

Single Rulebook Q&A

Question ID	2019_4859
Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit risk
Article	164
Paragraph	4
Subparagraph	-
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	Not applicable
Date of submission	07/08/2019
Published as Final Q&A	18/02/2022
Disclose name of institution / entity	Yes
Name of institution / submitter	European Central bank
Country of incorporation / residence	Germany
Type of submitter	Competent authority
Subject matter	Range of application of the LGD regulatory floor for the calculation of own funds requirements at individual and consolidated levels
Question	Shall the LGD regulatory floor be applied at the territory level of the Member state to exposures secured by property located in the territory of that Member state (Article 164(7) CRR) for the calculation of own funds requirements at any level, i.e. individual and/or consolidated level?
Background on the question	It is unclear whether the LGD regulatory floor shall be applied at territory level of the Member state to exposures secured by property located in the territory of that Member state for the calculation of own funds requirements at any level, i.e. individual and/ or consolidated level. For instance, a credit institution has received permission to use the IRB approach for its mortgages portfolio at individual (subsidiary) level and consolidated level. One mortgage portfolio (i.e. in a subsidiary in an EU Member state) has an average LGD below 10%. So far, credit institution applied LGD regulatory

floor at the individual level and then reported the same local RWA at consolidated level. It is unclear whether the credit institution could continue applying the floor at the individual level for individual capital requirements but then also applying the floor at consolidated level across several mortgage portfolios across several legal entities and jurisdictions for calculating own funds requirements at consolidated level. As in the other jurisdictions, the average LGDs are above 10%, applying the LGD regulatory floor at consolidated level significantly reduces the total RWA and creates discrepancy between RWA at individual and consolidated levels for the mortgage portfolio with the low average LGD. In doing so, the Supervised Entity would align the scope of application of the floor with the scope of consolidation.

Final answer

According to Article 11(1) of Regulation (EU) No 575/2013 (CRR) “*parent institutions in a Member State shall comply, to the extent and in the manner prescribed in Article 18, with the obligations laid down in Parts Two, Three, Four, Seven and Seven A, on the basis of their consolidated situation, with the exception of point (d) of Article 430(1)*”. The rules governing the LGD regulatory floor under Article 164 CRR belong to Part Three of the CRR and therefore they fall within the scope of Article 11 CRR. Having said that, for the purpose of Article 164(4) CRR, the exposure-weighted average LGD has to be calculated by taking into account all respective retail exposures secured by residential property or commercial immovable property and with neither benefiting from guarantees from central governments of the institution, irrespective of whether it is calculated on individual or consolidated level and irrespective of whether the floor in terms of Article 164 (6) CRR has been adjusted.

According to Article 164(6) CRR, for retail exposures “*the authority designated in accordance with paragraph 5 of this Article shall periodically, and at least annually, assess whether the minimum LGD values referred to in paragraph 4 of this Article are appropriate for exposures secured by mortgages on residential property or commercial immovable property located in one or more parts of the territory of the Member State of the relevant authority*” and may eventually set higher minimum LGD values for those retail exposures located in one or more parts of the territory of the Member State of the relevant authority. Moreover, “*those higher minimum values may also be applied at the level of one or more property segments of such exposures*”.

Furthermore, according to Article 164 (10) CRR “*the institutions of a Member State shall apply the higher minimum LGD values that have been determined by the authorities of another Member State in accordance with paragraph 6 to all their corresponding exposures secured by mortgages on*

residential property or commercial immovable property located in one or more parts of that Member State”, and thus irrespective of the Member State in which the institution has been authorised.

Hence, according to Article 11(1) CRR in conjunction with Article 164(10) CRR the parent institution must apply the higher minimum LGD values that have been determined by the relevant authority in a Member State pursuant to Article 164(6) CRR to also meet its obligations on the basis of its consolidated situation.

Therefore, in addition to the minimum LGD values referred to in Article 164(4) CRR (the standard floor) which apply for all retail exposures irrespective of the Member State where the exposures are located where a Member State’s relevant authority increases the floor for retail exposures located in one or more parts of the territory of that Member State or for one or more property segments of such exposures, this higher floor must be applied to the portfolio of mortgages on properties located on this part/those parts of that Member State or belonging to this property segment/those property segments, without taking into account the exposure-weighted average LGDs for retail exposures located in other parts of the territory of that Member State and of other Member States.

Link

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European Banking Authority, 02/07/2022
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