POLISH BANK ASSOCIATION

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European Banking Authority

Subject: Polish Bank Association response to EBA consultation on Draft Regulatory Standards on conditions that competent authorities shall take into account when determining higher risk-weights, in particular the term of "financial stability considerations" under Article 124(4)(b) CRR and the conditions that competent authorities shall take into account when determining higher minimum LGD values under Article 164 (6) CRR (EBA/CP/2015/12)

Dear Sirs,

Polish Bank Association welcomes the opportunity to comment the EBA consultation paper related to Draft Regulatory Standards on conditions that competent authorities shall take into account when determining higher risk-weights, in particular the term of "financial stability considerations" under Article 124(4)(b) CRR and the conditions that competent authorities shall take into account when determining higher minimum LGD values under Article 164 (6) CRR. In our opinion this document is necessary in order to implement common practice in this area, which will allow to maintain level playing field between banking institutions active in international scale.

The proposed solution is the third way of setting the risk weights for some classes of assets. Behind the standardized approach and the IRB method the proposed solution is the third approach. The risk weights used in Consultative Document are more flexible than in the standardized approach, so this approach is more similar to the IRB method. However, new proposal has also important differences in comparison to the IRB because the risk weighs are not set up by the banks using advanced

method, but it is set up directly by the supervisor. Additionally, risk weights used in proposed method can be set up only between thresholds established by the European Commission and the risk weights are used by all institutions active in the same jurisdiction.

Detailed responses:

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

In our opinion all categories of conditions indicated in draft of RTS are reasonable and they are consistent with general idea of the CRR. However, there are few additional aspects which we would like to mention in this point.

Firstly, the conditions named in the draft of RTS are very general and they leave high level of flexibility in practical use of these conditions by supervisors. The consequence may be big diversity of approach used by each supervisors. The practical application of these conditions will determine our final opinion concerning the adequacy of proposed approach.

Secondly, we have to remember that similar conditions are already named in the existing prudential regulations for banks. These conditions are set up as the ground for setting up additional capital buffer in banks, particularly systemic buffer. We are afraid that the application of similar conditions in two prudential regulations will cause twice negative consequences for the institutions which are strongly engaged in exposures secured by immovable property. This approach can have strong negative impact on scale of changes in the situation on the real estate market.

Thirdly, the level of collateral is not the unique reason of any problems appearing in the mortgage credits. The situation is more complicated and we are not convinced that the higher minimum LGD and higher risk-weights will solve the problem of difficulties occurring sometimes in this area.

Quarterly, indicating the problem of stability of global systemically important institutions as the condition for setting higher risk weights for some classes of assets will cause important challenge for the countries where such institutions have not their headquarters. In that situation the problem of stability for home market is more important and the host country imports in specific way the necessary changes in prudential requirements observed from home country's perspective. This approach may generate additional problem in home-host relations between supervisors and this problem should be taken into account preparing the final version of delegated regulation.

Lastly, there is no sufficient long-term database concerning the situation in bank portfolios of mortgage credits. This situation is particularly the problem in area of commercial properties and probably it is more important in the counties with shorter history of modern banking. We are fully conscious of the need to create the adequate database but we have also to have time to build this database in correct way. We recommend to add the recommendation for setting up the proper database in the financial system.

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

Generally we agree with the conditions indicated in the draft of regulation, however we have to stress the problem of specification of loss expectations in the situation when there is no sufficient database concerning the credit portfolios and no adequate database which describes correctly the situation on the real estate market. In our opinion this problem is additionally higher in area of residential properties where the changes in the state programs or changes in tax deductibility may cause strong changes on the property market.

We would like also to emphasize the problem of correct division of two types of bank exposures: the exposures generated by the credits granted for purchase of immovable property and the exposures generated by the credits secured by the immovable property. Looking at the problem of stability of financial market and the stability of whole economy we are convinced that the supervisors should analyze mainly the portfolio of credits granted for purchase of immovable property and attach less importance to the other credits secured by the immovable property.

We do not support the approach where the lack of sufficient information concerning the actual situation on the real estate market or the credit market may be the sufficient assumption for application of higher prudential requirements. Such database can not be created quickly and the authorities should support this process and not punish the banking sector for lack of database until now.

