HELLENIC BANK ASSOCIATION

Response from the Hellenic Bank Association to the EBA discussion paper EBA/DP/2015/01: *Future of the IRB Approach*

General comments

The Hellenic Bank Association (HBA) was established in 1928 and is a non-profit legal entity, representing the vast majority of Greek and foreign credit institutions that operate in Greece, which hold more than 95% of assets of the Greek banking system.

The HBA appreciates the opportunity to respond to the discussion paper on *the future of the IRB approach,* since it is an opportunity for the industry to give feedback on the content and the impact of the upcoming changes.

Response to the consultation questions

Q1: The proposed prioritisation of regulatory products is based on the grouping of such elements that in the EBA's view can be implemented in a sequential manner. Do you agree with the proposed grouping? If not, what alternative grouping would you suggest?

According to the discussion paper, the RTS on assessment methodology for the IRB approach that affects directly supervisory authorities and indirectly supervised institutions, are expected to enter into force by mid-2016, while the other RTS and Guidelines will enter into force by end-2018. The proposed prioritisation implies that credit institutions shall make all the necessary preparations in order to comply with the provisions of the RTS on assessment methodology and subsequently shall review their IT systems and policies in order to ensure their compliance with the newly-established rules concerning the definition of default and other risk parameters.

With regard to the proposed prioritisation of the EBA regulatory products (RTS and Guidelines), we consider that the adoption of the RTS and Guidelines on the specification of the definition of default should be a priority, since it is a significant and crucial parameter for the calculation of RWAs and a major source of discrepancies across Member States. Therefore, we propose the regulatory products of the Phases 2 and 3 to precede the adoption of the RTS on the assessment methodology so as to relieve institutions from making double effort to implement the proposed changes.

Q2: What would you consider the areas of priorities?

The HBA considers that the EBA should have as a priority due to its key importance the specification of the ***definition of default*** of the obligor, especially with regards to the following aspects:

- ***the materiality threshold*** of past obligations past due;
- the qualitative indications of ***unlikeliness to pay***, and particularly, of ***distressed restructuring*** of the credit obligation; and
- reclassification of defaulted exposures to the non-defaulted status.

Q3: Do you consider the proposed timeframe reasonable? In particular do you consider reasonable the proposed timeline for the implementation of the changes in the area of: a. definition of default; b. LGD and conversion factor estimation; c. PD estimation; d. treatment of defaulted assets; e. CRM?

The proposed timeframe for the implementation of the new rules is considered very tight, especially with regard to the credit institutions that currently use the standardised approach and prepare the implementation of the IRB approach. Specifically, pursuant to the final RTS on data waiver permission (EBA/RTS/2014/14), institutions can use data covering a period of two years for probability of default, own-loss given default and own-conversion factor estimates for certain types of exposures. This means that the implementation of the proposed changes in the concerned timeframe will be very burdensome for these institutions.

Consequently, the HBA suggests the adoption of a 3-year implementation period, at least, which will allow credit institutions to have sufficient time to adapt to the revised framework.

Q4: Are there any other aspects related with the application of the definition of default that should be clarified in the GL?

Further clarifications regarding the distressed restructuring conditions will be highly appreciated. Indicatively, we expect clarification of the following aspects:

- the status of the loan/obligor at the date of the restructuring (i.e. significant loan overdue exceeding 90 days;
- unlikeness to pay trigger events such as significant deterioration of the client's financial position;
- events that negatively affect the client's financial position;
- the type of concessions/modifications to the loan agreement terms applied (i.e. extension of credit facility/loan tenor more than 20% of initial duration/tenor, partial write off of loan (capital/and or interest)).

