.e. the fundamental drivers of demand and supply, the structural and cyclical characteristics) and the future macroeconomic conditions (i.e. forecasts of key macroeconomic variables).

11. The length of the forward-looking horizon of at least one year and up to three years is subject to the decision of the relevant authority. This decision should take into consideration the characteristics and actual developments of the immovable property market, the risk of underestimating the vulnerabilities stemming from that market, the position in its economic and financial cycles, and the fact that the appropriateness assessment shall be conducted at least once a year. Although a longer horizon could allow for an early build-up of resilience in times when the systemic risks are increasing, a horizon above three years may increase the degree of inaccuracy of the loss expectation.
12. Although risk weights under the SA and minimum LGD values under the IRB Approach share common characteristics, as both are elements needed in the calculation of own funds requirements for exposures (SA) or for retail exposures (IRB Approach) secured by immovable property, the approach to assessing their appropriateness differs. Besides, from a microprudential perspective, IRB Approaches with own estimates of LGD are approved and closely monitored by supervisors and regularly validated by institutions. Furthermore, rating systems are subject to a degree of conservatism pursuant to the requirements for the IRB Approach under Regulation (EU) No 575/2013.
13. IRB Approaches may, however, not capture all risks from a macroprudential perspective. An assessment of the appropriateness of minimum LGD values in these RTS should therefore consider whether the minimum LGD values cover the sources of systemic risks beyond the economic downturn considerations (as further specified in regulatory technical standards and EBA guidelines) and idiosyncratic risks. For this purpose, the relevant authority is asked to perform a systemic risk assessment taking into account macroeconomic imbalances impacting LGD values beyond the economic cycle, based on the following conditions: demand and supply conditions on real estate markets and dynamics in real estate prices, conditions that impact on drivers of LGD values and other conditions that indirectly impact on the value of collateral taken into account in LGD estimation.
14. In general, the assessment of the appropriateness of minimum LGD values should consider the regulatory guidance on LGD estimation provided by the EBA Guidelines on PD estimation, LGD estimation and the treatment of defaulted assets⁴, the EBA Guidelines for the estimation of LGD appropriate for an economic downturn⁵, the final draft RTS on the specification of the nature,

⁴ EBA Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures of 20 November 2017 (EBA/GL/2017/16) available at <https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2033363/6b062012-45d6-4655-af04-801d26493ed0/Guidelines%20on%20PD%20and%20LGD%20estimation%20%28EBA-GL-2017-16%29.pdf?retry=1>

⁵ EBA Final Report Guidelines for the estimation of LGD appropriate for an economic downturn ('Downturn LGD estimation') of 6 March 2019 (EBA/GL/2019/03) available at <https://www.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>

severity and duration of an economic downturn⁶, and the EBA Guidelines on credit risk mitigation for institutions applying the IRB Approach with own estimates of LGDs⁷.

15. An important provision mentioned in CRR2 is the cooperation and coordination between the competent authority and the designated authority. Such a requirement ensures a complete assessment of the appropriateness of risk weights or minimum LGD values, including the proper identification of risks, and the avoidance of overlaps, double counting of risks and duplicative or inconsistent actions. Besides, cooperation and coordination ensure that the interaction with other measures, in particular those taken under Article 458 of the CRR2 and Article 133 of Directive 2013/36/EU, is duly taken into account.

16. These draft RTS are meant to support the periodical assessments of the appropriateness of risk weights or minimum LGD values. For this purpose, the types of factors or the conditions that relevant authorities shall consider during such assessments must rely on the latest data available to them. Furthermore, these draft RTS together with an ESRB recommendation (see paragraph 7) are meant to provide a framework for the relevant authority when setting higher risk weights than those set out in Article 125(1) or 126(1) of CRR2 and when setting higher minimum LGD values than those referred to in Article 164(4) of the same Regulation. When considering any changes to risk weights or minimum LGD values, the relevant authority should also be aware of the direct linkages to other parts of the regulation, including the impact of such changes on the calculation of large exposure values, liquidity and capital ratios, reporting requirements and other macroprudential measures.

17. In addition to the adequate consideration of the loss experience and the differences between assessing risk weights under the SA or minimum LGD values under the IRB Approach, the draft RTS also pay attention to other key elements for the appropriateness assessments, which include:

- a) the existence of national specificities relating to the real estate market and its financing, such as public and private guarantee schemes, tax deductibility, recourse regimes or social safety nets;
- b) the assessment at the level of parts of the territory or at the level of specific property segments, if deemed relevant (see paragraph 8); and
- c) the data problems concerning relevant indicators, such as availability, quality, granularity or harmonisation.

⁶ EBA Final Draft 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 of 16 November 2018 (EBA /RTS/2018/04) available at https://www.eba.europa.eu/sites/default/documents/files/documents/10180/2459703/3136b895-0dfb-454f-8984-beddb888b8cc/EBA%20BS%202018%20xxx%20%28Final%20draft%20RTS%20on%20economic%20downturn%29_final%20%28002%29.pdf?retry=1

⁷ EBA Final Report Guidelines on credit risk mitigation for institutions applying the IRB approach with own estimates of LGDs of 6 May 2020 (EBA/GL/2020/05) available at https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Guidelines/2020/Guidelines%20on%20Credit%20Risk%20Mitigation%20for%20institutions%20applying%20the%20IRB%20approach%20with%20own%20estimates%20of%20LGDs/883366/Guidelines%20on%20CRM%20for%20A-IRB%20institutions.pdf

3. Draft regulatory technical standards

COMMISSION DELEGATED REGULATION (EU) .../..

of **XXX**

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the types of factors to be considered for the assessment of the appropriateness of risk weights and the conditions to be taken into account for the assessment of the appropriateness of minimum LGD values

(Text with EEA relevance)

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 648/2012⁸, and in particular the third subparagraph of Article 124(4) and the third subparagraph of Article 164(8) thereof,

Whereas:

- (1) To ensure coherence between the assessments of the appropriateness of input parameters for the determination of own funds requirements for exposure types secured by immovable property set out in Article 124 (2) of Regulation (EU) No 575/2013 and in Article 164 (6) of that Regulation, it is appropriate to include both sets of the relevant regulatory technical standards required by Article 124 (4) and by Article 164 (8) of Regulation (EU) No 575/2013 respectively in a single Regulation. Considering that the assessments of the appropriateness of risk weights or minimum LGD values are distinct from the specification of the rigorous criteria for the assessment of the mortgage lending value, the scope of this Regulation is limited to the types of factors or conditions required for these assessments.
- (2) To ensure a harmonised approach in the periodical assessments referred to in Article 124 (2) and Article 164 (6) of Regulation (EU) No 575/2013 performed by the authorities set out in Article 124 (1a) and Article 164 (5) of that Regulation, this Regulation specifies the types of factors to be considered in the assessment of the appropriateness of the risk weights and the conditions to be considered for the assessment of the appropriateness of minimum LGD values, respectively.
- (3) To ensure proportionality, there is a need to account for the heterogeneity of the immovable property markets across Member States while at the same time setting out a sufficiently harmonised framework for the assessments of the appropriateness of the risk weights and the minimum LGD values in accordance with Article 124 (2) and Article 164 (6) of Regulation (EU) No 575/2013. To that end, the Regulation stops short of imposing a one-size-fits-all approach and instead provides the authorities set out in Article 124 (1a) and Article 164 (5) of Regulation (EU) No

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OJ L 176, 27.6.2013, p. 1.

575/2013 with all the necessary elements as to the types of factors or the conditions for the purposes of their assessments.

