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Ihr Zeichen, Ihre Nachricht vom Unser Zeichen, Sacharbeiter Durchwahl Datum

BSBV 115/Dr.Egger/We 3137 7 August 2015

**EBA – Consultation Draft RTS on specialised lending exposures gem. Art. 153 (9) CRR**

The Division Bank and Insurance of the Austrian Federal Economic Chamber, as representative of the entire Austrian banking industry, appreciates the possibility to comment on the above mentioned Consultation Paper and would like to submit the following position:

**General remarks**

Pursuant to the CRR specialised lending exposures should possess the three characteristics given in the Art. 147(8). Nevertheless according to the CEBS Guideline 10 not all of these requirements have to be met to the same full extent. The most important criterion is that the primary source of repayment is income generated by the asset. We would like to know whether the implementation of this RTS would change this approach and lead to the equal importance of all defined criteria. Especially it is unclear whether the “entity which was created specifically to finance or operate physical asset” is an indispensable prerequisite in order to qualify an exposure as specilised lending or whether “an economically comparable exposure” can be treated as a structure substitute for SPV (“substance over form” principle).

In our opinion the assessment criteria should be structured and split into two groups, i.e. quantitative and qualitative risk factors. When possible, factors should be harmonized and used consistently across different categories of specialised lending. This structure of assessment would be clearer and closer to the actual rating process.

**Question 1:**

* 1. **What are the operational challenges of using the slotting approach?**

On entity level we do not see any indication of operational challenges specific to the supervisory slotting approach. Guidelines can be set in place to regulate the assessment by model users (e.g. locally quantifiable and objective threshold for “strong DSCR”) and reduce room for individual interpretation. If required, internal loss experience and / or expert view can be applied to calibrate these thresholds so that the slotting criteria are in line with the EL- and RWA-figures per slotting category as provided in CRR, §158(6) and §153(5).

* 1. **Is it possible to obtain comparable capital requirements across institutions using the slotting approach?**

Referring to question 1.1., comparability of capital requirements across institutions can only be ensured by the same interpretation of the slotting criteria and by means of consistent calibration.

* 1. **Should the slotting approach in your view be extended to other types of exposures, and if yes, for which types of exposures would this be particularly useful?**

Given that the historical evolution of the supervisory slotting approach being a ‘simple’ IRB alternative for low default portfolios and since currently the treatment of these low default portfolios are under various regulatory revisions, any consideration of extending the slotting approach to other portfolios should be subsumed by those existing activities. (We are referring to BCBS work on a revised standardized approach, the revisions of the IRB approach and the initiatives with respect to risk weighting of sovereign exposures.)

**Question 2:**

* 1. **What would be the preferred approach for the combination of the factors into a final assignment to a category?**

We apply a scorecard based approach to obtain slotting categories by mapping scores – through ratings and recovery expectations – to slotting categories. This is the most preferred approach as it is internally applied (e.g. in credit approval and pricing) which requires an increased granularity of scores compared to the four slotting categories:

* + - Supervisory slotting criteria is broken down to more granular and clearly defined risk factors
    - Segment specific scorecards per sub-portfolio (e.g. real estate type) integrating specific factors of the slotting criteria driving the default risk of a specialised lending project
    - Scorecards are calibrated to ratings based on internally available default experience
    - The default rating is combined with an estimate of the transaction’s recovery and mapped to a slotting category by means of the expected losses provided in CRR, §158(6).

In view of its scorecard approach and considering the options proposed in the document, we prefer option 2:

* + - *We believe that the above explained scorecard based approach is a direct interpretation of option 2*: The slotting criteria are split up into risk drivers, and the weighted scores assigned to each driver are added up to a total score which is, in turn, calibrated and mapped to a supervisory slotting category I to IV.
    - Option 1 would force us away from the current scorecard approaches it applies a cap on a category level with equal importance (see also 2.2 and 2.4.1). It would hence counteract our internal efforts towards an IRB rating approach in the long run.
    - We capture the key elements of option 1 by applying negative information/warning signals subsequent to model calibration, hence ensuring that critically weak transaction characteristics have a significant impact on the final risk assessment.
  1. **What are the advantages and drawbacks of either approach?**

We do not see any methodological advantages of option 1 over option 2: In capping the final slot, option 1 assumes equal importance of all risk drivers which, in our opinion, does not seem sufficiently risk sensitive. In particular, option 1 does not show sensitivity to the specific situation of the transaction where certain drivers or combinations thereof might be relatively more important.

