European Mortgage Federation Position Paper on the Draft Regulatory Technical Standards on the conditions that competent authorities shall take into account when determining higher risk-weights

The European Mortgage Federation (EMF)[1] is pleased to present its comments on the Draft Regulatory Technical Standards on the conditions that competent authorities shall take into account when determining higher risk-weights.

1. There is general concern for the Pillar I implications of this Regulatory Technical Standards.

2. We appreciate that the competent authority will be required to be transparent with regards to the expected effects of and the justification behind a proposed increase/reduction in the capital floor. Moreover, the consultation paper recommends that when assessing the loss expectation authorities should base their judgement on a combination of historical analysis and the expected evolution in immovable property market. The link between forward and historical indicators appears to be still vague in the wording of the draft.

3. There is a risk that the vague link between forward and historical indicators will lead to decisions based on considerable parts of expert judgement. Basically, unquantifiable inputs, such as supervisory judgement, override the underlying assumptions of the risk-model hampering the use of the model as a tool for measuring risk. As a consequence, excessive use of expert/supervisory judgement will reduce the attention given to the predictive capabilities of a quantitative risk model. Therefore, heavy reliance on non-quantifiable input should be kept to a minimum.

4. We welcome the requirements for the competent authorities to describe and justify the expected effects of a potential increase in minimum LGD-values, which eventually should lead to enhanced harmonisation.

5. There is no clear lower limit to how small a "property segment" can be. In the paper, the property segment "is identified as a homogenous group of exposures of a significant size based on the type of real estate exposure or based on the geographical location". Naturally, the word "significant" is hardly specific.

6. Competent authorities, as things are now, lack guidance on the opportunity to raise/lower floors. There is a worry that competent authorities will have their multiple targets and a single lever. Thus, predictability will be hampered. Authorities could be seen, in an increased manner, and for reasons not easily predictable, implementing sudden adjustments of LGD or of Risk Weights – and thereby distort the competitive landscape.

7. There are diverging views between ECB (for SSM banks) and NCAs (for LSI banks) regarding the risk assessment of domestic real estate markets and the scope as well as the extension of prudential measures

8. There is a need for consistency between macro-prudential assessments (ESRB level) and supervisory measures at credit institution level.

[1] Established in 1967, the European Mortgage Federation (EMF) is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The EMF provides data and information on European mortgage markets, which were worth over €6.7 trillion at the end of 2013. As of February 2015, the EMF has 18 members across 14 EU Member States as well as a number of observer members.

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9. Increase of capital requirements for secured exposures may not go beyond capital requirements for the same exposure type treated as unsecured exposures

10. Draft RTS provides large scope for discretion to supervisory authorities, triggering level playing field concerns within the Eurozone in case of diverging assessments of loss expectations and forward looking market developments

11. The indicative loss benchmark of 0,3% should be replaced by 0,5% in order to be consistent with the CRR hard test ratio of 0,5%. We propose the following metrics between loss rates and risk weights (max 150% risk weight on the following basis: 0,5 x 150/35 % = 2,2 %)

    For residential property:

    Adjusted loss rate up to 0,5 % → RW = 35 %

    Adjusted loss rate totaling 1 % → RW = 2 x 35 % = 70 %

    Adjusted loss rate totaling 1,5 % → RW = 3 x 35 % = 105 %

    Adjusted loss rate beyond 0,5 % x 4,3 = 2,2 % → RW = 150 % = 4,3 x 35 %

    For commercial property:

    Adjusted loss rate up to 0,5 % → RW = 50 %

    Adjusted loss rate totaling 1,4 % → RW = 2 x 50 % = 100 %

    Adjusted loss rate totaling 2,1 % → RW = 3 x 50 % = 150 %

    Adjusted loss rate beyond 2,1 % → RW = 150 %

12. The adjustments allowed to be made to the average exposure weighted LGD on the basis of the forward-looking immovable property market developments raise the same level playing field concerns as above. They are furthermore unlimited. The adjustment criteria should be defined and be limited at 100%.

13. The designation of competent authorities to raise minimum LGD values raises some concerns. This is due to the fact, that such an instrument, even if applied with due care, can have severe and unforeseen consequences on the level playing field of IRB-institutions.

14. In addition, it is imperative, that such policy instrument will not be used as an alternative to requirements for adjustment to poor performing internal models. For example, a "muting" of the risk sensitivity of an IRB-model by raising the minimum LGD value could be of little use. On the contrary, it could potentially have quite severe side effects on an IRB-model which is performing poorly due to model specific details.

15. It is also important to stress that a severe increase in the data to be provided by financial institutions could be a prerequisite to facilitate the detailed analysis required for competent authorities to decide on raising minimum LGD values. An increase in red tape, of this sort, would be conflicting with the European Commission current objective of reducing the regulatory burden on the European financial institutions.

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