- (4) Against this background, this Regulation strikes a balance between achieving harmonisation and preserving the flexibility necessary for the performance of the assessments referred to in Article 124 (2) and in Article 164 (6) of Regulation (EU) No 575/2013, also having regard to the fact that the ultimate decision as to the appropriateness of the risk weights and the appropriateness of minimum LGD values lies within the competence of the authorities set out in Article 124 (1a) and Article 164 (5) of that Regulation.
- (5) To further specify the loss expectation to be considered for the purposes of determining the appropriateness of risk weights, this Regulation lays down the types of factors to be taken into account, in particular the historical evolution and cyclical characteristics of the immovable property market as reflected in immovable property market transactions and prices and in their volatility, the past and present structural characteristics of the immovable property market, the fundamental drivers of demand and supply in the immovable property market, the riskiness of the exposures secured by immovable property, the expected evolution in immovable property market prices and the expected volatility in those prices, the expected evolution in meaningful macroeconomic key variables that could affect the solvency of borrowers, the time horizon over which the forward-looking property market developments are expected to materialise, the national specificities related to the real estate market and its financing, and any other data indicators and sources which provide insight into the forward-looking property market developments.
- (6) Where specifying the conditions for assessing the appropriateness of minimum LGD values, this Regulation should focus on aspects beyond economic downturn and idiosyncratic risks. To target the sources of systemic risk, elements such as the demand and supply conditions of real estate markets, the dynamics in real estate prices, conditions that impact on drivers of LGD values, and other conditions that indirectly impact on the value of collateral taken into account in LGD estimates, should be taken into account.
- (7) Where specifying the conditions for determining the appropriateness of minimum LGD values, this Regulation sets out a number of considerations to be taken into account, among them whether macroeconomic imbalances are related to an economic downturn, whether other macroprudential measures in force already address the identified systemic risks, the degree of uncertainty around the evolution of immovable property markets, national specificities related to the real estate market and its financing, and relevant benchmarking comparisons of LGD estimates across institutions or Member States.
- (8) Furthermore, this Regulation should clarify that specificities exclusively related to the national real estate market and its financing should be taken into account during the assessments of the appropriateness of the risk weights or the minimum LGD values in accordance with Article 124 (2) and Article 164 (6) of Regulation (EU) No 575/2013.
- (9) Regulation (EU) 2019/876 amending Regulation (EU) No 575/2013 enabled the assessments of the appropriateness of risk weights or minimum LGD values to pertain to one or more property segments or parts of the territory of a Member State. This Regulation should, therefore, set out that the types of factors or the conditions laid down therein may be applied to one or more property segments or to one or

more parts of the territory of a Member State. Where data collected in EU harmonised reporting is not sufficiently granular to allow for the assessments of the appropriateness of risk weights or minimum LGD values at the level of a property segment or of a part of a territory of a Member State, additional sources of data should be able to be used for such an assessment to be enabled.

- (10) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority (EBA) to the Commission.
- (11) The EBA has conducted an open public consultation on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits, and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010⁹.

HAS ADOPTED THIS REGULATION:

Article 1

Types of factors to be considered for the assessment of the appropriateness of the risk weights

1. For the purpose of assessing the appropriateness of the risk weights referred to in Article 124 (2), first subparagraph, of Regulation (EU) No 575/2013, authorities referred to in Article 124 (1a) of that Regulation shall determine:
 - (a) the loss experience as the ratio of the following:
 - i. in the case of exposures secured by mortgages on residential property as referred to Article 124 (2), first subparagraph, of Regulation (EU) No 575/2013, the losses reported in accordance with Article 430a (1)(a) of that Regulation and the exposure value reported in accordance with Article 430a (1)(c) of that Regulation; and,
 - ii. in the case of exposures secured by mortgages on commercial immovable property as referred to in Article 124 (2), first subparagraph, of Regulation (EU) No 575/2013, the losses reported in accordance with Article 430a (1)(d) of that Regulation and the exposure value reported in accordance with Article 430a (1)(f) of that Regulation;
 - (b) the loss expectation as the best estimate of losses to be realised during a forward-looking horizon of at least one year and up to three years as further specified by the authority referred to in Article 124 (1a) of Regulation (EU) No 575/2013. The loss expectation shall be determined as the average of the estimated losses for each year during the chosen forward-looking horizon.
2. The loss expectation referred to in point (b) of paragraph 1 shall be determined by either adjusting the loss experience referred to in point (a) of paragraph 1 upwards or downwards, or by keeping the loss experience unchanged, to reflect the forward-looking immovable property market developments referred to in Article 124 (2), first subparagraph, point (b), of Regulation (EU) No 575/2013 during a forward-looking horizon of at least one year and up to three years.

⁹ 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).

3. The loss expectation referred to in point (b) of paragraph 1 and determined in accordance with paragraph 2 shall be based on the following:
- (a) the historical evolution and cyclical characteristics of the immovable property market as reflected in immovable property market transactions and prices, and in the volatility of these prices, evidenced by the relevant data indicators or qualitative information;
 - (b) the past and present structural characteristics of the immovable property market, and also the future evolution of those structural characteristics. Structural characteristics relate to the size of the immovable property market, the specificities of real estate financing, national taxation systems and the national regulatory provisions for buying, holding or letting immovable property;
 - (c) the fundamental drivers of demand and supply in the immovable property market, evidenced by any relevant data indicators or qualitative information, such as lending standards, construction activity, vacancy rates, or transaction activity;
 - (d) the riskiness of the exposures secured by immovable property measured by indicators relevant for the property segments and if relevant to parts of the territory, having regard to Section 6 of the EBA Guidelines on subsets of exposures in the application of a Systemic Risk Buffer (EBA/GL/2020/13) issued in accordance with Article 133 (6) of Directive 2013/36/EU¹⁰ and the lending standard indicators specified in the ESRB recommendation on closing real estate data gaps (ESRB/2016/14);
 - (e) the expected evolution in immovable property market prices and the expected volatility in those prices, including an assessment of the uncertainty around these expectations;
 - (f) the expected evolution in meaningful macroeconomic key variables that could affect the solvency of borrowers, including an assessment of the uncertainty around these expectations;
 - (g) the time horizon over which the forward-looking property market developments are expected to materialise;
 - (h) national specificities related exclusively to the real estate market and its financing, including public and private guarantee schemes, tax deductibility and public support in the form of recourse regimes and social safety nets;
 - (i) any other data indicators and sources which provide insight into forward-looking property market developments which impact the loss expectation referred to in point (b) of paragraph 1 or support the data quality of the loss experience referred to in point (a) of paragraph 1.
4. In the case where uncertainty referred to in point (e) of paragraph 3 is high, a margin of prudence in the determination of the loss expectation shall be considered.
5. When applying paragraph 1, the authorities referred to in Article 124 (1a) of Regulation (EU) No 575/2013 shall have regard to other current macroprudential measures in force, including measures in national law designed to enhance the resilience of the financial system such as, but not limited to, loan-to-value limits, debt-to-income limits, debt-service-to-income limits and other instruments

¹⁰ Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

addressing lending standards, that already address the identified systemic risks affecting the appropriateness of risk weights referred in Article 124 (2), first subparagraph, of Regulation (EU) No 575/2013.

Article 2

Conditions to be taken into account for the assessment of the appropriateness of the minimum LGD values

1. For the purpose of assessing the appropriateness of the minimum LGD values referred to in Article 164 (6) of Regulation (EU) No 575/2013, the authorities referred to in paragraph 5 of that Article shall, when performing the systemic risk assessment on the basis of macroeconomic imbalances impacting on LGD estimates beyond the economic cycle, have regard to all of the following conditions:
 - (a) demand and supply conditions of real estate markets and dynamics in real estate prices, including, where relevant and if a robust estimation is available, the degree of overvaluation or undervaluation of real estate prices;
 - (b) conditions that impact on drivers of LGD estimates, including, if relevant, changes in the length and the effectiveness of the process for pursuing recoveries as a result of changes in the recovery procedures, changes in the frequency of the return of obligors or individual credit facilities to non-defaulted status that are caused by changes in unemployment rates or changes in household or corporate debt levels, and interest rates;
 - (c) other conditions that indirectly impact on the value of collateral taken into account in LGD estimates, including, if relevant, loan-to-value (LTV) ratios, cross collateralisation and other common forms of credit protection relevant to retail exposures secured by immovable property in the respective Member State.
2. When applying paragraph 1, the authorities referred to in Article 164 (5) of Regulation (EU) No 575/2013 shall also have regard to the following:
 - (a) whether the macroeconomic imbalances are related to an economic downturn, and hence are considered in the downturn LGD estimation for the respective exposures;
 - (b) other current macroprudential measures in force, including measures in national law designed to enhance the resilience of the financial system such as, but not limited to, loan-to-value limits, debt-to-income limits, debt-service-to-income limits and other instruments addressing lending standards, that already address the identified systemic risks affecting the adequacy of minimum LGD values;
 - (c) the degree of uncertainty around the evolution of immovable property markets and their price volatility;
 - (d) national specificities exclusively related to the real estate market and its financing, including public and private guarantee schemes, tax deductibility and public support in the form of recourse regimes and social safety nets;
 - (e) where relevant and available, benchmarking comparisons of LGD estimates across institutions or Member States for comparable portfolios, risk levels and facilities secured by immovable property pledged as collateral.

