EACB Comments

European Commission Public Consultation

IMPLEMENTING THE FINAL BASEL III REFORMS IN THE EU

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Answers to specific questions

CREDIT RISK

➢ *External credit risk assessment approach (ECRA) vs. standardised credit risk assessment approach (SCRA)*

1) Views are sought on the relative costs and benefits of the ECRA provided by the final Basel III standards and the SCRA? In particular, how do the two approaches compare in terms of risk-sensitivity, impact on risk-weighted assets (RWAs) and operational burden? Please specify the relative costs and benefits of the two approaches for exposures to i) institutions, ii) covered bonds and iii) corporates. Please provide relevant evidence to substantiate your views. 2) Would you deem refinements or clarifications necessary concerning the approach that you generally prefer, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

In terms of general approach we see that the new SCRA is not only more complex but also not necessarily more risk sensitive or holistic than the existing SA for unrated banks and corporates by disregarding relevant and well established practices (e.g. rating derived from country of incorporation for unrated banks).

We also note that the overall design of the SCRA for unrated corporates is insufficient, especially when seen in the EU context, given the reality and needs of EU markets. In Europe, unrated corporates count for the vast majority of banks' corporate clients, and they should not be penalized simply due to a historic lack of coverage of external rating, and by the lack of proper sensitivity embedded in the Basel proposal.

Furthermore, we have serious reservations on the introduction of a due diligence process within the ECRA, which not only contradicts the basic principle of a standardised approach but can also reveal complex and costly to implement and open to interpretation and potential heterogeneous application (how would then the results of the ECRA risk weights compare?).

➢ *Enhanced due diligence requirements*

3) Views are sought on the costs and benefits of implementing the various clarifications and specifications provided by the Basel III standards (paragraph 4) in relation to the due diligence to be performed by institutions. Please provide specific answers on each of the clarifications/specifications and support your view with relevant evidence.

4) If you are of the view that the CRR/D should be amended to clarify/specify the rules on due diligence requirements, what would constitute an appropriate approach in your view? Please specify and provide relevant evidence.

5) In your view, should the due-diligence requirements differentiate between exposures for which a rating exists and unrated exposures treated under the SCRA (see above 1.1.1.1.), and if so, why? Please elaborate and provide relevant evidence.

In general, we support the use of external ratings when calculating the risk weights for exposures to banks and corporates as this approach reflects the nature of the SA for credit risk. Given the simplified character of the SA, the additional due diligence process to calculate the 'correct' risk weight seems rather redundant. As a result, all institutions (also very small banks) would have to draw up an internal process for the calculation of risk weights – similarly to what done at a more complex level with IRB. Moreover, rating agencies are supervised entities with a sophistication degree that should ensure ratings are adequate

In addition, the description of the overall due diligence process is too vague to have a concrete grasp of supervisory expectations. This could lead also to heterogeneous attribution of RWs for similar exposures: while the BCBS has criticized this aspect for internal models, even despite the substantial work undertaken to improve consistency and comparability, it seems to introduce an undue source of variability in the SA.

A detailed and prescriptive requirement to perform an additional due diligence process contradicts the fundamental principles of a standardised approach. In particular, it is difficult to understand why based on the results of due diligence the treatment of a rated corporate could be revised downwards (i.e. increase the RW) but not upwards (i.e. reduce the RW).

Furthermore, any requirement should only be considered for exposures that are material for the institution.

Finally, we believe that at least non-complex banks should not be obliged to implement such a process.

➢ *Exposures to institutions*

6) Views are sought on the costs and benefits of implementing the definition of grades under the SCRA provided by the Basel III standards (paragraphs 22-29). Please provide relevant evidence to substantiate your views.

7) In your view, are the quantitative and qualitative criteria for the classification of counterparties into grades sufficiently clear or do you consider more specifications necessary to ensure a harmonised application of these criteria throughout the Union?

Please elaborate and provide relevant evidence.

8) What are your views in relation to a potential clarification that also minimum capital and buffer requirements beyond the Basel minima (e.g. higher Pillar 1 requirements pursuant to Article 458 CRR or systemic buffers pursuant to Article 133) should be taken into account for the classification into grades, where applicable in the jurisdiction of the counterparty institution?

9) Would you deem any other or further clarifications necessary to perform the classification into the three grades? Please elaborate and provide relevant evidence.

<u>ECRA for interbank exposures</u>

The revised Basel framework outlines two techniques for determining the capital requirements for interbank exposures. According to Para 18-20 (in the SA chapter) the banks are required to use for rated bank exposures the ECRA. However, according to Para. 18 the ratings must not incorporate assumptions of implicit government support. There are only some exemptions for public banks which are owned by their respective government.

We see the point that probability of government support for banks has considerably decreased within the new resolution frameworks. Nevertheless, for instance the BRRD still includes a possibility for the governments to support the banks under certain specific conditions. The recent changes in the rating methodologies of the rating agencies might already reflect these changes in the probability of support and are rather a choice of the rating agencies.

The requirement not to reflect the implicit government support is rather a matter for the market and rating agencies to determine.

<u>SCRA for unrated banks</u>

According to Para 21-31 banks are required to use the SCRA for unrated bank exposures. SCRA completely removes without good justification the possibility to derive the risk weight of the obligor bank from the risk weight of the jurisdiction in which it is incorporated (+1 notch). This leads to potentially much higher risk weights compared to current treatment. We might see in this a link to the proposal of excluding government support in the external ratings, however unrated banks are generally the smallest among the non-systemic ones that under the current resolution framework would in any case not be bailed out. For many such unrated banks applicable risk weight is currently 20%.

Under the revised SA a risk weight of 40% may be applied, where all grade A criteria are met. For grade A, application of a risk weight of 30% is also possible, provided that the bank has a CET1 ratio of 14% or higher and a leverage ratio of 5% or higher. Unfortunately, many banks do not meet these criteria, largely reducing the scope of such provisions and de facto doubling the capital charge for such exposures.

It should be at least possible to assign lower risk weights to unrated bank exposures in countries/areas where recorded losses are demonstrably lower.

According to Footnote 18 exposures to banks without an external credit rating may receive a risk weight of 30%, provided that the counterparty bank has a CET1 ratio which meets or exceeds 14% and a Tier 1 leverage ratio which meets or exceeds 5%. We support the general idea to significantly reduce the risk weights if the bank is a financially sound institution. Nevertheless the proposed threshold of a CET1 ratio of more than 14% is way too high. It has to be borne in mind that current Article 92(1)(a) CRR stipulates a minimum CET1 ratio of 4.5%.

14% would be more than three times the regulatory minimum CET1. Hence, the proposed thresholds of Footnote 18 need to be reduced significantly in the course of an implementation into the CRR, for instance down to the double amount of the legal minimum requirements of 4.5% CET 1 ratio (i.e. 9%).

<u>Exposures within an IPS and a cooperative banking group</u>

We would also highlight here that according to Footnote 14 in the chapter of the BCBS standard related to the standardised approach for credit risk national, supervisors may allow banks belonging to the same institutional protection scheme (such as mutual, cooperatives or savings institutions) in their jurisdictions to apply a lower risk weight than that indicated by the ECRA and SCRA to their intra-group or intra-network exposures provided that both counterparties to the exposures are members of the same effective institutional protection scheme (IPS). The IPS being a contractual or statutory arrangement set up to protect those institutions and seeks to ensure their liquidity and solvency to avoid bankruptcy.

The implementation of the standards in the EU should maintain the existing CRR treatment:

- Art. 113(7) CRR, and
- Art. 113(6) CRR,

So that intra-network or intragroup exposures shall be assigned a risk weight of 0%.

<u>Minimum capital and buffer requirement criteria</u>

The minimum capital and buffer requirements not explicitly envisaged in the Basel standards should not be taken into account for assigning grades to unrated banks, since those requirements (e.g. Art. 458 CRR; Art. 133 CRD) are specific to Member States. Otherwise the approach would be even more burdensome due to the fact that institutions would always have to identify and assess the current national applicable jurisdiction (and buffers in place) for the counterparty. On the other hand counterparty institutions would face undue constraints to fulfil the classification criteria of Grade A, becoming all of a sudden riskier without a change of risk profile which would be inconsistent with a higher capital demand. This would create an uneven playing field and inhibit the exchange of short-term liquidity between institutions, adding friction on the interbank market. Para. 23 of the 2017 Basel agreement explicitly excludes certain Pillar 2 requirements from the minimum requirements for Grade A bank exposures. This should also be clearly spelled out in the proposed CRR III.

10) In your view, what are the relative costs and benefits of using the original maturity as opposed to the residual maturity for identifying short-term interbank exposures? Please provide relevant arguments and evidence to substantiate your views.

11) What are your views on the extension of the scope of the preferential treatment for short-term interbank exposures under Basel III from three to six months for exposures to institutions that arise from the movement of goods across national borders? To what extent would the change in definition change the amount of

exposures benefitting from the preferential treatment? Please provide relevant evidence to substantiate your views.

Currently (see EBA Policy Advice on the Basel III Reforms: Credit Risk, Nr. 100.) more than 80% of European institutions use the residual maturity approach in line with CRR. Using the original maturity-approach instead of the residual maturity-approach for identifying short-term interbank exposures would have the effect that less interbank exposures would qualify as short-term exposures (the substitution of the residual maturity approach by the original maturity-approach would reduce the short-term interbank exposure portfolio by a quarter on average according to the EBA impact study). Consequently, less interbank exposures would be eligible for the preferential RW treatment and RWAs would increase.

The current preferential treatment of short-term exposures to banks (up to 3 months) that is based on the residual maturity (and not on the original maturity) according to Art. 119 and 120 CRR should instead remain unchanged.

Indeed, the usage of the original maturity-approach for identifying short-term interbank exposures is not justified from a risk perspective, since an exposure with a residual maturity of three months or less is not per se riskier than an exposure with an original maturity of three months or less. The decisive criterion for identifying short term exposures should solely be the maturity of three months or less (particularly in the current scenario where uncertainty is higher but the risk of default is lower according to the EBA Policy Advice on the Basel III Reforms: Credit Risk, Nr. 97.), and not whether such maturity of three months or less is original or residual.

The stated objective of the preferential treatment of short-term interbank exposures is to avoid inhibiting the exchange of interbank short-term liquidity via too restrictive risk weights.

- *Exposures to corporates*

12) What is the share of your institution's/(member) institutions' exposures to rated and unrated corporate SMEs and to non-SMEs? What is the share of exposures to unrated corporates whose parent companies are externally rated? Please provide relevant evidence (e.g. underlying calculations, studies etc.).

13) Views are sought on the definition of 'investment grade' provided by the Basel III standards (paragraph 42). In particular, would you deem further refinements or clarifications necessary in order to ensure a consistent application across the Union? Please elaborate.

14) What other measures, if any, could be taken to increase the risk-sensitivity of the standardised RW treatment of corporate exposures which currently have no external rating? Please elaborate and provide relevant evidence.

15) In your view, which other aspects, if any, should be considered in the context of revising the standardised treatment of corporate exposures? Please elaborate.

Q12

SME exposures

In the area of retail exposures we appreciated the recognition given by the BCBS to a dedicated treatment of SME exposures. Nevertheless the SME supporting factor included in Art. 501 CRR is a much better instrument to safeguard continued financing to this category of exposures, in particular following the revision of the factor in the banking package finalised in May 2019 (CRR 2).

We recommend that in implementing the Basel standards the existing EU rules are maintained.

Q13

Unrated corporates

With regard to unrated corporates, we see a need to adjust the new Basel SA approach to the reality and needs of EU markets. In Europe, unrated corporates count for the vast majority of banks' corporate clients.

This is particularly relevant as most of such exposures are nonetheless considered as "investment grade" by banks and this assessment should be helpful to determine the RW in the SA (especially for the purpose of calculating the floor). Indeed, under the SA, these counterparts all receive a 100% RW. In reality, while the level of risk varies significantly across these exposures and while the new BCBS framework aimed to increase granularity in the SA, there is no risk differentiation perceived here.

We would propose that banks may assign unrated corporate counterparts an "Investment Grade" classification, provided that the bank has the necessary information about the client. However, as "investment grade" is a concept stemming from the IRB framework, to ensure that the solution is simple enough to apply it also for SA banks, the information needed should be readily available: we propose to consider as investment grade exposures that are not in watch list.

The internal bank information at the time the loan is granted or the counterparty is reviewed can indeed suffice. If the loan is granted and not moved under watch-list, the creditworthiness of the counterparty would be an investment grade. Conversely, if there is a need to move a counterparty under watch-list (but without an unlikely-to-pay or Past-due default) the counterparty could fall under non-investment grade. This would also allow convergence between SA and IRB as the concept and use of watchlists is homogeneous across the industry.

We also suggest to avoid the requirement that the corporate entity has to issue securities on a recognized exchange (as many such corporates may not issue listed securities), with an objective criterion that is more relevant for the European corporate sector.

Finally, we support the use of ratings provided by central banks where these exist (e.g. as done by Banque de France), and would support promoting such initiatives for other central banks. In this regard, it can be noted that Anacredit is providing a great deal of punctual credit information that could be used to this effect.

The result would be a mixed approach, where external ratings may be used for those corporate entities which have an external rating, and the division into "Investment Grade" and "Non-Investment Grade", could be applied to all other unrated corporates (that are not already classified as SMEs). For investment grade exposures, the 65 % risk weight should apply as in jurisdictions where, unlike in the EU, external ratings are not allowed for prudential purposes. Otherwise, the level playing field with other jurisdictions would be compromised, especially when comparing with the US.

Q14 see above

- *Treatment of specialized lending (SL)*

16) Views are sought on the costs and benefits of implementing the specific treatment of SL exposures provided by the Basel III standards (paragraphs 44-48). In particular, how does this treatment compare with the current treatment in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

17) Would you deem further refinements or clarifications concerning the structure or calibration of the treatment for SL necessary, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

18) In your view, what other measures should be taken to better reflect the particular characteristics of SL exposures (as compared to general corporate exposures) thereby increasing the risk-sensitivity of the SA-CR and improving consistency with the IRBA? Please elaborate and provide relevant evidence.

19) In your view, which other aspects, if any, should be considered in the context of revising the treatment of SL exposures?

Q16

Corporate exposures are to be treated as a specialised lending if such they possess certain characteristics of control of the assets cash flows and the risk taken over time, either in legal form or economic substance. We would emphasize that promoting viable infrastructure projects in domains like transport, energy, innovation, education, research is of vital importance for Europe's competitiveness, the economic growth of the Union and to stimulate job creation.

Against this background, the CRR2 introduced a preferential treatment for infrastructure financing exposures in Art. 501a. According to this provision capital requirements for specialised lending exposures shall be multiplied by a factor of 0.75 if certain criteria are met. For instance, this preferential treatment shall apply to exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services.

We believe that the preferential treatment for specialised lending exposures according to the proposed new Article 501a CRR should be maintained. This category should, as indicated in the CRR, cover the transactions that fulfil the criteria either in legal form or economic substance.

Moreover, we also underline that the reduction of RW of 25% achieved via the support factor will not compensate for the huge increase in RW under the A-IRB (due to input floors and due to overly punitive SA RW).

Since almost no SL transaction is externally rated, the revised SA approach greatly lacks risk sensitivity for specialized lending: only one bucket RW for object finance and commodities finance and three buckets for infrastructure project finance is by far insufficient. In comparison, unsecured corporate loans have four RWs.

Also the criteria for high quality infrastructure projects are too restrictive and would fail to identify the low risk ones, they should be enlarged consistently.

Specialised lending is treated under the SA like unsecured corporate loans, and even more severely for project finance. This would suggest that the overall security packages negotiated for SL transactions is valued nil, which would vastly penalizes these activities and even more so through the output floor.

As unintended consequence banks will choose the riskiest transactions which will have sufficient margins to support the overshooting RWs and/or increase margins, which will lead to increase the cost of using the infrastructures for end users.

Q17

Amendments to the high quality criteria are necessary in order to avoid that the main part of high quality transactions remains unrecognised. For the operational phase, economically comparable financing should be included, i.e. providing via the structure put in place the same degree of control that would result from a SPV and taking into account the cash flows over the whole asset life. Moreover, high quality should cover operational phase but also the pre-operational one when the construction contracts provide a good mitigation of construction risk (like in infrastructure SF), and should also include projects with part of revenues contracted as long as they are resilient to downside sensitivities (like in the SF), finally, termination amount in case of termination of the offtake contract should be required only when off-taker is non replaceable.

Q18

A more granular SA table should be defined for SL. The EBA recognizes that SL should not be treated as unsecured exposures. Hence RWs should be positioned on an average level lower than unsecured unrated corporates. We propose RWs from 50% to 110% with an intermediate 75% level, taking into account the quality of the transaction and the LTV. This would be justified by loss rates observed (e.g. slides presented by AFME to BCBS during public hearing regarding SA), with loss rates twice lower than those of unsecured corporates and also justified by loss data collection performed by 7 Dutch and French Banks showing loss rates on portfolios lower than 0.20% (i.e. similar to High investment grade corporates or investment grade ones).

Q19: No answer

Please see also our answers under Q69 and following.

➢ *Equity and other capital instruments*

20) In your view, are there any issues with the definition of equity exposures provided by the Basel III standards (paragraph 49) and the list of other instruments to be treated alike? In particular, would you deem further refinements or clarifications necessary regarding the scope of the equity exposure class in order to ensure a consistent application across the Union? Please elaborate.
21) Views are sought on the costs and benefits of the revised standard treatment for equity exposures under Basel III (paragraph 49-50). In particular, would you consider any further differentiation among equity exposures (apart from "speculative unlisted equity exposures" and "national legislated programmes" – see 1.1.4.2. and 1.1.4.3.) warranted, and if so, how should this differentiation be made and what would be its prudential rationale? Please elaborate and provide relevant evidence.
22) What other measures or safeguards could be put in place with regards to equity exposures to increase the risk-sensitivity and robustness of the credit risk framework and prevent regulatory arbitrage between the banking book and the trading book? Please elaborate and provide relevant evidence.

Q20

Equity exposures in banks

The foreseen increase in RWs for equity holdings in banks (from 100% to 250%) is extremely dangerous for a number of decentralised cooperative banks' groups and networks due to:

1) the monitoring of prudential requirements on an individual basis;
2) their inverse pyramid structure, where local and regional banks own their central body (general feature of cooperative groups and networks).

The equity stakes in the central body are a sizeable asset (for the smallest banks the most sizeable) for many cooperative banks. Given the steep increase in the RWs envisaged by the BCBS, the consequences in terms of capital impact would be tremendous and would not be justified from a risk perspective as those equity holdings are not held for speculative purposes. This increase of risk weights would practically result in a discrimination of cooperative groups and should be carefully addressed when implementing the deal.

This type of equity exposures should be excluded from the general treatment of equities proposed in the new Basel standard. This could be done in the following manner:

- For banks belonging to an IPS by reflecting the conditions already included in Art. 49(3)(a) and (b) CRR for the purpose of non-deduction of holdings of own funds, i.e.: belonging to the same institutional protection scheme (IPS), granting of the Art. 113(7) CRR permission by the competent authority, drawing up by the IPS of a consolidated or aggregated balance sheet, no double gearing of capital.[1]
- For banks belonging to a group by reflecting the provisions of Art. 49(2) CRR and that are permanently affiliated to a central body.

In fact, for cooperative banks affiliated in such organisational structures the equity holding within the group/network does not follow a speculative or profit making goal. There is an intimate knowledge of the other entity (the availability of information is not comparable to other equity holding investments) and a structural relationship between the entities which is reflected in the governance and business operations.

Furthermore, it should be envisaged that also MREL/TLAC instruments should not be risk weighted at 150% but rather at 100%.

Indeed, the subordination requirement is a provision of the TLAC term sheet rather than BRRD, where it follows only individual MREL decisions. Moreover, in the EU there is a category of MREL/TLAC eligible instruments that is senior non-preferred that is not catered for by the BCBS proposals. See also our answer to question 59.

Q21

Equity exposures outside the financial sector

[1] One of our members organised in an IPS structure has elaborated some examples of impact on the banks within the network for the higher risk weights in the equity of their central institution (as of 30 September 2019):

- Institution with a balance sheet of approximately € 300mn: € 9.2 million vs € 22.9 million (i.e. +149%).
- Institution with a balance sheet of approximately € 1bn: € 53.5 million vs € 133.6 million (i.e. +150%).
- Banking group with a balance sheet of approximately € 28.5bn: € 2.4 bn vs € 6 bn (i.e. +150%).

The BCBS proposals has consequences also for the equity investments that many banks (applying the SA) have in local businesses in a number of Member States.

We highly regret that reasonable and well established equity holdings of banks in successful European enterprises would be negatively and unduly affected. Overall, the proposed treatment of equity exposure shows no granularity whereas the various types of equity investments meet different financial objectives. Long-term investments are suffering from a punitive risk weight while their contribution to the economy through capital market is positive and necessary. It is a crucial moment to decide whether to facilitate capital investments for EU investors or not, especially as we are aiming to establish a capital markets' union. Inevitably, the increase of risk weights will force banks to sell existing equity holdings in the non-financial sector. Some members reported that international investors are already inquiring when certain industrial holdings will be sold due to the pressure of the Basel reforms. This would lead to major disruptions in the economies of Member States with potential labour market losses.

Overall, we see a danger that such proposal would trigger widespread divestments and also lead to undue short termism in the prudential framework. This is an area in which the EBA (and more generally the ESAs) are conducting detailed analysis on the state of undue short-terms pressure from the financial sector on corporations to fulfil a Commission call for advice. We stress that in some Member States while banks have held equity holdings in certain industries for decades, supporting their long term growth through all business cycles, new investors would only aim to maximise returns short term, without having to deal with the burden of increased capital requirements. This would certainly be a source of unwarranted short-termism.

The further proposed five-year linear phase-in arrangement for existing equity investments from the date of implementation of the Basel standard (Footnote 29 of the BCBS standard) in order to avoid a rapid, exorbitant increase of capital requirements is not sufficient to avoid negative consequences in the long run, not only for banks but also for territorial cohesion and the real economy (including the labor market). We belive that the provision will inevitably lead to sales of equities in strategic important companies.

Against this background it is necessary to maintain the current risk weight (100%) in the CRR for equity investments outside the financial sector under the SA, and apply it as a structural measure across the entire banking sector in CRR3.

We would envisage two tools to that end, one to address holdings that were acquired by institutions before the 2017 Basel reforms.

Indeed, many members in a number of Member States hold significant participation outside the financial sector and with regard to the aforesaid it is urgent that a 100% RW is introduced. A grandfathering mechanism is to be introduced in a new Article 133a CRR instead of the BCBS phase out:

- *"Article 133a – Existing equity exposures*
  For equity exposures acquired by institutions and EU subsidiares of institutions prior to [1. Januar 2023] a 100% RW shall apply."

