Public Hearing: Consultation on RTS on equivalent legal mechanism for unfinished property

EBA Prudential Regulation and Supervisory Policy

Virtual meeting, 11 June 2024
Ground rules for this virtual meeting.

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<th>Mic and video off</th>
<th>Questions/comments?</th>
<th>Slides on EBA website</th>
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<td>Please keep yourself muted and the video off while listening.</td>
<td>Please use the chat or raise your hand to ask for the floor.</td>
<td>The presentation used today will be made available on the EBA’s website after this hearing.</td>
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EBA Roadmap on CR mandates under CRR3
EBA Roadmap – Overview CR

Phase 1
Implement the critical elements of the SA and review targeted elements of the IRB frameworks
This group mostly covers mandates related to the SA, with the notable exception of a review of the frameworks on the definition of default and on the categorisation of model change.

Phase 2
Specify the treatment of project finance under the SA, start the review of the IRB repair programme products
The mandates mostly relate to clarification on the IRB approach, while on the SA some specifications are provided on the newly introduced specialised lending exposure class.

Phase 3
Complement the IRB repair programme
The key product will be the publication of the guidelines on CCF estimation. This phase also contains various reports assessing specific elements of the Basel III framework in the context of its EU implementation.

Phase 4 and later
Finalise the assessment of the framework
Most of the mandates relate to reports assessing specific elements of the Basel III framework in the context of its EU implementation, with the policy work confirmed to target elements of lower materiality.
## EBA Roadmap – CR Phase 1

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<td>Report to the Commission on the eligibility and use of policy insurance as</td>
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<td>RTS to specify the term “equivalent legal mechanism” in place to ensure</td>
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<td>Guidelines</td>
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<td>Guidelines specifying the terms substantial cash deposits, appropriate</td>
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<td>Guidelines on the definition of default, in particular for diminished</td>
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Legal Basis and Scope of the RTS
Legal Basis and scope of the RTS

**Mandate: Article 124(12)**

_EBA shall develop draft regulatory technical standards to specify what constitutes an “equivalent legal mechanism in place to ensure that the property under construction is completed within a reasonable time frame”, in accordance with Article 124(3)(a)(iii). EBA shall submit those draft regulatory technical standards to the Commission by ... [1 year after entry into force of this amending Regulation]._

**Scope of the CP RTS**

Applies to residential real estate exposures under construction, built around the _three conditions_ of Article 124(12) :

- **Condition 1:** Where a _central government, regional government or local authority or a public sector entity_ involved, exposures to which are treated in accordance with Articles 115(2) and 116(4) of the CRR, respectively, ...
- **Condition 2:** ...has the _legal powers and ability_ to ensure that the property under construction will be finished within a reasonable time frame...
- **Condition 3:** ...and is _required to or has committed in a legally binding manner_ to do so where the construction would otherwise not be finished within a _reasonable time frame_.

03
Baseline vs Alternative Approach
Baseline and Alternative Approach

Two approaches proposed:

- **Baseline** (main text)
  - [Condition 1 changed]: Non-central government, with **Counter-guarantee** provided by government / assimilated entities
  - [Conditions 2 and 3 unchanged]: non-central government has **legal power and ability** + is **required to finish construction in a reasonable time**;

- **Alternative** (consultation box):
  - Non-central government entity responsible for ensuring the **completion within a reasonable time frame**.
  - Private completion guarantees with **safeguards in place**:
    - Mechanism enforced by law in a mandatory manner;
    - Protection provider: institution subject to capital requirements ≈ to banks or insurance
    - minimum level of creditworthiness: RW ≤ 20%.
    - minimum requirements on the guarantee
      - Wide coverage of the construction risk
      - Minimum standards for guarantees as provided in Article 213 - CRR (adjusted for the specific case)
04

Questions for consultation
Questions for consultation 1/3

Practical cases consideration

Possible drawback of Baseline Approach: only a few (none?) practical cases (no central governments providing counter guarantees?)

Q1(a) and Q1(b) practical cases of:
- Central governments or public entities ensuring property completion (CRR original Article 124);
- Entity other than central government ensuring property completion (RTS baseline & alternative approach).

Minimum requirements on the guarantee

Alternative Approach safeguard: minimum requirements in terms of guarantees (not limited to credit worthiness of developer, but also including construction risk).

Q2: Activation of the guarantee rights (legal and practical).

Q4: Alternative mechanisms ensuring recognition of construction risks (beyond the real estate developer's financial difficulties).
Questions for consultation 2/3

Minimum Level of creditworthiness

Alternative Approach safeguard: RW (protection provider) ≤ 20%.

Q3: RW of current protection providers of completion guarantees

Scope of application

Scope of application the equivalent legal mechanism: IPRE and non-IPRE exposures.

Q5: Unique characteristics of IPRE vs. non-IPRE exposures for differentiated requirements.
Empirical assessment of the effectiveness of the equivalent legal mechanism under the Alternative Approach

Q6: Empirical evidence of sovereign intervention outside Europe for unfinished properties.

Q7: Average time for protection provider to step in and complete construction after developer default.

Q8: Historical average loss rates for developers and completion guarantee providers.

Q9: Empirical data related to:
   a) (Number of triggered completion guarantees) / (total number of projects covered by the guarantees)
   b) (Triggered completion guarantees that resulted in completion) / (total number of triggered completion guarantees)
   c) (Triggered completion guarantees transformed into repayment guarantees) / (total number of triggered completion guarantees)
   d) (Cases where protection providers failed to meet obligations due to any deficiency) / (total number of times completion guarantees were granted, specifically in cases where real estate developers defaulted).
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Next Steps
Next steps

13 August 2024
Ends of Consultation Period

Q4
Processing feedback and finalizing the RTS

Q1-Q2
Internal bodies approval
Final Report publication and transmission to Commission

2024
2024
2025
06

Annex
Regulatory Treatment of unfinished RRE

The lending is to a natural person and the immovable property is either a residential property under construction or it is land upon which a residential property is planned to be constructed where that plan has been legally approved by all relevant authorities, as applicable.

Does it satisfy the conditions in Art. 124, para. 3 - point a - point iii – indent 1 or 2?

1) The property is up to four units, is the primary residence of the obligor and the lending is not indirectly financing ADC exposures
2) A central government or assimilated body has the legal powers and ability to ensure that the property under construction will be finished; alternatively, there is an equivalent legal mechanism

Requirements art. 124(2)(e)?

NO

«Whole Loan» Treated in accordance with Article 125(2)

YES

1) The immovable property securing the exposure is the obligor’s primary residence [...];
2) The exposure is to a natural person and is secured by an income-producing residential housing unit [...];
3) The exposure is to associations or cooperatives of natural persons that are regulated by law and solely exist to grant their members the use of a primary residence in the property securing the loan;
4) The exposure is to public housing companies or not-for-profit associations that are regulated by law and exist to serve social purposes and to offer tenants long-term housing.

Art 124(2)(e)

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