

ESBG response to the EBA consultation on draft technical standards on off-balance sheet items under the standardised approach of credit risk

ESBG (European Savings and Retail Banking Group)

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June **2024**



**Questions**

**Question 1: Do you have any comment on the non-exhaustive list of examples provided?**

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| We would like to make the following comments:   1. In the case of mortgage offers and commitments, we consider that they should go to bucket 2 (50%), instead of bucket 1 (100%), as they are subject to conditions not linked to credit risk and are not equivalent to contracts. The same would apply to pre-approved Commitments if they are contractual arrangements and are non-revocable (Not UCC). This treatment would be in line with EBA's Q&A 2017\_3376 (<https://www.eba.europa.eu/single-rule-book-qa/qna/view/publicId/2017_3376>) where it is indicated that such binding offers should carry a CCF of 20%, as they are considered "medium/low-risk items". Therefore, we understand that being low-risk products and as there are conditions that may limit the materialization of such offers, the CCF should not be 100%. 2. Trade finance should not be penalized, as it is financing that supports the real economy and penalizing it could cause market disruption. Additionally, this could result in a comparative grievance against entities that do not have to comply with the CRR Capital requirements meaning that there would not be an even playing field in trade finance market. 3. Clarify whether the RWA calculation for binding mortgage offers and other commitments has to be made or can be made with the same approach that would be used for established contracts. For example, if mortgages are included in an IRB rating system, may or shall the institutions have to also apply the IRB approach to binding mortgage offers? 4. Clarify whether the extension of the IRB models to mortgage offers or other commitments should be considered as a change in the models and follow the established governance for these changes in terms of communications and requests with the supervisor. 5. According to the non-exhaustive list of examples *“Forward starting loan i.e. loan offer accepted by the client (commitment), where the agreed terms and conditions require that the client must draw certain amounts at certain points in time”* is assigned to bucket 1. What would be a treatment of a forward starting loan which has been accepted by a client, however drawing is in the future dependent on e.g. a review of the rating which has to be assigned to a certain grade, thus there is no certainty that the amount is going to be drawn? 6. Another item which is assigned to bucket 1 as per the non-exhaustive list is *“Contingent item where the conditional event that prevents exposing the institution to the risk of credit losses in case of a default has not been triggered yet but it is related to credit risk, and the institution’s guarantee is only conditional on a default event for the guaranteed credit obligation”*. Following the conditionality principle described in the consultation paper the principle is based on degree of conditional events that trigger on-balance sheet conversion i.e. the higher of the number of events the lower the percentages. This should mean in practice that 100% is assigned if the conditionality is only based on a default of obligor only; 50% is assigned if conditionality is based on ability to meet contractual obligation + on a default of obligor**.** The draft RTS explains this principle in relation to the non-credit risk related event which precedes a default of obligor (i.e. two events – one is non-credit risk related event + the other one is credit risk related event). Taking into consideration the above cited item, does this contingent item represent the situation when there are two events, however both events are credit risk related (whereas the second event is a default) thus the assignment will be always to bucket 1? In another words, does the conditionality principle (described for bucket 2) also apply for a situation when a contractual obligation which must occur before a default has a characteristics of credit risk related event? 7. The non-exhaustive list also includes in bucket 3 „*Undrawn amounts of factoring arrangements in the context of commitments to finance the seller of receivables, invoice discount facilities, because this is a contractual arrangement to purchase assets, hence falls under the definition of commitment under article 5(9) while not being a credit substitute*.“ How „*while not being a credit substitute“* should be interpreted? Is it to be understood that in the case of some constellations an undrawn amount of a factoring arrangement can be regarded as credit substitute? If yes, could you provide any examples? Furthermore, the text is referring to “*undrawn amounts of factoring arrangements*”. Is the undrawn amount the difference between the limit provided in the factoring contract and already drawn amount or the limit is capped by the total amount of purchased receivables? Example: Factoring contracts include limits for the maximum amount of advance payment to be provided to the clients (seller) on the transferred receivables. In addition, the contract stipulates that that maximum x % of the transferred receivables (usually 80 %) can be drawn by the client as advance payment. The remaining 20% is called retention. So if the limit stipulated in the contract is EUR 10 mill and the total amount of transferred receivables are EUR 6 mill, then at this moment the client can maximum draw min(10, 6 x 80%), which is EUR 4,8 mill. Nevertheless, if the transferred receivables increase to EUR 20 mill in the next month, then the client can maximum draw min(10, 20 x 80%), which is EUR 10 mill. |