* 1. **What would be the impact of both options on capital requirements?**

Given the current scorecard approach (mapped to slots), a capital impact of the two options has not been assessed.

* 1. **Are both options equally clear or should further guidance be provided?**

Option 1:

General remark: Option 1 regulates how to obtain a cap on the slot but not ‘what’ is capped: Is the final slot supposed to be a capped weighted average slot? In particular, option 1 does not regulate how to obtain categories for the individual sections as e.g. financial strength.

Option 2:

* According to option 2, all criteria should be taken into consideration at least with 10% weight.
* For banks applying the scorecard approach to supervisory slots, it needs to be further regulated if risk drivers not relevant in the scorecard but relevant in the supervisory slotting approach need to be integrated in the scorecard directly. These drivers will lead to a parallel shift of the score which is usually accounted for in the model calibration and, hence, redundant in a scorecard. This question for further regulation particularly addresses our view on Question 4, documentation requirement (d).

In our opinion the assessment criteria should be structured and split into two groups, i.e. quantitative and qualitative risk factors. When possible, factors should be harmonized and used consistently across different categories of specialised lending. This structure of assessment would be clearer and closer to the actual rating process.

* 1. **Are there other approaches that could be used to harmonise how the different factors are combined into a final assignment for the risk weight?**

We do not propose any alternative approaches.

**Question 3: *Do you agree with the classification of specialised lending and the descriptions given?***

Generally we agree with the classification but we propose better harmonization of the wording in the definitions. Especially the point 2(a) should start as follows: “a specialised lending exposure shall qualify as ‘project finance’ where the funding is used *to finance the development or acquisition of* large, complex (…)”.

Similarly, for ‘real estate’ definition the text should include the phrase “lease or rental payments *obtained from one or several third parties* or the proceeds (…)”.

Typically specialised lending exposures have at least three counterparties/stakeholders involved: (i) Sponsor, (ii) Financial Institution(s), and (iii) Lessee/Off-taker (being not under management control of the Sponsor). Thus we understand that “third parties” has to be interpreted as being not under management control of the Sponsor. Therefore exposures where the Sponsor and the Lessee(s)/Off-taker(s) coincide do not qualify as specialised lending.

Additionally, in our opinion the acquisition of land should not qualify to the category ‘real estate’. The assessment criteria outlined in Annex 2 cannot be applied to a land plot financing which is more characterized as asset based lending. Land plot financing is not coherent with the basic principle of specialised lending, i.e. creating or adding/increasing value of the asset(s).

Regarding SL IPRE, one of our bigger member institutions is currently overhauling its SL decision tree particularly delineating SL exposures from corporate exposures. In this regard, it is analysing the adequacy of “hotels in operations phase” in certain situations to be assigned to SL exposures as stated in the proposed description.

**Question 4: *Do you agree with these documentation requirements for each specialised lending exposure for which risk weights are assigned according to this Regulation?***

We generally agree with the documentation requirements **(a), (b), (c) and (e)**

Re. requirement **(d):**

* + - We map risk drivers of its applied scorecard to the factors and sub-factors “financial strength”, “political and legal environment”, “transaction and/or asset characteristics”, “strength of the sponsor and developer” and “security package” and thereby shows adequate coverage of all assessment criteria. *However, we apply a different aggregation scheme of model scores.*
    - In this regards, we obtain model scores per above sub-factors. *This model score, however, is not calibrated to a slot. Calibration to slot takes place on the aggregated / final score level.*
    - A calibration of model scores per each of the above named factors and sub-factors would mean a significant calibration effort for our scorecard approach.
    - *Conclusion: Given our understanding of documentation requirement (d), we do not agree and sees this as an additional burden for banks on the path towards IRB-compliance given the additional effort of model score calibrations to slots.*

**Question 5: *Do you have any suggestions or comments on the assessment criteria for project finance?***

In our opinion list of assessment criteria should be broader and harmonized across the categories of specialized lending. The table below summarizes our proposal for additional parameters.

Additionally, as mentioned before, in our opinion the assessment criteria should be structured and split into two groups, i.e. quantitative and qualitative risk factors. When possible, factors should be harmonized and used consistently across different categories of specialised lending. This structure of assessment would be clearer and closer to the actual rating process.