In complement, equity investments undertaken with a strategic view and long term commitment should be granted a 100% RW in all Member States, also with a view to safeguard the origination of new long term equity investments.

This mechanism could be particularly considered for long-term existing equity investments. Appropriate conditions could be envisaged to adequately and prudently frame such option, e.g. a minimum number of years of holding of the equity exposure, the absence of speculative/short term movimentation of the exposures, a certain degree of granularity etc. This could be done on the basis of a mechanism similar to the accounting choice envisaged under the old IAS39 to determine exposures available for sale and those held to maturity. A no-tainting rule could also be foreseen, and a five consecutive years holding period by the institution or subsidiaries of the institution could be deemed sufficient to receive a 100% RW.

Finally, we would like to highlight that a specific exemption should be made in the CRR for equity investments for the purpose of financing energy neutralstructures in the effort of greening the economy. Please refer to our answer to Q191 for the details.

23) Do you agree that speculative unlisted equity exposures such as investments in private equity or venture capital firms should be subject to a relatively higher RW than other equity exposures? If you disagree, please explain and provide relevant evidence to substantiate your view.

24) Views are sought on the definition of 'speculative unlisted equity exposures' provided by the Basel III standards (paragraph 51 and footnote 31). In particular, would you deem further refinements or clarifications necessary and if yes, what should those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

25) What other measures could be put in place to address the elevated risk from unlisted equity exposures? Please elaborate and provide relevant evidence.

Q23

The 400% RW for equity investments in unlisted companies that are invested for short-term resale purposes or are considered venture capital or similar investments which are subject to price volatility and are acquired in anticipation of significant future capital gains can lead to unintended consequences for the markets.

Such a regulatory measure is likely to lead banks for cost reasons to no longer invest in (small and middle-sized) start-ups. However, the funding of these start-ups is essential for their business survival on the market. In such a situation start-ups would not be able to achieve a solid market position, create jobs and stimulate economic growth in Europe.

Q24

While we understand the aim to avoid arbitrage between the banking and the trading book, in general, (listed or unlisted) equity exposures that are held for a longer period of time shall not be qualified as 'speculative'.

26) In your view, should the discretion for "national legislated programmes" provided by the Basel III standards should be implemented in the Union? If you disagree, please explain and provide relevant evidence to substantiate your view.

27) Would you deem additional safeguards necessary to ensure that only exposures under legislative programmes that effectively reduce the risk can benefit from the preferential RW? For instance, should the preferential RW for exposures subject to national legislated programmes be made dependent on evidence of lower riskiness of respective exposures, and if yes, what kind of evidence would be adequate?

28) In your view, how should "national legislated programmes" be defined within the context of the Union? In particular, would you deem further refinements or clarifications necessary concerning the existing definition, and if yes, what would those be and what would be their prudential rationale? Please elaborate.

Q26

We appreciate in principle the provision for national supervisors to allow banks to assign a risk weight of 100% to equity holdings made pursuant to national legislated programmes that provide significant subsidies for the investment to the bank and involve government oversight and restrictions on the equity investments.

However, we regret that such treatment can only be accorded to equity holdings up to an aggregate of 10% of the bank's combined Tier 1 and Tier 2 capital. This does not reflect business reality where equity holdings are not acquired in connection to a public/government supported scheme and rather sets a number of further restrictions that would largely affect business relationship and the real economy. These exposures should be granted a grandfathering treatment to avoid disruptive consequences on the real economy.

- *Retail exposures*

29) Views are sought on the costs and benefits of introducing the sub-asset class of transactors for regulatory retail exposures and specifying the treatment for other retail exposures. In particular, how does the approach provided by the Basel III standards compare with the current approach in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

30) In your view, does the reduction in RWs for exposures to transactors under Basel III prudently reflect the risks associated with such exposures? Please elaborate and provide relevant evidence.

31) Would you deem further clarifications necessary concerning the notion of transactors and other retail, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

32) In your view, which other aspects, if any, should be considered in the context of revising the treatment of retail exposures? Please elaborate and provide relevant evidence.

33) In your view, is the current CRR sufficiently clear to ensure a harmonised application of the "granularity criterion" or do you consider further guidance necessary? If yes, what are your views as to what this further guidance should entail?

Q33

Retail granularity criterion

We strongly advise against the implementation of a hard granularity criterion as envisaged in the BCBS standard, according to which no aggregated exposure to one counterparty shall exceed 0.2% of the overall regulatory retail portfolio.

Although room is left for alternative supervisory approaches when another method to ensure satisfactory diversification is determined, we still see no need and no justification to enforce a hard granularity criterion. We would also note that to avoid concentration risk there is already in place the well implemented regime of large exposures.

Furthermore, we would like to stress that the granularity criterion particularly places at a disadvantage smaller banks, as to take full advantage of the retail RW of 75% for an SME with a € 1mn loan an institution needs a retail portfolio of at least € 500mn. This amount can hardly be achieved by smaller banks many of which may have the entire balance sheet summing € 500mn. The overall recognition of the SME category would be overshadowed by the shift of wording on the granularity criterion, as it becomes binding as an additional prerequisite for a treatment as regulatory retail.

A proportional approach could be envisaged for credit institutions with a retail portfolio (without taking account of granularity criterion) below a certain threshold (e.g. €500 million (0.2%=1/500)) to be subject only to the loan size criterion removing 0.2% granularity criteria.

The BCBS rightly considers the diversification criterion to be one of the primary justifications for the current preferential treatment. However, adopting a 'one-size-fits-all' approach in this area, and setting a very low threshold, is likely to result in unintended negative consequences. Indeed, for institutions with small portfolios the proposed thresholds can be reached very easily. Therefore, small business-retail customers of smaller banks would be strongly discriminated and competition within the banking sector is likely to be distorted via the prudential regulation. This can entail significant drawbacks; in particular the specific business model of local banks (informally-intensive and traditional lending activity, i.e. so called relationship lending) might be negatively affected by the prudential regulation, mainly for two reasons:

- The 'too-small-to-survive/succeed problem' would be exacerbated due to regulatory-induced incentives to grow in size (while in some cases merger operations are the principal way to increase efficiency and strengthen the resilience of very small banks this principle cannot hold true for every case);
- The commitment of the bank towards the SMEs-borrower would be weakened and in turn the typical benefits of the relationship lending would be jeopardized.

It is imperative for the growth of regional economies to maintain the availability of credit to retail individuals by smaller credit institutions. In some cases, the market area of credit institutions is even restricted to a very limited number of municipalities. The proposed 0.2% of granularity criteria would impose harsh constraints on credit availability, and raise pressure on supervisors and policy makers to ensure that local economy is unharmed by imposing unnecessarily rigid diversification rules. Against that background the granularity criterion shall remain a recommendation of the Basel Committee only as it was practiced in the past.

The use of an absolute threshold, as it is the case today, would be a fairer solution and avoid any discrimination.

➢ *Real estate (RE) exposures*

34) Views are sought on the relative costs and benefits of the LS approach and the WL approach provided by the final Basel III standard. In particular, how do the two approaches compare in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

35) Would you deem further refinements or clarifications necessary concerning the

approach that you generally prefer, and if yes, what would those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

36) What would justify implementing both approaches in parallel from a risk perspective? If both approaches were to be implemented and made available on discretionary basis, how would comparability across institutions be ensured and how would regulatory arbitrage as well as undue complexity be prevented in this case?

Q34

In order to minimize the impact of inclusion of LTV, the legal possibility to split an exposure secured by residential real estate in a fully secured part and in a not secured part (Loan Splitting, LS) – as per Para. 65 of the BCBS standard and as reasonably practiced across the EU – should be implemented into the CRR irrespective of whether the repayment of the loan is materially dependent of cash flows generated by the property or not. All Member States should be able to apply loan splitting.

This methodology is actually the predominant interpretation of Basel 2 framework and is already implemented. The advantages of LS consist in avoiding sharp discontinuities with a smoother correlation between LTV and the effective risk weight – in other words it makes the framework more risk sensitive without unduly increasing the complexity.

Indeed, we see that as jurisdictions have a discretion to apply a loan splitting approach for residential real estate in addition to the whole-loan approach there may be stances for potential discrepancies for banks operating across multiple jurisdictions (e.g. in the EU and in non-EU countries) if home and host jurisdictions choose different approaches.

We do not see a significant regulatory arbitrage risk if the Whole Loan (WL) approach for proportionality reasons may be chosen. The choice between both approaches is rather determined by historic mortgage lending traditions and the treatment of real estate as a collateral tool. National discretion would allow Member States to apply tailor made approaches in accordance with their historic and legal environment.

Finally, we would also highlight that collateral recognition for commercial real estate should be better aligned with the framework for residential real estate.

Indeed, the risk sensitivity of residential real estate and commercial real estate is empirically different, whereas in the Basel recommendations the two display the same haircut: only 55% of the market value is retained.

Due to the fact that the market for Residential Property is commonly more liquid than the one for Commercial property when a Bank has to sell these properties, we recommend a 65% threshold on Residential Property whereas a 55% threshold could be maintained on Commercial property, corresponding to percentages of the property value to be recognised.

We consider that it is important to maintain a risk sensitivity approach in line with the underlying risk when defining the corresponding haircuts.

<u>Fitting the LTV based approach into the reality of EU markets: a possible alternative</u>

Overall, we recommend the introduction of objective but flexible criteria into the CRR3, to recognise dual recourse of EU loans for which the borrower is personally liable (no walk away option like in the US where the homeowner can hand over the keys to the bank in case the outstanding loan amount exceeds the value of the property)[2] and other relevant national specificities of each Member State. Implementing a one-size-fits-all approach in Europe may lead to unintended consequences, especially for residential real estate markets that are strongly characterized by domestic features that mitigate risks but that are not taken into account in the BCBS framework. Next to insolvency laws we would mention social welfare systems; country specific guarantee systems, the mandatory building-up of savings as part of tax incentive, the predominance in some Member States of fixed rate mortgages and rental market restrictions. This results in a lower risk profile in the EU compared to other jurisdictions where real-estate loans are only backed by the collateral provided by the borrower and where borrowers are not personally liable and have a less developed welfare system and less restricted rental markets. Furthermore, the articles 124–126 CRR (and other macroprudential tools) already provide a legal basis for competent authorities to increase risk weights for exposures that are secured by real estates if loss figures which are based on empiric data and alarming developments in the real estate sector justify such a measure.

Q35

Taking these macroeconomic specific European elements into account, we suggest that the risk weights proposed under both the loan splitting and the whole loan approaches, are lowered when the bank has dual recourse on the customer or when the average loss rate (net credit losses per annum divided by the total mortgage portfolio) on residential real estate exposures in a specific market are considered to be sufficiently low.

In this sense we would propose a number of alternatives to ensure a more adequate reflection of risks, including the two here below, a third acting on the granularity of LTV buckets and a fourth one for a so called SA+ presented in more detail under Q59.

Alternative 1

In case real estate loans are covered by dual recourse, a “credit risk mitigation factor” of 50% can be applied to the risk weights under the residential LTV whole loan and loan splitting approach.

In this sense, dual recourse means that the borrower remains liable for the full amount of loan taken, also when in default the coverage from selling the mortgaged real estate collateral is not sufficient to repay the loan. That is, the lender has a claim on the borrower's other funds, possessions, future income or funding sources when the proceeds from selling the real estate collateral is not sufficient to repay the loan.

Example

The bank applies the Loan Splitting approach and has a contractual and legal enforceable dual recourse.

The LTV < 50%, meaning that the risk weight applied amounts to 20% (as stated in table 11 paragraph 64 SA credit risk December 2017 of the Basel Committee). However due to the fact that a dual recourse gives the bank a stronger position than under a non-recourse

[2] EACB members in Germany, France, Italy, Spain, The Netherlands, Austria, Denmark and Finland indicate that they apply dual recourse for residential real estate loans.

loan, the bank applies a credit risk mitigation factor" of 50%, meaning that the exposures is risk weighted at 20% * 50% = 10%.

Applying this approach to a reference residential real estate portfolio will reduce the risk weight for this portfolio by 50%. Taking into account that under the current CRR, the risk weights for these portfolios based on approved internal models are even lower than under such alternative, this would be an adequately prudent approach, taking into account dual recourse which is a key EU credit risk mitigant.

Alternative 2

In case of no dual recourse loans (under both LS and WL), the RWs for the SA could be adjusted as follows:

a) Multiplying the risk weighting by 75% when the losses stemming from lending collateralised by residential property do not exceed 0.3% of the outstanding loans collateralised by residential property in any given year;
b) Multiplying the risk weighting by 65% when the loss rate of the individual bank on residential real estate exposures must not exceed 0.15% in any single year.

Where the loss rate in a given year exceeds the percentages stated above, the eligibility to use alternative 2a or 2b shall cease and the conditions stipulated under Basel proposal shall apply until the above conditions are again satisfied.

In the case we apply this approach to a reference residential real estate portfolio that under the Basel SA proposal, we determined that alternative 2a will reduce the risk weight of the portfolio to an average 24% and alternative 2b to 21%. Taking into account that under the current CRR, the risk weights for these portfolios based on approved internal models are even lower, we consider this a prudential approach.

<u>Alternative 3: LTV buckets for residential real estate (enhanced granularity for both Loan Splitting and Whole Loan approach)</u>

More in general, we would also highlight that the envisaged buckets' granularity is not sufficient. Beside the more general criticism on the approach followed by the BCBS and its vast impact in terms of increase in capital requirements, we would also highlight that (as previously indicated) current Articles 124–126 CRR (and other macroprudential tools) already provide a legal basis for competent authorities to increase risk weights for exposures that are secured by real estates if loss figures which are based on empiric data and alarming developments in the real estate sector justify such a measure. On the legal basis of the current Article 124(2) CRR such an increase of risk weights for real estate exposures can also already be linked to the fulfillment of a certain LTV ratio.

A general inclusion of the LTV ratio in the CRR as the primary risk indicator would lead to an additional, inappropriate financial burden both for implementation by small and non-complex banks and as a reference for IRB banks. It could overall have the unintended effect of encouraging lending to customers with worse financial standing.

When calculating the LTV ratio a considerable number of parameters (e.g. market value, encumbrances in the land register[3], generated cash flows, number of house units,

[3] It should also be noted that land registers do not respond to a common definition and identical content across Member States, other adequate instruments are also possible.

informations about the primary residence of the borrower etc) have to be determined and also accurately documented with a considerable effort. Certain collaterals and risk surcharges must be recognized separately after the LTV calculation. Furthermore, an appropriate, additional IT infrastructure could have to be implemented in the banks' systems for LTV calculation purposes, which requires time and additional resources.

Moreover, the proposed LTV-based approach should not penalize the best quality loans. The framework should be made more granular and risk-sensitive. That is why for residential real estate exposures, additional LTV buckets should be added below the 50% RW. This would increase risk sensitivity without compromising on soundness. Currently, by using the suggested framework, where the lowest LTV bucket is 50%, a large chunk of the loans provided (residential real estate exposures) are belonging to the same LTV bucket (LTV <= 50 %), penalizing particularly low risk mortgage loans. We would suggest adding LTV buckets (as per the table below).

LTV range	Risk weight
≤30%	10 %
30% < LTV ≤ 40%	15 %
40% < LTV ≤ 50%	20 %
50% < LTV ≤ 60%	25 %
60% < LTV ≤ 80%	30 %
80% < LTV ≤90%	40 %
90% < LTV ≤ 100%	50 %
LTV > 100%	70 %

The increased granularity could be applied to both Loan Splitting and Whole Loan approaches. From a risk sensitivity perspective, the Loan Splitting approach as proposed in the Basel standard completely ignores any effect of the real estate collateral above LTV 55 %. For institutions primarily concentrated on lending in the 55-80 % LTV band the loan splitting approach would be unduly penalizing.

Thus, we suggest further refinement to the Loan Splitting approach. The RW in the 55-80% LTV band based on the risk weight of the counterparty should be reduced by a factor of 25%-points to reflect that the loan is fully and completely secured by the real estate property. The RW under the Loan Splitting approach to a retail customer with an unsecured risk weight of 75% should thus be reduced to 50% in the 55-80% LTV band.

We would also invite the Commission to explore alternatives to enhance the granularity of the LTVs on the basis of a simple set of variables readily available also to most SA banks. We provide a more detailed illustration of such SA+ approach under Q59.

Framework issues

In the EU there is much less evidence of risk capture problems for residential real estate, and in any case not at generalised level. Moreover, competent authorities in the EU are already entitled to set higher risk weights based on the loss experience and forward looking market developments of exposures secured by immovable property according to specific CRR powers (e.g. macroprudential tools). Indeed, the Basel revised SA targeting residential real estate does not seem adequate for all markets (not only when comparing the EU and US, but also within the EU).

For mortgage markets Basel reforms could have severe consequences if markets' specificities are not well considered. A one-size-fits-all approach may lead to unintended consequences especially for residential real estate markets strongly characterized by domestic features which mitigate risks but are not taken into account in the BCBS framework; this is the case for insolvency laws; social welfare system; legal system regarding mortgages; country specific mitigating factors (guarantee systems, mandatory building of savings); predominance in some Member States of use of fixed rate mortgages with a connected reduction of the risk of the counterparty as the bank fully controls the interest rate and can manage it via its ALM; specific market dynamics (e.g. high LTV markets with scarce history of losses, or markets where LTV is not a key driver for lending).

In addition, some of the rules on the calculation of the LTV and the recognition of collateral have very asymmetric effects on individual jurisdictions. For example, the LTV calculation cannot be adjusted if the loan is not amortising, as in some jurisdictions mortgage loans are not amortized (or only to a small extent), but cash is instead invested in savings/pension plans linked to the mortgage (which cannot be touched other than to repay the loan at maturity). This is largely driven by the tax laws in the country in question. The proposed treatment discriminates against mortgages in these countries as these are classified as high risk (high LTV), while the effective LTV (and the actual real estate exposure) are reducing through the accumulated savings.

The finished property criterion for residential real estate should also be deleted as it would lead to unreasonable high risk weights. This would be also consistent with EBA Q&A 2015_2304, and 2016_2641.

The issue in paragraph 67 of the final BCBS paper is that the terminology around "servicing" and "repayment" is still used inconsistently, although this has improved since the second CP text. We had already raised this issue and believe it should now be addressed when transposing the BCBS standard.

For instance in BCBS para. 51, the confusion and inconsistency between repayment and servicing is evident: the narrative tends towards the more holistic concept of "servicing" – i.e. meeting all the payment obligations under the loan, both interest and instalments of principal. But the use of the term "repayment" can only refer to principal – although usually interest makes up the majority of any regular payment obligation, interest is paid but not repaid, so repayment cannot refer to any element of interest. Thus both the bullet point in para. 50 and the text in para. 51 should refer to servicing the loan. This would also make clearer that interest-only loans, fully serviced from the borrower's other income, do not fall into the IP-RRE category.

Para. 67 has responded to this criticism, as the term "servicing" has been adopted throughout. The problem is that the headings for both Tables 11 and 12 refer to "Repayment". We think this is most likely an oversight, but it remains a concern. So we urge the Commission to treat the language used in Para. 67 as definitive, and correct the inconsistent language in the headings of the two Tables, when transposing them into Level 1 text – so, change "repayment" to "servicing". In that way, interest-only lending will clearly qualify for the Table 11.

37) Do you consider the assessment of the condition of "strong positive correlation" on a portfolio basis more appropriate than the assessment based on the individual RE exposure, and if yes, why? Please explain.

38) If the assessment based on a portfolio basis were introduced, what are your views on whether it should be the only approach available in the Union or it should be an alternative approach to be applied at supervisory discretion on a case-by-case basis? Please explain.

For commercial real estate, the Basel package foresees that when repayment of the loan is not materially dependent on the cash flow generated by the property and the LTV ratio is less or equal 60%, a 60% RW shall apply, and if LTV is higher than 60%, the risk weight of the counterparty shall apply. In all other cases, if the repayment of the loan is materially dependent on the cash flow generated by the property RWs from 70% to 110% shall apply and other criteria (finished property, legal enforceability, claims over the property, ability of the borrower to repay, prudent value of property, documentation) have to be met for assigning these risk weights. Otherwise RWs would go up to 150%.

Given a 50% RW under Art. 126(1) and (2) CRR, the capital increase these exposures face is more than remarkable. In addition, there seems to be a poor recognition of security (i.e. collateral) as commercial real estate exposures can even be assigned risk weights higher than unrated (unsecured) corporate exposures.

Secured exposures risk weights should be at least below the risk weights of unsecured exposures.

The granularity and risk sensitivity of the proposed LTV approach should be enhanced to avoid penalising the best quality tranches of credit. In the lower proposed LTV-buckets the RWs are too high compared to industry benchmark.

We would suggest that commercial real estate market portfolios with historically low default ratios should be treated with a more risk-sensitive approach. Making the standardised risk weights more granular on lower LTVs, by introducing one or two LTV-buckets below 60%, would capture more accurately the risk profile of the commercial real estate portfolios of prudent and stable banks in large parts of Europe.

In order to minimize the impact of inclusion of LTV, the LS approach should be implemented into the CRR irrespecitve if the repayment of the loan is materially dependent of cash flows generated by the property or not. All jurisdictions in Europe should be obliged to apply loan splitting and there should be no national discretion on the chosen approach (whole loan vs. loan splitting approach).

We would also support the idea to use the Hard-Test for commercial real estate business as a substitute for the criterion of an independent debt service. It should also be possible to apply the Hard-Test for residential real estate business. In general, as indicated above, the risk weights for residential real estate should be more risk sensitive. As a further alternative to the proposals indicated (more granular table for LTVs, use of a SA+), a reduced risk weight or a multiplier lower than one (e.g. 0.75) could be considered for portfolios that pass the Hard-Test and in addition show a methodologically proved low default history.

<u>Social housing</u>

The framework for the revised SA may also have unfortunate consequences for all lending (existing and new) to a relevant part of the "social housing" sector (i.e. not for profit or charitable provision of housing at affordable rent to economically less advantaged clients).

Indeed, the new approach generally seeks to make a finer distinction between loans secured on rented as opposed to owner-occupied housing. In the first consultation, most IP-RRE appeared to be excluded from the preferential RW for residential real estate under the "material dependence" criterion. It was pointed out that loans financing rented social housing should be treated as RRE, and this general point was accepted in the second consultation, along with adjustments in the final agreement also to reflect the fact that not all providers would be cooperatives as in some Member States, many/most are in fact community benefit societies, not pure tenant cooperatives. Unfortunately, a new element was added which could cause problems for certain categories of supported housing providers that serve some of the EU's most vulnerable and disadvantaged residents.