**Question 2: Which is the average period of time given to the client to accept the mortgage loan offer?**

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| The period of time given to the client can vary between 30 days and 2 months, depending on the credit institution. |

**Question 3: What is the applicable percentage that institutions currently apply to these commitments?**

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| Some institutions have indicated 0%, as they are not considered contractual arrangements, while others apply 20%(please see EBA Q&A 2022\_6602, EBA Q&A 2017\_3376 for further reference). |

**Question 4: What is the average acceptance rate by the client of a mortgage loan offered by the bank?**

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| Approximately 80% |

**Question 5: Do you have any comment on the allocation criteria proposed under Article 1?**

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| Article 1, point 3 of the draft RTS states that commitments whereby the client must draw certain amounts in the future shall be assigned to the bucket 1 referred to in Annex I to Regulation (EU) No 575/2013 within the limits of those amounts.  This provision is unclear about the timeline for when a client must draw on the commitment, which could create uncertainty and inconsistency in the calculation of the exposure value of off-balance sheet items.  The response recommends that article 1, point 3 of the draft RTS should be amended to define a clear and reasonable timeframe for the drawdown of commitments, considering the contractual terms and conditions, the expected behaviour of the client, and the market conditions. For example, if one has a forward-starting facility that will be accessible in two years, only after paying off an existing facility, the EAD would be zero since the EAD is calculated for a 12-month period.  The response also suggests that the EBA should provide examples and guidance on how to apply article 1, point 3 of the draft RTS in different scenarios and situations.  In relation to the conditionality principle and contingent items, we would like to point out that even the claim exists it does not necessarily mean that the claim must be paid. The claim is in most cases withdrawn by the beneficiary after the applicant/corporate client is willing to extend the said instrument to the benefit of the respective transaction and hence possibility to heal and improve the underlying service and/or perfect the delivery of goods. Moreover, the claim is also subject to a possible injunction and therefore will be decided by a court ruling before payment is affected. Furthermore, under letters of credit, presentation of documents might be discrepant with the underlying letter of credit, i.e. payment is not triggered until the issuing bank and/or applicant is confirming the acceptance of such. In the guarantee business, payment claims are technical in nature, specifically very short in nature, on average between 5 and 10 days, and moreover such drawdowns are always documented by an approved guarantee facility credit line.  In addition to the re-classification of contingent items can EBA specify under which item in bucket 1 re-classified off-balance sheet items should be subsumed (e.g. Other off-balance sheet item constituting a credit substitute where not explicitly included in any other category)?  According to the draft RTS a commitment that is not a credit substitute may be assigned to bucket 3 or bucket 5, depending on whether it meets the definition of unconditionally cancellable commitment. Following this wording, it could be said that the commitments can be only assigned to bucket 1, 3 and 5. What is unclear is how to treat commitments related to trade-finance facilities. Example: a commitment to open short-term self-liquidating trade letters of credit arising from the movement of goods. The item doesn´t have characteristics of a credit substitute and it is also not unconditionally cancellable. Based on the formulation of the draft RTS such items should be assigned to bucket 3 (40%), however such treatment would be more prudent than with the given instrument i.e. with open short-term self-liquidating letter of credit which should be assigned to bucket 4 with a 20%. Can EBA clarify a treatment of commitments related to trade finance facilities?  What concerns the treatment of contractual arrangements offered by an institution, but not yet accepted by the client, where the client must draw a certain amount in the future (example a mortgage loan offer) EBA proposes that such commitments should get the same treatment as if accepted (100%). The assignment to 100% is linked to the fact that the client must draw a certain amount in the future. However, at the time when the offer hasn´t been accepted by the client yet, there is no certainty that the amount will be drawn in the future. A client can even reject the offer in the period, which was given to the client, thus in such case there is no drawing.    We would propose to include a grandfathering provision for the existing instruments (already given) assigned to a sub-category “Other off-balance sheet items carrying similar risk and as communicated to EBA” which would allow to treat such instruments in the respective bucket as per the communication towards EBA. |