The idea of changes in the level expected losses as the main premise for setting higher prudential requirements causes for some concerns in banking society. We are not convinced that the level of loss experience may always correctly determine the level of expected losses. There are many different factors which may have the impact on the level of expected losses in banks and making

simple expectation for future only taking into consideration the loss experience from the past can not be treated as adequate approach.

We have also the systemic problem to accept the approach where future expected losses are the ground for setting higher risk weights. In our opinion the level of risk weights should depend on the level of unexpected losses and not the level of expected future losses. The last one should be taken into account by the making adequate changes in process of granting the credits to clients. The capital buffer in bank is maintained mainly to cover the unexpected losses.

We have also to have in mind that credits granted for financing purchase of property are the long-term credits. The life of credit is long and the losses occur mainly in longer horizon. The banks with portfolio of "younger" credits have the lower loss experience and higher quality of credits than banks with "older" portfolio. The specific maturation of portfolio should be taken into account when the additional prudential burdens are to be established.

It is difficult to accept the content of explanatory box in this area. Indicating the quantitative limits of losses for banks in the area which should be treated as domain of qualities' approach is not correct.

Our concerns generate the idea of expected evaluation in immovable property market prices expressed in Article 2 (b) as the precondition for assessment of appropriateness of the risk weight. The expectation of market participants concerning future prices of properties can differ strongly and this factor should be calibrated for prudential regulations in better way. In our opinion some additional requirements concerning the method of assessment of this prediction should be delivered in the RTS. The present draft does not establish any limits in this area and this approach may generate the unneeded concerns.

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?

The differentiation of assessment for immovable property markets in different member states is necessary. The level of development of local market and specific situation on this market in every country should determine the individual approach of banking supervisor.

Question 4: Do you agree with the specification of the term of "financial stability considerations"?

Generally the specification of term "financial stability considerations" is formulated in the proper way. However, some concern may cause the point (a) where the risk of international systemic bank and risk of local active bank are included in the same way. In consequence, the international active bank has smaller chance to be included in term "financial stability considerations" because it has more diversified credit portfolio in comparison to the local bank. This opinion leads us to the conclusion that stronger link should be made between higher risk weight requirements and the future changes in situation on the local market. The banks active on the same local market should have the same prudential requirements granting credits to clients.

We have some fears concerning the inclusion of forward-looking immovable property market development as the condition for application of higher risk weight. This kind of information may be used by market participants and may have strong negative impact on the changes on the property market. The supervisor prediction can be used as the driver to mobilize the activity of speculators and in consequence may make the situation on the property market less stable than without supervisor's prediction. The forecast of supervisor may hence quickly turn out to be true or real situation may occur worse than in situation without the prediction of supervisor.

Other challenge for prudential policy is the application of higher capital requirements when the supervisor expect worse situation on property market in near future. The application of higher risk weights in such moment may act procyclically on development of situation on property market. Hence the supervisors should be very cautious in setting higher requirements in such moment of business cycle.

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.)

Generally we agree with the proposal of Article 4. Our main concern in this area regards the title of the Article. In fact, this Article does not include any other conditions. It delivers rather some explanation concerning the previous named conditions.

Question 6: Do you agree with the conditions for specification of the exposure weighted average LGD and 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?

We agree.

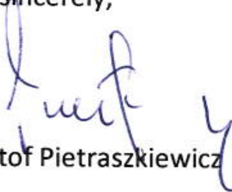
Question 7: Do you agree with the other conditions for the setting of higher minimum LGD values?

The supervisor should explain in detailed way the reason of application of higher prudential requirements. This explanation may have the positive impact on the market and may indicate potential future risk generated in this area. In details, we are interested how the authorities will set up higher LGD values for different parts of credit portfolio in every bank.

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

The specific situation of local property market, particularly residential market, should be stronger included in the RTS as the precondition for setting higher requirements. There are other factors than named in the draft of the RTS which should be included in analyses before any decision concerning implementation of higher risk weights will be made. As the example we can point out that the time necessary usually for recovery of money invested by bank in credit may differ distinctly in every jurisdiction. The time necessary for sale of credit collateral may differ and this factor may have the impact on level of risk generated by the credit portfolio in bank.

Yours sincerely,



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