Article 3

Assessments for property segments or specific parts of the territory – use of other sources of data

1. The types of factors set out in Article 1 or the conditions set out in Article 2 may be applied by an authority referred to in Article 124 (1a) and in Article 164 (5) of Regulation (EU) No 575/2013 to one or more property segments or to one or more parts of the territory of the Member State of that authority, as appropriate.
2. To determine the loss experience in accordance with Article 1 (1)(a) or the minimum LGD values in accordance with Article 2 for a property segment or a part of the territory of the Member State of an authority referred to in Article 124 (1a) and in Article 164 (5) of Regulation (EU) No 575/2013, other sources of data including national adhoc reporting and credit registers relating to that property segment or part of the territory of a Member State may be used, where the data collected in accordance with Article 430 (1)(a) and Article 430a of that Regulation is not sufficiently granular.

Article 4

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 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

4. Accompanying documents

4.1 Cost-benefit analysis / impact assessment

This analysis provides the reader with an overview of the findings as regards problem identification, possible options to remove problems and their potential impacts. Both a qualitative and quantitative analysis are provided. The quantitative section is meant to provide the reader with information about the materiality of the exposures secured by mortgages on real estate properties (mortgages hereinafter). Furthermore, this section provides a framework for assessing the implementation of the draft RTS. The qualitative analysis provides a discussion about pros and cons of the requirements set out in the RTS.

A. Problem identification: quantitative analysis

Mortgages represent a substantial share of European institutions' loan portfolios, on average 24% of the total exposure value.^{11,12,13} In 4 out of 26 jurisdictions, mortgages represent more than 1/3 of the exposure value (see Figure 1).

The exposure value (EV) is the prudential definition of the value of an exposure and this definition differs materially from the applicable accounting definitions. Under the Standardised Approach (SA), the EV is net of credit risk adjustments¹⁴, while under the Internal Ratings-Based (IRB) Approach the EV is gross of credit risk adjustments¹⁵. Both approaches include on-balance-sheet exposures and off-balance-sheet exposures weighted by the appropriate percentage or conversion factor.¹⁶

For the quantitative analysis, credit risk adjustments have been added back to the SA EV to align the definition with the one applicable under the IRB Approach. On 31 December 2019, 83% of all mortgages were reported under the IRB Approach.

¹¹ The average is computed as an exposure-weighted average.

¹² The analysis is done on a sample of 118 credit institutions (excluding subsidiaries located outside institutions' country of origin) of 26 EEA states, which report both COREP and FINREP data to the EBA. The reference date of the analysis is 31 December 2019. The analysis considers for the Standardised Approach the exposures that are associated with a weighting factor of 35% or 50% and for the IRB Approach the exposure classes Retail - Secured on real estate property - Of which: SME, and Retail - Secured on real estate property - Of which: non-SME. The total amount of exposures secured by mortgages on real estate properties observed in the sample is EUR 5.2 trillion.

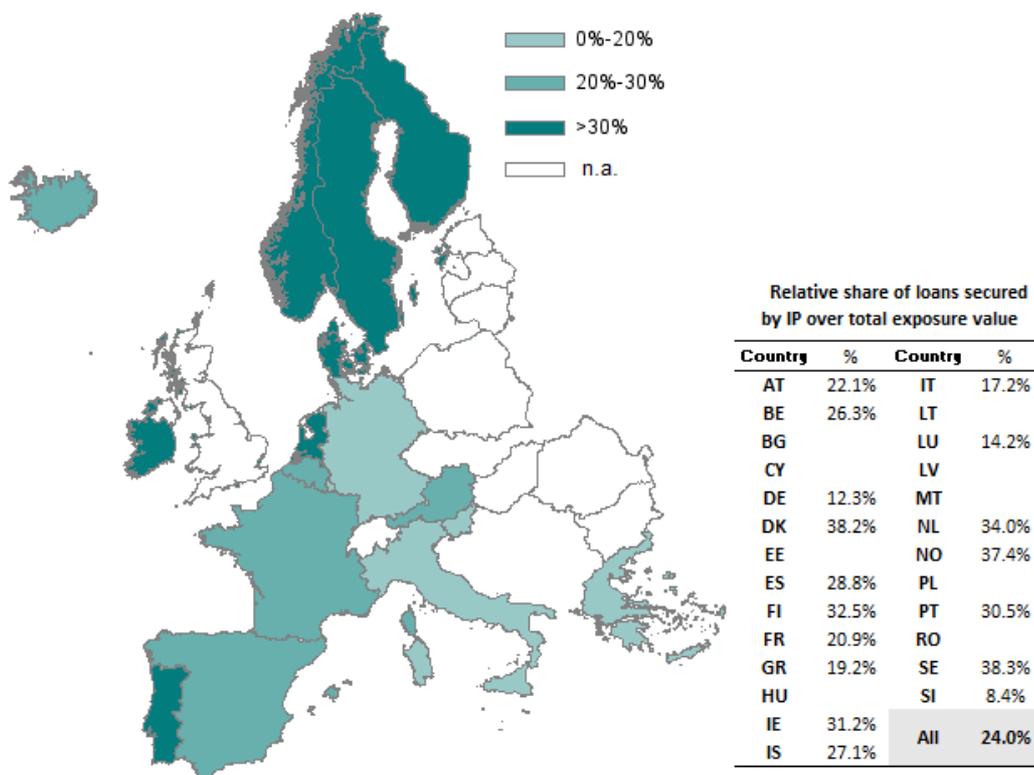
¹³ The mortgages classified as in default under the SA are excluded as they are not affected by Article 124(2) of the CRR2.

¹⁴ See Article 111 of the CRR2.

¹⁵ See Article 166 of the CRR2.

¹⁶ See Article 4(56) of the CRR2.

Figure 1: Exposures secured by mortgages on real estate properties as a share of total exposure value as of December 2019



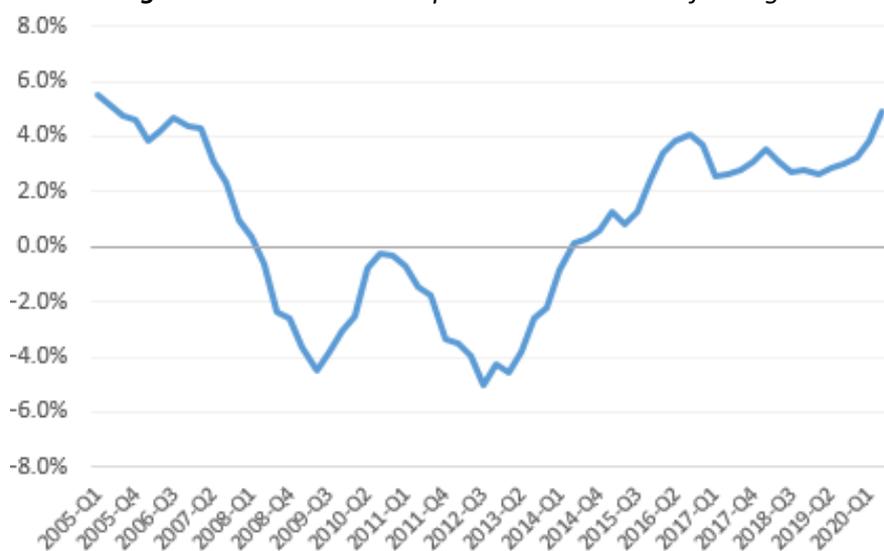
Note: Country data should be interpreted with caution because differences in the representativeness of the sample across countries may affect data comparability. Moreover, the information used represents institutions' portfolios without considering the residence of the obligor. Countries with fewer than three institutions in the sample are not represented.
Source: EBA Supervisory Reporting and own calculations

B. Policy objectives

The risk weights under the SA, as well as the parameters of the IRB Approach including minimum LGD values, are laid down in the CRR. Articles 124(2) and 164(6) of the CRR2 provide the relevant authorities with a certain level of flexibility to deal with eventual underestimation of macroprudential risks relating to mortgage portfolios, in particular by allowing relevant authorities to increase the risk weights or minimum LGD values set out in the CRR in cases where it is found that risk weights or minimum LGD values are not appropriate and that such an inadequacy could affect the current or future financial stability of the respective Member State.

For example, relevant authorities could make use of these provisions in times of potential overheating of the housing markets. Figure 2 shows the dynamic of house prices in the euro area between 2005Q1 and 2020Q1.

