

CP on conditions that competent authorities shall take into account when determining higher risk weights or higher minimum LGD values (Art 124(4)(b) and 164(6) CRR)

Public Hearing

September 1<sup>st</sup> 2015

# Work plan

- ✓ 6 July 2015 EBA published Consultation Paper
  
- ☐ 6 October 2015 End of consultation
- ☐ 1<sup>st</sup> half 2016 EBA to submit the final draft RTS to the European Commission

# EBA mandate

- **Article 124(4)(b) CRR:** “to specify the conditions that competent authorities shall take into account when determining higher risk-weights, in particular the term of “financial stability considerations””
- **Article 164(6) CRR:** “to specify the conditions that competent authorities shall take into account when determining higher minimum LGD values , in particular the term of “financial stability considerations””
- This CP for these draft RTS specify these conditions jointly in one RTS:
  - **Standardized Approach (SA):** setting higher risk weights
  - **Internal Ratings Based (IRB) Approach:** setting higher LGD floors
- Purpose: ensuring consistency in setting of higher risk weights and higher LGD floors, i.e. consistency between capital requirements and level of risk

# EBA mandate

- **Standardised Approach:**

- **35%** risk weight for exposures fully and completely secured by residential property
- **50%** risk weight for exposures fully and completely secured by commercial immovable property

This CP specifies the conditions that competent authorities shall take into account when increasing these risk weights of 35% or 50%, up to 150%.

- **Internal Ratings Based Approach:**

- **10%** minimum LGD value for retail exposures secured by residential property
- **15%** minimum LGD value for retail exposures secured by commercial immovable property

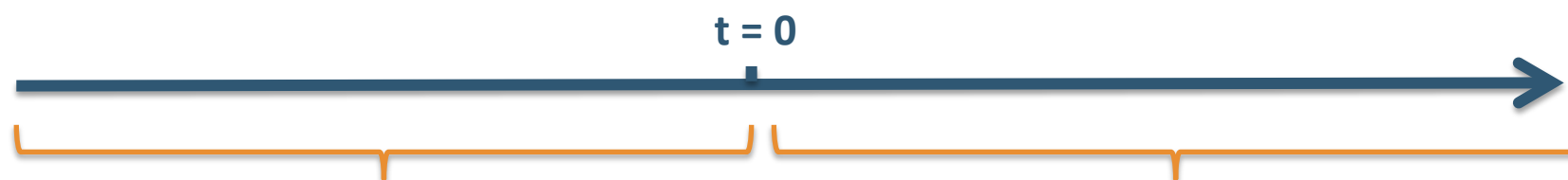
This CP specifies the conditions that competent authorities shall take into account when determining higher minimum LGD values

# Approach in this CP

	<b>Standardised Approach</b> <b>Setting higher risk weights</b> <b>Article 124(2) CRR</b>	<b>Internal Ratings Based Approach</b> <b>Setting higher LGD floors</b> <b>Article 164(6) CRR</b>
1	Assessment of appropriateness of the risk weights (Article 2)	Assessment of appropriateness of the minimum LGD values (Article 5)
2	Financial stability considerations (Article 3)	
3	Other conditions (Article 4)	Other conditions (Article 6)

# Assessment of the appropriateness of the risk weights or LGD floors

- Joint assessment of both **backward-looking** and **forward-looking** elements



## Loss experience/observed LGD

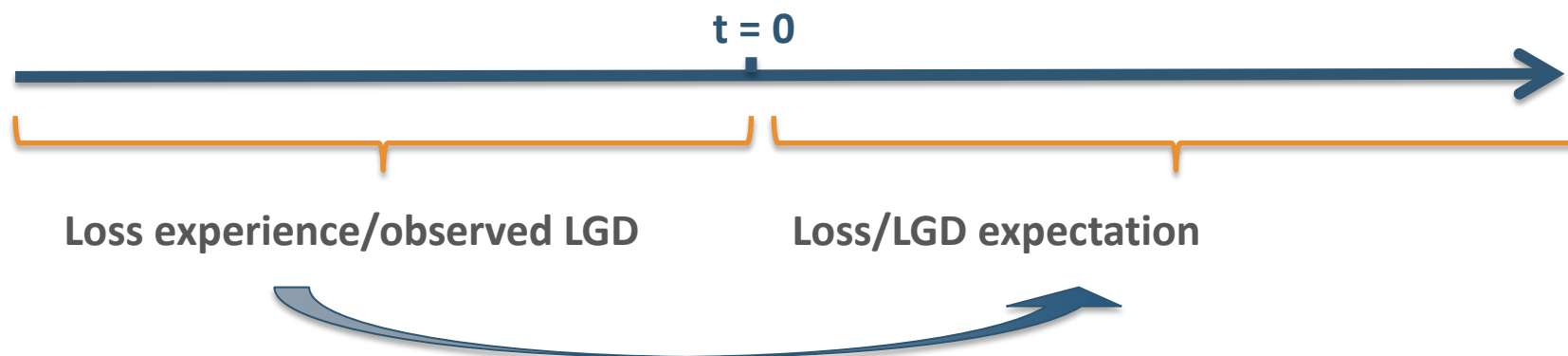
- Expressed as a ratio (%)
- Based on data collected under Article 101 CRR or any other relevant indicators

## Loss/LGD expectation

- Expressed as a ratio (%)
- Reflect forward-looking immovable property market developments