In particular, para. 68 (pages 22-23) contains the following definition covering social housing finance as a preferential category:

"*An exposure secured by residential real estate property to public housing companies and not-for-profit associations regulated under national law that exist to serve social purposes and to offer tenants long-term housing.*"

Much of the new wording caters for the great majority of social housing providers, however there are a number of associations doing really important work by providing shorter-term housing in the form of hostels, move-on accommodation, short-term housing for the homeless, young people leaving care, refuges for women fleeing domestic violence, etc. The housing itself is clearly occupied (successively) long-term by these client categories, but (for obvious reasons) each individual resident may need / be offered only shorter-term housing, or will naturally move on to longer- term housing where possible.

We would ask EU authorities to make the language slightly more flexible to clarify that the long term provision of such housing is not disadvantaged, notwithstanding that successive individual occupancies of any unit may be shorter-term. The associations providing it are often smaller, and therefore more reliant on bank finance than on capital markets issuance. It should be possible to find a formulation that covers such worthy activities which temporarily provide a primary residence for these vulnerable people, without also covering pure holiday accommodation or other short term occupation.

We would suggest "*…that exist to serve social purposes by the long-term provision of housing to tenants*", <u>this would make clear that it is the provision of the housing, rather than the duration of individual tenancies, that needs to be long term</u>.

39) What are your views on the costs and benefits of implementing the preferential treatment for certain properties under construction as provided by the Basel III standards? Please provide relevant evidence supporting your view.

40) Do you consider the threshold of one-to-four family residential housing units appropriate, and if not, which other threshold would you consider to be more appropriate? Please provide evidence supporting your view.

See answer to Questions 48-49.

41) Views are sought on the costs and benefits of the valuation criteria provided by

the Basel III standards. In particular, how does this approach compare with the current approaches available under the CRR (MV and MLV) in terms of simplicity, comparability, risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

42) Would you deem additional specifications necessary to clarify how the MV or the MLV currently used by institutions would need to be adjusted to meet the valuation criteria provided by the Basel III standards? Would you deem further clarifications necessary to ensure a consistent application of the valuation criteria across the Union? Please elaborate.

43) What other measures could be taken to ensure that the value of RE collateral is sustainable over the life of the loan? Please elaborate and provide relevant evidence.

44) In your view, which other aspects, if any, should be considered in the context of revising the valuation criteria for RE property? Please explain.

The Basel III standard states that the valuation must be apraised in a prudent and conservative manner, excluding expectations on price increases, and adjusted to take into account the potential that the current market price is significantly above a sustainable value over the life of the loan. In our opinion, both the 'mortgage lending value' and 'market value' methodology fit with the Basel requirement – for 'market value' being the acted knowledge non-compulsary arm's-length transaction inbetween independent agents in the real estate market as the elements of prudential, conservative and sustainable valuation.

If the current CRR approach were not to be retained, the established terms should be used in order to allow maintaining the definition/formula behind.

In addition we like to highlight that the use of Market Value (MV) and Mortgage Lending Value (MLV) is not only used in the SA (Art. 124, 125 and 126 CRR), but these concepts are also referred to in the context of the credit risk mitigation framework (Art. 229 CRR) and in the large exposures framework (Article 402 CRR). Furthermore, these valuation concepts are linked with capital requirements for exposures in the form of covered bonds. Art. 129 CRR sets out a number of requirements to qualify for a preferential risk weight on covered bonds, which includes in Art. 129(3) CRR an indirect reference to the concept of MV and MLV given its reliance on the credit risk mitigation framework (Art. 229(1) CRR).

Adjusting the valuation principles would is in our view not be advisable as this will increase the operational cost to implement as it not only affects RWs under the SA, but also credit risk mitigation and large exposures. Besides these costly operational changes, it will also have an impact on covered bond programs that are secured by real estate. This was also explicitly stipulated by EBA in their opinion on mortgage lending value of 5 October 2015 (EBA/Op/2015/17).

Although we are of the view that the current CRR already gives sufficient rules on valuation, we like to emphasise that the question on ensuring that the value of RE collateral is sustainable over the life of the loan is misleading.

For short term loans (mostly with variable or short term interest rates) the valuation over the life of the loan will reflect more the current real estate market circumstances and will be more easily predictable than for long term loans. For long term loans it is therefore tempting to use a reflection to past real estate price volatility. This will indeed be higher than for short term loans. However, the risk from the customer point of view is higher for short term loans than for loans were cash flows are fixed for 10 or even 30 years as normally due to inflation, income rises while the interest payment remains fixed.

In this context it is also necessary to bear in mind that the likelihood of default is higher during the first years of loan. After the first years without delinquency, the probability of default of a customer decreases substantially. When taking these specificities into account, the framework should not encourage constant refinancing.

Taking these arguments on board, we are of the view that both valuation methodologies should be maintained:

a) As the methodologies are compliant with the principles for real estate valuation in the new Basel framework;
b) This reduces the operational cost of implementing the new prudential regulation for banks and supervisors;
c) It ascertains market confidence in the European covered bond market.

We are not against further harmonisation of these valuation principles at European level, but recommend the Commission to first look at the opinion issued by EBA on 5 October 2015 (EBA/Op/2015/17), where EBA stated that the Commission should initiate legislative steps to clarify the scope of the RTS empowerment addressed in article 124(4) CRR, excluding any implications on covered bonds.

45) Views are sought on the costs and benefits of capping the property value at loan origination. In particular, how does the approach provided by the final Basel III standards compare with the current approach of the CRR in terms of possible cyclical effects on RWs, risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

46) What other measures or safeguards could be provided to address possible cyclical effects of the re-valuation of real estate property? Please elaborate and provide relevant evidence.

47) In your view, which other aspects, if any, should be considered in the context of revising the requirement for re-valuation of RE collateral? Please elaborate and provide relevant evidence to substantiate your views.

Q45

The EACB does not see any benefit of capping the property value at loan origination, but rather drawbacks. In fact, capping the property value at loan origination during the life of the loan would favour short termism, thus increasing risk instead of reducing it.

According to the Basel agreement (but, it appears, contrary to the current provisions of CRR and to the approach that EBA is suggesting in its draft Guidelines on loan origination and monitoring), institutions should be using only the original property value measured at the time of loan origination or the result of a downward-only revaluation, if deemed necessary (footnote 37). In its advice from August 5th 2019 the EBA sets out two options as a wat forward: option 2 would give the possibility to revise the property value over the lifetime of the loan, we would recommend following this route.

Indeed, time renders valuations at origination outdated, an important issue especially for residential real estate mortgage portfolios in Members States with typically long-term loans and with fixed interest rates.

The value at origination means that housing price increases cannot be translated in lower mortgage rates for the customers. Rising housing market prices due to market forces should decrease the LTV and substantially reflect a lower real risk profile of the mortgage. In contrast, value at origination would intensify the incentive for house-owners to move their mortgage to other mortgage providers, in order to benefit from lower LTVs in their lending rates. This could lead to larger inefficiencies and higher prepayment risks, leading eventually to higher costs for home owners.

In fact value at origination encourages lenders to shorten their tenor and apply for short interest rate periods, decreasing the resilience of economises in in certain Member States. In fact it shifts the interest rate risk from the lender (the banks) to the borrower (the European consumer), where the banks have more knowledge and instruments to hedge interest rate risk.

Indeed, we contrast the approach of the BCBS with the requirements of CRR Article 208(3)(b), which should rather be connected to Article 125(2): the value of residential property collateral would so be monitored at least every three years. In our opinion, if LTVs are to be the prime determinant of the SA risk weights, they should be accurate, that is, calculated on the basis of a reasonably current property value as well as the current effective debt outstanding.

Moreover, in considering the suitability of the new Basel requirement for European circumstances, it is necessary to take account of fundamental differences between most EU residential mortgage markets and those, for instance, of the USA, as it is feared the latter unduly influenced many of the final terms of the latest Basel Agreement. The European tradition, generally, may be characterised as "originate to hold" – that is, the original lender expects to retain the customer relationship, and the loan asset on its balance sheet, for the lifetime of the loan. While some European lenders have made some use of securitisation, the originate to hold model remains predominant, and- in our view – preferable for consumer protection reasons. By contrast, the US model may be characterised as "originate to distribute/on-sell" with the original lender recurring to a much wider extent to offload existing mortgages via securitisations.

Also, from an operational point of view, the implementation of value at origination will be extremely complex for existing loans as until now the EU allows market value and mortgage lending value. In many cases banks generally did not record the value at origination in applications as it was not required by law. In order to re-assess the value at origination for the current mortgage portfolios – taking into account modification made to the property that unequivocally increased the value – will be extremely costly and arbitrary.

Q47

It is also necessary to bear in mind the near-universal experience in mortgage lending that (ceteris paribus) the likelihood of default (measured under IRB by the PD) is greatest in the first few years of the loan. Then, after a period of, say, three years without delinquency (i.e. "seasoning") the propensity to default has fallen substantially. So the RW framework should discourage, or at least not encourage, constant refinancing, with the temptation to make "equity withdrawal", instead of progressing to repay the original loan.

A simplified example might best illustrate how the Basel original valuation feature will incentivise riskier outcomes :

*Borrower X has bought a house costing € 100,000 with an initial loan of €86,000 from lender A : at 86% LTV this loan carries a RW of **40%** under Table 11 (on page 21 of the Dec 2017 Basel text).*

*After 3 years, X has repaid a total of €5,000 but considers refinancing her loan. The house vaue has now risen to € 110,000. Lender B has no difficulty offering a loan of €81,000, based on the current valuation, which gives a LTV of 74%, requiring a RW of only **30%** under table 11. For lender A, however, the LTV based on original valuation remains at 81%, keeping the RW at **40%**. So, B is able to undercut A's mortgage rate as the capital cost of its loan is **25% lower** , for near identical risk.*

*But the perverse incentives do not end there, as B can even offer a lower rate while tempting X to withdraw some equity from the property, all at the lower RW. X now fancies spending €6,000 on some expensive jewellery, and wants to take the cash out of the increased value of the house. This would take her total debt to € 87,000. Lender B is quite relaxed, as this will still take its LTV to only 79% and therefore still a RW of 30%. For lender A, the RW has to stay at least 40%, **even on the original amortised amount of €81,000 – so this RW is actually higher than for B's proposed loan of €87,000 on the same property**. And if A allows any equity withdrawal, the RW will get close to the 50% bucket.*

So, what does lender A do? While the normal practice would be to provide the extra money as a "further advance", A realises that to keep borrower X it has to game the rules. So, via a lending subsidiary, it offers X a completely new loan of € 87,000 at the current valuation of € 110,000 at a 30% RW. The new money repays the orginal loan to A itself, leaving the borrower with € 6,000 to spend on jewellery. This is what Basel facilitates, but should the Commission and the EU necessarily follow suit?

So, we demonstrate above that being required to adhere to an original valuation (that may be well out of date) will create serious perverse incentives where the borrower is considering refinancing. The rule would in fact encourage repeated switches of lender: for the same loan (monetary amount) and the same property, the risk weight (and thus the pricing) applied by a new lender could be lower if there has been an increase in property value since the original loan was made, as the new lender will (indeed, must) use the latest valuation, while the original lender cannot. The risk, of course, is almost the same (in fact, if anything, the risk to the new lender is initially greater, as it has had no prior relationship with that borrower). And as we have shown, the new lender can tempt the borrower away from the original lender, and away from prudence, by offering extra cash for spending, so increasing the burden of indebtedness, all at the same lower RW. It is essential that original lenders are not competitively disadvantaged in this way. Otherwise they will simply be driven to subterfuges such as re-documenting and re-advancing the loan in order to benefit from the new valuation. *Cui bono?*

We consider that there is a sensible middle ground, represented by what is currently in Article 208. It would be equally foolish to revalue mortgage collateral every few months, as it would be to fail to monitor proprerty values at all. Article 208 requires monitoring at least every three years. We believe that institutions should have the possibility to reflect the result of a revaluation at intervals of not less than [two] years, or otherwise (for fair competition reasons) in the case of renegotiation where the borrower is proposing to refinance with another lender.

Such an approach as outlined above would be more faithful to European traditions, more beneficial to consumers, and ensure fairer competition in the refinancing situation, as well as being more in line with current risk management and underlying risk.

To conclude, existing provisions in the CRR, (e.g. Art. 124(2) and 124(5) CRR) provide sufficient room to eliminate possible cyclical effects on RWs. In addition, authorities can recur to Art. 164(5) to floor the LGD in case developments in the real estate market of Member State requires a prudential intervention as well as article 458 CRR for macro-prudential or systemic risk. Additionally under Council Regulation (EU) 1024/2013 (the SSM Regulation), the ECB is responsible for assessing macro-prudential measures adopted by national authorities. The ECB also has the power to apply, if deemed necessary, more stringent measures than those adopted nationally. In order to fulfil this role, the ECB uses a range of indicators to assess the real estate risk from a macro-prudential perspective.

48) What are your views on the costs and benefits of replacing the existing treatment of 'speculative immovable property financing' with the treatment of ADC exposures as provided by the Basel III standards?

49) Would you deem further refinements or clarifications necessary concerning the scope or definition of ADC exposures, and if yes, what would those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

Q48

For the new category of land acquisition, development and construction ("ADC") the BCBS envisages a RW of either 150% or 100% (para. 75). As laid down in paragraph 74, this category refers to loans to companies or SPVs financing any of the land acquisition for development and construction purposes. The BCBS explicitly refers to:

- Loans for land acquisition for any development and construction purposes: i.e. cases where a land is not bought yet. The granted loan is intended to finance firstly the acquisition and secondly any development and construction on this property. The acquisition of forest or agricultural land where there is no (intended) planning consent is not within the scope of this category.
- Loans for development and construction of any residential or commercial property: This provision addresses situations where a loan is intended to finance either the development (e.g. by applying for a planning consent) or the construction of buildings on an already owned property.

ADC exposures are considered as high risk and assigned the same risk weight as 'defaulted exposures'. A preferential 100% risk weight is permitted if certain criteria are met (Para. 75 in the SA chapter).

We understand that in any event the criterion "finished property" is not applicable to ADC exposures since the main characteristic of this exposure class is a not finished property.

Secondly, the significant portion of total contracts should take into account the specifics of the market and the reduced risk of expected reselling price. Therefore, we advocate for a minimum threshold for significant portion of total contracts of 20%, and flexibility for national competent authorities to deviate subject to macroprudential measures' approval process.

Moreover, according to the wording of this category only these loans are to be qualified as ADC where a development or construction – combined with a precedent acquisition of land or not – is to be financed.

The sole land acquisition without any intention of development or construction is not addressed by the provision.

Finally, land should receive recognition as collateral (see also Q50).

Q49

First, we propose to introduce harmonized threshold (minimum pre-sale level) at national market level and to mandate the national competent authorities to set appropriate levels. For more European consistency and level playing field, the ESRB could review NCA proposals.

In addition, the introduction of threshold should apply not only to residential exposure, but also be extended to commercial exposures.

Second, we believe that small scale home builders deserve a distinct treatment as their risk profile is usually lower than that of speculative building development. The unintended consequences of an undifferentiated treatment would negatively affect the financing of essential real economy players. In general risk weights of ADC exposures should be lower than the risk weights of defaulted exposures.

Also, in addition to agricultural land and one-to-four family residential housing units that will be the primary residence of the borrower, also property development financing should be included in the list of exemptions exempted from the finished property criterion in the first bullet point of Para 60 of the BCBS Standard. Moreover, the proposed scope of application of ADC as a new exposure class is too broad as it covers (all) loans to companies or SPV financing for land acquisition, development and construction purposes of any residential or commercial property. On the basis of this definition also each commercial real estate financing for the purpose of starting up a company would apply a risk weight of 150%. As a consequence this would lead to more expensive loans for company founders which is for sure contrary to the intention of the European legislator as it hinders economic growth in Europe.

Hence, an ADC exposure shall only be given if the loan is granted for land acquisition, development and construction purposes with the intention of reselling for profit and if the repayment of the loan is materially dependent on this generated profit. In any case when defining ADC exposures it has to be legally ensured that the personal use of the borrower, leasing purposes and non-profit financing of the real estates are out of scope of application.

Besides, the proposed approach of the BCBS on the regulatory treatment of ADC exposures penalizes banks using the standardised approach for credit risk in comparison to institutions using IRB approaches as latter are allowed to take collaterals into account in their calculations of the risk weight. Thus, for the reason of equal treatment it has to be legally ensured that significant disadvantages for institutions using the standardised approach compared to IRB banks are avoided in the whole area of real estate financing and in particular with regard to the treatment of ADC exposures in the course of the implementation of the ”Basel IV” Standard.

Therefore we propose at least to exclude from ADC and to apply lower risk weights to the following exposures in this category:

- loans to small scale home builders;

- loans to company founders and companies in a start-up phase, loans where the personal use of the borrower, leasing purposes and non-profit financing is ensured.

Property

All one-to-four family residential housing units that will be primary residence of the borrower and where the lending is not indirectly financing ADC exposures can be risk weighted according to paragraph 64 and 65, subject to national discretion. This provision should be preserved in the EU implementation. Additionally, we need to point out that the requirement for the property to act as a "primary residence" of the borrower in the future is not a feasible one. The requirement should be aligned to a more feasible precondition.

We believe that "private residence" would be an appropriate and feasible precondition and would propose a formulation along the following lines:

"The property is a one-to-four family residential housing units that will be private residence of the borrower and where the lending to the individual is not indirectly financing ADC exposures."

Further, for the purpose of reducing administrative costs for both the authorities and the institutions a general presumption of a one-to-four family residential housing as a private residence should be provided in the regulation. Unnecessary costs could be reduced if detailed analyses were only necessary where doubts regarding the residential use of the property arise.

According to para. 62 modifications made to the property that unequivocally increase its value could be considered in the LTV. Regarding the requirement of "unequivocal increase" we advocate for a methodology where the construction process is considered.

Due diligence

According to the new Standard credit institutions should perform a due diligence to evaluate whether the risk weight according to the standard is appropriate. There is a big range for the intensity of a "due diligence". We advocate for keeping in mind that the burden of such a due diligence should be kept at a proportionate level, e.g. only available information should be required to be used for the due diligence.

50) In relation to the condition for applying the preferential risk weight of 100% to certain ADC exposures, do you consider further specification necessary to ensure a harmonised application of this condition across the Union, for example by defining or quantifying any of the terms mentioned above? Please elaborate and provide relevant evidence to substantiate your views.

See also above.

The EACB would like to emphasise that the current treatment of speculative immovable property lacks guidance from the legislator and supervisor (EBA). Art. 128(3) CRR mandates EBA to draft guidelines specifying which types of exposures other than those mentioned in Art. 128(2) CRR are to be associated with particularly high risk and under which circumstances. However, EBA/GL/2019/01 do not cover the specific case of real estate. We therefore favour the inclusion of a separate category in the standardised approach framework.

However, in order to cluster these exposures and link them to exposures risk weighted under the IRB approach, further guidance on how to classify "ADC" immovable property financing in the prudential framework is needed. For example, in Pillar 3 template CMS[4] the ADC exposure will be reported in row "corporates" or "retail" where the same exposures risk weighted under the IRB approach will potentially be reported as high volatility commercial real estate. This inconsistency reduces comparability of the disclosures.

Furthermore, further refinements or clarifications are needed on the scope and application of the ADC category. Although we appreciate the choice made by the BCBS to exclude the acquisition of farmland and/or forest from this category, itis not clear how to read "*where there is no planning consent or intention to apply for planning consent*"[5]. We advise to specify that the building of residencies, stables or other real estate related to the "farming or foresting" activity should not be considered as ADC exposures.

In order to further clarify the ADC exposure, it would be advisable that EBA in close collaboration with the industry come to a workable scope and definitions. The horizontal review by the ECB in 2019 showed that it is not that easy to define a good scope given the many funding structures and risk management conditions banks have put in place to reduce the risk of ADC exposures. To give a flavour of issues encountered, we can provide some examples of the difficulty to come to a classification of exposures into the ADC category:

- What should be the characteristics of the counterparty to classify an exposure in ADC? Does this mean that that it should be a professional company (not being a private person) or SPV which, by fully bearing the risk, initiates, organises, executes and coordinates all tasks necessary for real estate development (including buying necessary land and/or objects) with the intention to sell or lease during or after development?
- What about the situation when the loan has the purpose of construction? Does this mean that the object does not yet exist at the time of financing?
- With regard to pre-sale or pre-lease contracts, how should institutions read "significant portion"[6] ? Should institutions read this in the context of the amount of m2 that has been pre-leased, or the in terms of units pre-leased (where the latter is more complex as office buildings can in most cases have a flexible structure), etc.
- What is meant with substantial cash deposit? Would a contract where the seller and the buyer agree legally that the buyer pre-finances seller during the phase of construction also classify as a substantial cash deposit and what will be the consequences in certain Member States when this would not be the case?

We also recommends to ban the restriction of Basel III (paragraph 75) of pre-sale or pre-lease contracts to residential real estate. The EACB considers receiving the pre-sale or pre-lease under a commercial real estate contract also a strong incentive to stabilise the economy of a Member State.

In order to take into account these kind of issues that are specific for ADC exposures, we recommend the introduction of objective flexible criteria into the CRR3 that would allow a practical implementation of this category, otherwise an inappropriate risk weight of 150 % for solidly financed real estate projects would be assigned in (too) many cases.

In any case, in order to avoid a too abrupt and unjustified increase of the applicable risk weights compared to the current risk weights for real estate exposures a grandfathering

[4] See BCBS page 46 Pillar 3 disclosure requirements – updated framework, December 2018
[5] See BCBS footnote 51 page 24 Basel III: Finalising post-crisis reforms, December 2017
[6] See BCBS paragraph 75 page 24 Basel III: Finalising post-crisis reforms, December 2017

provision should be included for these loans [incurred prior to 1 January 2023] which prospectively (may) be qualified as 'ADC exposures' according to a new Article 4(1)(79) CRR.

Finally, the Basel proposals for assigning a 100% RW for ADC is too restrictive compared to the empirical needs.

The new Basel framework covers only large financing program from land to the construction. However, the less risky financing programmes (i.e. only the loan for the land and next, the pre-sales are sufficient to finance the construction) does not benefit from the 100% RW.

The issue is that (1) the land is not retained as an eligible collateral i.e. 'commercial real estate property' and (2) the land acquisition is RWed at 150%.

In addition, even if the real estate developer provides some additional collateral, cash collateral included, with the current CRR, these additional guarantee are not eligible (e.g. see EBA Q&A 2013_215 : " […]regardless of whether these exposures are securitised by collateral.")

As a result, the safest financing approach for real estate development is also the most penalized by both current approaches and by the new Basel proposals.

Therefore, we recommend to introduce a more granular risk-weight taking into account the possibility for banks to finance land acquisition at 100% RW which is more coherent with the underlying risk.