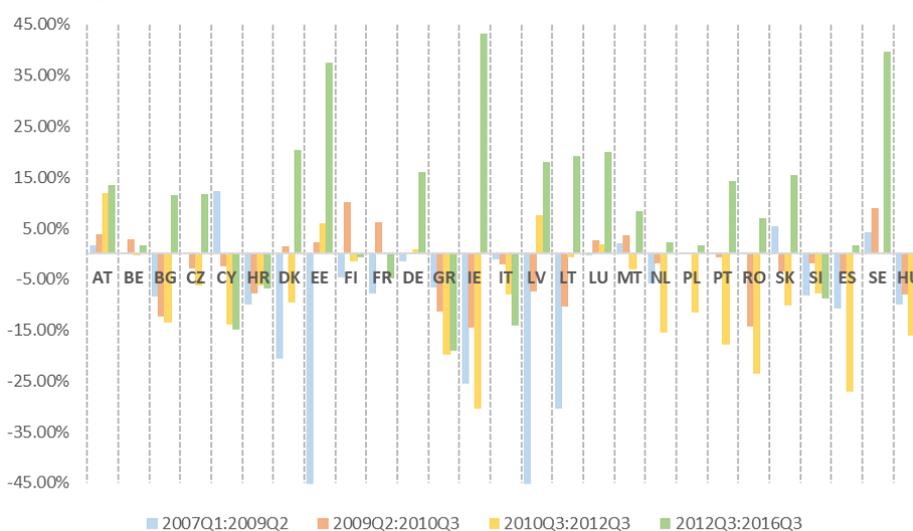
Figure 2: Euro area house prices – annual rate of change



Source: BIS Statistics Warehouse¹⁷

Figure 3 provides, as an illustrative example, the dynamics of prices at country level during and after the 2007-2008 Great Financial Crisis (GFC). These periods show significant variations in house prices at country level within the EU, illustrating the heterogeneity of European property markets. From these figures, it can be seen that European housing markets have faced periods of large price variation although with relatively high country dispersion.

Figure 3: Real house prices, rate of change in the specified periods



Source: BIS Statistics Warehouse

The objective of the RTS is to provide a sufficiently harmonised framework for assessing the appropriateness of risk weights under the SA or the appropriateness of minimum LGD values under the IRB Approach, taking into consideration the heterogeneity of real estate markets in the EU. The

¹⁷ <https://stats.bis.org/>

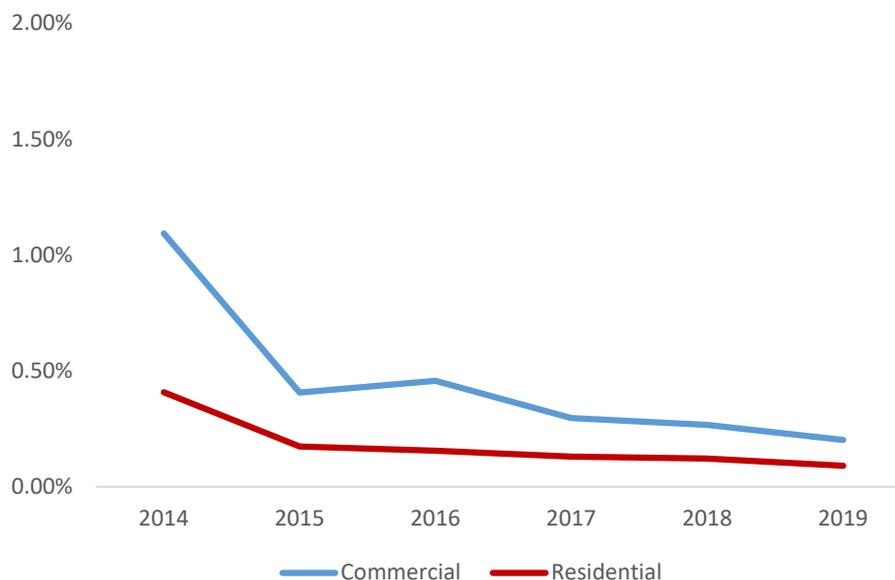
RTS require the assessment of the appropriateness of the risk weights under the SA based on the loss experience (based on the data collected under Article 430a of the CRR2) and the loss expectation to be determined according to types of factors. Concerning the minimum LGD values, the RTS require assessment of whether these minimum LGD values are appropriate from a systemic risk perspective beyond the economic cycle.

According to Article 430a of the CRR2 and Article 101 of the CRR, institutions are required to report losses for all defaults on exposures secured by real estate property that occur during the respective reporting period and irrespective of whether the work-out (the recovery process) has been completed during the period or not. More specifically, institutions report all losses stemming from lending collateralised by residential property or by commercial immovable property up to the part of exposure treated as fully secured according to Article 124 CRR.

Figure 4 below depicts the dynamic of the annual loss rate for EU institutions reported as mentioned above for exposures secured by residential properties and exposures secured by commercial properties. Since there may be a long time lag between default and loss realisation, loss estimates are reported in cases where the workout has not been completed within the reporting period. In particular for IRB institutions, it can be assumed that the loss estimates are based on the estimated LGDs. The data include immovable property financed by foreign institutions (cross-border) and foreign branches¹⁸. This enables, on the one hand, better segmentation of the loss experiences by country and, on the other hand, observation of losses reported from foreign institutions. At the aggregate level, the loss rate observed in 2014 appears higher than what can be observed in the subsequent years.

¹⁸ See Article 430a (2) of the CRR2 and Article 101(2) of the CRR.

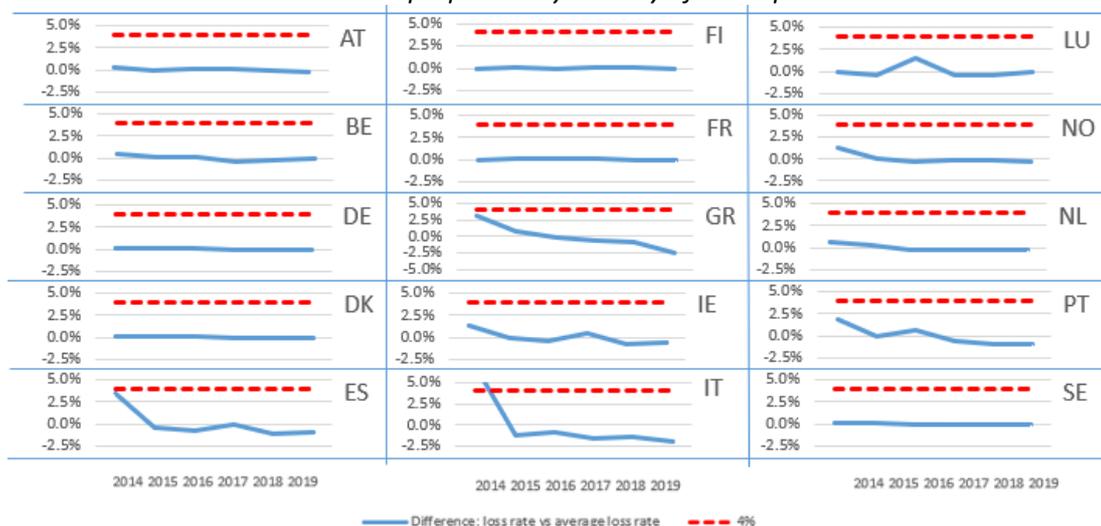
Figure 4: Annual loss rate for exposures fully secured by commercial/residential immovable properties from data collected under Article 430a of the CRR2 and Article 101 of the CRR



Source: EBA Supervisory Reporting and own calculations

The RTS require assessment of the appropriateness of the 35% and 50% risk weight assigned under the SA to exposures secured by immovable properties, leveraging the data regarding the loss experiences. For example, it can be seen that the risk weight of 50% for exposures secured by commercial properties is equivalent to $50\% \times 8\% = 4\%$ of minimum required capital (MRC). This means that institutions are required to have, at least, capital to cover losses exceeding the expected loss by an amount up to 4% of the EV. This requirement can be compared with the dynamic of the loss rate calculated on the basis of the data under Article 430a of the CRR2 as depicted in Figure 5 for several Member States. In particular, the MRC can be compared with the highest difference between the annual loss rate and the average of the loss rates observed for the parts treated as fully and completely secured in the period.

Figure 5: Difference between the annual loss rate and the average of the loss rates observed in the period from data collected under Article 430a of the CRR2 and the minimum required capital (MRC) implied from the risk weight under the SA for exposures fully secured by commercial immovable properties by country of the exposure



Note: Country data should be interpreted with caution because differences in the representativeness of the sample across countries may affect data comparability. Countries with fewer than three institutions in the sample are not represented. During the period 2014-2019 the macroeconomic development was in general positive at the EU level, which naturally kept loss rates relatively low.
Source: EBA Supervisory Reporting (Templates C.15) and own calculations

For the purpose of assessing the appropriateness of risk weights, the draft RTS require consideration of the loss expectation. This element should be determined by a set of factors listed in the draft RTS and according to the extent to which a factor is deemed to be relevant for the immovable property market of the Member State and available for the relevant authority. Although no single methodology is given in the draft RTS, a possible way (just as an example) of operationalising the link between loss expectation and the set of factors could be by estimating a model correlating these factors with the annual loss rate¹⁹. This model, in turn, could be used to evaluate the loss expectation under different scenarios.

