# PBA response to the EBA consultation on draft technical standards on equivalent mechanism for unfinished property under the standardised approach of credit risk

## General comments

Polish Bank Association welcomes the opportunity to respond to the EBA consultation and to comment the proposal of technical standards on equivalent mechanism for unfinished property under the standardized approach of credit risk in the CRR.

According to the CRR provision of Article 124, banks should be able to benefit from the possibility to consider unfinished residential property as eligible collateral for the purpose of RWA calculation.

For properties in construction related to an ADC program, the CRR allows for the recognition of such properties as eligible collateral when their completion is insured by a sovereign entity or alike. However, such type of scheme is at the best very unusual, not to say unknown in practice to banks. According to our knowledge this situation exists not only in Polish practice and in Polish law, but it is common also in other European economies. Hence, the EBA mandate aiming at clarifying what is an equivalent legal mechanism to the above and allowing for unfinished collateral recognition is thereby highly welcomed by banks.

In this situation which are common nowadays on property market in Poland and in other European economies we recommend to the EBA to consider alternative approach that will allow to recognize completion guarantee provided by financial sector entities. Thanks to the completion guarantee mechanism which gives high degree of certainty to a buyer, the unfinished property can be disposed for a value reflecting its stage of completion in a standard way.

## PBA response to the consultation’s questions

#### Q1(a): Are there some practical cases where a central government, regional government or local authority or a public sector entity involved, exposures to which are treated in accordance with Articles 115(2) and 116(4) of the CRR, respectively, has the legal powers and ability to ensure that the property under construction will be finished within a reasonable time frame and is required to or has committed in a legally binding manner to do so where the construction would otherwise not be finished within a reasonable time frame (i.e. existence of cases referred to in Article 124(3)(a)(iii) of the CRR)?

We do not know in Polish legislation any cases where a central government, regional government or local authority or a public sector entity involved, exposures to which are treated in accordance with Articles 115(2) and 116(4) of the CRR, respectively, has the legal powers and ability to ensure that the property under construction will be finished within a reasonable timeframe and is required to or has committed in a legally binding manner to do so where the construction would otherwise not be finished within a reasonable time frame.

#### Q1(b): Are there some practical cases where legal powers and ability to ensure that the property under construction will be finished within a reasonable time frame is given to an entity that is neither a central government, nor an entity for which exposures are treated in accordance with Articles 115(2) or 116(4) of the CRR (i.e. existence of cases referred to in the current Article 1 of the RTS)?

We do not know in Polish legislation any practical cases where legal powers and ability to ensure that the property under construction will be finished within a reasonable time frame is given to an entity that is neither a central government, nor an entity for which exposures are treated in accordance with Articles 115(2) or 116(4) of the CRR.

#### Q2: With regard to subparagraph (d)(iii)(first indent) above, could you provide insights into how pledging the rights under the completion guarantee functions from both a legal and practical perspective? Specifically, in current market practices, are the rights pledged only upon the default of the obligor? If so, are any measures being considered or implemented to mitigate the legal risks associated with the pledge potentially needing to be upheld by the insolvency administrator under applicable insolvency law, and at last to ensure effective protection of the institution's interests?

There is no direct ex-ante pledge of the completion rights at origination or in case of default, hence we can not provide any insights in this area.

#### Q3: Could you provide the RW assigned to the entities that are currently protection providers for such completion guarantees, as well as the type of counterparty (i.e. financial institution, other financial sector entity or corporate)? Would, in view of these RW, the alternative treatment as financial guarantee achieve sufficient recognition of completion guarantee?

As we have stated in answer to Q1, in the economic practice the completion guarantee providers are financial sectors entities, mainly banks. The completion guarantees are not performance bonds made by the issuer of guarantee (in situation when the developer fails in its duty in regards of the construction achievement) but pure financial guarantees.

#### Q4: In the case where the requirements on the guarantee would be limited to cover the simple case where the construction works are impeded by financial difficulties faced by the real estate developer, which other mechanisms could ensure the appropriate recognition of the construction risk beyond the creditworthiness of the real estate developer in the own fund requirements?

In our opinion it is possible to implement some mechanisms in order to ensure the appropriate recognition of the construction risk beyond the creditworthiness of the real estate developer. Such example could be building a national development fund to which all developers would contribute. The fund would be disbursed to complete a development project in a situation of financial difficulty.

#### Q5: Which specificities of IPRE and non-IPRE exposures could warrant differentiated requirements on the equivalent mechanism?

The equivalent mechanism is important from the point of view of IPRE's exposure because it secures possible claims by purchasers or tenants who are assumed to generate cash flow on the property. For non-IPRE exposures, the investor will not realize his/her needs (residential or commercial on the property). These are the specificities which could warrant differentiated requirements on the equivalent mechanism.

#### Q6: Could you provide empirical evidence of cases where a sovereign outside Europe has intervened to complete an unfinished property?

We do not know of any such cases.

#### Q7: The text of Article 124(3)(a)(iii)(second indent) refers to the completion of the property under construction within a reasonable time frame. What is the average time for the protection provider to step in once the real estate developer fails to meet its obligations? What is the average time for the protection provider to complete the construction of an immovable property, once the completion guarantee is triggered? For the previous responses, please specify at what stage the construction was and how many housing units it comprised, if such data is available.

We do not know of any such cases.

#### Q8: Do you have any empirical evidence regarding the historical average loss rates for both real estate developers and entities providing completion guarantees? If available, please provide the pertinent empirical data

We do not know of any such cases.

#### Q9: In order to conduct a comprehensive assessment of the completion guarantee risk, could you provide data related to the following indicators over the longest possible time horizon on a yearly basis: [for data collection purposes, we assume that there is only one completion guarantee per project, so that a credit institution should not double count the trigger of a completion guarantee for several housing units in the same property]

#### b) Ratio of number of times completion guarantees have been triggered over the total number of projects covered by the guarantees.

#### c) Ratio of number of times completion guarantees have been triggered and resulted in completion divided by number of times completion guarantees have been triggered.

#### d) Ratio of number of times completion guarantee have been triggered and were ultimately transformed into repayment guarantee divided by number of times completion guarantees have been triggered.

#### e) For cases where the Real Estate Developers (REDs) defaulted, ratio of number of times completion guarantees have been triggered but for which the protection provider failed to meet its obligations (e.g. due to deficiency of the protection provider) divided by number of times completion guarantees have been granted.

We do not know of any such cases.