- *RW multiplier to certain exposures with currency mismatch*

51) What are your views on the costs and benefits of introducing the RW multiplier described above? Please provide relevant evidence to substantiate your views.

52) In your view, what other measures could be taken to address the risks associated with currency mismatches? Would the restriction of this measure to retail and residential RE exposures to individuals be appropriate to tackle such risks in the EU? Please elaborate and provide relevant evidence.

53) In your view, which other aspects, if any, should be considered in the context of revising the treatment of exposures with currency mismatch under the SA-CR? Please provide relevant evidence to substantiate your views.

For unhedged retail and residential real estate exposures to individuals where the lending currency differs from the currency of the borrower's source of income, the BCBS foresees that institutions apply a 1.5 multiplier to the applicable risk weight. However, the risk weight for unhedged retail and residential real estate exposures to individuals where the lending currency differs from the currency of the borrower's source of income is limited as it shall not exceed 150%. The introduction of this new exposure class seems not justified as it penalizes exposures with currency mismatch in a generalised manner despite the creditworthiness.

The risk weight multiplier for exposures with currency mismatch should not be enshrined in the CRR.

If ultimately a multiplier for RW to exposures with currency risk will be included in the European transposition of the Basel III standards the multiplier should at least not be applied to ERM II currency pairs.

Finally, we would also note that Art. 354 CRR, for the calculation of own funds requirements for foreign-exchange risk, gives institutions the possibility to provide lower own funds requirements against positions in closely correlated currencies.

The EBA maintains a list and any changes are published in the Official Journal as ITS[7]. If any provision addressing risk arising from currency mismatches were to be added, it should contain at least a similar differentiation between more and less risky currency pairs.

➢ *Off-balance sheet (OBS) items*

54) What is your view on the Basel III definition of commitments? Please provide relevant evidence to substantiate your views.

55) What is your view on the national discretion to exempt certain arrangements for corporates and SMEs from the definition of commitments? In your view, which arrangements should be exempted from the definition of commitment, if any? Please provide relevant evidence to substantiate your views.

56) In your view, which other aspects, if any, should be considered in the context of the treatment of off-balance sheet exposures? Please provide relevant evidence to substantiate your views.

Q54

The BCBS standard introduces a new 10% CCF for unconditionally cancellable commitments (UCCs), para. 84, as well as the definition of commitment and UCC (para. 78 and footnote 53). The definition should be better analysed in order to be further clarified to retain a 0% CCF of UCCs.

Additionally, correlated side effects should be considered, e.g. the impact on the large exposure regime which is for instance linked with the CCFs for credit risk standardised approach.

The decision to significantly increase the requirements of certain off-balance sheet commitments (Para. 79 SA chapter and Para. 102 IRB chapter) will have a negative impact on lending activities of banks.

Q55

We support the newly defined exemptions and criteria, since it is necessary to fully exclude arrangements that are not entered financially and that can be cancelled unilaterally without notice nor condition. This should not be a national discretion but be implemented homogeneously across the EU, along with the new definition.

57) What are the costs and benefits of the new CCF introduced by the Basel III standards? In particular, how does the Basel III treatment of OBS items compare to the current treatment in terms of risk-sensitivity and impact on RWAs. Please provide relevant evidence to substantiate your views.

58) In your view, which other aspects, if any, should be considered in the context of revising the treatment of OBS exposures? Please provide relevant evidence to substantiate your views.

[7] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018R1580&from=EN

Q57

Currently a 0% credit conversion factor (CCF) is included in Article 166(8)(a) CRR. According to this provision for credit lines that are unconditionally cancellable at any time by the institution without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness, a CCF of 0% shall apply.

The removal of 0% CCF for UCCs is unduly punitive and does not give an adequate view of underlying risks. It also does not necessarily reflect actual usage ratios of such credit lines.

In practice our understanding is that the prudential definition of commitment is aligned with the accounting principles. We also understand that the BCBS introduces a national discretion to exempt certain arrangement and to treat them as uncommitted (footnote 53) therefore with a 0% CCF.

Basel III considers that the exemption of uncommitted lines is defined exclusively Corporate and SME counterparties. We propose not to introduce any restriction so that potential arrangements with Financial Institutions or Retail Clients[8] follow the same principle. Indeed, the conditions of the footnote 53 relate to characteristics of the possible exposure, not to the counterpart type. Not enlarging the scope would result in an increase of prices for end users or consumers, notably given the strong impact it would notably have on trade finance.

Therefore we propose that the definition of commitments, UCC and uncommitted lines is explicitely clarified in the revised CRR in order to exempt commitement that are not commissionned, are closely monitored by banks and can be unilaterally interrupted .

In addition, in order to be operational, we suggest that the definition is transposed directly in CRR (no national discretion for European implementation).
Generally, a definition of commitment aligned with the one used for accounting purposes will allow to keep consistency between banks balance sheets and regulatory capital calculations.

Q58

We would also point out the following with regard to EBA recommendation CR-SA35 for a mandate to review CRR Annex I:

- In general, we consider the current CRR provisions are sufficiently clear, and where necessary leave enough room to national interpretation for national-specific products.
- We acknowledge that EBA had to process some Q&A and that those items might need to be clarified in level 1 text.

Therefore, we suggest the following adjustments: the "medium risk" category should be limited to items 2-a) and 2-b iii), a new "intermediate risk" category shall cover 2-b i), ii) and iv). Low risk category would have to include the transposition of footnote 53 extended to any type of counterparties (i.e. FI and retail).

In addition, in order to take into account the newly created 40% CCF, Art. 111 CRR could establish: medium risk be kept at 50%, intermediate risk at 40%, medium/low kept at 20% and low risk set at 10% (0% applying when conditions of footnote 53 transposed as explained above are fulfilled).

[8] In the current environment unconditionally cacellable commitments are a widespread loan instrument for retail clients and all sizes of corporate clients in Europe.

➢ *Other provisions*

59) In your view, which other aspects, if any, should be considered in the context of revising the SA-CR? Please elaborate and rank your answers from the most important to the least important aspect.

Exposures to regional governments or local authorities

We would encourage the carrying forward of the existing treatment of exposures to regional governments or local authorities as akin to central governments exposures as according to Art. 115 CRR which already stresses "specific revenue-raising powers" and "institutional arrangements" that reduce the risk of default, with a much simpler framework than the one put forward in the new Basel draft.

Risk weighting of MREL/TLAC instruments

With regard to the requirement to apply a risk weight of 150% to all positions eligible as TLAC (Para. 53 in the BCBS SA chapter), we believe that particular attention should be paid to the fact that the MREL framework in the EU (i.e. both hard MREL or TLAC and institution specific MREL) and the bail-in have wider scope and more complex mechanisms than the TLAC framework envisaged by the FSB and to which the BCBS refers.

It should be avoided by all means that this requirement could touch upon all positions that may qualify as "minimum requirement for eligible liabilities" (MREL) or that may be bailinable.

We would even recommend the introduction of a threshold for TLAC instruments below which the 150% RW would not apply, this would help in maintaining an appropriate level of liquidity in the TLAC instruments' market.

Exposures to covered bonds

With regard to covered bonds, it is very positive that the Basel Committee for the first time recognised them as a separate and high quality asset class with preferential treatment compare to unsecured exposures to banks.

We would expect that the new harmonised European framework for covered bonds (the Covered Bonds Directive and amendments to Art. 129 CRR) as adopted by the Council and the European Parliament in April 2019 will form the basis for the EU implementation.

With regard to the treatment of covered bonds in the IRB models, we suggest maintaining the current treatment defined in the CRR.

Proposal for a Basel II SA grandfathering with corrective factor

The new SA for credit risk is certainly much more complex than the existing SA, particularly but not limited to the so-called "due diligence requirements", also entailing a deep effort of reclassifying a number of exposures, retrieving or mining for information to assign the correct exposure class etc. This would impose a massive administrative burden on banks, especially the smaller ones.

To avoid such vast administrative burden and implementation costs associated to the switch, for our smaller member banks we would suggest that at least small domestic retail banks (up to € 5bn total assets), could be given the option to grandfather the existing (i.e. Basel II) standardised approach, under the condition of a capital adjustment (i.e. an increase). Such adjustment should ensure that the level playing field is safeguarded vis à vis other banks.

Indeed, it is essential that in no way such a mechanism leads to a distortion of competion, particularly by leading to unduly reduced capital requirements. Rather, in complement and in order to ensure that level playing field is maintained and that there is no advantage in terms of capital requirements, the resulting capital charges according to the grandfathered framework would be multiplied by a conservative scaling factor that reflects the requirement for higher capital that Basel III would entail for banks of the relevant category.

Based on the recent findings of the EBA impact analyses, it appears that most SA banks would face increases of about 6%. In order to add a margin of conservatism, we would suggest to consider an adequately prudent and conservative scaling factor. For instance 1.07 would be a basis for reflection, which would have to be fine tuned also on the basis of the Commission impact assessment. This would have the effect of the capital impact of implementing the new SA without incurring in the administrative burden connected to its implementation. The objective to enhance the soundness of banks via a higher capital demand would be fulfilled without incurring into the administrative costs that implementing a much more complex SA would entail.

Alternatively, such granfathering clause and the relative increase factor, could take the form of a phase-in period (or Basel II SA phase out). Or, this could be provided at least for the more burdensome changes (classification of the stock of the exposures) over a more adequate transitional time span.

Proposal for a possible SA+ approach for residential real estate

Residential mortgages are one of the areas where for which the output floor is likely to drive one of its largest impacts.

Overall, under the new proposed rules for a loan with an LTV between 60% and 80%, the SA risk weight is 30%, and the new SA would allow the RW to go down to 20% only if LTVs are equal to or lower than 50%. These however are loans which are often partially amortised and that could take a smaller cut of the loan portfolio. On average, it is likely that the SA risk weight for the overall retail mortgages portfolio would be between 25% and 30%. Despite the intention to introduce more risk sensitivity to justify the increased granularity of the SA the Basel proposal only relies on one variable, the loan-to-value, which is a discriminant variable but not necessarily the most discriminating. It would be sensible to allow some adjustments in the SA that would bring additional risk sensitivity and narrow the gap with IRB models. As for many banks it would be rather difficult to create and get their own IRB models approved, we would propose a Standard Plus Approach (SA+) that employs discriminating variables easily available to all banks.

While different lenders create different score models based on their own criteria, experience shows that most internal models use exactly the same top internal variables. First, credit alerts tend to have the highest impact in the score, even higher than LTVs (for example, a great discriminant variable is non-payment for more than 30 days, which is for many banks a reason for moving a loan to Stage 2 in IFRS 9). Then, personal income and average deposits tend to be the next variables in line. The remaining variables used in mortgage models normally have a much lower predictive power than credit alerts, personal income and deposits. Also, there is an important difference in the use of the variables personal income and average deposits: while personal income is always at hand when granting a loan, it might not be available during the life of the loan unless the salary is paid directly into the same bank; this the practical reason why some banks give a greater weight in their scores to average deposits than to personal income.

A simple but practical implementation of the expert criteria explained above could be a risk weight table as follows, that employs three variables: (1) Alerts, (2) Income or Deposits, (3) LTV.

The proposed risk weight table for reducing the gap with IRB methods would not change any of the SA risk weights for the LTVs above 80% as its main purpose is to be particularly fair with those banks using the SA that have quite conservative policies for loan approvals and that would still be penalised, it would in addition also reduce the impact of the floor.

STANDARD PLUS APPROACH (SA+)	Go up one level in risk weight vs SA	Standard Approach (SA)	Go down one level in risk weight vs SA
Alerts (30 day non-payment last 12m)	No alerts		There are alerts
Monthly Income or Deposits (average last 6m)	and loan payments < 35% of income or <50% deposits		
LTV ≤30%	5%	10%	15%
30% < LTV ≤ 40%	10%	15%	20%
40% < LTV ≤ 50%	15%	20%	25%
50% < LTV ≤ 60%	20%	25%	30%
60% < LTV ≤ 80%	25%	30%	40%
80% < LTV ≤90%	40%	40%	40%
90% < LTV ≤ 100%	50%	50%	50%
LTV > 100%	70%	70%	70%

60) Which elements of the revised SA-CR, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

61) Which elements of the revised SA-CR, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected

recurring costs.

The implementation of ancillary due diligence processes for rated exposures to banks and corporates, the assessment of the investment grades for bank exposures and the LTV approach are the biggest challenges for banks using SA-CR.

Indeed, the reclassification of the stock of real estate exposures is one of the most burdensome element of the new SA, particularly (but not limited to) when having to collect LTV data where that is absent.

The identification of the relevant benchmarks in order to classify exposures to institutions into one of the three risk-weight buckets (Grades A, B and C) causes comprehensive additional burden. That's why the SCRA shall be designed in the most pragmatic, easiest manner possible for the institutions as the vast majority of the European banks don't have a rating.

Internal ratings based approaches (IRBA)

62) What are your views on the costs and benefits of reducing the scope of internal modelling as described above? In particular, how would this reform impact the robustness and levels of RWAs for the affected portfolios? Please provide relevant evidence to substantiate your views.

63) What other measures could be put in place to improve the robustness of internal estimates for the relevant asset classes? Please elaborate and provide relevant evidence.

64) In your view, which other aspects, if any, might be considered in the context of the revision of the scope of internal modelling to address RWA variability? Please provide relevant evidence to substantiate your views.

The reduction of scope of internal models will inevitably result in reduced risk sensitivity. This is in turn likely to lead to the inappropriate pricing of risk, less lending in low-risk asset classes (due to excessive capital requirements in relation to the actual risks and return), perverse search for yield incentives for some market participants, less diversification across banks' credit portfolios, a shift of risks to the unregulated sector and a corresponding increase in risk to the financial system as a whole. Despite the agreement reached in Basel, we still do not see this as a viable solution.

We would highlight that the BCBS proposals would have the effect of a double penalisation for the assets today treated under IRB and that would have either to be shifted under the SA or be limited by input and output floors, with the lack of risk sensitivity that these floors imply. For instance, assets that will continue to be treated under the IRB (e.g. retail, including residential real estate) would be impacted by the increase generated by input floors of about 10-20%. In addition to this increase in capital requirements, the SA output floor effect is then still to be considered and would push the capital increase even higher, in some cases even above 35%.

All in all, and knowing that the banking sector contributes to 70% of the lending in the Union, adjustments are needed in order to avoid disintermediation, reduction of lending capacity and ultimately credit constraints in the EU despite the expansionary efforts of central banks.

Impact on business

The measures may have a substantial effect on banks and on their role in provision of financing to the economy, and at least the on balance financing will be affected (more finance will be shifted off balance). Making credit intermediation by banks less attractive also contradicts the expansionary stance of Central Banks and the efforts to increase liquidity in the market. Furthermore, non-bank institutions are not governed by the same capital requirements and supervision and they will gain an unfair competitive advantage in the financing landscape. This will not be beneficial to the continuity of financial institutions, and it will also not be helpful for stability and for the economy at large.

It should also be avoided that increased capital requirements do not result in a self-amplifying loss of confidence in banks: while nothing has changed in the real economy, nor in the banks' credit portfolio, it would appear that capitalization has deteriorated. Instead, proposals relate to very general measures not linked to the development of underlying risk and not adequately recognizing the value and role of collateral.

The proposals should be carefully assessed in all their consequences, such as reduced incentives for accurate risk measurement, excessive risk taking, shift of significant parts of lending towards the shadow bank system, increased lending cost (e.g. for the commercial real estate sector and specialised lending).

It should also be recalled that while accounting standards for credit risk will use models to estimate future losses in the IFRS 9, the use of models for prudential purposes would be largely scrapped reinforcing the hiatus between the two perspectives.

Also, European banks have invested heavily in internal models and integrated them in their management, limits, allocation of own funds, EVA and Raroc tools, etc., and would see their competitiveness impaired.

It should finally be considered that a backstop is already envisaged in the form of the leverage ratio, thus making an output floor redundant and adding a further layer of complexity.

Equities

The use of the PD/LGD approach goes hand-in-hand with applied rating models. In principle there are no convincing arguments against using PDs/LGDs in case of equities. Reverting to the standardised approach would strongly penalize the equities compared to other asset classes.

- *PD – increase of the input floor*

65) Views are sought on the costs and benefits of increasing the PD input floor to 0.05%. In particular, how does the increased floor compare with the current floor in terms of achieving the aim of decreased RWA variability? What is the impact of this change on RWA levels? Please provide relevant evidence to substantiate your views.

66) In your view, how does the increased floor compare with the current floor in terms of achieving the aim of increased conservatism? Would you consider a floor that implicitly assumes that a default occurs once every 2000 years to be sufficiently prudent? Please explain.

67) What other requirements or safeguards could be implemented in the area of PD estimation to achieve a minimum level of conservatism and/or reduce RWA variability?

Please provide relevant evidence to substantiate your views.

68) In your view, which other aspects, if any, should be considered in the context of revising the PD input floor? Please provide relevant evidence to substantiate your views.

Input floors: Minimum PD for corporate and banks exposures

We see that an increase in the corporate PD floor would result in two negative effects:

- The credit costs for low risk borrowers are artificially increased. This, as it reflects on cost of capital, will ceteris paribus lead to reduced lending, lower investment and less economic activity and, therefore, reduced growth.
- The artificially inflated risk provisions will lead banks to shift their portfolios to higher risk borrowers with higher expected returns. Therefore, instead of increasing financial stability, an increase in the PD input floor will effectively reduce financial stability because higher risk customers are artificially more attractive.

An input floor for PD as it was designed in the Basel II package is understandable and necessary for corporate customers as there is never a 0% chance of default. Thus, even credits with the highest creditworthiness should result in an allocation of prudential capital.

However, there is no empirical reason to increase the input floor as done in the 2017 accord as prudently calibrated internal models, validated by supervisors, will account for any higher credit risk. We would advise against this blunt measure.

The European legislator should very carefully review the effect of the floor increases in the course of their implementation into the CRR.

Input floors: Agri-lending

Similarly to what indicated above, the proposed exposure level input floors do not contribute to increase comparability and transparency, and instead are likely to increase RWs variation due to a missing link with the underlying risk.

Generic LGD input floors will negatively affect strongly collateralized lending. This effect is further amplified by the aggregated SA-floor.

One of the sectors where this will be particularly visible is agri-lending in the EU (agricultural and food sector). This area is characterized by a consistently low risk profile and highly collateralized positions, which can be very easily liquidated. The underwriting criteria are more conservative than applied in commercial/residential real estate financing, with moderate LTVs. The portfolios have performed very well historically compared to non-agri portfolios and multi-year historic impairments are low.

- *LGD – input floors under AIRBA*

69) Views are sought on the costs and benefits of exposure-level LGD input floors. In particular, how do the floors compare with the current treatment in terms of achieving the aims of conservatism and RWA variability? What is the impact of this change on RWAs? Please provide relevant evidence to substantiate your views.

70) As regards the different types of exposures and collateral, to what extent do you consider that the LGD input floors maintain an adequate level of risk sensitivity with respect to the wide range of practices of EU institutions?

71) What other requirements or safeguards could be implemented in the area of LGD estimation to achieve a minimum level of conservatism and/or reduce RWA variability? 72) In your view, which other aspects, if any, should be considered in the context of revising the LGD input floor? Please provide relevant evidence to substantiate your views.

Q69

Input floors: LGD floors for real estate exposures

With respect to secured, retail mortgages (both residential owner occupied and residential retail IPRE) the proposed LGD floors are a very blunt instrument to managing potential underestimation risk, in particular for low LTVs. The input floors do not take into account the naturally existing differences across residential mortgage markets, and this creates issues that can only partially be remedied by further refining the floor calibration.

For instance, residential real estate RWAs in France would increase by a factor of 2 or 3 while the real rate of arrears/non performing exposures has remained very low (between 0.89% and 1.45% from 2001 to 2013), and also the Dutch, German and Danish markets would be negatively affected. Specific concerns and proposals were put forward during the SA consultation but were not taken into account by the BCBS, while a differentiated treatment was envisaged for jurisdictions that forbid the use of external ratings to allow banks to weigh under the SA corporates 'investment grade' at 75% versus 100% in Europe (BBB + client).

Specialised lending

Q69

We note that the whole framework, composed of the A-IRB with LGD input floors (in addition to the SA approach on which the output floor is calculated), results in a non-risk sensitive framework for internal models, in particular in the case of SL. This is penalizing for low risk transactions and will have the unintended consequences of reduction of volumes of loans, increase in price for end-user, increase of risk in banks balance sheets. We believe that these unintended consequences could be reduced by re-introducing risk sensitivity in the LGD input floors (and in the SA approach, see Q18).

While we appreciate that A-IRB models are kept to some extent, we also note that the LGD input floors to be applied to those models were not discussed, nor tested before the publication of the December 2017 final text. Also, there is an unintended overlapping of the A-IRB by the F-IRB, as LGD input floors applied to A-IRB LGDs are calculated on the basis of F-IRB haircuts applied to collaterals asset values. Moreover, F-IRB collaterals eligibility criteria, not specific to SL, also apply for these LGD input floors calculation that result notably for infrastructure project finance in a very penalizing unsecured corporate LGD floor.

It seems that SL were somehow omitted in the final BCBS text, regarding the LGD input floors calculation, as the parameters of calculation of these floors were defined for corporates but not specified for SL. However, we believe that the intention of the BCBS was clearly to keep internal models in order to keep their risk sensitivity which is key for these activities.

Good quality SL portfolios, as highlighted by the data collection presented to DG FISMA by 7 French and Dutch banks, show very low loss rates below 0.20% over the past 11 years.

The data collection also show that banks developed internal models which have shown to be robust and relevant, and which enable to adequately price low risk transactions in terms of margins. The LGD input floors should only apply when internal models are not performing.

EBA additional analysis on SL should include a data collection and review of the performance of SL internal models. Also a possibility would be to re-calibrate these model, as considered in the TRIM process, but not applying input floors when the model back testing is satisfactory.

Q71

For SL, we propose a direct LGD input floor set at 10%.

For unsecured corporate loans, where we would expect a 40% LGD (as practiced on capital markets), the floor is set at 25%, i.e. 15 points lower. In the case of project finance, based on S&P average historical LGDs of roughly 25%, we think that a 10% LGD floor for SL would also be 15 points lower than the average level and thus calibrated consistently with the one applied to unsecured corporate loans. We believe that this unique and direct 10% LGD input floor for SL is also justified by the fact that in 50% of cases, LGD were below 10% for project finance (source S&P) given these low risk transactions that should not be penalised by a 25% floor for project . Regarding aircraft finance, the AWG study has shown LGDs around 8%, with an LGD of 1.3% in half of the cases also supporting a much lower input floor than the 15-25% ones.

For SL, the LGD calculation should not be based on collateral haircut.