Besides the additional clarifications regarding restructured loans (paragraph 3d of article 178), stated by the EBA, as the main objective of the future guidelines in this matter, the following situations (paragraph 3 of article 178) should also be subject to review, and a more practical guidance should be provided:

- harmonisation of the "non-accrued status" of a credit obligation, including the impact on different accounting procedures across the EU credit institutions;
- the definition of a "significant perceived decline in credit quality" should be clarified;
- a "material credit-related economic loss" in a sale of a credit obligation should be clarified. This could be achieved, for example, by introducing a relative threshold for the observed loss due to the sale of a credit obligation (as a percentage of the outstanding amount) to identify cases that fall under this situation;
- the definition of the distressed restructuring may be further clarified with more details provided for :
  - ➢ indicative types of restructuring that lead to material economic loss (e.g. partial write-off);

- materiality thresholds for economic loss (e.g. amount of forgiveness/postponement of interest or capital).

Q6: To what extent is it possible to adjust your historical data to the proposed concept of materiality threshold for the purpose of calibration of risk estimates?

Adjustment of historical data is feasible, albeit difficult particularly for credit institutions, which during the last years have been merged with or have acquired other credit institutions. In Greece, as a result of the fiscal crisis there was an unprecedented restructuring of the banking system, since thirteen (13) credit institutions were resolved by the use of the bridge institution tool and the sale of business tool.

Under such circumstances the adjustment of the historical data to the proposed concept of materiality threshold, particularly with regard to the computation of the LGD of loans granted by the absorbed institutions, which apply different IT systems and credit policies is extremely difficult. In addition, the adjustment of historical data implies substantial organisational cost and devotion of human resources.

Q7: What is the expected materiality of the changes in your IRB models that will result from the proposed clarifications as described in section 4.3.2?

Although it is not possible to estimate accurately the impact of the proposed changes, it is expected that changes in IRB models will imply significant organisational cost (e.g. IT systems, reporting) and it is likely to cause material effects in the institutions' capital adequacy.

Q8: Do you consider the direction of the proposed changes adequate to address the weaknesses and divergences in the models across institutions?

We welcome the enhancement of the harmonisation of the regulatory framework in order to deal with the inconsistencies and weaknesses identified in the implementation of the IRB requirements across Member States. Therefore, we consider that the proposed changes are in the right direction and will contribute to the achievement of the aim to have comparable IRB models and will facilitate transparent comparison across institutions.

Q10: Do you have dedicated LGD models for exposures in default that fulfil the requirements specified in section 4.3.3.(ii)?

According to the current status, a potential excess of provisions for defaulted loans cannot be used to cover a shortfall for non-defaulted loans, while the opposite, i.e. an excess from non-defaulted used to cover shortfall for defaulted, is allowed as clearly specified in EBA Q&A (Question id 2013_573). In addition, stressed financial conditions in the banking sector of countries under financial turmoil have led to an extended provisioning coverage of defaulted loans, thus under current conditions banks operating in the above described environment appear to have significant excesses in defaulted loans and shortfalls in non-defaulted exposures. The above mentioned factors combined with the restricted recognition of excesses in capital (0.6% of IRB calculated RWAs) is expected to create a rather asymmetric negative effect on capital. In this context, it is proposed that IRB shortfall should be calculated on a total exposure basis.

Q11: Do you consider the direction of the proposed changes adequate to address the weaknesses and divergences in the treatment of defaulted assets across institutions?

The HBA considers suitable the proposed changes and in the right direction, particularly with regard to the arrangements providing for the use of not only historical but also looking-forward data in the context of the LGD in-default calculations.

Q13: What are the impacts for the institutions that should be considered when specifying the conditions for PPU and roll-out?

The arrangements to be adopted in the final RTS on assessment methodology regarding PPU and roll-out plans shall ensure that supervisory authorities have the discretion to approve changes in the roll-out plan, when there are significant changes in the business environment and in particular changes in strategy, mergers and acquisitions (Art. 7(3)(a)). In addition, it is necessary the final provisions concerning the timeframe for the implementation of the roll-out plan to take due account of the changing regulatory environment in which institutions operate.

Q14: Do you expect that your organisational structure and/or allocation of responsibilities will have to be changed as a result of the rules described in section 4.3.5?