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| Financial Strength | * Advance Ratio * Cash-Flow predictability (all three subcategories) |
| Political and legal Environment | No comments |
| Transaction/Asset Characteristics | * Financing term compared to the economic life of asset * Location * Operating risk: Permits/licensing |
| Strength of Sponsor/Developer | * Financial capacity and will to support the property |
| Security Package | * Quality of insurance coverage * Rights/means to monitor location and condition of asset |

For all classes of specialised lending, it is or view that specific extra collateral (e.g. cash collateral accounts covering construction phase or similar) should be taken into account as EL-mitigating measures and, hence, slotting-category / RWA enhancing mechanisms.

The scorecard approach does not take into account any risk driver that does not add to the discriminatory power of the supervisory slot. The effect of such driver is accounted for in the calibration of the model by means of our SL portfolio specific default and loss experience. Such drivers might include constant drivers either due to the economic structure of the portfolio or the lending policy requirements. Changes to such drivers (e.g. changes in the lending policy) would be analysed for impact on the model as part of the associated model governance (e.g. responsibility of the operational model owner to trigger a model review when the lending policy is adjusted).

**Question 6: *Do you have any suggestions or comments on the assessment criteria for real estate?***

Under political and legal environment - country specific risks are well represented in case of SLPF slotting criteria and are underrepresented in case of SLIPRE slotting criteria.

In our opinion list of assessment criteria should be broader and harmonized across the categories of specialized lending. The table below summarizes our proposal for additional parameters.

Additionally, as mentioned before, in our opinion the assessment criteria should be structured and split into two groups, i.e. quantitative and qualitative risk factors. When possible, factors should be harmonized and used consistently across different categories of specialised lending. This structure of assessment would be clearer and closer to the actual rating process.

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| Financial Strength | * Financial ratios should be harmonized with the point (b) for Project Finance. Additionally in our opinion DSCR and ICR ratios should be considered relevant for the construction phase as well (calculated on the cash flow assumption of the completed property) * Financial structure (as in point (d) for Project Finance) * Foreign exchange risk (as in point (e) for Project Finance) |
| Political and legal Environment | * Political risk * Acquisition of all necessary supports and approvals * Enforceability of contracts, collateral and security |
| Transaction/Asset Characteristics | * Construction risk (as in point (b) for Project Finance) * Completion guarantees or liquidated damages (as in point (c) for Project Finance) * Track record and financial strength of contractor in constructing similar projects (as for Project Finance) * Operating risk: Operator’s expertise, track record, and financial strength * Operating risk: Permits/licensing * Financing term compared to the economic life of asset |
| Strength of Sponsor/Developer | * Sponsor support, as evidenced by equity, ownership clause and incentive to inject additional cash if necessary |
| Security Package | * Pledge of accounts * Rights/means to monitor location and condition of asset |

**Question 7: *Do you have any suggestions or comments on the assessment criteria for object finance?***

Comment: In our opinion list of assessment criteria should be broader and harmonized across the categories of specialized lending. The table below summarizes our proposal for additional parameters.

Additionally, as mentioned before, in our opinion the assessment criteria should be structured and split into two groups, i.e. quantitative and qualitative risk factors. When possible, factors should be harmonized and used consistently across different categories of specialised lending. This structure of assessment would be clearer and closer to the actual rating process.

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| Financial Strength | * Financial ratios should be harmonized with the point (b) for Project Finance * Financial structure (as in point (d) for Project Finance) * Foreign exchange risk (as in point (e) for Project Finance) * Cash-flow predictability |
| Political and legal Environment | * Enforceability of contracts, collateral and security |
| Transaction/Asset Characteristics | * Completion guarantees or liquidated damages (as in point (c) for Project Finance) * Track record and financial strength of contractor in constructing similar projects (as for Project Finance) * Operating risk (as in point (d) for Project Finance) |

The criterion “Operator’s financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease” is repeated under “Operating risk” and under “Strength of Sponsor/Developer”. In our opinion this double nomination should be corrected. Operator’s financial strength is part of the operating risk, thus it should be deleted in the “Strength of Sponsor/Developer”

**Question 8: *Do you have any suggestions or comments on the assessment criteria for commodities finance?***

No comments.

**Question 9: *Do you have any suggestions or comments on the Impact Assessment?***

No comments.

Please give our concerns due consideration.

Yours sincerely,

Dr. Franz Rudorfer

Managing Director

Division Bank and Insurance