**Question 6: Do you have any suggestion regarding allocation criteria for buckets 4 and 5?**

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| We propose to include in bucket 5 also “Facility allowing for a rejection of any utilization of the line without any given reason even though the line is formally provided for optional utilization”.    Although Annex I CRR requires for the assignment to bucket 4 that the documentary credits are collateralized by the underlying shipment (in case of an issuing institution or a confirming institution) we would like to point out that confirmed letters of credit to the benefit of the beneficiary/corporate client whereas goods are delivered to the applicant of such letter of credit can only be evidenced by the underlying transport documents which are usually issued in the name of such applicant or the issuing bank. For the confirming bank a documentary credit isn´t collateralized by the underlying shipment. Following the above stated, we would like to propose to include in bucket 4 also documentary credits evidenced by the underlying transport documents, to especially also accommodate shipping routes via truck and railways as these documents do not represent title documents. |

**Question 7: Do you have any comment on the factors that may constrain unconditionally cancellable commitments proposed under Article 2?**

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| The classification of Commitments as UCC should be based on the ability to unilaterally cancel the Commitment. In view of this, we would like to raise the following points:   1. Greater clarity should be provided in the definition of events that prevent the unilateral cancellation of a Commitment, since the risk of litigation and reputational risk is inevitable and inherent to any banking product, as there is always the possibility of litigation. 2. There should be objective criteria for commercial and reputational limitations that prevent the unilateral cancellation of a Commitment. Such criteria should be objective and equivalent among the different EU countries to avoid situations of comparative grievance between countries (a level playing field should be defined). 3. It is considered that the 10% CCF already covers these risks of litigation, reputation, and those originated by other commercial and/or operational limitations. If these residual risks did not exist, logically the CCF would have to be 0%, since all exposures for which the risk could materialize would be cancelled before the client could dispose of them. 4. Additionally, legal risk is already covered by capital for operational risk (Pillar I). Including legal risk in the capital calculation for risk, through higher capital requirements for Commitments, would result in double counting for legal risk.   Furthermore, under Article 2 of the draft RTS, which specifies the factors that may constrain the institutions’ ability to cancel the unconditionally cancellable commitments referred to in Annex I, if the institution is de facto constrained from cancelling the commitment, the profile of those off-balance sheet instruments is not representative of bucket 5 and a higher percentage should be assigned.  Our concern is that this could ultimately end up granting local competent authority too much flexibility, which could lead to diverging practices and outcomes in the EU, and thus undermine the level playing field, as indicated previously, and the comparability of capital requirements for off-balance sheet items.  The response suggests that Article 2 of the draft RTS should be revised to provide more guidance and criteria for the competent authorities to exercise their discretion, and to ensure more transparency and accountability for their decisions. For example, one could set some clear and specific criteria linked to shortcomings in risk management, business factors and reputational risk.  Lasty, with respect to the aforementioned point 1, the threshold for litigation risk needs to be defined, as one could argue that an institution will always be under threat of litigation, even if a claim is unfounded. If there is not established a threshold for “litigation risks”, then the argument can be made that a commitment can never be considered “unconditionally cancellable” due to the fact that there is always a possibility for litigation.  Please note the potential interplay with IFRS 9 B 5.5.39 & 40, in the sense that those unconditionally cancellable commitments (hence, having by definition a “contractual maturity” of 0-1 days) in respect of which that unconditional cancellability may not be de facto applied would meet the criterion (b) in B 5.5.39 and, assuming the other two criteria (a) and (c) are also normally fulfilled, they would fall under the accounting requirement of B 5.5.40, namely a so-called “behavioural maturity” would need to be estimated (in absence of a higher than 0 “contractual maturity”) for the purpose of applying the IFRS 9 impairment requirements on such off-balance exposures (the newly applicable “bucket 3” CCF being of course another factor in the related credit loss allowance calculation). It further means that the factors drafted in Article 2 would presumably become a practical “application guidance” for IFRS accountants, in distinguishing between (a) unconditionally & immediately cancellable (hence: 0 contractual maturity) loan commitments subject to “behavioural maturity”-based loss allowance calculation requirements of IFRS 9 (hence: still falling under “loan commitments” for IFRS accounting purposes), i.e. those UCCs allocated to bucket 3 due to falling under Article 2 and (b) unconditionally & immediately cancellable loan commitments not subject to “behavioural maturity”-based loss allowance calculation requirements of IFRS 9 (hence: not falling under “loan commitments” for IFRS accounting purposes, but as IAS37 governed “contingent liabilities”, hence: not subject to any provisioning unless non-performing), i.e. those UCCs allocated to bucket 5 due to not falling under Article 2. In respect of (b) above, please further note that the newly applicable CCF of 10% might result in CRR-based FINREP provisioning of such exposures, whilst for IFRS purposes such provisions would need to be reversed (based on IAS 37), unless the related client is non-performing. |

