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FBF RESPONSE TO EBA CONSULTATION PAPER ON ASSIGNING RISK WEIGHTS TO SPECIALISED LENDING EXPOSURES UNDER ARTICLE 153(9) OF CRR) (EBA/CP/2015/09)

I- General comment

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorized as banks and doing business in France, i.e. more than 390 commercial, cooperative and mutual banks. FBF member banks have more than 38,000 permanent branches in France. They employ 370,000 people in France and around the world, and service 48 million customers.

The FBF welcomes the opportunity to comment on the EBA's Consultation on Assigning Risk Weights to Specialised Lending Exposures. Please find our main comments below.

We understand this consultation fits not only within the EBA's mandate as per article 153(9) of CRR but also within the ongoing wider revision of the prudential treatment of credit risk and the update of the Basel framework.

As stated in our response to the Basel Committee's consultation on the revisions to the standardised approach to credit risk, we believe a one-size-fits-all approach has certain limitations. The corporate portfolio is one obvious example that a homogenous approach does not work in practice, given the wide variety of counterparties and sectors concerned that are included in this portfolio.

Therefore, an adequately calibrated slotting approach can be a useful alternative to the standardised prudential treatment of specialised lending exposures within the corporate portfolio. Indeed we believe that the prudential treatment of the specialised lending portfolio under the standardised approach according to the slotting approach may better reflect the underlying risk profile of these assets than, for instance, a prudential treatment based on the corporate portfolio risk drivers proposed within the revision of the Standardised Approach for Credit Risk by the Basel Committee.

We would like to take this opportunity to emphasize that specialised lending projects do not imply a higher inherent level of risk when compared to other types of corporate exposures –please see our response to question 2. The EBA's proposed process for taking into account the factors affecting the risk weights of specialised lending exposures may lead to mechanically increase capital requirements on this portfolio as treatment according to category 1 in the risk weights table may de facto never be assigned in practice.

Proposed RWA should better reflect the hierarchy of risks within the various categories of specialized lending. As regards more particularly real estate exposure, we are in favour of splitting this class into two sub-groups: Income Producing Real Estate on the one hand and Acquisition, Development and Construction on the other hand. Generally, we support the introduction of specialised lending sub-portfolios, provided that the proposed risk weighting methodologies are risk-sensitive.

Please find our detailed feedback within our answers to the EBA's questions.

II- <u>Answer to questions related to the consultation</u>

Question 1: What are the operational challenges of using the slotting approach? Is it possible to obtain comparable capital requirements across institutions using the slotting approach? Should the slotting approach in your view be extended to other types of exposures, if yes, which types of exposures would this be particularly relevant for?

As stated in the introduction, an adequately calibrated slotting approach can be a useful alternative to the standardised prudential treatment of specialised lending exposures within the corporate portfolio as it may better reflect the underlying risk profile of these assets.

Question 2: What would be the preferred approach for the combination of the factors into a final assignment to a category? What are the advantages and drawback of either approach? Are both options equally clear or should further guidance be provided? Are there other approaches that could be used to harmonise how the different factors are combined into a final assignment for the risk weight?

We are in favour of option 2, the weighted average approach, for the purpose of combining factors in order to assign a final prudential treatment category. Option 2 allows to adequately take into account the whole spectrum of different scores affecting the decision to assign a category and better reflects the underlying risk of the specialised lending transaction.

We believe option 1 would unduly penalise specialised lending exposures as it may lead to mechanically increase capital requirements on this portfolio. As stated in the introduction, we believe that specialised lending projects do not imply a higher inherent level of risk when compared to other types of corporate exposures.

Question 3: Do you agree with the classification of specialised lending and the descriptions given?

Article 2 of the draft RTS establishes four different classes of specialised lending exposures; we agree with the overall classification and description of these classes.

However as regards real estate exposures, it could be deemed relevant if not necessary to split this particular class of specialised lending into two sub-classes. This would allow credit institutions to distinguish between two very different types of specialised lending projects with specific features.

The draft RTS deals with the issue to a certain extent, yet not in a complete way in our opinion. As a matter of fact, annex 2 of the draft RTS includes a distinction between three different types of real estate exposures identified as “complete and stabilized property”, “complete but not stabilized property” and “construction phase”. This distinction however only applies to the fifth sub-factor (Cash-flow predictability) of Financial Strength. As further explained in our answer to question 6 (please see below), such a distinction could also be relevant for other factors and/or sub-factors.

We would therefore suggest splitting the real estate class and retain two sub-classes: on the one hand Income Producing Real Estate (IPRE) where institutional investors, REITs and similar investment vehicles develop or acquire a real estate property intended to be held for the long run (for example, in order to generate rental income); on the other hand, Acquisition, Development and Construction (ADC) projects which would include running a real estate construction programme with the objective of resale. These two sub-classes are consistent with the categories of real estate exposure put forward by the Basel Committee in its consultative document on revisions to the standardised approach for credit risk.

As a matter of fact, the Basel Committee in its consultative document does make a distinction between IPRE and ADC, assigning to each class a different weight. Therefore since the EBA’s objective, as we understand it, is to ensure that the assessment criteria are tailored to the nature and specificities of different specialized lending exposures, we strongly suggest that such a distinction be made between the aforementioned 2 sub-classes of real estate exposure.

Question 4: Do you agree with these documentation requirements for each specialised lending exposure for which risk weights are assigned according to this Regulation?

No comment

Question 5: Do you have any suggestions or comments on the assessment criteria for project finance?

No comment

Question 6: Do you have any suggestions or comments on the assessment criteria for real estate?

As regards real estate, annex 2 of the EBA’s consultative paper lists, for each factor, the sub-factors and criteria against which real estate exposures shall be assessed.

Following our answer to question 3, we would like to point out that the second sub-factor of Financial Strength and related criteria, namely the DSCR (Debt Service Coverage ratio) and ICR (Interest Coverage ratio) financial ratios, would only be relevant and applicable to IPRE exposures. The DSCR and the ICR reflect the amount of cash-flow generated from the asset and available for the repayment of, respectively, the principal and interests and the interests during the life of the loan. These ratios would not be relevant to all types of real estate exposures. For example, to assess risk weights to be assigned to ADC exposures, credit institutions use specific ratios to evaluate the overall risk of the project.

As far as this particular sub-factor is concerned and in order to address this issue, the EBA could either make a clear distinction between IPRE and ADC exposures and define two sets of criteria applicable to each type of exposure, as per sub-factor (e) regarding cash-flow predictability where three types [1] of exposures are identified. Alternatively, the EBA could introduce in the draft RTS a provision allowing credit institutions, on the basis of their duly documented expert judgement, to replace the aforementioned ratios by internal ratios when the latter prove to be more appropriate to assess exposures' risk profiles. We would welcome this latter option.

Finally, as regards the second factor of annex 2 (Political and legal environment), this factor would always be assigned to the strongest category, namely category 1, for real estate exposures located in France and also most likely in the same category for exposures located in another Member State. As a matter of fact the assessment criteria as currently presented in the draft RTS are only based on legal considerations (e.g. enforcement of contracts, capacity to seize assets within the legal environment). We therefore believe risks related to economic environment should be covered by the first factor (Financial Strength).

Question 7: Do you have any suggestions or comments on the assessment criteria for object finance?

No comment

Question 8: Do you have any suggestions or comments on the assessment criteria for commodities finance?

No comment

Question 9: Do you have any suggestions or comments on the impact assessment?

No comment

[1] Namely "complete and stabilized property", "complete but not stabilized property" and "construction phase".