

European Mortgage Federation-European Covered Bond Council (EMF-ECBC)

EMF-ECBC comments on the EBA Consultation Paper on Draft Regulatory Technical Standards specifying the types of factors to be considered for the assessment of appropriateness of risk weights under Article 124 (4) of Regulation 575/2013 and the conditions to be taken into account for the assessment of appropriateness of minimum LGD values under Article 164 (8) of Regulation 575/2013

20 July 2021

Preliminary remarks

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC) is pleased to provide herewith its views on the EBA Consultation Paper on “Draft Regulatory Technical Standards specifying the types of factors to be considered for the assessment of appropriateness of risk weights (RW) under Article 124 (4) of Regulation 575/2013 (CRR) and the conditions to be taken into account for the assessment of appropriateness of minimum LGD values under Article 164 (8) of Regulation 575/2013” (further referred to as “the EBA CP”).

The EMF-ECBC would like to highlight that the EBA’s proposals could result, along with National Supervisory Authorities’ actions, in an increase in banks’ capitalisation on exposures collateralised by real estate, with subsequent knock-on effects for the financing of the purchase or renovation of commercial and/or residential property.

The EBA itself in the CP appears indirectly to be concerned about the impact of a possible increase in RW or minimum LGD values in the real estate market when it recommends avoiding “double counting” effects or underlines that *“When considering any changes to risk weights or minimum LGD values, the relevant authority should also be aware of the direct linkages to other parts of the regulation, including the impact of such changes on the calculation of large exposure values, liquidity and capital ratios, reporting requirements and other macroprudential measures”*.

The EMF-ECBC fully agree that “double counting” should be avoided and an increase in Risk weights or LGD values cannot be made with reference to factors included in other tools used to handle systemic risk and financial stability. With the different tools already in place, there should be a requirement in the RTS that authorities would have to disclose the assessments of factors in Article 1 or the conditions in Article 2 that lead to a change in the Risk weights or LGD values. These assessments should be made public together with the Risk weights and LGD values.

Furthermore, we would like to highlight that every specific action in relation to a specific national real estate credit market could undermine the level playing field among different EU Member States. Indeed, the scope of regulation should avoid any actions which increase competitive gaps in the European banking sector.

Answers to the questions in the consultation paper

Question 1. What is the respondents' view on the types of factors to be considered during the determination of the loss expectation for the appropriateness assessment of risk weights under the SA?

In general, in order to identify all relevant elements to assess all the possible implications by the decisions proposed in EBA CP, the EMF-ECBC recommends National Competent Authorities to adopt appropriate consultation processes and impact studies before deciding to set higher RW or imposing stricter criteria than those set out in Article 125 (2) and 126 (2) CRR or setting other minimum average exposure.

Furthermore, we have concerns regarding the EBA CP's suggestion that a longer forward-looking horizon than 3 years "may increase the degree of inaccuracy of the loss expectation." We believe that a longer period could in fact avoid/overcome any possible conjunctural economic effect which can affect the forward-looking assessment of loss expectation. In light of this, we suggest that National Competent Authorities decide annually the length of this period, which could be even longer than 3 years.

From a more technical perspective, considering that in the SA, risk weights on exposures reflect all credit risk factors of that specific exposure (on the borrower and collateral side), we suggest that Competent Authorities also take into account the general level of borrower indebtedness on real estate market. Indeed, the general level of indebtedness could represent an important element to assess borrower capacity to sustain mortgage loans.

Finally, the EBA CP considers "price" as the "base of value" to evaluate the real estate collateral. We would like to point out that the CRR provides that the properties securing mortgage exposures must be evaluated using as "base of value" the "Market value" (MV) or the "Mortgage lending value" (MLV). These bases of value are recognised and defined by International and European Valuation Standard Setters (RICS, TEGOVA, IVSC). Furthermore, in many Member states, public and private databases collect information only on MV and MLV. In this regard, we propose that EBA CP takes into account the concepts of "Market Value" and "Mortgage Lending value" instead of "price" to assess/monitor the value of real estate.

Question 2. What is the respondents' view of the option of considering climate related risks in the determination of the loss expectation where the relevant authority was in a position to perform an appropriateness assessment to one or more parts of the territory of the Member State? What would for the respondent be the benefits and the challenges (costs) of such option?

The EMF-ECBC recognises the relevance of risks related to "climate change" - namely "transition risks" and "physical risks" - and their potential impact on the level of credit risk of banks' portfolios.

Against this background, and with the objective of supporting banks in managing climate change risk and therefore contributing to financial stability, the EMF-ECBC is making very important progress in promoting consistent and comprehensive data collection and disclosure through our Energy Efficient Mortgages Initiative (EEMI) and our recently launched Energy Efficient Mortgage Label, as well as the Covered Bond Label, which together provide banks with important tools to better understand asset quality, and classify and measure credit risk.

The EMF-ECBC recognises that we are at an early stage in relation to considering climate related risk in the determination of loss expectation and that data on these types of risks is still limited and international/national

climate related policies are still uncertain. The same considerations/views are also highlighted by the recent EBA Report “Mapping climate risk: Main findings from the EU-wide pilot exercise” issued on 21 May 2021. We would like to take this opportunity to highlight academic studies conducted by the EEMI and beyond, and the disclosure efforts through the EEM Label that are seeking to deliver a better understanding of market impacts and data evidence.

In this context, and so as not to act prematurely, we propose to consider assessment of climate related risks in the determination of the loss expectation at a time when more data is available in this area.

Question 3. What is the respondents’ view on the conditions when assessing the appropriateness of minimum LGD values (cf paragraph 1 of Article 2)?

Question 4. What is the respondents’ view on the considerations to be taken into account when assessing the appropriateness of minimum LGD values (cf paragraph 2 of Article 2)?

LGD values in IRB banks are approved and supervised by Competent/Relevant Authority. For this reason, it is even more important that Competent Authorities adopt appropriate consultation processes and impact studies before deciding to set higher minimum LGD threshold.

Also in this case, as we mentioned in our response to Question 1, we propose that the EBA CP takes into account the concepts of “Market Value” and “Mortgage Lending value” instead of “price” to assess/monitor the value of real estate.

Question 5. What is the respondents’ view on the use of other data sources?

Question 6. Do respondents want to raise other considerations relevant for the application of this article?