As regards the minimum LGD values, Article 430a of the CRR2 is not referred to in the RTS. The RTS focus more on whether the macroeconomic imbalances in a specific real estate market may affect LGD estimates beyond the economic cycle and how this might render the minimum LGD value inappropriate. This “systemic risk” view beyond the economic cycle is necessary in order to reflect the regulatory requirements regarding the downturn LGD that has to be applied by institutions. For example, it can be noted that imposing a minimum value on the LGD implies, for a given loan to value ratio, a floor on the haircut applied to the value of the immovable property pledged as collateral for the loan. Indeed, given the LGD_{floor} , the maximum recovery (R) expected is:

$$R = (1 - LGD_{floor})Loan$$

¹⁹ This is only a simplified example of how to operationalise the link between the types of factors and the annual loss rates. This is not a recommendation or policy advice.

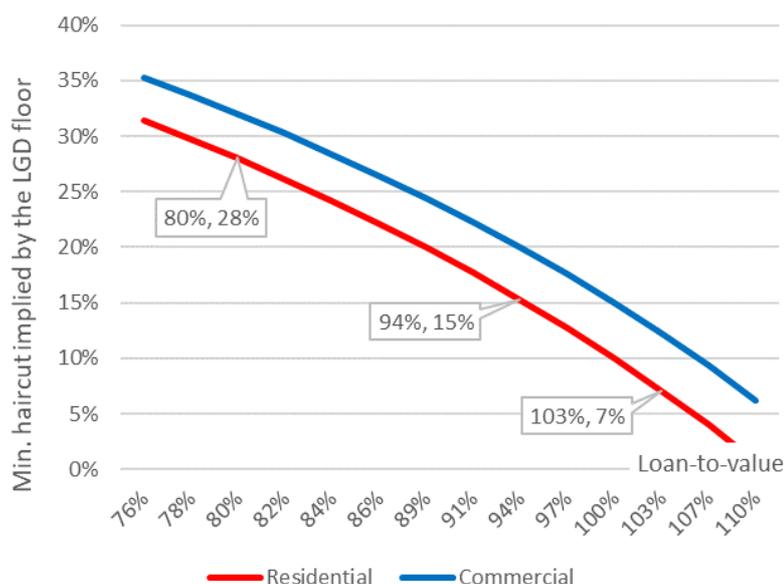
That means that the minimum haircut (H) applied to the value of the collateral can also be derived as:

$$H = 1 - \frac{R}{Value} = 1 - \frac{(1 - LGD_{floor})Loan}{Value} = 1 - (1 - LGD_{floor})LtV$$

where *LtV* is the loan-to-value ratio.

Figure 6 shows the relationship explained above between the minimum haircut implied by the minimum LGD value and the loan-to-value ratio for retail exposures secured by residential and commercial immovable properties. The minimum haircut could be compared with the expected price change. For example, with a loan-to-value equal to 80%, the 10% LGD floor implies a minimum haircut equal to 28%. This quantity could be interpreted as the potential price fall in an economic downturn before arriving at the minimum loss implied by the minimum LGD value. As the LTV increases, the potential price fall absorption implied by the 10% LGD minimum value reduces.

Figure 6: Relationship between minimum haircut given the minimum LGD value and LTV



C. Baseline scenario

Article 124 (2) of the CRR2 allows relevant authorities to increase the risk- weights applied to exposures secured by mortgages under the SA for credit risk. This would directly affect the minimum capital requirements. Article 164 (6) of the CRR2 allows relevant authorities to modify the minimum LGD values set in Article 164 (4), i.e. 10% for residential mortgages and 15% for commercial mortgages. The impact on capital requirements in this case is indirect and would be effective only if the minimum LGD values become binding. However, modifying the LGD so as to comply with the eventual modified minimum LGD value would have an impact not only on the

RWAs but also on the estimated expected loss amount (EL) and this could shape further impacts on the capital requirements.

The quantitative analysis showed the relevance of the mortgage portfolio and the potential variability in house prices dynamics at the European level and across countries. This evidence gives support to the importance of harmonising – across the EU – the approaches used for the evaluation of the adequacy of the prudential treatment of this portfolio, but also to the necessity of leaving adequate flexibility at country level to address specific characteristics within the real estate market.

The current situation, i.e. the baseline scenario, has been assessed by a survey conducted by the EBA among the competent authorities. This survey revealed the existence of some room for further harmonising current practices. The survey documents a situation of significant heterogeneity in terms of reference data exploited and approaches used. Hence, the reference to the need to use the data collected on the basis of Article 430a of the CRR2 could entail a cost as, according to the survey, not all authorities rely completely on these data. On the other hand, the use of a common database would help to increase harmonisation among the authorities. Moreover, the data collected on the basis of Article 430a are only one of the elements that these draft RTS require to be considered in the assessment of the appropriateness of risk weights.

Also, the provision requiring formulation of a loss expectation on the ground of the set of factors that the draft RTS delineate may entail additional efforts for some authorities. In turn, this could help to foster a better understanding of the motivations behind the eventual decisions on the appropriateness of the actual prudential treatment.

E. Cost-benefit analysis

Qualitative analysis

The EBA has been mandated to develop RTS to specify the types of factors or the conditions to be considered for the assessments of the appropriateness of the risk weights under the SA or the minimum LGD values under the IRB Approach. There is clearly a trade-off between full harmonisation of the assessments and taking into account national specificities of the real estate markets. This heterogeneity also emerged in the survey conducted by the EBA. This is why the types of factors or the conditions mentioned in this Regulation provide for a mapping of the most used classes of indicators and leave the relevant authorities enough room for manoeuvre in choosing the specific ones on the basis of which the abovementioned assessments of appropriateness should be carried out.

The setting of a common framework, in terms of the types of factors or the conditions to be taken into account when applying the discretion granted by Articles 124(2) and 164(6) of the CRR2, leaves sufficient flexibility in designing the assessments performed by relevant authorities but simplifies and harmonises the understanding of the reasons motivating actions taken on the basis of the assessments.

The common framework proposed for the appropriateness assessments in the draft RTS relies, where possible, on definitions that are already harmonised in the EU (either CRR or other harmonised legislation). This supports the consistent application of Articles 124(2) and 164(6) of the CRR2 across Member States. Allowing Member States to define the conditions for the application of Articles 124(2) and 164(6) of the CRR2 without any further guidance would instead increase complexity.

The availability of databases with harmonised data, as it is based on the same reporting rules, such as the one established on the basis of Article 430a of the CRR2, can help to harmonise the approaches used to assess the adequacy of the current prudential treatment.

It must be noted that some of the types of factors mentioned in the RTS can only be monitored if appropriate data are available, leading to potential data gaps between Member States.

F. Assessment

In December 2019, the total amount of MRC stemming from mortgages was equal to about EUR 72 billion, representing 10.3% of overall (i.e. including market risk and operational risk) minimum requirements.²⁰ As shown above, leveraging Articles 124(2) and 164(6) of the CRR2, material differences in the prudential treatment of mortgages could be introduced between Member States.

The common framework presented in the RTS ensures a harmonised application of the prerogatives set in Articles 124(2) and 164(6) of the CRR2. Within the framework delineated by the RTS, the relevant authority can find the right balance between properly assessing the adequacy of risk weights under SA or of minimum LGD values under the IRB Approach from a macroprudential perspective and the flexibility to implement the types of factors or the conditions suitable for its banking sector and immovable property market.

The RTS have benefited from a survey conducted among the competent authorities regarding the current practices. On the basis of the analysis of this information, it is possible to state that the general principles established by the RTS should not result in a significant increase in costs for the relevant authorities.

²⁰ Based on COREP data.