- Indicative benchmarks for the setting of higher risk weights

# Assessment of the appropriateness of the risk weights or LGD floors



- (a) Historical evolution in the immovable property market (prices and volatility)
- (b) Expected evolution in the immovable property market (prices and volatility)
- (c) Time horizon of these forward-looking expectations
- (d) Fundamental drivers of demand and supply (loan-to-value ratio and debt service-to-income ratio)
- (e) Past and present structural and cyclical characteristics of the immovable property market
- (f) Reductions in collateral values due to monitoring of property values and on property valuation

# Approach in this CP

	<b>Standardised Approach</b> <b>Setting higher risk weights</b> <b>Article 124(2) CRR</b>	<b>Internal Ratings Based Approach</b> <b>Setting higher LGD floors</b> <b>Article 164(6) CRR</b>
1	Assessment of appropriateness of the risk weights (Article 2)	Assessment of appropriateness of the minimum LGD values (Article 5)
2	Financial stability considerations (Article 3)	
3	Other conditions (Article 4)	Other conditions (Article 6)



# Financial Stability Considerations

- ... are deemed to exist when refraining from setting higher risk weights or higher LGD floors would have **a material impact on the current or future financial stability** of the financial system, in one of the following ways:
  - One or several G-SIIs or O-SIIs risk being impacted by the loss/LGD expectation
  - Several institutions risk being impacted by the loss/LGD expectation, in such a way that could result to spill-over effects to other exposures
  - Forward-looking immovable property market developments determined by structural characteristics
  
- ./... which may lead to **a significant decline in the resilience of the financial system or a material disruption in the flow of lending to the economy**
- Competent authorities shall take pro-cyclical effects into account

# Approach in this CP

	<b>Standardised Approach</b> <b>Setting higher risk weights</b> <b>Article 124(2) CRR</b>	<b>Internal Ratings Based Approach</b> <b>Setting higher LGD floors</b> <b>Article 164(6) CRR</b>
1	Assessment of appropriateness of the risk weights (Article 2)	Assessment of appropriateness of the minimum LGD values (Article 5)
2	Financial stability considerations (Article 3)	
3	Other conditions (Article 4)	Other conditions (Article 6)

## Other conditions when setting higher risk weights or LGD floors

- When setting higher risk weights or LGD floors, competent authorities shall determine:
  - An **explanation** as to why increasing the risk weights/LGD floors is deemed to mitigate the financial stability considerations
  - An **explanation** as to why the risk weights/LGD floors are increased in a way that ensures correspondence between
    - the higher risk weight and the loss expectation
    - the higher LGD floor and the LGD expectation
  - An **assessment** of the potential pro-cyclical effects of setting higher risk weights/LGD floors on the financial stability considerations

## Conditions related to property segments

- When setting higher risk weights to one or more property segments:
  - A **clear definition** of the property segment
  - A **homogeneous group** of exposures of a **significant size** based on the **type** of real estate exposure or based on the **geographical location**

# Indicative benchmarks

- For exposures secured by residential property:

Loss expectation	Risk weight
Loss expectation < [0.10 - 1.5%]	35%
[0.10 - 1.5%] < Loss expectation < [ x%]	35% - 100%
Loss expectation > [ x%]	100% - 150%

- For exposures secured by commercial immovable property:

Loss expectation	Risk weight
Loss expectation < [0.15 - 2%]	50%
[0.15 - 2%] < Loss expectation < [ x%]	50% - 100%
Loss expectation > [ x%]	100% - 150%

# Overview of questions for consultation

**Question 1:** Do you agree with the three main categories of conditions specified for the setting of higher risk weights (paragraph 1) and the setting of higher minimum LGD values (paragraph 2)?

**Question 2:** Do you agree with the conditions for specification of the loss experience and the loss expectations? Do you agree with the adjustments allowed to be made to the loss experience on the basis of the forward-looking immovable property market developments?

**Question 3:** Do you agree with the indicative benchmarks for the assessment of the appropriateness of the risk weights and to guide the setting of higher risk weights across immovable property markets in different member states as specified in Article 4(3) and 4(4)? What levels of these indicative benchmarks would be most appropriate and why?

**Question 4:** Do you agree with the specification of the term of “financial stability considerations”?

**Question 5:** Do you agree with the other conditions for the setting of higher risk weights? (Please provide your feedback related to the indicative benchmarks (in Article 3(3) and 3(4)) in your response to Question 3 above.)

**Question 6:** Do you agree with the conditions for specification of the exposure weighted average LGD and the LGD expectation? Do you agree with the adjustments allowed to be made to the average exposure weighted LGD on the basis of the forward-looking immovable property market developments? Do you agree that it is not appropriate to set indicative benchmarks for the setting of higher minimum LGD values because of the specificities of national immovable property markets and because of the relationship of the LGD parameter with the other internal model parameters?

**Question 7:** Do you agree with the other conditions for the setting of higher minimum LGD values?

**Question 8:** Do you have any suggestions on the Impact Assessment?

Questions ?



## **EUROPEAN BANKING AUTHORITY**

---

Floor 46, One Canada Square, London E14 5AA

---

Tel: +44 207 382 1776

Fax: +44 207 382 1771

---

E-mail: [info@eba.europa.eu](mailto:info@eba.europa.eu)

<http://www.eba.europa.eu>