**Question 8: Do you have any comment on the notification process proposed under Article 3?**

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| What concerns the notification process for “Other off-balance sheet items carrying similar risk and as communicated to EBA” EBA proposes to notify such items through regular reporting in accordance with Regulation 2021/451. Following the current version of respective Regulation, including the recently proposed amendment, it doesn´t appear that templates for COREP would have any specific section which would address such notification process. In FINREP templates such items are simply subsumed under “Other commitments”, so it is unclear how exactly the information about certain off-balance sheet items (the ones which are not listed in Annex I or not mentioned in the example list provided in the draft RTS) is supposed to be communicated to EBA through supervisory reporting regulation. |

**Question 9A. For credit institutions: What is the materiality in your institution of the off-balance sheet items that would fall under the categories “Other off-balance sheet items carrying similar risk and as communicated to EBA” listed in each bucket of Annex I?**

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**Question 9B. For credit institutions: Do you identify any specific item you may hold off-balance sheet that is currently classified as “Other off-balance sheet items carrying similar risk and as communicated to EBA” and that may experience a change in bucket allocation based on the criteria listed in Article 1 of these RTS? What would be the related change in the associated percentage as per article 111(2)?**

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| As per the notification which was submitted in the past to communicate “Other off-balance sheet items carrying similar risk” there are instruments (in form of guarantees) in the portfolio which have characteristics of trade finance, however the maturity of such instruments is longer than one year. Although such instruments have a longer maturity, ICC statistics show, that there is no material difference in related draw down risk for guarantees with a tenor of more than 1 year and with a tenor of less than 1 year. As the risk deriving from trade related off-balance sheet items doesn´t depend of whether its term is longer or shorter than one year, but rather of the close connection to the underlying trade transaction and as the restriction to maximum tenor for trade finance doesn´t reflect correctly the structure of trades, we treat such off-balance sheet items (as per the notification letter) in bucket 4 (20%) under “Other off-balance sheet items carrying similar risk and as communicated to EBA”.  In this respect, the understanding is that the treatment for “Other off-balance sheet items carrying similar risk” notified in the letter is valid also under CRR3. |

**About ESBG (European Savings and Retail Banking Group)**

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Published by ESBG. May 2024