4.2 Feedback on the public consultation

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
General comments			
Impact on capital requirements and overlaps	One respondent noted the potential linkages between increasing risk weights and minimum LGD values and other parts of the regulation.	The EBA notes that action under Articles 124 and 164 of the CRR could impact other parts of the regulation. As stated in the Background and rationale section of these draft RTS, when considering any changes to risk weights or minimum LGD values, the relevant authority should also be aware of the direct linkages to other parts of the regulation, including the impact of such changes on the calculation of large exposure values, liquidity and capital ratios, reporting requirements and other macroprudential measures.	None
Negative impact on lending	Respondents highlighted that the regulation, together with the actions of national authorities, might lead to an increase in banks' capitalisation with respect to the real estate loans, with negative consequences for the provision of these loans.	The EBA would like to clarify that these draft RTS do not result in any increase in capital requirements, nor do they require national authorities charged with the application of Articles 124 and 164 of the CRR to take any action. As clarified in Recital (3), these draft RTS strive for more consistency by setting a sufficiently harmonised framework for the assessment of the appropriateness of risk weights under the SA and the minimum LGD values under the IRB Approach.	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Overlaps of macroprudential requirements	<p>Respondents noted that financial stability risks are targeted by multiple tools set by authorities, including floors to risk weights for the IRB Approach. Respondents expressed their opinion that the RTS should be made clearer to make sure authorities do not have discretion to impose multiple macroprudential tools targeting similar systemic risks and that they disclose any assessments leading to changes in risk weights or minimum LGD values.</p> <p>One respondent pointed to the potential link with Article 458 of the CRR. The conditions to apply higher minimum LGD values are (correctly) quite strict (although they are formulated quite generally so the competent authorities have ample freedom to interpret them). Consequently, authorities tend to revert to Article 458, which is a less targeted and sophisticated measure to increase capital requirements.</p>	<p>The EBA is aware of the possibility of such duplicated actions. The EBA would like to highlight that Articles 124(1a) and 164(5) of the CRR foresee that the cooperation between the competent authority and the authority designated by the Member State for the application of these articles shall aim at avoiding any form of duplicative or inconsistent action between the competent authority and the designated authority, as well as ensuring that the interaction with other measures, in particular measures taken under Article 458 of the CRR and Article 133 of Directive 2013/36/EU, is duly taken into account.</p> <p>Furthermore, the draft RTS address such concerns. When relevant authorities determine the loss experience and loss expectation for assessing the appropriateness of risk weights, they shall have regard, according to Article 1(5) of these draft RTS, to other current macroprudential measures in force. Similarly, according to Article 2(2)(b) of these draft RTS, when authorities assess the appropriateness of minimum LGD values they shall have regard to other current macroprudential measures in force.</p>	None
Transparency of decisions and processes	<p>Two respondents suggested that there should be a requirement in the RTS for authorities to disclose the assessments of factors that lead to a change in</p>	<p>The purpose of these draft RTS is to specify the types of factors to be considered for the assessment of the appropriateness of risk</p>	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>the risk weights or LGD values. These assessments should be made public together with the risk weights and minimum LGD values.</p> <p>One respondent added that the methodologies applied to determine the loss expectation should be shared in advance with the banks to facilitate capital planning and render decisions predictable and transparent. The respondent added that banks must be able to ascertain the reasons upon which the national competent authority's decision is based and must be able to recalculate the RWA or LGD amount.</p>	<p>weights and the conditions to be taken into account for the assessment of the appropriateness of minimum LGD values; disclosure by competent authorities is outside of the scope of these draft RTS.</p>	
Degree of national discretion	<p>One respondent mentioned that the rules proposed to regulate authorities' discretionary powers look very broad and vague. The same respondent proposed that there should be proper reasons for changes of risk weights or LGD parameters based on objective criteria that show explicitly that there are no multiple capital requirements subject to the same risk.</p> <p>Another respondent noted that rules should be introduced for quantifying the change in risk and how this is related to risk weights and minimum LGD parameters in order to make outcomes predictable and transparent. The same respondent proposed the introduction of "buckets" or steps for the change in risk weights and minimum LGD values.</p>	<p>As stated in Recitals (3) and (4) of these draft RTS, to ensure proportionality the draft RTS account for the heterogeneity of the immovable property markets across Member States while at the same time setting out a sufficiently harmonised framework for the assessments of the appropriateness. The EBA is of the opinion that the draft RTS strike a balance between achieving harmonisation and preserving the flexibility necessary for the performance of the assessments.</p> <p>Furthermore, these draft RTS do not include considerations on factors that could adversely affect current and future financial stability, or details on indicative benchmarks for the calibration of any increases in risk weights or minimum LGD values.</p>	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Level playing field and impact on the single market	Two respondents mentioned that specific action with respect to specific national real estate markets could undermine the level playing field between the individual EU Member States, and that this should be avoided.	The EBA is aware that national real estate markets, or their segments, can be subject to different risks. These draft RTS intend to limit the room for such heterogeneous action and ensure a harmonised approach for the periodical assessment of risk weights and minimum LGD values.	None
Reciprocation	One respondent noted that the requirement to apply a higher risk weight or a higher minimum LGD set in another Member State should be accompanied by a materiality threshold.	Considerations regarding reciprocation of higher risk weights and minimum LGD values set by authorities of another Member State are out of scope of these draft RTS. Nevertheless, Article 124(6) and Article 164(10) of the CRR set out requirements regarding risk weights and minimum LGD values determined by the authorities of another Member State.	None
Climate risks	Respondents noted that climate risks should not be considered in the list of relevant factors when assessing the appropriateness of risk weights. One respondent pointed to a potential increase in the cost of funding for low greenhouse emissions housing.	The EBA takes note of the consensus recorded in the answers regarding the inclusion of climate risks. Given the challenges and costs recorded for such an option, climate-related risks will not be considered in the determination of the loss expectation when relevant authorities assess the appropriateness of risk weights under the SA Approach.	None
Interactions with other provisions on risk	One respondent assumed that the alternative treatment under Article 230(3) of the CRR can	These draft RTS are meant solely to support the periodical assessments of relevant	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
weights and minimum LGD values	<p>continue to be used for banks using the IRB Approach even if a higher risk weight or minimum LGD value are set in accordance with the draft RTS. In this case, the risk weight would be the higher of (i) 50% under Article 230(3) of the CRR and (ii) the risk weight determined in accordance with the draft RTS.</p> <p>The same respondent highlighted that in line with the requirement set out in Article 193(1) of the CRR, no higher risk weight may be assigned to an exposure secured by immovable property than would be necessary if no immovable property collateral were to be received.</p>	<p>authorities for the appropriateness of risk weights under Article 124(2) of the CRR or the appropriateness of minimum LGD values under Article 164 (6) of the CRR. Therefore, the applicability of Articles 230(3) and 193(1) of the CRR is out of scope of these draft RTS.</p>	
Introduction of time of origination and period of RTS application	<p>One respondent highlighted that application to stock and new exposures or only new exposures is a factor to be considered for the assessment of the appropriateness. New exposures, according to the respondent, are those originated following a period after the adoption of these draft RTS. The respondent suggests that the stock will remain subject to the former risk weight and “all exposures including the stock” and the decision should apply to newly originated exposures.</p> <p>The respondent provides a proposal for amendment.</p>	<p>These draft RTS cannot specify the type of exposures secured by immovable property nor the segments that will be subject to any increase in risk weights or minimum LGD values following the periodical assessment of authorities tasked with the application of Articles 124(2) and 164(6) of the CRR. These draft RTS deal only with the types of factors and conditions to be considered in the assessments of the appropriateness of risk weights under Article 124(2) of the CRR or the appropriateness of minimum LGD values under Article 164(6) of the CRR by the relevant authorities.</p>	None
Balancing mechanism	<p>One respondent proposed that some form of “balancing mechanism” should be introduced. This would mean, where the authority has decided to</p>	<p>Specifying the type of exposures to which a higher minimum risk weight applies is beyond the scope of these draft RTS, which aim to</p>	