We support the EBA recommendation to apply A-IRB collateral eligibility criteria for SL regarding LGD input floors. Yet the remaining issue is the fixed 40% haircut on collateral value which was not designed for SL. Also valuing a project company would be challenging. As high recoveries generally result for SL from restructurings of loans with almost no loss in most cases, the logic of the sale of the asset is not adequate. Hence the haircut for LGD input floor calculation does not make sense. This is why we propose a unique 10% direct LGD input floor with no calculation based on an asset value haircut. This 10% LGD floor would be directly compared to the SL internal models LGDs.

- *LGD – regulatory values under FIRBA*

73) Views are sought on the costs and benefits of the revised regulatory LGD values to be used under the FIRB Approach. In particular, how does the approach provided by the Basel III standards compare with the Basel II standards in terms of risk-sensitivity, impact on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

74) In your view, are the regulatory LGD values sufficiently prudent in light of the decrease of the regulatory LGD value for unsecured corporate exposures and the changes affecting secured exposures? Please explain and provide relevant evidence to substantiate your views.

75) In your view, which other aspects, if any, should be considered in the context of revising the regulatory LGD values to be used under the FIRB Approach? Please provide relevant evidence to substantiate your views.

See above.

We would also flag that the calculation of the LGD in F-IRB changed regarding collateral recognition, with the explicit haircuts for non-financial collaterals introduced. Additionally, haircuts for receivables are increased to 40% (Para. 75 IRB approach chapter).

The explicit haircuts of 40% for non-financial collaterals are not risk based and do not consider link in any way the pertinence of the valuation and the resulting value of the collateral. Therefore, very sloppy valuations with high outcomes are treated as beneficial compared to prudent valuations with lower value of the collateral.

The increase in haircuts for receivables to 40% is not economically consistent as it is not adjusted for any kind of creditworthiness. An increase of haircuts is therefore arbitrary and does in no way reflect true risks of the given collateral.

Such arbitrary haircuts applied independently from the valuation of the collateral do not bring any added value. Therefore, a different approach is necessary: instead of applying generic haircuts to all collateral depending on the process of valuation, if banks conduct a prudent valuation of their collateral, no haircuts on the value of the collateral is necessary.

- *EAD – introduction of an input floor*

76) Views are sought on the costs and benefits of exposure-level EAD input floors. In particular, how do the floors compare with the current treatment in terms of achieving the aims of conservatism and RWA variability? What is the impact of this change on RWAs? Please provide relevant evidence to substantiate your views.

77) What other requirements or safeguards could be implemented in the area of EAD estimation to achieve a minimum level of conservatism and/or reduce RWA variability?

78) In your view, which other aspects, if any, might be considered in the context of revising the EAD input floor? Please provide relevant evidence to substantiate your views.

- *EAD – scope of modelling*

79) Views are sought on the costs and benefits of restricting the use of EAD modelling to undrawn revolving commitments. In particular, how would the removal of EAD modelling for other product types impact the robustness and level of RWAs for those portfolios?

80) What other measures could be put in place to improve the robustness of internal estimates of EAD? Please specify and provide relevant evidence.

81) In your view, which other aspects, if any, should be considered in the context of the revision of the scope of internal modelling of EAD? Please provide relevant evidence to substantiate your views.

- *EAD – regulatory CCF values*

82) What are your views on the costs and benefits of using SA CCFs for the FIRB Approach? How would this change impact the robustness and level of RWAs for the affected portfolios?

83) What other measures could be put in place to improve the adequacy of the regulatory CCFs under the FIRB Approach? Please elaborate and provide relevant evidence.

84) In your view, which other aspects, if any, should be considered in the context of the revision of the regulatory CCFs under the FIRB Approach? Please provide relevant evidence to substantiate your views.

- *Maturity factor – clarifications on the calculation of effective maturity*

85) What are your views on the costs and benefits of the proposed clarification regarding the determination of effective maturity? In particular, how would the proposed change impact the robustness and level of RWAs under the AIRB Approach?

86) In your view, which other aspects, if any, should be considered in the context of the treatment of the maturity parameter? Please provide relevant evidence to substantiate your views.

- *Sovereign exposures – no substantive change*

87) Views are sought on the treatment of sovereign exposures proposed in the BCBS consolidated framework referred to above. In your view, how would the exemption from the removal of the IRBA and from the input floors, on the one hand, and the implementation of the remaining reforms of the IRBA, on the other hand, impact the robustness and levels of RWAs for sovereign exposures treated under the IRBA?

- *Sovereign exposures – public sector entities (PSEs) and regional governments and local authorities (RGLAs)*

88) What are your views on the costs and benefits of the proposed treatment of PSEs and RGLAs resulting from the changes applicable to exposures to central governments and exposures to institutions compared to the current framework? Please elaborate and provide relevant evidence.

89) In your view, are there other ways to achieve more robust RWA estimates for exposures to PSEs and RGLAs that would mitigate the potentially significant differences in treatment described above? Which are they and what would be their costs and benefits and their prudential justification?

90) In your view, which other aspects, if any, should be considered in the context of the revision of the treatment of PSEs and RGLAs? Please provide relevant evidence to substantiate your views.

- *Additional enhancements of IRB risk parameters estimation practices*

91) What are your views on the proposed enhancements of IRB risk parameter estimation practices?

92) What other measures could be put in place to improve the robustness of internal estimates? Please elaborate and provide relevant evidence.

93) In your view, which other aspects, if any, should be considered in the context of the revision of estimation practices to address unwarranted RWA variability? Please provide relevant evidence to substantiate your views.

- *Other provisions*

94) In your view, which other aspects, if any, should be considered in the context of revising the IRBA? Please elaborate and rank your answers from the most important to the least important aspect.

Trade finance related bank exposures

'Trade finance products' (letters of credit and guarantees) play an important role in the European economy as they are commonly used for payment and financing of international trade. They provide importers and exporters with financing options to safely transact across borders, also with less-trusted counterparties and for transactions with parties in less-developed countries essential for commodities, such as wheat, sugar, oil and fuels. The procedures for these products are highly standardised by the ICC.

Under the new Basel accord, the risk weight for exposures to banks cannot be any longer based on A-IRB, leading to banks falling back to F-IRB or SA.

Although the SA includes a calibration for bank related trade finance products, the BCBS did not adjust the parameters underpinning the F-IRB for these exposures, like the standard LGD and maturity. It therefore overshoots the amount of regulatory capital banks needs to hold, this emerges starkly when looking at the historically low default rates. Furthermore, we are of the view that under the SA, trade related bank exposure should be risk weighted irrespective whether the issuing bank is located in a country that applies a prudential regime equivalent to the EU as this results in unjustified higher capital charges for trade finance, particularly for exports to developing and least developed countries. This will negatively impact European exporters and their global competitiveness, putting them at a disadvantage.

With regard to trade related bank exposures we therefore propose:

- Under the SA, trade related bank exposure should be treated equally irrespective of whether the issuing bank is located in a country that applies a prudential regime equivalent to the EU, as all these exposures are all subject to ICC UCP 600.
- To take into account the low risk of trade related exposures under F-IRB.
- To allow in Art. 172 CRR the use of empirical PD's by ICC Trade Register or introduce a Trade Support Factor or give the bank the option to use SA instead of F-IRB to solve the issue of one PD per obligor for these exposures.
- Allow for a trade specific LGD and not the fixed 45%.
- Replace the maturity floor of 2.5 years with the actual remaining maturity.
- Reduce the credit conversion factors for medium risk (annex I CRR) for trade finance products (i.e. documentary credit products).

- *Implementation challenges and administrative burden*

95) Which elements of the revised IRBA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the

one-off costs to substantiate your views.

96) Which elements of the revised IRBA, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

Given the CRR structure, where Art. 111-141 are related to SA and the articles following SA are related to IRB, it is envisioned that banks applying SA can opt to use the IRB approach following supervisory approval. However, there is no provision foreseeing that IRB banks can revert to a full application of the SA. For example, the SA Art. 112 CRR provides for 17 exposure classes, while Art. 147 CRR aggregates these in only 7 asset classes. In other words, banks will need to go in detail through all their credit portfolios in order to allocate exposures from 7 to 17 assets classes. This illustrates the hurdle that IRB banks face when implementing the SA and that should give room to adequate implementation measures and a sufficiently long phase-in period. Numerous other issues are for instance related to the way exposures secured by real estate, exposures in securitization and trading books portfolio's will have to be calculated and reported and several new data-points (e.g. company revenues p.a., LTV data, data for exposures secured by real estate, CVA etc.) have to be identified, collected and linked to software solutions through new interfaces.

This makes the implementation of the SA extremely complex. Besides IT consequences, IRB banks will also need to decide upon several discretionary options under the SA approach like for example what credit risk mitigation methods to apply.

Revisions are also needed when designing the implementing measures to use real maturity in IRB-F.

When the EU implementation comes due, at least processual relief should be ensured for IRB-banks with regard to the SA calculation, e.g. no due diligence process for exposures because of the already existing internal rating processes. Additionally, for the purpose of calculating the output floor the different ways of recognition of valuation adjustments between standardised approach (valuation adjustments reduce RWA) and IRB approach (include RWA before valuation adjustments) have to be reflected as well as the different approaches themselves (SA: RWA include EL+UL; IRB: RWA include exclusively UL) and the related link to double counting of credit risk when applying the IFRS 9 expected loss model.

We would also recommend ensuring that the revisions are implemented in a way that allows the calendars of all initiative to converge, avoiding overlaps and the doubling of processes among the EBA IRB repair measures, the TRIM and the Basel implementation.

Credit risk mitigation – SA-CR

- *Removal of own estimates of haircuts and use of supervisory haircuts*

97) What are the costs and benefits of replacing own estimates of haircuts with the use of supervisory haircuts? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

98) Do the revisions affect certain exposure classes more than others? Please elaborate and provide relevant evidence to substantiate your views.

➢ *Specific operational requirements for credit derivatives: restructuring as a credit event*

99) What are the costs and benefits of the recognition of credit derivatives in cases where restructuring is not specified as a credit event? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

100) Do the revisions affect certain exposure classes more than others? Please elaborate and provide relevant evidence.

➢ *No recognition of n^{th}-to-default products as eligible CRM technique*

101) What are the costs and benefits of not recognising nth-to-default credit protection? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

➢ *Other provisions*

102) In your view, which other aspects, if any, should be considered in the context of revising the CRM framework under the SA-CR? Please specify and rank your answers from the most important to the least important aspect.

One reason for the low risk sensitivity of the SA for credit risk relates to the very restrictive recognition of collateral. We believe that banks should at least be allowed to consider other physical collateral under the same conditions as in the IRB base approach. This would be appropriate so that loans secured by other physical collateral would receive a lower risk weight, given the actual lower risk. Alternatively, a correspondingly lowered risk weight for the part secured with other physical collateral should be possible. In particular, loans to SMEs secured with other physical collateral would benefit from such treatment.

➢ *Implementation challenges and administrative burden*

103) Which elements of the revised of the CRM framework under the SA-CR, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

104) Which elements of the revised CRM framework under the SA-CR, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

Credit risk mitigation – IRBA

➢ *Unfunded credit protection (UFCP) – the treatment of AIRB exposures secured by SA-CR or FIRB guarantors*

105) What are the costs and benefits of the revised treatment of AIRB exposures

secured by SA-CR or FIRB guarantors? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

106) Would you deem further refinements or clarifications necessary in this context to ensure consistency across the Union? Please elaborate and provide relevant evidence.

- *UFCP – relevant risk weight function and input floors to be used under the substitution approach*

107) What are the costs and benefits of the revised treatment of UFC under the substitution approach? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

- *Eligibility and treatment of conditional guarantees*

108) What are the costs and benefits of the limited recognition of conditional guarantees? Please compare the approach under Basel III in terms of risk-sensitivity, comparability, impact on RWAs and operational burden with the current CRR treatment. Please provide relevant evidence to substantiate your views.

- *Other provisions*

109) In your view, which other aspects, if any, should be considered in the context of revising the CRM framework under the IRBA? Please specify and rank your answers from the most important to the least important aspect.

We welcome the decrease of the LGD for senior claims on other corporates that are not secured by recognized collateral (Para. 70 IRB chapter).

Nevertheless, there are some uncertainties arising from the table in Para. 75 with regard to the proposed haircuts. It is unclear, if the haircuts included in the table replace the level of minimum collateralisation as mentioned in the second BCBS consultation paper (BCBS 362; chapter 4.2.2). It should be clarified if haircuts replace the level of minimum collateralisation.

- *Implementation challenges and administrative burden*

110) Which elements of the revised CRM framework under the IRBA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

111) Which elements of the revised CRM framework under the IRBA, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

SECURITIES FINANCING TRANSACTIONS (SFTS)

Minimum haircut floors for certain SFTs

112) How do you view the potential effectiveness of minimum haircut floors with regard to achieving their prudential objectives? Would the incentive provided by the framework be sufficient to encourage institutions to meet the minimum level of over-collateralisation?

113) Would the introduction of minimum haircut floors particularly affect certain types of in-scope SFTs or certain counterparties with which institutions conduct in-scope SFTs? If so, which effects would you expect and how could prudential regulation address them?

114) Would you deem further clarifications necessary, for instance, concerning the scope of application of the framework or the formulas that identify in-scope SFTs non-compliant with the minimum haircut floors? If yes, please specify.

115) As an alternative option to implementing minimum haircut floors for in-scope SFTs in the prudential framework as provided by the Basel III standards, such floors could be implemented via a market regulation. How would you compare the two alternative options in terms of achieving the prudential objectives? Would one of the two options affect more significantly the SFTs market? Please provide relevant evidence to substantiate your views.

116) In your view, which other aspects, if any, should be considered in the context of the possible implementation of minimum haircut floors in the Union? Please specify and provide relevant evidence.

We support conclusions in the EBA opinion indicating that more quantitative analysis is necessary prior to any implementation in the EU.

Other revisions to the calculation exposure at default for SFTs

117) What are your views on the expected effects of these revisions with regard to risk-sensitivity, recognition of netting, impact on RWAs and comparability across institutions? Please provide relevant evidence to substantiate your views.

118) Would these revisions particularly affect certain types of SFTs or counterparties with which institutions conduct SFTs? Please support your view with specific evidence to the extent possible.

119) Would you face any operational burden to implement these revisions, particularly those revisions restricting the use of internal modelling? If so, please elaborate on the possible change and its underlying reasons.

120) In your view, which other aspects, if any, should be considered in the context of implementing the revisions to the calculation of the exposure value for SFTs in the counterparty credit risk framework? Please specify and rank your answers from the most important to the least important aspect.

Please see above.

Implementation challenges and administrative burden

121) Which revisions related to SFTs, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

122) Which revisions related to SFTs, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

OPERATIONAL RISK

Discretion to set the ILM equal to 1

123) How would exercising the discretion affect the link between capital incentives and management of operational risks? Please elaborate.

124) Would you deem it necessary to mitigate possible cliff effects that might derive from the introduction of an institution-specific ILM? If so, which measures should be considered, for how long should they be applicable, and what would be the prudential rationale to implement them? Please elaborate.

The idea of the loss component was to take into account the economic risk profile of an institution and to incentivize banks to manage operational risk. Therefore we consider that the impact of the component would be wiggled down in case it were "deactivated" completely based on discretion of the competent authority (which is a grave contradiction to the principles of risk-sensitive capital requirements and of single rule book). A virtuous circle can be triggered for the OR management when there is a chance to reduce the OR capital with ILM lower than 1. At the same time, given that the calculation of the ILM is quite subjective a cap at 1 is necessary also where the ILM is calculated.

Indeed, we favour the application of calculated ILM (internal loss multiplier).

We appreciate the possibility to have an exception for bucket 1 banks (i.e. banks with a business indicator <= 1bn) which should have the option to use an ILM equal to 1, as the marginal benefit of a calculated ILM on their required capital would be outweighed by the costs incurred to perform the calculations. Indeed, we believe that such option to choose an ILM of 1 should be available to all institutions.

In general, the Basel standard defines a set of criteria to be complied with to use the internal loss data in the calculation of the capital requirements for operational risk, however we would highlight that: i) no relevance of historical losses is considered; ii) a clear guidance on the loss data collection methodology is missing; iii) the timing losses and pending losses are not appropriately considered; iv) the requirements to set the ILM to 1 are unspecific.

Discretion to increase the loss data threshold to € 100.000

125) What are your views on how a loss data threshold that is increased for some

institutions may affect the soundness and risk-sensitivity of the operational risk framework, the volatility of the ILM, its comparability between institutions, and the incentive to carefully manage small to medium-sized losses? Please specify your views.

126) If the discretion was retained, which conditions and criteria should be introduced in order to ensure a level playing field in its application by supervisors? Please elaborate.

127) Which threshold (EUR 20,000 or EUR 100,000) would better reflect the current threshold used for your loss data collection? Please elaborate and provide relevant evidence.

National competent authorities should retain the discretion to increase the loss data threshold from EUR 20.000 to EUR 100.000. There are cases, in which this higher threshold would better reflect the risk profile of an institution. Indeed, incidents with high frequency being considered as "expected losses" and taken into account in the provisioning process, the OR capital should only reflect unexpected losses: depending on the entity size or accounting practice, the higher threshold would better reflect the actual capital needs. This would not only allow institutions to focus on material losses, but also avoid penalising banks, whose LC might be materially driven by recurrent low-severity losses.

We could also see that the threshold could for instance be linked to a percentage of the business indicator for example make treatment across institutions more consistent.

Discretion to use the ILM for bucket 1 institutions

128) What are your views on how this discretion might affect the overall level of own funds for operational risk of bucket 1 institutions and the comparability within bucket 1? Please elaborate your views.

129) If the discretion was retained, which conditions and criteria should be introduced in order to ensure a level playing field in its application by supervisors? Please elaborate.

130) If the discretion was retained, do you consider this could help smoothing the transitioning of institutions from Bucket 1 to Bucket 2? Please elaborate.

Para. 11 of the BCBS standard indicates that for banks in the Bucket 1 internal loss data does not affect the capital calculation with the result of the operational risk capital being equal to the BIC. At national discretion, supervisors may allow the inclusion of internal loss data into the framework for banks in bucket 1.

We support the discretion to allow the use of an ILM set at 1 for bucket 1 banks, as the costs of calculation for this category of banks would be only marginally smaller (if at all) than the capital increase they would face otherwise.

At the same time, bucket 1 banks should still have the choice to use their bank-specific ILM, when calculating operational risk regulatory capital. Bucket 1 banks with a history of low operational losses should be allowed to calculate their operational risk regulatory capital using their bank-specific ILM instead of the standard ILM of 1. If such banks were obliged to use the ILM=1, despite being below 1, they would be importantly discriminated. This would eventually result in seeing that smaller historic losses (in absolute terms) end up with higher operational risk regulatory capital.

Indeed, we see that some institutions which are in the bucket 1 have already a proper identification and collection of relevant loss events. As the loss history of an institution has a direct impact on its operational risk capital calculations, if an institution-specific ILM is applied, we support implementing the supervisory discretion to use the ILM also for banks in bucket 1, in order to establish a robust connection between capital requirements and sound management of operational risk. This discretion (applying ILM for banks in bucket 1) can lead to an opportunity for banks in bucket 1 to "improve" governance and organizational requirements for operational risk, e.g. the loss data requirements specified in paragraphs 19 to 31 of the Basel III standard.

Some bucket 1 members that would be able to calculate an ILM reported that application of bank specific ILM can have beneficial effects on the own funds requirements based on historical data. In such cases, comparability among bucket 1 banks (i.e. some using a set ILM=1 and some calculating an own ILM) will be ensured when considering the sum of Pillar 1 and Pillar 2 requirements for operational risk, which should be viewed as a whole:

- Most bucket 1 banks using the ILM for Pillar 1 will adopt from the start a more risk sensitive approach for the purpose of their ICAAP, thereby potentially reducing the Pillar 2 requirement;
- Bucket 1 banks not using the ILM for Pillar 1 might be subject to Pillar 2 capital add-on if they stick to a less risk-sensitive approach for their ICAAP.

For the sake of clarity, as indicated above we propose to explicitly indicate that bucket 1 banks may be allowed to opt for an ILM=1, while others could still calculate their specific ILM.

Level playing field will be ensured by making the supervisory discretion conditional upon governance and organizational requirements for the sound management of operational risk, constituting a robust safeguard against divergent application.

Implementing the supervisory discretion will undoubtedly smooth the transition of bucket 1 banks to bucket 2, as it will mitigate anticipated cliff effects, i.e.:

- Quantitative cliff effects due to the use of the ILM in the calculation of the capital requirement for bucket 2 banks;
- Qualitative cliff effect due to the obligation to comply with governance and organizational requirements (e.g. with regards to loss data requirements) for bucket 2 banks.

More in general, in the context of the reforms of the operational risk framework, we have previously addressed the concerns of smaller and non-complex firms that were likely to be caught up in the EU implementation of the Basel III measures, but who have never attempted modelling for operational risk, or captured detailed OpRisk loss data, so as to ensure that the replacement SMA was not excessively complex.

Since those proposals envisaged that the ILM component would not be required for Bucket 1 firms, we called for measures to avoid a sharp cliff effect when a firm transitions from Bucket 1 to Bucket 2 and has to apply the ILM for the first time. The Commission's document recognises that Bucket 1 firms do not need to calculate an ILM. Oddly, final Basel III (para. 12 of OpRisk section) gives a general discretion to supervisors to set ILM =1 for all banks. Our proposal was indeed more modest: either the option to set ILM = 1 should be extended to all Bucket 2 banks; or banks transitioning in quantitative terms from Bucket

1 to 2 should be allowed to set ILM =1 for, say, the next three full financial years, while they build up their OpRisk loss data set. That way these cliff effects can be avoided.

Discretion to request institutions to use less than five years when the ILM is greater than 1

131) What are your views on the discretion for supervisory authorities to request the institutions to use less than 5 years of loss data (when the ILM >1)? In which circumstances would such a request be justified? Please elaborate and provide relevant evidence.

Supervisors may require institutions to use less than five years of losses if they believe the losses are not representative of the institution's operational risk exposure (for instance for newly established banks or activities). We consider that this can be extend to acquisition of new business if significant modifications in the operational risk management framework is demonstrated.

Exclusion of certain operational risk loss events

- *Materiality threshold*

132) What would you consider to be the appropriate thresholds for allowing a request for exclusion of loss events from loss data history, for current and divested activities? Please explain and provide relevant evidence to substantiate your views.

Referring to para. 27 of the BCBS standard loss events that are no longer relevant to the bank's risk profile can be excluded from the LC subject to a strong justification and supervisory approval. It should be considered as a sufficient justification if a bank decides to divest activities and takes the appropriate measures to support the decision by including appropriate provisions in e.g. internal documented decision of the Management Board in its management function or by integration in internal policies.