It is expected that the implementation of the RTS on the assessment methodology will trigger substantial changes in the institutions' organisational structure, mostly relating to provisions regarding validation function. For this reason, we propose as an alternative to the establishment of an independent validation unit, to lay down an option to outsource the validation function. With regard to point (c), par. 1 of Art. 10 of the draft RTS on the assessment methodology, we believe that, under the condition that the independence of the validation function is ensured, credit institutions should be free to decide the hierarchy level of consolidation of reporting lines of the validation function and the credit risk control unit according to their internal function and governance.

Q15: Do you agree that CRM is a low priority area as regards the regulatory developments?

Taking into account that the EBA is mandated to develop RTS on specific aspects of the CRM framework (i.e. recognition of conditional guarantees, liquid assets, internal models approach for master netting agreements) and in view of the upcoming thorough revision of the CRM framework by the Basel Committee, we consider the task of the EBA on CRM as a rather low priority in terms of significance. However, it is worth mentioning that the EBA regulatory products concerning CRM are expected to have substantial effects on LGD, mainly on IT systems and LGD models. Establishing rules affecting LGD shortly after the adoption of RTS and Guidelines (Phase 3) on the same field will be a heavy burden for institutions and will imply cost in terms of financial and human resources.

For this reason, we urge the EBA to examine the policy option to develop the RTS regarding CRM, in particular RTS on the eligibility of conditional guarantees, in parallel with the regulatory products on LGD in order to relieve credit institutions from making double effort in order to comply with the new requirements.

Q17: Do you agree that the area of disclosures needs to be strengthened, in particular with regard to disclosures related with the benchmarking exercise, for instance by publishing them on the EBA website?

Enhancement of the disclosure requirements will contribute to the improvement of comparability among institutions and will strengthen market discipline. In this context, we welcome EBA Guidelines (EBA/GL/2014/14) requiring disclosures on a more frequent basis and encourage the implementation of the Basel Committee Standards on revised Pillar III disclosures at a European level via EBA Guidelines.

Benchmarking exercise is a useful tool for supervisory authorities in order to examine and compare IRB models and to understand the methods used by credit institutions to calculate capital requirements. Disclosure of the results of the benchmarking exercise does not seem to have added value, since the goals of enhanced disclosure are achieved by other prudential requirements, like the abovementioned. On the contrary, it will increase complexity and it is quite possible to be misunderstood by investors and stakeholders; in this case might trigger stress events concerning the viability of institutions.

Q22: Do you see merit in moving towards the harmonisation of the exposure classes for the purpose of the IRB and the Standardised Approach

The proposed regulatory development concerning the harmonisation of exposures classes for IRB and standardised approach is in the correct direction and will enhance the comparability of capital requirements among institutions using different approaches. The inconsistency between the two approaches regarding the definition of retail exposures is a typical example of the existing discrepancies between them. The HBA supports the alignment of exposure classes and considers that will contribute to the better use by the investors and other third parties of the Pillar III disclosures, which will be strengthened even more by the next year (BCBS revised Pillar III disclosures).

Q24: Do you agree that the possibility to grant permission for the data waiver should be removed from the CRR?

Undoubtedly, allowing institutions to use data of a shorter observation period creates uncertainty with regard to the estimation of risk parameters. However, the HBA considers appropriate the existing arrangement, which provides for the possibility supervisory authorities to grant permission for the data waiver, where specific quantitative and qualitative conditions referred to the EBA RTS on data waiver permission are fulfilled.

Q25: Are there any other aspects of the IRB Approach not discussed in this document that should be reviewed in order to enhance comparability of the risk estimates and capital requirements?

The margin of conservatism is a significant matter, which in the past had substantial effects on institutions' capital requirements, especially in cases where the lack of data led to the imposition of capital add-ons by the supervisory authorities based on conservative judgments. Thus, the HBA disagrees with the proposed arrangement concerning the direct application of the margin of conservatism to IRB models in the context of Pillar I.