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>increase the risk weights applicable to exposures, an individual identified exposure would not be subject to the increased risk weight if the institution can demonstrate that the exposure secured by immovable property is “over-secured” in equal proportion.</p>	<p>ensure a harmonised approach in the periodical assessments referred to in Articles 124(2) and 164(6) of the CRR and do not include considerations on the scope of application of any increases in risk weights or minimum LGD values.</p>	
<p>Responses to questions in Consultation Paper EBA/CP/2021/18</p>			
<p><u>Question 1. What is the respondents' view on the types of factors to be considered during the determination of the loss expectation for the appropriateness assessment of risk weights under the SA?</u></p>			
<p>Changes to the types of factors</p>	<p>It is proposed by three respondents that the RTS should take into account “market value” and “mortgage lending value” as “base of value” instead of “price” to evaluate the property collateral.</p>	<p>The draft RTS do not limit the factors to be taken into consideration, but rather strive for a minimum degree of harmonisation, while taking into account national specificities. Article 1(3)(i) of the draft RTS specifies that relevant authorities shall base the determination of loss expectation on any other data indicators and sources which provide insight into forward-looking market developments which impact the loss expectation.</p>	<p>None</p>
<p>Inclusion of additional factors</p>	<p>Three respondents pointed to the need to consider the general level of borrower indebtedness in the list of factors as well as the location of collateral and national laws which could affect the riskiness of exposures and loss expectation.</p>	<p>The borrower indebtedness, location and national laws are considered in Article 1(3) (d) and 1(3) (b) of these draft RTS.</p> <p>Specifically, Article 1(3)(d) of these draft RTS clarifies that indicators relevant for the property segments shall be used to measure the riskiness of exposures. Indicators could be</p>	<p>None</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		<p>relevant to parts of the territory. Authorities shall regard to lending standard indicators specified in the ESRB recommendation on closing real estate data gaps (ESRB/2016/14) which include measures of borrower indebtedness.</p> <p>Article 1(3)(b) of these draft RTS specifies that structural characteristics of the immovable property market include among others national taxation systems and the national regulatory provisions for buying, holding or letting immovable property.</p>	
Length of the forward-looking horizon	<p>As regards the length of the forward-looking horizon for the loss expectation, two respondents stated that forming expectations about the evolution of the immovable property market and macroeconomic variables over a three-year horizon could be unfeasible due to the unpredictability of sudden events.</p> <p>Two respondents noted that a horizon longer than three years would be more appropriate for forming the forward-looking loss expectation to avoid incorporating conjectural economic effects. One respondent added that authorities could decide annually on the length of this horizon possibly beyond three years.</p> <p>Another respondent did not agree that authorities should decide on the length of the forward-looking horizon.</p>	<p>The EBA takes note of the heterogeneity recorded in respondents' answers. Article 124 of the CRR does not stipulate the length of the horizon which should be taken into account for forward-looking immovable property market developments. To improve the harmonisation of the framework and thereby to enhance the comparability of the assessments, these draft RTS specify the forward-looking horizon.</p> <p>Ultimately, the choice of the forward-looking horizon for the determination of loss expectation is a trade-off between accuracy of projection and uncertainty. A longer horizon increases the uncertainty of estimates for the loss expectation, while a short-term horizon allows a larger influence of short-term fluctuations on shorter-term developments. The choice of a period between one and three</p>	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
		years aims to further balance the heterogeneity of national real estate markets with the need to harmonise the criteria for determination of the forward-looking loss expectation.	
Consultation process	Three respondents noted that consultation with the industry is important when determining the loss expectation if it leads to a change in risk weights before deciding to set higher risk weights or impose stricter criteria.	The interaction with the public concerning the consequences depending on the result of the assessment process is out of the scope of this mandate, which is limited to specifying the types of factors to be considered for the assessment of the appropriateness of the risk weights.	None
Impact on capital requirements and overlaps	Another respondent stated that the relevant authorities should consider the built-in buffer that Articles 125 and 126 of the CRR require. Article 125 (2)(d) of the CRR requires that the part of the loan to which the preferable 35% risk weight is assigned does not exceed 80% of the market value of the property in question or 80% of the mortgage lending value of the property (residential property). Article 126 (2)(d) of the CRR mirrors this requirement for commercial immovable property, meaning that the preferential 50% risk weight part of the loan must not exceed 50% of the market value of the property or 60% of the mortgage lending value.	The EBA clarifies that Article 1(1) (a) of these draft RTS defines the loss experience according to losses stemming from exposures fully secured by mortgages on residential property referred to in Article 125 of the CRR and exposures fully secured by commercial immovable property referred to in Article 126 of the CRR. Nevertheless, these draft RTS state in paragraph 16 of the Background and rationale section that authorities should be aware of any direct linkages to other parts of the regulation.	None
Definition of loss experience	Furthermore, one respondent argued that the RTS should further refine the definition of loss experience to ensure that the period used is long	Concerning the determination of the loss experience based on the data collected, and annually reported under Article 430a of the	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>enough and at least three years to provide stable estimates. The same respondent added that “statistical outliers” should be taken into account with caution for the assessment of higher risk weights according to the EBA draft RTS.</p>	<p>CRR by the institutions, the relevant authority is expected to use the latest available information (including reporting data) when conducting the appropriateness assessment. However, this is a general expectation which also applies to all types of factors and the conditions mentioned in the draft RTS and not only to the loss experience (paragraph 1 of Article 1 of these draft RTS). To the extent that historical outliers are not related to forward-looking immovable property market developments or the types of factors considered under Article 1(2) of the draft RTS, they should not influence the loss expectation.</p>	
<p>Factors not to be considered</p>	<p>Two respondents were against using macroeconomic data for adjusting the loss expectation because their use would require ongoing evaluation by the relevant authorities.</p>	<p>The EBA notes that the ongoing evaluation is already foreseen in Article 124(2) of the CRR. Therefore, the assessment could allow the inclusion of variables having a higher frequency, such as macroeconomic variables.</p>	<p>None</p>
<p>Need for methodology /specific metrics</p>	<p>Two respondents expressed a preference that other data indicators and sources mentioned in Article 1(3)(i) should be specified further.</p>	<p>Given the heterogeneity of immovable property markets across the Member States, it is not desirable to provide a one-size-fits-all approach. Member States shall have the ability to consider all relevant factors which impact the loss expectation or support the data quality of the loss experience.</p>	<p>None</p>
<p>Exemptions from the application of minimum risk weights</p>	<p>One respondent proposed a “balancing mechanism” so that individual exposures are exempted from the application of the new</p>	<p>See reply in the General comments section – Balancing mechanism.</p>	<p>None</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>minimum risk weights if the institution can demonstrate that the exposure secured by immovable property is “over-secured” in equal proportion.</p>		
<p><u>Question 2. What is the respondents’ view of the option of considering climate-related risks in the determination of the loss expectation where the relevant authority was in a position to perform an appropriateness assessment for one or more parts of the territory of the Member State? What for the respondents would be the benefits and the challenges (costs) of such an option?</u></p>			
Lack of support	<p>All respondents agreed that climate-related risks should not be considered for the determination of the loss expectation since there are no final conclusions on the prudential and supervisory treatment of such risks.</p>	<p>The EBA fulfils its various mandates on ESG-related risks and undertakes various actions and measures to obtain a better understanding of climate-related risk.</p> <p>In conjunction with the banking industry view, this will help in coming up with a common and better understanding of ESG risks.</p> <p>At present, the consideration of climate-related risk seems therefore to be at an early stage.</p> <p>The EBA will nonetheless continue to deliver on its mandates, including the assessment of the justification (or lack thereof) for applying a dedicated treatment to exposures associated with environmental objectives (Article 501c of the CRR).</p>	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Overlap with ongoing regulatory initiatives	Three respondents noted that considering climate-related risks could create overlaps with other ongoing EBA regulatory work on sustainable finance.	See reply to first comment under Q2.	None
Impact on capital requirements and overlaps	Two respondents argued that considering climate-related risks could lead to duplication of capital charges because risks foreseen to materialise and impact property are already taken into account in the collateral valuation and risk management processes, while a few physical risks are covered by primary or secondary insurance on the collateral asset.	See reply to first comment under Q2.	None
Lack of historical data/ challenges to projections	Respondents highlighted also a few technical difficulties when considering climate risks. Respondents pointed to the lack of historical data on climate risk, which also limits understanding on how such risks could affect institutions' portfolios. Respondents noted further that the three-year horizon for the determination of the loss expectation could be too short to account for the materialisation of climate risks.	See reply to first comment under Q2.	None
Negative impact on lending	As regards the costs of such an option, one respondent argued that considering climate risks could increase the cost of lending to finance the green transition, given that housing contributes significantly to GHG emissions.	See reply to first comment under Q2.	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<u>Question 3. What is the respondents' view on the conditions when assessing the appropriateness of minimum LGD values (cf. paragraph 1 of Article 2)?</u>			
Degree of national discretion and implications for EU harmonisation	One respondent proposed to stipulate a limit in the RTS for higher minimum LGD values set by relevant authorities, arguing that such a limit would help ensure a uniform application of the RTS and limit the scope for discretion.	The mandate provided to the EBA in Article 164(8) of the CRR only relates to conditions that the relevant authority should take into account when assessing the appropriateness of minimum LGD values. The EBA is not mandated to specify ranges or limits for higher minimum LGD values that could be set by relevant authorities responsible for the application of Article 164 of the CRR.	None
Clarifications on conditions	One respondent noted that the RTS should further clarify the reference to changes in the recovery procedures under Article 2(1)(b) of the RTS. In particular, the respondent argued differences across banks in recovery procedures may bias the assessment with the potential to penalise banks with the most efficient processes. Hence the respondent argues that relevant authorities should rely purely on structural considerations and changes to national frameworks.	Recital (6) of these draft RTS clarify that with regard to conditions for assessing the appropriateness of minimum LGD values, this Regulation should focus on aspects beyond economic downturn and idiosyncratic risks. Therefore, the reference to changes in recovery procedures should not be understood as targeting the efficiency of individual institutions' recovery procedures.	None
Inclusion of LTV in the list of factors	One respondent highlighted several challenges relating to the use of loan-to-value (LTV) ratios referred to in Article 2(1)(c). In particular, the respondent pointed out that industry-average LTV may not be meaningful as banks may adopt different business models or strategies leading to heterogeneous LTV ratios. The respondent argued that to avoid penalising more prudent banks parameters such as the LTV ratio should only be	The EBA takes note of the LTV differences that might arise between banks within a Member State due to factors such as variations in underwriting policies, risk appetite or business strategy. The assessment of such factors remains, however, out of scope of the draft RTS as they take a macroprudential perspective. Furthermore, LTV ratios are only one input of the assessment of relevant	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>considered for additional analyses but not as a direct input to a computation formula.</p> <p>Furthermore, the respondent noted that high LTV ratios may arise in cases of borrowers with high creditworthiness (low PD) and in relation to unfunded credit protections (UFCP) not captured by the LTV definition.</p>	<p>authorities on minimum LGD values. According to Article 2 paragraph 1 of the draft RTS, relevant authorities shall have regard to all the conditions laid out in points (a)-(c) and not rely only on a single condition identified as affecting systemic risk.</p>	
<p>Loss experience as the basis of the assessment</p>	<p>One respondent proposed that the loss experience in line with the losses reported under Article 430a (1) of the CRR for exposures secured by immovable property should be the starting point for the assessment of the appropriateness of the minimum LGD.</p> <p>The respondent highlighted further that the assessment of minimum LGD values differs from the assessment of risk weights, since banks' LGD models already reflect elements varying over time.</p>	<p>The EBA agrees that the assessments of the appropriateness of risk weights under the SA approach and minimum LGD values under the IRB Approach differ. From a microprudential perspective, IRB Approaches with own estimates of LGD are approved and closely monitored by supervisors and regularly validated by institutions. Furthermore, rating systems are subject to a degree of conservatism pursuant to the requirements for the IRB Approach under the CRR.</p> <p>For the above reason, the draft RTS consider minimum LGD values for the sources of systemic risks beyond the economic downturn considerations (as further specified in regulatory technical standards and EBA guidelines) and idiosyncratic risks.</p> <p>Therefore, the loss experience is not included in the conditions for the assessment of minimum LGD.</p>	<p>None</p>