Further, the materiality threshold for such an exclusion should be set at a low level, e.g. 5%, and any excluded events should be together subject to the threshold. Otherwise, the threshold would not become effective.

We are not convinced that a materiality threshold would be relevant when requesting exclusion of data losses from the loss data history. For example, where a bank stops providing a given product or service (e.g. it does no longer offer payment services to its customers), there is no reason to retain any loss data related to such activity, no matter what their size may be: here, imposing a materiality threshold would distort the reality of operational risk.

More broadly, there would some merit in refining the concept of divested activities, which should include, beyond the sale of a business, also the termination of an activity.

In the case a materiality threshold is maintained, we propose also to fix the percentage in relation with the gross income and not with the average annual losses. In case of multiple low losses, it would result in never excluding losses from the database.

- *Minimum retention period*

133) What would be in your view an appropriate minimum retention period for the losses that will be excluded from the loss dataset? What would be an appropriate starting point of this period? Please explain and provide relevant evidence to substantiate your views.

The concept of retention period is not relevant for losses exclusions linked to divested activities: by nature, such activities will no longer affect the operational risk profile of the bank and no minimum retention period should be requested.

With regards to non-divested activities, we believe that the length of the retention period should be function of the remedial actions undertaken by the bank to tackle the cause of excluded losses: the more robust remedial actions are, the shorter the retention period should be.

Other operational risk topics

- *Governance and organizational requirements*

134) What are your views on retaining the aforementioned CRR provisions and adapting the corresponding CDR provisions with a view to maintain their binding status?

135) Does your institution already comply with the relevant requirements? Please list the requirements that are not currently applicable to your institution and whether there is any additional operational burden associated with achieving compliance.

136) Are there any concerns in terms of proportionality that you would consider important to raise? Which threshold would you consider appropriate for the applicability of the governance and organisational requirements? Please elaborate.

Q135

Some members report that they have data available to calculate the SMA capital. However, as mentioned in the previous paragraphs, some specifications on the data to be used, e.g. the link to other reporting (FINREP), are useful to avoid misinterpretations.

Q136

Requirements referred to in Art. 321 CRR concern qualitative standards for Advanced measurement approaches. For instance, "*an institution shall have an independent risk management function for operational risk*". We consider that such requirements need adjustment to take into account the proportionality principle. Many small and non-complex banks do not have an independent risk management function for operational risk (this function being part of the global risk management function). It should be avoided that AMA-like requirements become the standard for all banks.

Quantitative and qualitative provisions of the Commission delegated regulation 2018/959 were calibrated for banks using the AMA approach. While these provisions make sense for large groups deploying internal model-based methodologies for operational risk, they are clearly too complex and too burdensome for smaller banks that use currently non-AMA approaches. In this context, Bucket 1 banks certainly constitute the population of banks that would require a more proportionate application of governance and organizational requirements. Bucket 1 institution should be exempted from such organizational requirements as having the audit function to verify the operational risk framework at least on annual basis, the obligation to make use of external data, etc.

- *ICAAP and Pillar 2*

137) What are your views on requiring the inclusion of the abovementioned elements (internal loss data, scenarios, external loss data and key risk indicators) in the ICAAP for operational risk? Please explain your reasoning in case of disagreement (separately for each element).

138) Would you deem further refinements or clarifications necessary concerning the ICAAP for operational risk, and if yes, what would those be and what would be their prudential rationale? Please elaborate and provide relevant evidence.

139) What threshold would you consider appropriate for the applicability of the aforementioned ICAAP requirements for Pillar 2? Please elaborate.

Q137

It should be noted that some institutions would aim to use a more risk sensitive approach than the SMA, such as the (simplified) AMA model/stress testing model, already mentioned above, in the ICAAP.

Including the internal loss data, scenarios, external loss data and key risk indicators is of course a part of the ICAAP.

Institutions do not regularly make use of external loss databases, which (i) are very costly (ii) may not reflect the specificities of some business models. Consequently, we would disagree with any binding requirement forcing banks to utilize external loss data for the purpose of their ICAAP, which must remain a self-assessment exercise driven by banks' risk profile.

- *Identifying BIC items in Financial Reporting (FINREP)*

140) What are your views on the costs and benefits of using FINREP templates as a reference for a harmonised identification of BIC items in the EU? Please substantiate your views with relevant evidence.

141) What are your views on introducing a mapping table via Level 2 measures to allow for timely updates in case the corresponding FINREP standards change? Please elaborate.

142) In your view, which other aspects, if any, should be considered in the context of mapping BIC components and FINREP items? Please elaborate.

We would agree in using FINREP templates as the reference for identifying BIC components via the mapping table elaborated by EBA. This measure will bring clarity, simplicity, consistency and comparability in the calculation of the BIC across European Banks (of all sizes). It will be beneficial for both banks and banking supervisors.

Other provisions

143) In your view, which other aspects, if any, should be considered in the context of

revising the operational risk framework? Please elaborate and rank your answers from the most important to the least important aspect.

In the calculation of the LC the relevance of historical losses must be provided. Losses that are less likely to repeat themselves in the future due to discontinued business/products or changes in law must be accounted for.

The RTS on AMA standards could for instance be considered in the implementation of the Basel reforms regarding loss data, thereby providing a clearer guidance for loss data collection methodology. A definition of timing losses and pending losses and a clear instruction on the requirements to set the ILM to 1 should also be provided.

Moreover, we flag that with regard to the calculation of the BI there is a lack of clarity (Para. 6 in the chapter related to operational risk):

- Expenses related to any preventive actions are not supposed to be captured in BI items. Otherwise it would be penalizing banks' investments in good risk management.
- There is no indication that for the consolidated reporting only the group composition at the end of each financial year is relevant and has to be taken into account in the calculation of the BI. Otherwise restatements could be possible.
- It has to be mentioned that the BI has to be calculated by only using the figures available at the end of each financial year: audited results, where available, otherwise business estimates.
- It has to be specified that in case an institution has been in operation for less than three years (the data is not available for the entire reference period) it may use forward looking business estimates for BI items unless the institution can prove to its competent authority that due to a merger or acquisition using a three years average would lead to a biased estimation for the capital requirement for operational risk.

Netting of income and expenses in the Services Component of the Standardised Measurement Approach (SMA) for operational risk

- In accordance with the Basel standard, income and expenses are included in the calculation of the capital requirement in the Services Component with the respective maximum and thus both increase capital requirements.
- Depending on the number of regulated financial institutions included in the value chain, the SMA capital requirements for services, as for instance income and expense from fees and commissions, multiply for the entire financial system.
- In the case of unregulated companies, on the other hand, income and expenses only lead to a capital requirement for the regulated institution at the end of the value chain. Thus, capital requirements for the same business activity are higher in comparison to unregulated companies included in the value chain. In our view, this represents a regulation driven distortion of the competition in the financial sector, which particularly favors shadow banks and unregulated market participants.
- We therefore call for netting income and expenses in the Services Component so as not to disadvantage certain transactions (in particular commission transactions).

Services component

- There is an element of competitive distortion in the services component as the capital requirements for a transaction that arises across the entire value chain increase each time an additional regulated institution is included in the chain. If, on the other hand, there are entities in the value chain which are not subject to the new capital requirements, the overall capital requirements for the same transaction will be lower across the chain, analogously in groups for which these sales/expenses are eliminated as part of a group consolidation. This approach favours unregulated market participants and creates a wedge between consolidated groups and decentralised financial networks with independently accounting units. This element should instead be neutralized.

Implementation challenges and administrative burden

144) Which elements of the revised SA-OR, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the one-off costs to substantiate your views.

145) Which elements of the revised SA-OR, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

It is nowadays clear that the increase in capital requirements for OpRisk will be relevant.

Moreover, one of the big challenges will be the implementation of accounting logic (and information) in the loss data collection process. Linking loss data to specific accounting transactions is tricky, as many losses due to operational risk are not linked to one specific transaction.

Moreover differing requirements with regard to how loss data is reflected in COREP reporting, EBA Stress Testing, SMA (Pillar 1) and Pillar 2 will increase the complexity of loss data processing and will cause the need to explain the differences between these views.

We also see as very burdensome and inefficient requirements linked to loss data identification (19.f et g) to isolate credit risk and market risk from operational risk.

MARKET RISK

Converting the reporting requirement into an own fund requirement

146) What considerations should be taken into account regarding the implementation of the revised trading book boundary? Please specify and provide relevant evidence to substantiate your views

147) What considerations should be taken into account in implementing any other revised elements of the FRTB framework, finalised by the BCBS in 2019? Please specify and provide relevant evidence to substantiate your views.

In the phased approach taken by the EU the revised Basel standards on the trading book/banking book boundary have not been transposed into the CRR2. We indeed expect further clarification on: the trading/banking boundary (prescriptive list of instruments belonging to each portfolio), the applicable boundary for transitory reporting requirements, many of the changes have helped allay some of industry's concerns on the capital impact.

However, we would like to stress once more that the trading book should only comprise those instruments for which the bank has indeed the intention to actively trade them, and not apply a purely accounting classification based approach that would inevitably lead to a boost of the trading book, particularly now after the entry into force of IFRS 9. Some further adjustments of the thresholds would allow to take into account the situation of institutions for which trading is not a core activity.

Furthermore the revised standards introduce additional requirements on IMA models, namely the desk level test on P&L attribution and the identification and capitalization of non-modellable risk factors, which generate additional complexities and costs in the implementation and operation of internal models which are often disproportionate for medium sized banks currently applying an internal models approach.

Introduction of the simplified standardized approach

148) What are your views on the introduction of the simplified SA-MR, in particular the revised calibration proposed by the BCBS? What would be the impact on RWAs and which types of activities or transactions, if any, would be particularly affected by the revised calibration? Please provide relevant evidence to substantiate your views.

Treatment of investments in Collective Investment Undertakings (CIUs)

149) What are your views on the costs and benefits of implementing the conditions provided by the Basel III standards for allocating investment in CIUs to the trading book? Please provide relevant evidence to substantiate your views.

150) What are the proportion and characteristics of the CIUs where a look-through is possible and how frequent is this possible? Please provide relevant evidence.

151) What are the proportion and characteristics of the CIUs traded in the EU for which the mandate of the CIU is available and daily price quotes can be obtained? Please provide relevant evidence.

152) Would you consider that the revised conditions for the application of the IMA for CIUs would significantly affect investments in those instruments? If yes, would there be any solutions to address this issue prudentially? Please explain and provide relevant evidence.

153) Would you consider that the revised approaches for calculating the own fund requirements for CIUs in the SA-MR would significantly affect investments in those instruments? If yes, would there be any solutions to address this issue prudentially? Please explain and provide relevant evidence.

154) What are your views in relation to the conditions and approaches under the Basel III SA-MR for the treatment of CIUs? In particular, how do the approaches compare in terms of operational burden? Please elaborate and provide relevant evidence to substantiate your views.

Date of application of new own funds requirements for market risk

155) Views are sought regarding the date of application of the new own funds requirements for market risk. Taking into account the time needed for the legislative process to implement the new own fund requirements for market risk in the EU and the time-consuming model approval process, which date would you consider appropriate for the application of the FRTB framework as a binding own fund requirements in the Union?

Other provisions

156) In your view, which other aspects, if any, should be considered in the context of revising the market risk framework? Please specify and rank your answers from the most important to the least important aspect.

Implementation challenges and administrative burden

157) Which elements/revisions of the SA-MR and, respectively, IMA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the expected one-off costs to substantiate your views.

158) Which elements/revisions of the SA-MR and, respectively, IMA, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

CREDIT VALUATION ADJUSTMENT (CVA) RISK

Revised CVA framework

159) Views are sought on the cost and benefits of implementing the revised CVA framework in the EU. In particular, how do the approaches provided by the final Basel III standards compare with the current approach of the CRR in terms of impacts on RWAs and operational burden? Please provide relevant evidence to substantiate your views.

160) Would in your view any type of transactions be particularly affected by the implementation of the revised CVA framework in the Union? Please provide relevant evidence to substantiate your views.

161) One of the main objectives of the final Basel III standards was to enhance the risk-sensitivity of the CVA framework. Are there in your view elements of the approaches of the revised CVA framework that do not achieve these objectives? If yes, which ones and what are the potential solutions to address them prudentially? Please provide relevant evidence to substantiate your views.

162) The final Basel III standards extend the scope of CVA risks subject to the framework. In this context, what are your views on the capacity of institutions in the EU to manage and hedge all CVA risks? Are CVA hedges under the SA-CVA and BA-CVA appropriately recognised? If not, what are the potential solutions to better recognise them prudentially? Please provide relevant evidence to substantiate your views.

163) Would you see particular challenges to implement the Basel III standards on CVA risk by the internationally agreed deadline, and if yes, why? Please elaborate..

Some members indicated that the operational burden of BA-CVA is approximately the same as the current approach. However, RWAs notably increase when moving from the current approach to BA-CVA.

We see that there is a need for an appropriate level of granularity. The rating grades should be differentiated rather than Investment Grade /non-Investment Grade; several buckets are needed to discriminate between alternative funds, banks, covered bonds and so on.

Also the Basel envisaged deadline of 2022 is too ambitious, especially given that it is not even in the CRR2. Also, the SA-CVA will be very cumbersome to implement

Finally, BA-CVA should, next to the credit hedges, also give benefit to market risk hedges.

Exemptions under the CRR

164) How do institutions currently manage the CVA risks arising from the counterparties exempted from the current CVA framework under CRR? Please provide relevant evidence to substantiate your views.

165) What would you consider to be the potential impacts on RWAs and in terms of operational burden stemming from removing the existing exemptions under the CRR would have? Please provide relevant evidence to substantiate your views.

166) In your view, which clarifications, if any, should be provided regarding the definition of the current exemptions, should these exemptions be retained under the CRR? Please provide relevant evidence to substantiate your views.

The introduction of the CVA risk charge was a consequence of the financial crisis, which highlighted that OTC derivatives carry a significant risk for own funds due to a credit rating decline of counterparties. The counterparties concerned were almost exclusively part of the financial sector. As non-financial counterparties (NFCP) bear no financial systemic risk, as far as they do not execute a significant OTC derivative transaction volume (measured by EMIR clearing threshold), the exemption was introduced into article 382(4)(a) CRR for good reasons and should be maintained.

Additionally, NFCP normally use derivative transactions for hedging market risks. A CVA risk charge would make hedging costs for these counterparties more expensive and will make hedge accounting under Directive 2013/34/EU extremely complex. Because these OTC derivative transactions are mostly tailor-made for counterparties' requirements, central clearing usually cannot be used to reduce these hedging costs.

Article 382(4)(d) CRR stipulates the exemption for central and regional governments, local authorities and supranational institutions, which receive a 0% risk weight in credit risk. This makes sure that the CVA risk charge is in line with the treatment under credit risk: risk positions against these counterparties generate no capital requirements and this provision should be maintained. Additionally these counterparties are not part of the financial sector that was mainly involved in the financial crisis. Thus, the exemption from the CVA risk charge should not be reviewed before any reform is made on the credit risk profile of such counterparties.

Intragroup transactions with a 0% RW, which comply with the strict conditions pursuant to Art. 113(6) and intra-IPS transactions which receive a 0% RW according to Art. 113(7) CRR, should not be made subject to an own fund requirement through the back door. To make the CVA risk charge consistent to article 107 et seqq. CRR the reference to Regulation (EU) No 648/2012 should be replaced by a reference to Articles 113(6) and 113(7) CRR.

Article 382(4) CRR defines a reasonable and comprehensible range of transactions that shall be excluded from the own funds requirements for CVA risk. A removal of such exclusions would lead to a massive deterioration of hedging opportunities for the real economy and to a multiplication of own funds requirements for the institutions.

Proportionality in the CVA framework

167) Views are sought on the costs and benefits of the simplified approach provided by the Basel III standards to calculate the own funds requirements for CVA risks. In particular, what would be the impact in terms of RWAs and operational burden? Please provide relevant evidence to substantiate your views.

168) Would you consider a simple multiplier applied to the own funds requirements for counterparty credit risk to provide an appropriate proxy for determining the own funds requirement for CVA risks of institutions with smaller derivatives portfolios, and if not, what would be a better proxy to measure those risks? Please provide relevant evidence to substantiate your views.

169) Views are sought on the appropriateness of the EUR 100 billion threshold for allowing institutions to use the simplified approach. How would this threshold compare to the eligibility criteria for the use of the existing simplified approach to calculate the own funds requirements for CVA risks under Article 385 of the CRR? How would the EUR 100 billion threshold compare to the eligibility criteria for the use of the simplified methods to calculate the exposure value for counterparty credit risk under Article 273a CRR? Please provide relevant evidence to substantiate your views.

The "Basis Approach for CVA" according to BCBS d424 leads to a significant increase in the applicable weighting factors, and consequent capital charge, if compared to the standard method currently provided for in Art. 384 CRR.

Hence, we fully support an introduction of a simplified calculation method for CVA risks in the CRR. Additionally, the proposed materiality threshold of € 100bn for applying this simplified method should be further increased in the course of its implementation into the CRR.

Internal CVA under the SA-CVA

170) What are your views on the principle-based definition of internal CVA sensitivities under the SA-CVA? Would these principles be aligned with the accounting CVA? Would these principles create undesirable effects or excessive operational burden if not aligned with these principles used for the accounting CVA? What would be the potential solutions to address those misalignments? Please elaborate and provide relevant evidence to substantiate your views.

171) In your view, what considerations should be taken into account in the supervisory permission process set up to approve internal CVA under the SA-CVA?

Fair value SFTs under the CVA framework

172) What are your views regarding the inclusion of fair-valued SFTs in the scope of the revised CVA framework in terms of impacts on RWA and operational burden? Please provide relevant evidence to substantiate your views.

173) Which portion of institutions' SFTs portfolios is fair-valued for accounting

purposes and according to which accounting standards? What are the features of those SFT transactions? Would the introduction of those SFTs in the scope of the revised CVA framework particularly affect those activities? Please elaborate and provide relevant evidence to substantiate your views.

Other provisions

174) In your view, which other aspects, if any, should be considered in the context of revising the CVA framework? Please specify and rank your answers from the most important to the least important aspect.

Implementation challenges and administrative burden

175) Which elements of the revised CVA framework, respectively, IMA, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the expected one-off costs to substantiate your views.

176) Which elements of the revised CVA framework, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

OUTPUT FLOOR (OF)

177) What are your views on the relative costs and benefits of including in the calculation of the OF more own funds requirements than those explicitly mentioned in the Basel III standards? In particular, how would such broader material scope compare to the scope required by the Basel III standards in terms of impact on RWAs, risk-sensitivity, comparability, complexity and operational burden? Please provide relevant evidence to substantiate your views.

178) Would you deem further refinements or clarifications necessary concerning the material scope of the OF, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

Q177

As it stands, the output floor will drive the largest impact of Basel III finalisation for European banks, particularly those with a low risk profile. The binding output floor will significantly decrease the risk-sensitivity in the capital requirements.

In general, we stress that the floored RWAs should be applied only at a consolidated and aggregate RWA level and to the capital buffers explicitly envisaged by the Basel Committee avoiding any goldplating and competitive disadvantage at global level.

<u>The Output floor and European banks versus US banks</u>

The Basel III Monitoring Report released in March 2019 indicates on page 4 a very strong disparity of the Basel 4 impacts by geographical zone, in particular between Europe and the USA: "The impact on MRC across regions is very heterogeneous for Group 1 banks with a moderate increase shown in the Americas (1.5%), a moderate decrease in the rest of the world (-2.7%) and in contrast to this a strong increase in MRC for European banks (+21.3%)".

In addition, it indicates that the impact of the output floor is 41.4% for European banks against only 6.3% for US banks. These figures concern 29 banks for Europe and 16 banks for the USA, all of Group 1 banks and are therefore significant.

It is imperative before proceeding to any European transposition to analyze the causes and consequences of these two findings:

- Where does the difference in impact between the two zones come from? Is it the result of assets so far poorly measured in Europe? We see rather it being the consequence of an externalization of assets, and retail assets in particular (those most affected by the output floor) in the US.
- Where does such a difference of the two zones come from on the output floor? As the risk weightings are close between the 2 zones, it seems that it is the breakdown of assets between SA and IRB methods under Basel 4 that is decisive in this, and the externalization clearly helps to it.

The two findings listed above express the fundamental difference between the European and US markets: in the US, banks can easily manage their assets through securitisations (including the well known recourse to agencies and federal bodies such as Fannie Mae etc...) and at the same time can raise significant CET1 capital. We can bet that US banks will always succeed in never displaying an significant level of output floor. In Europe on the other hand, banks are almost obliged to keep their assets on their balance sheet: there are fewer securitisations valid in terms of solvency and smaller capital markets. Indeed capital markets are still far from a genuine union and their fragmentation is an element that makes bank financing even more important. This is even more relevant for project finance for instance. European banks will therefore suffer – and will continue to do so for a long time – to undergo this structural impact of the output floor.

Moerover there will be a double negative impact of the output floor:

- at the time of the application date, with an effect that will be destabilizing in Europe, not only in terms of capital shortfall to cover but also in terms of credit flow to the economy.
- moreover, and this is often forgotten, this would also be crucial in a dynamic view post date of application, with the introduction of a permanent capital tax on European banks: with the output floor applying to any new transaction, the operations of European banks will have a much higher cost of capital than those of a US bank performing the same operations.

Overall it will be also the profitability of EU banks that will be affected by the introduction of the floor, overseas competitor will manage to offer much lower margins while still showing better ROEs, and the same could be true for new market entrants (like FinTechs).

Q178

179) Views are sought on the relative costs and benefits of applying the OF at all levels of the banking group (i.e. individual, sub-consolidated and consolidated) or solely at the highest level of consolidation in the EU. In particular, how do the two approaches

compare in terms of impact on RWAs, comparability, complexity and operational burden? Please provide relevant evidence to substantiate your views.

180) In your view, how would the two approaches affect the internal risk allocation across banking groups, in particular those with specific group structures or business models at subsidiary level? Please elaborate and provide relevant evidence.

181) What other solutions or safeguards could be envisaged as alternatives to your preferred approach? Please elaborate and provide relevant evidence.

Q179

We also highlight that for cooperative groups, the OF impact should take into account the existence of the solidarity mechanisms (group solidarity mechanisms with permanent affiliation to a central body or IPS): indeed we consider that the OF at entity level should be waived when monitored at consolidated level, especially in the case of law-based or unlimited solidarity mechanisms, or when there is no or very limited OF impact at consolidated level.

In fact, while in a joint-stock banking group the application of the OF can lead to the parent company contributing to the capital shortfall of the subsidiaries without seeing a notable impact on its own shortfall as it is monitored only at (sub)consolidated level (thus resulting more in a question of allocation of own funds than actual collection), in a cooperative group this is not the case due to the inverse pyramid structure (i.e. upstreaming of capital, as the local/regional banks own the central body), and to the allocation of the retail business at the level of local/regional banks.

