

Set up in 1960, the European Banking Federation is the voice of the European banking sector (European Union & European Free Trade Association countries). The EBF represents the interests of some 5000 European banks: large and small, wholesale and retail, local and cross-border financial institutions.

The EBF is committed to supporting EU policies to promote the single market in financial services in general and in banking activities in particular. It advocates free and fair competition in the EU and world markets and supports the banks' efforts to increase their efficiency and competitiveness.

Subject : EBF response to the EBA consultation on draft regulatory technical standards on Credit Risk Adjustments

The EBF welcomes the opportunity to share with the European Banking Authority (EBA) the views of the European banking sector on the consultative document on draft regulatory technical standards (RTS) on the specification of the calculation of specific and general credit risk adjustments according to article 105(4) of the draft capital requirements regulation (CRR).

The EBF and some of its constituents participated in the exchange of views at the public hearing organised by the EBA in its premises of London on 7 September 2012. In that meeting, the EBF and several of its members commented on the main concern of the European banking industry as regards the draft technical standards put forward by the EBA. The concrete proposals of the banking industry follow herewith together with their justifications.

Description of the main problem

In the first place, the problem arises from the separate treatment of specific and general credit risk adjustments (CRA) proposed in the draft CRR, in particular in articles 59, 105, 106, 155, 241 and 261 of the regulation. The current capital requirements directive (CRD) envisages a consolidated treatment of CRA irrespective of its nature, be it general or specific. Therefore, the current situation is as follows:

- Under the standardised approach, both general CRA and specific CRA are subtracted from the exposure value.
- Under the internal ratings based (IRB) approach, the sum of general CRA and specific CRA is compared to the expected loss (EL). In case of shortfall, the amount is deducted equally from tier-1 and tier-2.

The Basel III standards do not envisage any provision as to the potential separation between specific and general provisions in the computation of expected losses and the associated capital requirements.

Notwithstanding this, the draft CRR proposals, as disclosed by the Commission on 20 July 2011, introduce a departure from the Basel III standards by limiting the current CRD treatment to the specific CRA.

In the opinion of the EBF, the current CRD treatment makes more sense given that both types of provision are firstly created with charge to the profit and loss account thus they both reduce the amount of available core equity tier-1.

By and large, provisioning practices in Europe result in specific CRA greater than the expected loss best estimate (ELBE). The incentive to keep the current practices would be eliminated if the separation is put in place.

Besides the abovementioned rationale, the split of general CRA and specific CRA would give way to a new source of disparity among Member States because the current practices as to the constitution of provisions are, in practice, divergent across countries. It goes without saying that the constraint imposed by the separation of provisions would bring about further divergence across the board as it is known that provisioning policies differ substantially across Member States. The worst thing is that the separation of provisions would exacerbate the difference between countries by imposing a more restrictive requirement to banks which are actually subject to the most conservative provisioning practices.

As a matter of example, if the specific CRA exceeds the EL for exposures in default and, at the same time, there is a shortfall of (the sum of) specific and general CRA compared to the expected loss of non-defaulted exposures, then the firstly mentioned excess will count as tier 2 capital whilst the latter shortfall will be deducted from common equity tier-1.

The EBF understands that the situation explained above should ideally be resolved by amending the level 1 text (the CRR). For this reason, the EBF proposal to maintain the current CRD joint treatment of provisions will be shared with the Commission at the same time. Nevertheless, the EBF proposes that the EBA takes into consideration the problem described.

Against this background, the EBF proposes an amendment to the draft RTS and several amendments to six articles of CRR.

Proposed amendment to draft RTS

The amendment to the draft RTS consists in the deletion of article 5 paragraph 3 as it contributes to create the abovementioned problem by further developing the text of article 155 of CRR.

Proposed amendments to CRR

The proposed amendments to CRR in order to restore the current CRD treatment, which is compliant with the Basel III standards, are the following:

Article 59 of draft CRR	
<i>Tier 2 items</i>	
Text proposed by the Commission	Text proposed by the EBF
<p>Tier 2 items shall consist of the following:</p> <p>(a) capital instruments, where the conditions laid down in Article 60 are met;</p> <p>(b) the share premium accounts related to the instruments referred to in point (a);</p> <p>(c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 2 of Title II, general credit risk adjustments, gross of tax effects, of up to 1.25 % of risk-weighted exposure amounts calculated in accordance with Chapter 2 of Title II of Part Three;</p> <p>(d) for institutions calculating risk-weighted exposure amounts under Chapter 3 of Title II, positive amounts, gross of tax effects, resulting from the calculation laid down in Article 154 and 155 up to 0,6 % of risk weighted exposure amounts calculated under Chapter 3 of Title II of Part Three.</p>	<p>Tier 2 items shall consist of the following:</p> <p>(a) capital instruments, where the conditions laid down in Article 60 are met;</p> <p>(b) the share premium accounts related to the instruments referred to in point (a);</p> <p>(c) for institutions calculating risk-weighted exposure amounts in accordance with Chapter 2 of Title II, general credit risk adjustments, gross of tax effects, of up to 1.25 % of risk-weighted exposure amounts calculated in accordance with Chapter 2 of Title II of Part Three;</p> <p>(d) for institutions calculating risk-weighted exposure amounts under Chapter 3 of Title II, positive amounts, gross of tax effects, resulting from the calculation laid down in Article 154 and 155 up to 0,6 % of risk weighted exposure amounts calculated under Chapter 3 of Title II of Part Three.</p>

Article 105 of draft CRR	
<i>Treatment of credit risk adjustments</i>	
Text proposed by the Commission	Text proposed by the EBF
<p>1. Institutions applying the Standardised</p>	

