Comments

EBA consultation on draft RTS concerning the assessment of appropriateness of risk weights and minimum LGD values (EBA/CP/2021/18)

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General remarks

We assume that the alternative treatment under Article 230(3) of the CRR can continue to be used for banks using the IRBA even if a higher risk weight or minimum LGD is 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.

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. This means that, if the application of the draft RTS results in a higher risk weight than a comparable exposure or immovable property collateral, the risk weight for a comparable unsecured exposure (e.g. retail, SME, corporate) is applied, rather than the risk weight in accordance with the draft RTS.

The requirement to apply a higher risk weight or a higher minimum LGD set in another Member State is appropriate in order to ensure a level playing field. However, as in the case of the countercyclical capital buffer, a materiality threshold in terms of affected exposure should be defined, below which this requirement would not have to be met. The reason for this is that such immaterial exposures do not lead to a distortion of competition, the institution is not exposed to any materially higher risk, and hence the cost to the institution, with only a few exposures affected, would not be justified.

Answers to the consultation questions

1. What is the respondents' view on the types of factors to be considered (cf Article 1) during the determination of the loss expectation for the appropriateness assessment of risk weights under the SA?

To ensure that all relevant aspects are considered when the loss expectations are determined, the banking industry should be consulted through appropriate means if it emerges that observed trends and estimates would lead to a change in risk weights.

The loss expectations could be related to the amount of corporate and household debt. For that reason, this factor should also be taken into account when the loss expectation is estimated.

As well as factoring in pure price trends on the immovable property market, the trends affecting the market and/or mortgage lending values used by the banks and firmly anchored in their risk management should also be included as relevant factors. The reason for this is that these collateral values are more closely correlated with the bank’s risk exposure than pure price trends.

2. What is the respondents’ view of the option of considering climate related risk in the determination of the loss expectation where the relevant authority was in a position to perform an appropriateness assessment to one or more parts of the territory of the Member State? What would for the respondent be the benefits and the challenges (costs) of such option?

Considering climate-related risk separately in the determination of loss expectations does not make sense because the forward-looking horizon of up to three years is unlikely to capture any material additional risks on top of those already taken into account in the bank's collateral valuation and risk management, including scenario calculations, and risks identified from climate trends are already recorded. Long-term climate risks, which are associated with a high degree of uncertainty, cannot therefore reasonably be taken into account within the framework of the proposed methodology.

3. What is the respondents' view on the conditions when assessing the appropriateness of minimum LGD values (cf paragraph 1 of Article 2)?

The starting point for the assessment of the appropriateness of the minimum LGD must also be the consideration of the loss experience in line with the losses reported under Article 430a(1) of CRR II for exposures secured by immovable property. The reason for this is that is only possible to elaborate statements about the estimated future loss trend on the basis of loss experience trends. It is also particularly important to note in this context that the baseline for assessing the minimum LGD is completely different from the baseline for risk weights. This is because the individual LGDs are based on approved models that are reviewed regularly and also include downturn elements. In other words, the banks' LGD models already comprehensively reflect external circumstances and developments and change accordingly over time. By contrast, the risk weights are fixed by regulatory requirements and are not related to the bank's specific credit portfolio.

As the CRR does not stipulate any limit for the amount of the minimum LGD, this should be done in the RTS (e.g. a maximum of 25%) because a limit is also imposed on the higher risk weights. In addition, doing this will ensure the more uniform application of the draft RTS throughout the EU, as the scope for discretion would otherwise be too large.

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)?

To ensure that all relevant aspects are considered when the loss expectations are determined, the banking industry should be consulted by appropriate means if it emerges that observed trends and estimates would lead to a change in the minimum LGD. This is particularly important because the LGD models have been approved by the supervisory authorities and are reviewed regularly, and a downturn LGD is also applied.

As well as factoring in pure price trends on the immovable property market, the trends affecting the market and/or mortgage lending values used by the banks and firmly anchored in their risk management should also be included as relevant factors. The reason for this is that these collateral values are more closely correlated with the bank's risk exposure than pure price trends.

5. What is the respondents' view on the use of other data sources?

No comments.

6. Do respondents want to raise other considerations relevant for the application of this article?