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Draft EACB note on EBA draft RTS on conditions that competent authorities shall take into account when determining higher risk-weights, in particular the term of "financial stability considerations" under Art. 124(4)(b) CRR and when determining higher minimum LGD values under Art. 164(6) CRR

EBA CP/2015/12

Introduction

The members of the EACB welcome the opportunity to comment on the EBA draft RTS on conditions for competent authorities to determine higher RWs or minimum LGD values under Art. 124(4)(b) and 164(6) CRR respectively.

In general, we welcome EBA's approach foreseeing that the factors determining higher RWs and minimum LGD are based on circumstances in the national real estate market.

However there might be some difficulties due to a strict application of the "mandatory reciprocity‟, as per Art. 124(5) CRR. Indeed we do not see the rationale in the obligation to apply higher parameters irrespective of the actual significance of a possible real estate financing abroad. Institutions with only few real estate operations abroad would have considerable additional expense in the calculation of capital adequacy and the burden of monitoring such exposures would not be proportionate with their overall significance for the institutions' balance sheet. The use of a threshold for the aggregate significance of such exposures could instead be envisaged for the application of higher RWs or LGDs.

To enhance the transparency of determining higher RWs or minimum LGD values, the draft RTS should provide for publication and disclosure requirements by the competent authorities. This would also be important to avoid protectionist trends. Such disclosures should include, but not be limited to, explanation on different considerations made and overview of statistics used for the determining higher RWs or minimum LGD values.

Answers to selected questions

Q.1 Do you agree with the three main categories of conditions specified for the setting of higher risk weights (paragraph 1) and the setting of higher minimum LGD values (paragraph 2)?

A review of the adequacy of the higher risk weights is necessary, before they are implemented. We welcome the wide analysis possibly based on "other conditions" whereby numerous national circumstances can be covered. The "Financial Stability considerations", however, are prescribed by the CRR.

Q.2 Do you agree with the conditions for specification of the loss experience and the loss expectations? Do you agree with the adjustments allowed to be made to the loss experience on the basis of the forward-looking immovable property market developments?

We appreciate that the determination of the "loss experience" shall be done via existing financial data, without adding any new reporting requirements.

However, the adaptation of "loss experience" is vaguely described and both supervisors and institutions may need further clarity. National supervisors should be able to use their own approaches to derive the "loss expectation" of the "loss experience".

Q.3 Do you agree with the indicative benchmarks for the assessment of the appropriateness of the risk weights and to guide the setting of higher risk weights across immovable property markets in different member states as specified in Article 4(3) and 4(4)? What levels of these indicative benchmarks would be most appropriate and why?

Regarding benchmarks, due to general lack of historical default data we would suggest to set the benchmarks at the upper limits of the proposed intervals.

Notwithstanding the aforementioned, while the Consultation paper indicates the reasoning behind the proposed range for the RW benchmarks (pag. 24), it should provide more clarity on the calculation basis for the determination of expected losses (Art. 2(4), 4(3), 4(4)), in order to allow consistent proposals on the ranges envisaged.

Q.4 Do you agree with the specification of the term of "financial stability considerations"?

With regard to the financial stability consideration, we suggest avoiding reference to G/O-SIIs. This refers to situations where G/O-SIIs face the risk of being impacted by the loss or the worsening of the LGD expectation that could result in a significant decline in the resilience of the financial system or disruption in the flow of lending when losses materialize. Such a reference to negative impacts on a few large institutions may still trigger higher requirements for many sound institutions, even if they operate in other areas of the property market.

Q.5 Do you agree with the other conditions for the setting of higher risk weights? (Please provide your feedback related to the indicative benchmarks (in Article 3(3) and 3(4)) in your response to Question 3 above.)

Q.6 Do you agree with the conditions for specification of the exposure weighted average LGD and the LGD expectation? Do you agree with the adjustments allowed to be made to the average exposure weighted LGD on the basis of the forward-looking immovable property market developments? Do you agree that it is not appropriate to set indicative benchmarks for the setting of higher minimum LGD values because of the specificities of national immovable property markets and because of the relationship of the LGD parameter with the other internal model parameters?

We welcome that the process set out in paragraph 2 of Article 5 takes into account similar drivers as LGD modelling. We agree that indicative benchmarks are impossible to set as modelling practices might vary. Having said that, the possibility to add conservatism in determining LGD expectation in Art. 5(5) leaves too much discretion for setting LGD expectation. To avoid this, "uncertainty" of market prices and volatility should be set as deviations from normal levels, while "sufficiently long period" should be defined as an exact period of time or a period covering necessary economic cycles.

Q.7 Do you agree with the other conditions for the setting of higher minimum LGD values?

Q.8 Do you have any suggestions on the Impact Assessment?

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