We stress that the idea of solo level OF is highly questionable and should be dropped: it would in fact lead to have a capital demand at group level even where there is availability of own funds within the group.

Q180

Overall the idea of applying the output floor at the solo level is highly questionable and should be dropped as it does not improve the financial stability of group, but rather wastes resources (capital, fiscal, operational). In particular it generates fictitious internal processes (capital demands, guarantees) at group level even where there is availability of own funds within the group. We illustrate this as follows:

- In case of a group that is well capitalized as a whole (like in the case of cooperative groups), where there is no capital shortfall on aggregate, it could well be the case that at the level of the subsidiary (or affiliated bank in a cooperative group) – particularly for example in retail activities, where the floor hits the hardest – the output floor on a solo basis alone generates a need for capital. The output floor would also drive the largest impact at the level of the subsidiary (in proportion) because at higher levels there may be fewer retail activities (thus a lesser impact from the floor)
- However, to understand the meaning of such a shortfall one should not simply sum positive/negative impacts across subsidiaries/affiliated banks. The idea that individual output floors would be meaningful and that the solo impacts would be summed up does not reflect the way capital is managed within a group, e.g. via capital waivers.
- This case is even more relevant for cooperative banks, due to the peculiar capital management within the group and the existence of solidarity mechanisms that allow the prompt transfer of own funds within the group. All the more, there should be no output floor at the solo level within a cooperative group as this would take into account

the nature of capital steering and management of cooperative groups (which is recognized by the legal framework, e.g. Art. 113(6) CRR and Art. 10 CRR – and also Art. 113(7) CRR although less relevant in this context for the purpose of consolidated requirements).

Q181

No OF should be required at entity level when satisfied at consolidated level and entities benefit from the existence of adequate solidarity mechanisms.

182) In your view, should both of the transitional measures provided by the Basel III standards be implemented in the EU, and if not why?

183) Would you deem further refinements or clarifications necessary concerning the transitional measures, and if yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

184) In your view, what measures, if any, should be taken to ensure a smooth implementation of the OF? Please elaborate and provide relevant evidence.

We appreciate that the Basel standard foresees the output floor to be implemented on the basis of a 5 year phase-in period. However, at this stage, the timeframe seems too tight as it would lead to a too abrupt significant increase of own funds requirements for the affected institutions.

The phase-in period for the calibration of the output floor should be extended to at least 8 years.

The phase-in for the equity impact is defined only for the RWA increase of SA banks, whereas a RWA decrease for IRB bank is very important to smoothen for the global RWA increase of CR-IRB.

185) In your view, which other aspects, if any, should be considered in the context of implementing the OF? Please elaborate and rank your answers from the most important to the least important aspect.

The floor should only be calculated on the following Basel core capital requirements (CET1):

- Minimum requirement, at least 4.5% of risk-weighted assets;
- Capital conservation buffer set at 2.5% of risk-weighted assets;
- Countercyclical buffer, in case it is nationally applied;
- G-SIB buffer, in case the bank is identified as a G-SIB.

The total capital requirement (expressed in CET1) to be used for the output floor requirement is thus 7% (minimum requirement 4.5% plus capital conservation buffer 2.5%) plus any countercyclical buffer and G-SIB buffer.

Some jurisdictions, particularly in Europe, have set additional capital requirements, such as systemic risk buffers, O-SII buffers and various types of Pillar 2 buffers. These requirements are, however, not included in the Basel framework and should therefore not be used for the calculation of the output floor requirement.

We stress that the output floor will create a wedge between regulatory risk weights and the risk weights according to internal models. It will increase the incentive to take on high risk exposures at the cost of low risk exposures, which may drive more risk into the financial system.

In order to reduce the impact on risk sensitivity for European banks, we would even propose an EU-implementation where the output floor is one of three parallel capital requirements:

1) The risk-based requirement, i.e. "normal" capital requirements based on pre-floor RWAs consisting of the Basel requirements listed above plus any requirements for systemic risks, Pillar 2 etc. where jurisdictions find that appropriate (as currently the case);
2) The leverage ratio requirement as a separate second requirement (or one type of backstop requirement);
3) The output floor requirement as a separate third requirement (or second type of backstop) based on floored RWAs, with the floor covering only the capital buffers envisaged by the Basel Committee;

In any case, we reiterate that an output floor should be calculated only at the level of the consolidated group and only at the aggregate RWA level. In addition, an implementation of the output should be considered only with a homogenous implementation at the global level as a precondition to avoid competitive distortions.

Finally, the impact of the output floor could also be mitigated with the following options:

- carve-out of residential real estate portfolios from the calculation basis (e.g. as for current CRR exceptions for certain CVA exposures);
- acting on the methodologies via improvements in the sensitivity of the measurements and / or via more adjustments (of the SME factor type).

In particular, the carve-out solution would be especially relevant for cooperative banking groups which have very large retail activities, and where the retail activities are performed at the level of local/regional bank. As illustrated above, the floor would have a structural and wide impact on the RWAs of the low risk portfolios of such groups.

We would suggest to exclude from the output floor calculation the portion of residential real estate, also in consideration of the specificities of national markets and the way banks' practices reflect the latter. The home loans could then rather be taken into account again when assessing the Pillar 2 requirements.

186) Which elements of the OF, if any, would you deem particularly challenging to be implemented? Please elaborate and rank your answers from the most challenging to the least challenging revision. Please provide relevant evidence on the expected one-off costs to substantiate your views.

187) Which elements of the OF, if any, would in your view cause additional administrative burden? Please elaborate and provide relevant evidence on the expected recurring costs.

Additional costs include:

- capital circulation when there is an impact at sub-consolidated level without any impact at consolidated level;
- allocation rule for new administrative cost.

Additional administrative burden include:

- monitoring and capital policy when there is an impact at sub-consolidated level without any impact at consolidated level: e.g. 2-3 FTE/year.

CENTRALISED SUPERVISORY REPORTING AND PILLAR 3 DISCLOSURES

188) 188) Once EUCLID is fully implemented, would you support that the EBA, on the basis of the collected supervisory data from all institutions established in the Union, centrally discloses the information of all those institutions that are subject to disclosure requirements under CRR/D, thereby relieving institutions from mandatory disclosures?

189) If you support centralising disclosures at the EBA, please explain

i) whether in your view stakeholders (investors, etc.) would have the benefit in accessing disclosures of all institutions in one internet place?

ii) whether in your view a single location policy should be applicable to all type of institutions: small non-complex, large and other institutions?

iii) how responsibilities for the disclosed information should be shared between institutions, competent authorities and the EBA?

190) If you do not support centralising disclosures at the EBA, please explain why.

In principle, we would support a function for EBA to disclose data collected from all institutions established in the EU in order to increase efficiency and reduce costs.

Once EUCLID is fully operational and EBA also collects all the supervisory data from all banks, it seems logical that a centralized disclosure role can be performed.

That would be the most efficient way to disclose all information at the same place. However, from the description of EUCLID in the EBA's "Annual Report 2017", Pag. 70, it remains largely unclear, how EUCLID is going to be designed in detail in the future. Therefore, it is hard to evaluate the impacts of EUCLID on European banks.

Also, we are somewhat sceptic at this moment as the required data for the fulfilment of reporting requirements differ from the data in order to fulfil disclosure obligations. We see that EBA is aiming to map back to back reporting and disclosure requirement to align the data used (new reporting and disclosure ITS currently under consultation), but for the time being it appears certain that the implementation would cause additional reporting requirements for banks, as the requirements of reporting and disclosure may differ.

According to the Commission Working Document 'Fitness Check of EU Supervisory Reporting Requirements' (November 2019) 30 % of all compliance costs are caused by the fulfilment of reporting requirements. Therefore in any case, it has to be ensured that any additional operational burden for European banks is avoided. If this cannot be assured we any implementation of EUCLID should be postponed.

Otherwise, at least for small non-complex institutions (as from Art. 4(1)(145) CRR II) disclosure requirements should be waived. Obviously, these provisions require an inappropriate amount of staff and technical resources for small and non-complex banks for giving information which is largely irrelevant for the market participants.

SUSTAINABLE FINANCE

191) In your view, which further measures, if any, could be taken to incorporate ESG

risks into prudential regulation without pre-empting ongoing work as set out above? Please elaborate and provide relevant evidence to substantiate your view.

The way forward on ESG risk

A first step was taken by the European legislators to integrate ESG-related risks into the prudential framework through provisions in the CRR2/CRD5 by mandating the EBA to develop a suitable framework during the coming years: such phased approach will foster the integration of ESG-related risks in risk management processes along a reasonable path. Indeed, prior to any Pillar 1 capital provision, it is important to define some first "general" expectations (as done by the EBA action plan) and to recognize the steps taken by financial institutions in order to decarbonize their portfolios and address the issue via the adjustment of business strategies, risk management policies and disclosure.

Should the Commission decide to address a dedicated regulatory treatment for exposures associated substantially with climate aspects (or environmental and/or social objectives) in the course of the Basel III implementation (i.e. ahead of the delivery of EBA mandates), we consider it is of utmost importance to go for an incentive-based approach for "green" exposures ("green supporting factor") without recurring to a penalizing "brown factor".

We must also acknowledge that some challenges are still ahead for the EBA to be able to fulfil its mandates. Indeed, including ESG factors into the risk management processes necessitate to classify the portfolios and exposures according to a definition of those factors. Two components are hence essential: we need metrics and data.

- Regarding the metrics: we should to avoid a situation where each stakeholder has its own definition of what environmental factors are, therefore we need a common set of metrics (or classification system) that are specified for ESG factors.

  As much as at least some Governance factors are well known by the industry and widely used through their financial analysis processes, it is less the case for E and S factors. The EU Taxonomy currently in discussion will determine a set of metrics for E factors that will only focus on a (very) positive environmental (currently only climate) impact of a limited range of economic activities. However, for risk management purposes, the EBA will need to develop a taxonomy suitable for the lending business, i.e. allowing to identify good and bad risk. As for S factors and additional G factors, the impact is currently difficult to assess and we anticipate that the development of common metrics will take some time. We hence recommend European authorities to focus first on Environmental-related risks (starting with climate to integrate step by step other environmental objectives) in their development of prudential processes.

  In this respect it is also essential that proportionality is well embedded in any approach developed. Frameworks of differing complexity for the assessment of ESG risk seem appropriate.

  Furthermore, the principle of materiality must remain in the focus: banks should reflect ESG aspect in their risk management to the extent that they have a material impact in the classic risk categories. Conduct rules and risk management rules must not be mixed up.

  Finally, several risk-related initiatives are being developed by the market in terms of stress testing or portfolio analysis. We would like to highlight that due to the lack of hindsight available on these topics, the markets are currently in a phase of experimentation and there is a growing trend of best practice sharing. Although there would at some point need to harmonize all the initiatives taken in those regards, we think that the work achieved by the NGFS is sufficient for now, and that no regulatory framework should be established before the market can use common scenarios and methodologies in order to stress their portfolios.

The Need for Data

- Regarding the need for data: we are convinced that the market is going to adapt and that clients/issuers will be incentivized to disclose ESG-related data, through notably the coming review of the NFRD and many of the disclosure requirements that will soon come into force. Furthermore, the current state of play leads to a situation where financial players have to collect data from third-party data providers and ESG rating agencies. This poses a series of issues like a lack of comparability among ESG products due to the lack of transparency of the methodologies used by data providers. We hence recommend to enhance the supervision of those stakeholders in order to make sure they rightfully use the common classification system described above (once determined) and that their methodologies are comparable by investors.

  Furthermore, we urge for a maximum degree of convergence of definitions and requirements of regulation and of definitions regarding non-financial reporting, disclosure and prudential requirements (prudential reporting).

The Green Supporting Factor

Indeed, banks are the key source of financing in the EU. This is a crucial element when thinking of incentives for financing sustainable activities in the near future. A duly designed "green supporting factor" could leverage and prioritize green lending and support sustainable growth, especially as it would be backed by an EU taxonomy which defines sustainable economic activities.

To maintain a link with the actual risk, it should also be noted that ESG factors are playing a more important role in financial ratings – even by major rating agencies such as S&P or Moody's, and supervisors are starting to spell out first ESG stress tests. Also, a supporting factor shall not substitute the creditworthiness assessment.

Some research reports (e.g. from the Center for Sustainable Finance and Private Wealth of the University of Zurich and Oxford University/Arabesque Partners) also point to the conclusive correlation between good business sustainability practices and profitability.

In light of the increased capital requirements brought about by Basel III and the role for banks to act as facilitator for a green transition, regulatory balance is needed.

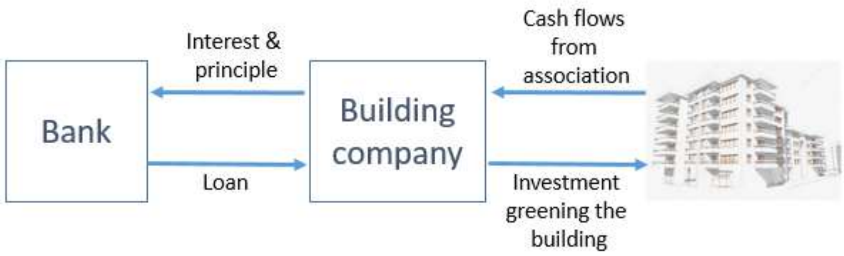
Incentivising green equity investments

Finally, we would like to highlight that a specific exemption should be made in the CRR for equity investments for the purpose of greening the economy by the means of achieving energy neutral solutions. When the owners of an apartment building (i.e. association of owners) renovate their building into a sustainable energy neutral complex, they should be able to ask the bank to pre-fund this conversion.

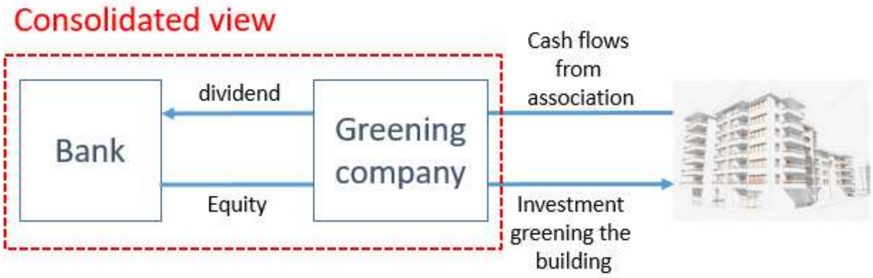
Energy neutral means that the owners of the apartments do not have to pay the energy company any money for heating and electricity as the renovations make the building (i.e.

themselves) self-supportive. This kind of renovations require however significant investments from the apartment owners (e.g. EUR 100.000 or 150.000) and normally owners do not have or do not want to invest these kind of amount immediately. In to pre-fund the conversion, the association has two options:

1. Ask a building company to pre-fund the conversion in return for monthly payments from the association (i.e. the cash flows without renovation going to the energy company) The building company does not has the cash either and will ask a bank for a loan.
2. Ask a bank to pre-fund the conversion in return for monthly payments from the association (i.e. the cash flows without renovation going to the energy company).



Bank does not have full control to receive the cash flows from the association as it is dependent whether the building company will pay back the loan, but risk weight is lower than equity stake.



Bank has full control to receive the cash flows from the association but risk weight is higher than providing a loan to the building company.

That is, the bank will set up a company that is fully owned by the bank itself that will pre fund and fully coordinates the renovation in return for the future cash flows from the owners of the apartments. This structure is less risky than when a building construction company is playing this middle role with the bank providing such company a loan. When the bank instead of the construction company is fulfilling this role:

a) it has full control over the cash flows it will receive in the future to repay the loan with interest in the form of dividend, compared to when providing a loan to the building constructor;
b) it diversifies its business model in the low interest environment;
c) it receives an incentive to contribute to the 'green deal'.

We would consider a risk weight of 20% for equity exposures that facilitate the greening of the economy when the bank has full control over the future cash flows received from the apartment owners. The same rationale holds true for windmill and solar power parks financing.

FIT AND PROPER

192) What would be the benefits and drawbacks of including the requirement for competent authorities to perform a fit and proper assessment of at least some key function holders in the CRD?

193) In your view, would it be useful to identify key function holders in a descriptive manner, and/or to specify certain roles as belonging, by default, to the set of key function holders? Please consider the practical implications of each option and the need for clarity and consistent application across institutions and competent authorities. Please elaborate and provide evidence.

194) Were the CRD to specify a number of roles that would be considered, by their very nature, to be occupied by key function holders, which specific roles should, in your view, be included in this list?

195) Views are also sought as to whether the scope of key function holders subject to fit and proper assessment should be limited to those holding these positions at group level or whether it should also include key function holders at the level of each institution? Please elaborate and provide evidence.

196) Should the key function holders be subject to fit and proper assessments by competent authorities, on what criteria could this assessment be performed?

Q192

Fit and proper assessment of key function holders by competent authorities would imply the following drawbacks:

- further significant administrative burden on banks;
- operational problems in cases where an appointment of a key function holder is urgent and is delayed due to a fit and proper assessment;
- labour law issues: indeed, the coming into effect of the employment contract would be subject to approval by competent authorities. This would be problematic since key function holders are employees and not board members. Indeed, key functions holders are professionals that credit institutions recruit because of their expertise (unlike the members of the management body who are candidates and are elected by the general assembly or by the board of directors). The assessment of their skills and knowledge must be a decision of the human resources department of the credit institution and not a decision of a supervisor.

In addition, banks should modify their practices and introduce longer trial periods in the key function holders' employment contracts in order to take into account the assessment by competent authorities. This, in turn, can make it more difficult to recruit them;

Overall, we do not see any benefits of including the requirement for competent authorities to perform a fit and proper assessment of at least some key function holders in the CRD. Indeed, the EBA-ESMA guidelines on suitability assessment are sufficient. Institutions have already robust processes in place to assess key function holders' suitability and are already subject to heavy administrative burden in this respect.

To conclude, this should remain for consideration at national level, taking into account that legal forms and business models of the CRD institutions in different EU member states vary.

In case the Commission decided that key function holders should be assessed by supervisors, this should only be applied at the level of the central body, as far as cooperative groups are concerned.

Q193

As mentioned in answer to question no. 192, the fit and proper assessment of key function holders is not desirable. Indeed, the EBA-ESMA guidelines on fit and proper assessment are already exhaustive on this point.

However, if the assessment is introduced, key function holders should be identified in a appropriate, precise and detailed descriptive manner in order to have a clear view on who and what to assess, ensure consistency across Member States and avoid a too far-reaching scope.

In addition, the assessment should be more flexible and less time-consuming than the one of board members.

Q194

If the CRD specifies a number of roles that would be considered to be occupied by key function holders, it would be of outmost importance to have a clear and narrow definition in order to avoid a too far-reaching scope. This is to avoid the risk that too many people fall in the definition without, in substance, playing the role of key function holders at their respective level, especially in cooperative groups.

In any case, should the Commission introduce fit and proper assessment of key function holders by supervisors, the scope of key function holders should be limited to the highest functions, actually allowed to exercise far-reaching powers and take relevant decisions within the bank.

Q195

In our opinion, as far as consolidating cooperative groups are concerned, the scope of key function holders subject to fit and proper assessment should be limited to those staff holding these positions at central institution level. Indeed, it is the central institutions that is mainly responsible for steering the banking group and the main responsibility of the said functions is centralised at this level, whereas the individual member institutions/subsidiaries/regional bank should not be subject to excess administrative burden.

For example, each internal audit officer/compliance officer/risk management officer at entity/subsidiary/regional bank level is closely monitored by the central body through instructions and internal rules.

In addition, an assessment of key function holders of each entity/subsidiary would bring about in practice a massive inflow of approval files to the supervisor, in particular from cooperative banks.

For example, considering only the three French cooperative groups, the approval files' number would be at least equal to 1.000.

Q196

We consider that the fit and proper assessments of key functions holders by competent authorities is really questionable and, therefore, we do not support any binding regulation in this respect.

Moreover, we consider that this assessment is not relevant insofar as key function holders cannot often make important decisions without a committee/board.

However, if introduced, key function holder assessment by competent authorities should be more flexible and less time consuming with respect to board members assessment. In addition, assessment criteria should be narrow and very clear.

197) Please explain what you consider to be the advantages and disadvantages of competent authorities conducting ex ante and ex post approval, respectively, of suitability of members of the management body.

198) If, in your jurisdiction, institutions are required to request approval for the appointment of members of the management body only after they take up their position, please explain what, if anything, would make it difficult for you to adapt to an ex ante system.

199) One issue that has been raised in the past in relation to ex ante assessment is avoiding vacant positions on the board. Please explain, based on your experience, to what extent this can be overcome (if it is an issue in the first place) giving examples and making reference where appropriate to succession planning and procedures in place for identifying skills/experience that could be particularly difficult to replace.

200) Which specific positions within the board and/or senior management of institutions do you believe should be considered as part of an ex ante assessment, given the responsibilities they hold and the risks they may pose? Please provide evidence and/or examples to support your views.

Q197

First, in our opinion the CRD should leave the choice between ex-ante and ex-post assessment to Member States, as recognized by the EBA-ESMA Guidelines on suitability assessment (EBA/GL/2017/12) and the ECB Guide to fit and proper assessments. In particular, it should be explicitly enshrined in Article 91 CRD that it is at the discretion of the Member State whether an ex-ante or an ex-post assessment of the (potential) member of the supervisory board will be conducted.

Indeed, a quarter of the Member States have decided to follow the ex-post assessment procedure pursuant to national corporate law, when implementing CRD IV and this did not cause problems.

This is indeed remarkable considering that most large banks (France, Germany, Italy - excluding UK banks) are submitted to ex-post assessment procedures.

As an argument in favor of ex-ante assessment, the ECB has often mentioned the difficulty of removing from the board a member not in line with the fit and proper requirements. However, with the introduction of Art. 91(1) in the CRD 5, if board members do not fulfil the fit and proper requirements, *"competent authorities shall have the power to remove such members from the management body. (…)"*. Therefore, in this new regulatory context, the argument in favor of ex-ante assessment is no longer valid and we do not see any advantage in adopting an ex ante assessment.