Approach shall treat general credit risk adjustments in accordance with Article 59 (c).	DELETION
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Article 106 of draft CRR	
<i>Exposure value</i>	
Text proposed by the Commission	Text proposed by the EBF
<p>1. The exposure value of an asset item shall be its accounting value remaining after specific credit risk adjustments have been applied. The exposure value of an off-balance sheet item listed in Annex I shall be the following percentage of its nominal value after reduction of specific credit risk adjustments:</p> <p>(a) 100 % if it is a full-risk item;</p> <p>(b) 50 % if it is a medium-risk item;</p> <p>(c) 20 % if it is a medium/low-risk item;</p> <p>(d) 0 % if it is a low-risk item.</p> <p>The off-balance sheet items referred to in the second sentence of the first subparagraph shall be assigned to risk categories as indicated in Annex I.</p> <p>When an institution is using the Financial Collateral Comprehensive Method under Article 218, the exposure value of securities or commodities sold, posted or lent under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions shall be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in Articles 218 to 220.</p>	<p>1. The exposure value of an asset item shall be its accounting value remaining after specific credit risk adjustments have been applied. The exposure value of an off-balance sheet item listed in Annex I shall be the following percentage of its nominal value after reduction of specific credit risk adjustments:</p> <p>(a) 100 % if it is a full-risk item;</p> <p>(b) 50 % if it is a medium-risk item;</p> <p>(c) 20 % if it is a medium/low-risk item;</p> <p>(d) 0 % if it is a low-risk item.</p> <p>The off-balance sheet items referred to in the second sentence of the first subparagraph shall be assigned to risk categories as indicated in Annex I.</p> <p>When an institution is using the Financial Collateral Comprehensive Method under Article 218, the exposure value of securities or commodities sold, posted or lent under a repurchase transaction or under a securities or commodities lending or borrowing transaction, and margin lending transactions shall be increased by the volatility adjustment appropriate to such securities or commodities as prescribed in Articles 218 to 220.</p>

Article 155 of draft CRR	
<i>Treatment of expected loss amounts</i>	
Text proposed by the Commission	Text proposed by the EBF

<p>Institutions shall subtract the expected loss amounts calculated in accordance with Article 154(2)(3) and (7) from the general and specific credit risk adjustments related to these exposures. Discounts on balance sheet exposures purchased when in default according to Article 162(1) shall be treated in the same manner as specific credit risk adjustments. Specific credit risk adjustments on exposures in default shall not be used to cover expected loss on other exposures. Expected loss amounts for securitized exposures and general and specific credit risk adjustments related to these exposures shall not be included in this calculation.</p>	<p>Institutions shall subtract the expected loss amounts calculated in accordance with Article 154(2)(3) and (7) from the general and specific credit risk adjustments related to these exposures. Discounts on balance sheet exposures purchased when in default according to Article 162(1) shall be treated in the same manner as specific credit risk adjustments. Specific credit risk adjustments on exposures in default shall not be used to cover expected loss on other exposures. Expected loss amounts for securitized exposures and general and specific credit risk adjustments related to these exposures shall not be included in this calculation.</p>
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Article 241 of draft CRR <i>Exposure value</i>	
Text proposed by the Commission	Text proposed by the EBF
<p>1. The exposure value shall be calculated as follows:</p> <p>(a) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an on-balance sheet securitisation position shall be its accounting value remaining after specific credit risk adjustments have been applied;</p> <p>(b) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an on-balance sheet securitisation position shall be the accounting value measured without taking into account any credit risk adjustments made;</p> <p>(c) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an off-balance sheet securitisation position shall be its nominal value, less any specific credit risk adjustment of that securitisation position, multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified;</p> <p>(d) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the</p>	<p>1. The exposure value shall be calculated as follows:</p> <p>(a) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an on-balance sheet securitisation position shall be its accounting value remaining after specific credit risk adjustments have been applied;</p> <p>(b) where an institution calculates risk-weighted exposure amounts under Sub-section 4, the exposure value of an on-balance sheet securitisation position shall be the accounting value measured without taking into account any credit risk adjustments made;</p> <p>(c) where an institution calculates risk-weighted exposure amounts under Sub-section 3, the exposure value of an off-balance sheet securitisation position shall be its nominal value, less any specific credit risk adjustment of that securitisation position, multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified;</p> <p>(d) where an institution calculates risk-weighted exposure amounts under Sub-section</p>

<p>exposure value of an off-balance sheet securitisation position shall be its nominal value multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified;</p> <p>(e) The exposure value for the counterparty credit risk of a derivative instrument listed in Annex II, shall be determined in accordance with Chapter 6. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the position.</p>	<p>4, the exposure value of an off-balance sheet securitisation position shall be its nominal value multiplied by a conversion factor as prescribed in this Chapter. The conversion factor shall be 100 % unless otherwise specified;</p> <p>(e) The exposure value for the counterparty credit risk of a derivative instrument listed in Annex II, shall be determined in accordance with Chapter 6. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the position.</p>
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Article 261 of draft CRR <i>Reduction in risk-weighted exposure amounts</i>	
Text proposed by the Commission	Text proposed by the EBF
<p>1. The risk-weighted exposure amount of a securitisation position to which a 1250 % risk weight is assigned may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the securitised exposures. To the extent that specific credit adjustments are taken account of for this purpose they shall not be taken account of for the purposes of the calculation laid down in Article 155.</p> <p>2. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the position.</p>	<p>1. The risk-weighted exposure amount of a securitisation position to which a 1250 % risk weight is assigned may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the securitised exposures. To the extent that specific credit adjustments are taken account of for this purpose they shall not be taken account of for the purposes of the calculation laid down in Article 155.</p> <p>2. The risk-weighted exposure amount of a securitisation position may be reduced by 12.5 times the amount of any specific credit adjustments made by the institution in respect of the position.</p>