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EBA/2019/D/2553

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Opinion of the European Banking Authority on measures in accordance with Article 458 Regulation (EU) No 575/2013

Dear Mr Guersent

On 27 June 2019 the European Banking Authority (EBA) received a request from the European Commission to revise or confirm the EBA opinion on the intention by the Central Bank of Estonia (Eesti Pank) to apply Article 458(2)(d)(vi) of Regulation (EU) No 575/2013 of the European Parliament and of the Council (the Capital Requirements Regulation – CRR). The request was accompanied by additional information provided by Eesti Pank.

The original EBA opinion as approved by the EBA BoS and submitted to the Commission on 15 May 2019[1] concluded that the evidence presented by Eesti Pank was not sufficient to support the suitability and appropriateness of the suggested measure to address the targeted risk. The revised notification (including Eesti Pank's response to the follow-up questions from the Commission) does not provide material grounds to change the original conclusion on the application of Article 458 of the CRR in Estonia.[2]

The background for the decision to maintain the original conclusion is based on the following considerations:

- In accordance with Article 458(2)(c) the designated authority is required to provide relevant quantitative and qualitative justification as to why other possible measures listed in the CRR or the CRD IV[3] cannot adequately address the macroprudential or systemic risk identified, taking into account the relative effectiveness of those measures. The EBA is called to give its opinion, among other aspects, on the compliance with such pecking order.

[1] EBA Op/2019/04

[2] It is acknowledged that the revised notification does no longer mention some of the aspects included in the original notification, which formed part of the original EBA assessment. For example, that the aim of the measure is to ensure a level playing field within the only two IRB banks, and also between IRB and SA banks. The original notification also included that one of the banks has an average risk weight considerably higher than the other IRB bank even though they have similar retail portfolios.

[3] Directive 2013/36/EU (the Capital Requirements Directive – CRD IV)

- The average risk weights on the real estate portfolios differ between the only two IRB banks, although the portfolios are similar. The risk weight floor is in current circumstances only binding for one of them. Apart from this difference between the IRB banks, the EBA reiterates that, in order to ensure the resilience of the bank against risks stemming from the mortgage segment or developments in the Estonian real estate (including the effectivity of relevant buffers), and in line with Article 458(2)(c), the designated authority is required to first ensure whether this concern could have been addressed through microprudential measures. In this case, the microprudential measure could also have had a macroprudential impact.

- In general, one of the aims with Pillar 2 is to cover or address risks that are not sufficiently covered by Pillar 1. Given that the calibration of the floor was carried out using a stress test based on a scenario similar to the macroeconomic shock that affected Estonia in 2008-2009, Pillar 2 guidance could be one of those microprudential measures to address potential risks highlighted by a stress test (as the one used in the calibration of risk weight floor) rather than imposing a floor to the average risk weights.[4] The EBA is cognisant that upcoming changes in CRR II[5] and CRD V[6] will turn Pillar 2 into a purely microprudential tool as of their date of application.

- In Article 180 (1)(a) of the CRR, the PD estimation is required to use long run averages of one-year default rates. In the EBA Guidelines on PD estimation, LGD estimation and treatment of defaulted exposures[7], it is further clarified that the long-run average default rate should be calculated as the average of observed one-year default rates if the historical observation period is representative of the likely range of variability of one-year default rates and, in particular, if the historical observation period contains an appropriate mix of good and bad years. If the period 2008-2009 is considered bad years for the Estonian banking sector (e.g. the period used in the calibration of the risk weight floor), it is likely that the forward-looking element is to some extent considered in the estimation of the long-run average PDs of Estonian IRB banks.

- In order to mitigate the changes in the intensity of macroprudential or systemic risk, the designated authority can, according to Article 458(2)(d)(vi) of the CRR, use stricter measures on risk weights for targeting asset bubbles in the residential real estate. According to the documentation, there is not currently an asset bubble in the Estonian real

[4] According to the EBA GL on common procedures and methodologies for the supervisory review and evaluation process (SREP) and supervisory stress testing, competent authorities should determine and set P2G based on the outcomes of the adverse scenario of the relevant supervisory stress tests, including the EU-wide stress tests performed by the EBA or any other relevant supervisory stress tests performed on a system-wide basis using a multi-factor scenario analysis over a forward-looking horizon of at least two years (either top-down or bottom-up).

[5] Regulation (EU) 2019/876 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 575/2013.

[6] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU.

[7] The Guidelines must apply at the latest from 31 December 2021, but earlier implementation is encouraged. Institutions should engage with their competent authorities at an early stage in order to determine an adequate implementation plan, including the timeline for the supervisory assessment and approval of material model changes, where necessary.

estate market. Nevertheless, the intention with the measure, as defined by the Eesti Pank, is rather to ensure that the two IRB banks hold sufficient own funds to cover systemic risks related to mortgage loans and the residential real estate market. In this case, and also mentioned above, other microprudential measures could have been more efficient.

Yours sincerely

José Manuel Campa

CC:

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