On the contrary, we see many disadvantages. Examples of disadvantages related to the ex-ante assessment by competent authorities:

1. Impediments to the sound functioning of the board, especially when the need to substitute a member arises suddenly given the duration of the assessment procedure (e.g. in case of death, resignation of one or more board members, …); this is particularly relevant in situations where the statutes of the institution require joint-representation in order to take a specific action.
2. the assessment process would be more complex and non-efficient: this is especially true for those member states where competent authorities have to supervise hundreds of (very) small banks each of which (i) having its own supervisory body and (ii) sending the fit and proper file to the supervisor at the same time.
3. Multiplication of assessment application: in order to mitigate the risk of opposition from the supervisor, the credit institutions will have to submit to the supervisor's assessment several approval files;
4. Risks related to the time taken by competent authorities to conclude the assessment procedure:
    a. risk that the ex-ante assessment procedure is not fulfilled within the time limit before the general assembly given the flow of approval files submitted to the supervisor at the same time;
    For example, in Finland, the assessment process of the supervisor currently takes up to 1,5-2 years which is excessively long time, especially in case the assessment is to take place in advance. A long assessment ex ante process, even if shorter than the current process, could seriously impaire work of board and senior management. Naturally, a candidate cannot terminate his contract before the approval of the supervisory authority. It is also noteworthy that at the senior management level non-compete clauses are very common and the average length of them is 6-12 months starting from the termination.
    b. risk that the ex-ante assessment procedure increases the difficulties to find candidates. For example, in France, if the board approves the draft resolution in the perspective of the General Assembly in February for a nomination in May, the notification file shall be sent to the supervisor in September at the latest (4 months before February) which would mean having the "go decision" from the potential candidate in July the year before the nomination, which is too much in advance of the nomination. This would also imply asking a candidate to freeze all their directorships for such a long period and, therefore, it would increase banks' difficulties to find candidates which are already significant given the limitation of the number of directorships, time commitment and other fit and proper requirements.

In addition to the above disadvantages related to the ex-ante assessment, it is worth mentioning that in some jurisdictions – for example the Italian one – the parent company is in charge of a first ex-ante evaluation of affiliated banks' board members. In this perspective, the parent company is empowered to oppose the appointment of affiliated banks' board members if those are deemed usuitable for the sound and prudent management of the affiliated bank itself.

Q198

Please see answer to question no. 197.

In addition, the introduction of the ex-ante assessment would create contradictions with the relevant current provisions of the Austrian Banking Act. This is, for example, the case of Austria where - according to those provisions - institutions have to report nominations of members of the management board and members of the supervisory board ex post to the national competent authority.

This ex post approach of the Banking Act is implemented for good reasons as it has to be borne in mind that from a practical view ex-ante assessments are protracted, cumbersome and costly.

Q199

Please see answer to question no. 197.

Q200

In our opinion no position (board members/senior management) should be considered as part of an ex-ante assessment.

201) Considering a scenario in which at least some fit and proper assessments were to be conducted by competent authorities ex ante, what would be, for you, the costs and benefits of a deadline for the assessment of proposed board members being set in the CRD? What would you consider a reasonable period of time for the assessment?

202) Do you currently use, or have you envisaged, other timelines for approval, e.g. whereby institutions only have a limited time to provide the additional information requested, or where the length of the assessment period depends on the specific type of position? If so, please explain the rationale for these timelines.

203) If competent authorities had a fixed time period for giving their approval to proposed new board appointments, would you nonetheless consider it preferable for a decision to be issued in cases where the competent authority decides to approve a candidate? Could you instead envisage a system of "tacit approval" (i.e. whereby, if no decision has been issued by the deadline, the institution can consider the candidate approved)?

Q201

In case ex ante assessment is introduced, there should definitely be a deadline for the assessment conducted by the competent authorities. A reasonable period of time for the assessment would be at most two months.

In addition to the deadline, a clear, non-questionable and invariable starting point should be introduced. The starting point of the assessment period should not be left at the discretion of the supervisor. An example of starting point could be 2 months **as from the date the competent authority has received a complete approval file**.

Q202

If the supervisor consider that the file is not complete, the assessment period is suspended by the supervisor until the additional information is provided by the relevant credit institution.

Q203

In our opinion, whatever the approval procedure is (either tacit or explicit), it is essential that an official process is clearly stated. In particular, this official process should undoubtedly identify the starting date and the subsequent deadline for the supervisor to conclude the fit and proper assessment and communicate the related decision to the bank.

204) Should the scope and format of fit and proper assessments be adapted to take into account the principle of proportionality, including in relation to any new provisions such as those discussed in Sections 9.2.1.1. and 9.2.1.2.? Please elaborate on your reply and provide examples.

205) What specific criteria would you consider appropriate as a basis for allowing some degree of proportionality in the fit and proper assessment, including in relation to any new provisions such as those discussed in Sections 9.2.1.1 and 9.2.1.2? Views are also sought on the possibility of granting competent authorities the right to apply supervisory judgement to enlarge the scope of their assessment based on the risk profile of the institution/role.

206) What specific risks do you see in allowing some degree of proportionality in the application of any new provisions, such as those discussed in Sections 9.2.1.1. and 9.2.1.2., on the timing of the approval of board members by competent authorities and of key function holders?

Q204

First, we appreciate that there is no proposal concerning the moving from CRD to CRR the governance provisions. This grants national legislators in the EU the competence to take the national peculiarities of the various governance structures of European institutions appropriately into account. Hence, governance requirements for the institutions shall remain regulated in the CRD.

Second, it is of utmost importance to take into account the proportionality principle, due to the fact that legal forms and business models of the CRD institutions vary in different EU member states.

Q205

The scope and format of fit and proper assessments should be adapted to take into account the principle of proportionality, including in relation to any new provisions such as those discussed in Sections 9.2.1.1. and 9.2.1.2.

We consider that the criteria laid down in the EBA's Guidelines on fit and proper are still appropriate as a basis for allowing some degree of proportionality.

We do not support the introduction of the possibility of granting competent authorities the right to apply supervisory judgement to enlarge the scope of their assessment based on the risk profile of the institution/role which goes against the principles of legal certainty, level playing field and harmonisation.

Q206

There may be risks in terms of legal certainty and level playing field.

207) What would be the benefits and drawbacks of designing an accountability regime whereby the management body of each institution would be required to draw up a statement of responsibilities of each of its members clearly identifying the activities for which they are responsible, beyond the sole responsibilities linked to their membership of specialised committees (e.g. risk committee, remuneration committee)?

208) How might the collective functioning of the board be affected by the introduction of a system where each individual has a defined set of responsibilities? Please consider the possible effects on both individual conduct and the board as a whole (e.g. the impact on the collective responsibility of the board, or on the quality of its discussions).

209) What would be the benefits and drawbacks of designing a similar accountability regime for key function holders (e.g. information on key function holders, their responsibilities, details of the firm's governance and structure)?

210) Would the assessment of individuals proposed for positions on the board or as key function holders be more accurate and/or reliable if the responsibilities the individual would be taking on were clearly defined, including in relation to any new provisions, such as those discussed in Sections 9.2.1.1 and 9.2.1.2?

Q207

We do not support this approach since it would breach company law in certain jurisdictions. There is a collective responsibility among board members. For example, the French model is based on the collective principle of the Board, which implies the collective responsibility of board members.

Q208

Please see answer to question no. 207. Overall, in our opinion, there is absolutely no need for such legislative measures as the current European and national company and banking supervisory law (especially the EBA Guidelines on internal governance) define a clear legislative framework for the accountability of the management body. Designing a parallel accountability regime would inevitably lead to conflicting legal frameworks and legal uncertainty.

In addition, if each board member has a set of own responsibilities, such distribution of roles would be contrary to tort law and would likely divide the board of directors and limit the exchange of information among board members.

Finally, the introduction of an own accountability regime would imply – in our opinion – that members of the management body would feel accountable for only for the in the scope of the statement of responsibilities.

Q209

The situation of key functions holders is not comparable with the situation of the members of the management body insofar as they are employees subject to the labour law. In any case, key function holders shall not absolve the liability of (i) the company itself and (ii) each member top management.

Finally, the design of a similar accountability regime for key function holders would mean excessive administrative burden with no notable benefits.

Q210

Please see answer to question no. 209.

In general, we do not see any benefit. Indeed, the positions and responsibilities of board members and key function holders are predetermined. Therefore, no additional accuracy can be achieved.

Furthermore, imposing individual liabilities on each board member is neither logical nor consistent with the role of specialized committees (audit, remuneration, risk, nomination, etc).

211) Do you consider that corporate culture could and should be taken into consideration as part of the fit and proper assessment? If yes, please explain how this could be most effectively achieved.

212) What do you consider would be the benefits of, and/or difficulties encountered in, including the ability to create and promote the organization's desired culture as part of the "fit and proper" assessment of members of the management body?

Q211

We think corporate culture is too abstract to be taken into account as part of the fit and proper assessment by supervisors. Furthermore institutions are constantly developing and fine-tuning their corporate culture which would make it even more difficult to take it into account as part of the fit and proper assessment by supervisors.

Q212

Please see answer to Q211. In addition, we do see corporate culture as an important part of the internal selection/assessment process, especially in cooperative banks. The supervisor has no sufficient evidence to do so.

Appendix

Why could Basel 4 via the output floor could create an unjustified competitive distortion between banks?

The figures used in this note come from the BCBS document "Basel III Monitoring report March 2019" (see tables in the annex). They are based on data from 189 banks.

The output floor (OF) depends on two parameters:
1) The IRB / SA- quotient of an asset or an asset class: it represents the ratio between the risk weighting of RWAs calculated under IRB models and the risk weighting of RWAs calculated under the SA.
This coefficient will quite substantially increase the amount of risks produced by the more risk-sensitive IRB method (IRB models are regularly subject to the control of and approval from supervisory authorities). That increase thus represents an extra cost of capital requirement due to an arbitrary tax "of harmonization".

Example: Under the final Basel III standards, the average risk weight for large corporates in European banks portfolios is 48.3% under the IRB method and 95.1% under the standardised method. The IRB / SA ratio is thus 51% (= 48.3 / 95.1); for residential real estate in the EU, this ratio is 35% (= 12.4 / 35.5) (see the last two tables in the annex).
→ The lower the IRB / SA- quotient, the higher the negative impact of the output floor on the bank.

2) The bank's mix of activities: credit risks and market risks portfolios measured under the standardised method (either mandatorily due to the texts, or by choice of the institution itself) and the risks, which must be calculated under the standardised approach (operational risk) have by definition an IRB / SA ratio of 100%. Given that the final Basel 3 recommendations (December 2017) set a lower threshold for the OF at 72.5% of the standardised approach, these risk portfolios will mitigate the gross increase introduced by the IRB / SA ratio.
→ The higher the proportion of risks measured under the standardised approach in a bank's portfolio, the lower the negative impact of the output floor on the bank.

These two parameters vary in opposite direction. The net impact - or amount of the OF - is determined by the following formula:
OF = max ((x / q * 72.5% - x) **-** (y * 27.5%); 0) where:
- q is the IRB / SA ratio of the IRB activities,
- x represents the risk weight of the activities measured under IRB model
- y represents the risk weight of the activities measured under standardised method and operational risk.

According to the first publicly disclosed analysis of the impact of the output floor (OF) of the Basel Committee (March 2019 monitoring report), there is a very significant difference by region: capital requirements would increase by +1.5% for US banks against +21.3% for EU banks (table C.73 page 154)**.**

The output floor is a major Basel 4 constraint for EU banks while it appears to have a significantly lesser (even negligible) impact on US banks.

The structural differences between the US and the European markets can explain this disparity:

- In the US, banks can sell their assets to the Freddie Mac & Fannie Mae agencies and through securitisations techniques. They can manage their balance sheet as such and will continue to do it by adjusting the two above-mentioned parameters that determine the OF to keep the impact of the floor down:
  - any sale of IRB assets reduces the OF,
  - regarding the IRB / SA quotient, it is particularly beneficial to sell lower risk mortgages (i.e. with a low IRB / SA ratio). The IRB / SA ratio then increases and the negative impact of the OF decreases accordingly.

- In the EU, on the other hand, banks do not have government-backed agencies to which they can transfer risks thereby reducing their need for capital nor a large and working facility for deconsolidating securitisations As a result European banks' balance sheets have a high proportion of long-term exposures. This situation is not expected to change in the short term. As such, European banks will suffer from the full impact of the output floor.

The example below illustrates this potential competitive advantage for US banks:
Let's take a universal bank-type with a balance sheet distributed as below:

- 30% of corporate loans exposures calculated under the IRB method,
  20% of residential real estate exposures also under the IRB method, and
  50% of other credit, market and operational risks measured under the standardised approach.

For a European bank, the impact of the OF would be an increase in RWAs of +21% as calculated below:

Activities	EAD EUROS	IRB risk weightings % (A)	Stand. Risk weightings % (B)	IRB / SA Quotient % (C) = (A) / (B)	Amount IRB EUROS (D)	Standard at 100% EUROS (E)= (D) / (C)	Standard at 72,5 % EUROS (F)= (E) * 72,5%
General corporate	60	48%	95%	51%	30	59	
General residential real estate	160	12%	36%	35%	20	57	
Other credits	150	conservative hypothesis :		100%	30	30	
Market & Operational risks	30	all under SA approach		100%	20	20	
Total	400				100	166	121
							21%

For a US bank with the same balance sheet but which has sold 50% of its lower risk real estate exposures calculated under the IRB approach (as is common practice in the US):

The impact is reflected both in the lower proportion of operations under the IRB method, but also in the IRB / SA ratio which consequently substantially increases as the residential real estate credit portfolio now contains the highest risks. Thus, the BCBS document shows a 59% IRB / SA ratio for general residential real estate loans in the USA.

General residential real estate loans	IRB	SA	Quotient
			IRB/SA
Europe	12,4	35,5	35%
Americas	20,5	35,0	59%

NB : that table of the BCBS document shows that the current risk weight for residential real estate credits under the SA method of US banks is 48.6% and will drop to 35% under the 2017 final Basel 3 Agreement. Such significant decrease demonstrates that the new SA method has been defined in a way that is beneficial to the US banks. In the EU, the risk weight will vary slightly and upwards from 35.1% to 35.5%.

<u>Final results</u>:

Activities	EAD EUROS	IRB risk weightings % (A)	Stand. risk weihtings % (B)	IRB / SA Quotient % (C)= (A) / (B)	Amount IRB EUROS (D)	Standard at 100% EUROS (E) = (D) / (C)	Standard at 72,5 % EUROS (F) = (D) * 72,5%
General corporates	60	48,3%	95,1%	51%	30	59	
General residential real estate	80	20,5%	35,0%	59%	16	28	
Other credits	150	conservative hypothesis :		100%	30	30	
Market & Operational risks	30	all under SA approach		100%	20	20	
Total	320				96	137	99
							3%

The externalization of only 20% of the assets of the balance sheet (80/400) corresponding to the low risk real estate assets (the assets that would typically be sold to Freddie Mac / Fannie Mae in the USA) reduces the negative impact of the output floor from + 20% of RWAs to almost zero.
Half of this decrease is due to the sale of the assets, while the other half can be attributed to the variation of the IRB / SA ratio.

Should this interpretation linked to the structural differences between EU and US markets be confirmed, the consequences would be major : the CET1 ratios of the European banks would not only drop significantly when Basel 4 comes into force but this unlevel playing field due to the OF would continue going forward with new credits.

The Basel Committee report provides some further useful information:

- US banks rely on internal models more often than their European counterparts do.
- Detailed tables highlight strong similarities between European and US banks. In the case of corporates financing, a major source of international competitiveness, the IRB / SA ratio is 51% in the EU versus 52% in the USA.
- The BCBS report clearly specifies that it compares the impacts of Basel 4 <u>net of any additional capital requirements by supervisors</u> (*"figures do not show supervisor-imposed capital add-ons").*

International standards must above all respect the principle of "same risks - same risk weight" to ensure a level playing field amongst different jurisdictions.

A striking characteristic of the Basel output floor system is the worldwide fungibility of its application.

- For instance, a sale of real estate loans in the US will free US banks from the OF requirement for their corporate and retail operations in the EU.

- For a corporate credit, the risk weight of most banks in the world will be subject to an OF requirement of up to +44% through a risk weight that would be raised from 48% to 69%. This arbitrary rate increase would not apply to US banks.
- For retail banks, the OF requirement would go as high as a doubling of the capital charges. Thus, for example, using the above data for mortgages, European banks would have a marginal capital cost of 26% (35.5% * 72.5%), higher than the 20.5% (without the OF) of US banks.

The EBA has declared that "the Floored RWAs will be the new metrics"[9] but this does not seem to be the case for all banks.

The EU must act on the output floor when transposing the Basel 4 agreement.

All this seems to be a cost far too high for an harmonization of global standards that aims at ensuring an international level playing field which in reality is not one. European banks will sustainably have to absorb this heavy impact of the output floor. It is the competitiveness of the European financial sector that will be at stake under Basel 4, with no justification from a financial stability perspective.

Given the potential level playing field challenge, it seems necessary, at the very least, to ensure that all the conditions for a fair competition are met in the EU. A deep and comprehensive analysis of the output floor impacts on European banks and the EU economy in particular is needed before transposing it. At the same time, Europe ought to review the methods of calculating the output floor to reduce the unjustified negative impact for European banks (backstop option, carve-out of the real estate loans under certain strict conditions, carve-out beyond the minimum requirements of own funds etc ...). The Basel 4 framework is expected to become the "ultimate" standard international regulation. Vigilance is needed more than ever: the economic issues and the unintended consequences are very sensitive and would be harmful to the European economy. It would be quite paradoxical for US banks to develop products and activities on the European market that are more attractive and more profitable (higher ROE) than those developed by their European counterparts.

[9] Hearing of July 2

Annex

Changes in Tier 1 MRC at the target level due to the final Basel III standards — Table 4

	Number of banks	Total		Risk-based requirements						Leverage ratio
				Total	Of which:					
		With MR	Without MR		Credit risk[1]	CVA	Market risk	Op risk[2]	Output floor[3]	
Group 1 banks	80	5.3	1.7	6.8	–0.7	1.8	3.5	–0.6	2.8	–1.5
Of which: Europe	32	21.3	17.4	25.7	4.1	4.7	3.3	4.7	8.8	–4.4
Of which: AM	16	1.5	–6.3	1.5	0.0	0.7	8.3	–5.2	–2.2	0.0
Of which: RW	32	–2.7	–3.4	–2.3	–4.3	0.6	0.7	–1.2	1.9	–0.4
Of which: G-SIBs	28	5.7	1.5	5.9	–0.4	1.6	4.1	–0.9	1.5	–0.2
Group 2 banks	67	9.0	8.3	15.9	7.8	1.0	0.6	1.3	5.2	–7.0

[1] Change in MRC due to the revised standardised and IRB approaches, including securitisation. [2] Change in MRC due to revised operational risk framework. Figures may not show supervisor-imposed capital add-ons. Therefore, increases in MRC may be overstated and reductions may be understated. [3] Net of existing Basel I-based floor according to national implementation of the Basel II framework.

Source: Basel Committee on Banking Supervision.

Banks constrained by different parts of the framework[1], by region

Group 1 banks, in per cent — Table C.73

	Europe		Americas		Rest of the world	
	Current	Final	Current	Final	Current	Final
Risk-based capital	41.4	20.7	37.5	62.5	71.9	46.9
Output floors	0.0	41.4	37.5	6.3	9.4	34.4
Leverage ratio	58.6	37.9	25.0	31.3	18.8	18.8

[1] Europe includes 29 banks, the Americas include 16 banks and the rest of the world includes 32 banks.

Source: Basel Committee on Banking Supervision.

Standardised approach risk weights under the current rules and the final Basel III standards, by region

Group 1 banks, in per cent — Table C44

	Europe		Americas		Rest of the world	
	Current	Final	Current	Final	Current	Final
Sovereign	7.9	7.9	8.1	8.2	8.6	8.6
Bank	16.1	20.6	34.1	26.8	27.2	54.0
Covered bonds	18.3	17.1	25.3	10.4	21.5	14.7
General corporate	93.2	95.1	96.1	91.8	92.7	94.4
Corporate SME	93.1	85.9	92.9	85.6	91.5	84.0
Specialised lending	99.3	102.9	81.9	101.4	94.0	102.1
Equity	207.9	265.0	99.3	215.0	550.2	295.0
Subordinated debt	151.5	190.4			108.1	143.9
Equity investments in funds	92.1	148.8	176.1	206.1	149.8	158.0
Retail	71.5	74.3	87.6	80.7	76.6	82.7
Real estate (total)	46.6	49.8	69.6	56.1	62.0	61.8
General residential real estate	37.1	35.5	48.6	35.0	46.9	44.6
General commercial real estate	58.4	68.8	100.0	106.8	94.9	91.1
Income-producing residential real estate	64.6	68.3	77.8	37.8	54.2	44.9
Income-producing commercial real estate	69.3	88.0	101.4	83.3	100.0	97.3
Land acquisition	104.6	136.7	85.7	118.6	102.2	121.6
Failed trades	126.3	126.3	117.1	117.1	274.1	274.1
Other assets	68.8	68.6	41.9	41.3	25.1	24.8
Defaulted	110.6	114.5	106.0	112.8	89.2	93.4
Total	41.4	43.6	60.0	57.5	37.3	40.4

Source: Basel Committee on Banking Supervision.

IRB approach risk weights under the current and the final Basel III standards, by region

Group 1 banks, in per cent — Table C50

	Europe			Americas			Rest of the world		
	Contrib. to total RWA	Current	Final	Contrib. to total RWA	Current	Final	Contrib. to total RWA	Current	Final
Large and mid-market general corporates	38.5	48.5	48.3	36.7	51.1	47.6	43.0	62.9	53.7
Specialised lending	7.4	45.7	51.4	6.9	65.8	62.6	5.3	78.1	65.7
SME treated as corporate	9.6	46.2	48.3	3.9	74.7	71.9	19.7	79.5	65.9
Financial institutions treated as corporates	2.7	26.0	29.0	5.0	38.5	39.0	1.2	34.9	37.4
Sovereigns	2.7	4.9	4.9	5.2	6.8	6.7	0.5	1.3	1.3
Banks	5.7	19.6	28.8	4.5	29.1	29.4	3.4	25.4	27.5
Retail residential mortgages	12.6	12.8	12.4	9.2	22.1	20.5	12.0	25.8	23.5
Other retail	8.5	31.0	34.6	5.3	45.2	42.3	4.0	39.0	38.2
Qualifying revolving retail exposures	2.1	30.1	30.5	9.1	36.3	34.4	2.2	28.3	28.2
Equity	7.6	299.8	257.2	4.0	116.8	185.7	5.2	197.1	251.2
Equity investments in funds	0.2	241.1	327.9	1.0	93.2	143.6	1.0	198.2	192.0
Eligible purchased receivables	0.1	20.1	24.6	0.2	32.3	32.1	0.4	37.7	37.5
Failed trades and non-DVP transactions	0.0	33.2	33.2	0.2	26.8	27.1	0.0	118.4	132.0
Other assets	2.4	62.3	59.6	8.9	45.5	41.4	2.0	129.0	129.3
Total	100.0	28.5	29.5	100.0	33.7	33.0	100.0	44.0	39.3

Source: Basel Committee on Banking Supervision.