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
<u>Question 4. What is the respondents' view on the considerations to be taken into account when assessing the appropriateness of minimum LGD values (cf. paragraph 2 of Article 2)?</u>			
Definition of macroeconomic imbalances	Two respondents noted that it should be clarified that the concept of macroeconomic imbalances impacting on LGD estimates beyond the economic cycle, as referred to in Article 2 of the RTS, should reflect scenarios reasonably to be expected and not reflect severe stress scenarios, arguing that estimates from internal models are required to be appropriate for an economic downturn, but not a severe stress scenario as considered in a stress test.	<p>Recital (6) of the draft RTS clarifies conditions for assessing the appropriateness of minimum LGD values. Therefore, when authorities assess minimum LGD values, they should abstract from microprudential considerations and consider aspects beyond economic downturn and idiosyncratic risks. These draft RTS do not intend to interfere with microprudential aspects related to the estimation of LGD values.</p> <p>The EBA would like to reiterate that Article 164(5) of the CRR foresees that the competent authority and the authority designated by the Member State for the application of this article shall avoid any form of duplicative or inconsistent action when assessing the appropriateness of minimum LGD values.</p>	None
Changes to the conditions	Three respondents proposed that the inclusion of trends affecting the market and/or mortgage lending values used by the banks be taken into account when assessing the appropriateness of minimum LGD values, arguing that these collateral values are more closely related with banks' risk exposures than pure price trends.	The draft RTS do not limit the conditions to be taken into consideration, but rather strive for a minimum degree of harmonisation while taking into account national specificities. Article 2(1)(c) of the draft RTS specifies that relevant authorities shall have regard also to other conditions that indirectly impact the value of collateral taken into account in LGD estimates.	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
Avoidance of procyclicality	Respondents highlighted that a procyclical calibration of minimum LGD values should be avoided since such a calibration may pose risks to financial stability.	The mandate provided to the EBA in Article 164(8) of the CRR only relates to conditions that the relevant authority shall take into account when assessing the appropriateness of minimum LGD values. These draft RTS do not include any considerations on financial stability or details on indicative benchmarks for the calibration of any increases in risk weights or minimum LGD values.	None
Consultation process	Several respondents highlighted that relevant authorities should adopt appropriate consultation processes and conduct impact studies before deciding to set higher minimum LGD values. In this context, respondents noted that LGD models are approved and regularly reviewed by competent authorities.	The interaction with the industry concerning the consequences depending on the result of the assessment process is out of the scope of this mandate, which specifies the conditions to be taken into account when assessing the appropriateness of minimum LGD values.	None
National specificities and transparency of decisions and processes	Furthermore, two respondents highlighted the relevance of national specificities relating to real estate markets and argued that given these specificities relevant authorities should disclose detailed reasoning when deciding to set higher minimum LGD values, including an exact specification and quantification of the targeted risk and how that risk impacts on risk weights and minimum LGD parameters.	According to Article 2(2)(d) of the draft RTS, authorities shall have regard to national specificities exclusively relating to the real estate market and its financing.	None
Definition of price volatility	One respondent noted that the RTS should further clarify which time horizon should be used to determine price volatility referred to under Article	The use of the term price volatility should rather be understood as referring to the uncertainty of dynamics in real estate prices	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	2(2)(c) of the RTS, and whether it should be based on historical observations.	and not as referring to historical volatility that should be considered in the estimation of downturn LGD parameters.	
Use of macroeconomic imbalances	Respondents noted that authorities should also consider the degree to which macroprudential imbalances and/or factors are already sufficiently reflected in the historical observation period or covered by the general requirements specific to own LGD estimates.	This point is addressed by Article 2(1)(a) of these draft RTS, which foresees that authorities shall have regard to whether the macroeconomic imbalances are related to an economic downturn, and hence are considered in the downturn LGD estimation for the respective exposures. As clarified in Recital (6), these draft RTS should focus on aspects beyond economic downturn and idiosyncratic risks.	None
Benchmarking comparisons	Two respondents noted that the purpose of the benchmarking analysis as regards Article 2, paragraph 2(3), should be further explained to clarify that it is intended to identify unwarranted systematics in LGD estimates induced by the specific macroeconomic imbalances rather than by the banks' compliance with legal requirements on LGD estimation.	Article 2(2)(e) of these draft RTS specifies that benchmarking exercises shall be within the considerations that relevant authorities should take into account when assessing the minimum LGD values. Benchmarking exercises are to be taken into consideration when the relevant authority deems the comparison as relevant, and the corresponding data are available. Benchmarking analysis should be performed for comparable portfolios, risk levels and facilities secured by immovable property pledged as collateral.	None
Margin of conservatism and minimum LGD	Two respondents noted that in IRBA models MoC (margin of conservatism) is always considered. If uncertainty in LGD estimates (for example regarding climate risks) is already considered in the	While the uncertainty from the micro perspective is already subject to a degree of conservatism pursuant to the requirements for the IRB Approach, the scope of these draft	None

Comments	Summary of responses received	EBA analysis	Amendments to the proposals
	<p>MoC component, it should not affect the minimum LGD level. Alternatively, it could be considered that some systemic risks are reflected in MoC, which would also be more precise, for example regarding areal distribution of loans.</p>	<p>RTS is to deal with macroprudential risks that are not captured by the IRB Approach.</p>	
<p><u>Question 5. What is the respondents' view on the use of other data sources?</u></p>			
<p>Cost of reporting</p>	<p>Two respondents pointed out that an additional reporting burden for the banking sector should be avoided and existing data should be utilised instead of introducing new reporting requirements.</p>	<p>Optimising supervisory reporting requirements and reducing reporting costs for institutions are part of the EBA's ongoing work on proportionality in supervisory regulatory and reporting framework. The draft RTS do not empower competent authorities to introduce new reporting requirements for the assessment of the appropriateness of risk weights or minimum LGD values only. However, the relevant authorities should be in a position to ensure adequate assessment of risk weights under the SA or minimum LGD values under the IRB Approach and have sufficiently granular data for this purpose.</p>	<p>None</p>
<p><u>Question 6. Do respondents want to raise other considerations relevant to the application of this article?</u></p>			
<p>Overlap with ongoing regulatory initiatives</p>	<p>Two respondents suggested that due to various ongoing new regulatory reporting requirements (Basel III+, Basel IV, COVID), any additional new initiatives which increase the regulatory reporting burden on the banking sector should be avoided.</p>	<p>See reply to Question 5.</p>	<p>None</p>

