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Assilea's Position Paper on EBA's Consultation on RTS on conditions for capital requirements for mortgage exposures

Assilea, the Italian Leasing Association, represents the Italian leasing industry. Our members are leasing companies classed into generalist banks, specialist banks, non-banking financial intermediaries, brokers and dealers, long-term rental companies, outsourcers specialised in the leasing market.

The Association's key task is to carry out institutional activities with a view to providing information and assistance to its Members and contributing towards the solution of leasing-related issues at different levels, in different domestic and international venues.

Assilea is member of **Leaseurope** (the European Leasing Federation) and of **ABI** (the Italian Banking Association) and actively participated to the drafting of the Position Papers released by the above mentioned Federation (joint Eurofinas and Leaseurope Position Paper) and Association (ABI's Position Paper).

We thank you for the opportunity offered with this consultation. Italy is the second country in the European ranking statistics for real estate leasing new business. Real estate leasing contracts are fully and completely secured by immovable property and in the leasing contract lessor remains the owner of the asset until the end of the contract. In Italy, real estate leasing is mainly offered on commercial (not residential) premises, thus most of the Italian real estate leasing exposures are weighted at 50%, for the part of the loan that does not exceed the market value of the asset.

Real estate leasing is a very important instrument for SMEs financing and the fact that the lessor maintains the full property of the asset allows to small enterprises, professionals and artisans the access to finance. Therefore it is important to fix rules and benchmarks that do not have any pro-cyclical impact on the economy and that do not have credit rationing effects.

In this paper we propose two benchmarks, in terms of losses stemming from lending collateralized by immovable property, that would be in line with the approach presented in your paper and that, according to our estimates, would adequately reflect a worsening of the real estate leasing market with higher capital requirements in the standardised approach.

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)?

We agree with the three main categories of conditions for the setting of higher risk weights (paragraph 1) and the setting of higher minimum LGD values (paragraph 2). They should include the combined result of the assessment of the appropriateness of the risk weights referred in the CRR and the methodology proposed in the consultative paper, financial stability considerations and the other conditions referred in Art. 4 and Art. 6 of the proposed Regulation.

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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?

We agree with the conditions for specification of the loss experience and the loss expectations, but we do not completely agree on what specified in paragraph 3 of article 2, as it seems redundant with paragraph 2 conditions. Paragraph 1 describes as competent authorities shall determine the loss experience relating to one or more property segments of exposures secured by immovable property based on the data indicators referred to therein, as a ratio of losses stemming from those exposures values; they should determine the losses which they expect to be realised as a ratio of losses expected for those exposures to those exposures values and consider the indicative benchmarks proposed in the consultative Regulation in paragraph 4 (perhaps there is a typing mistake on page 12, lett. c, where paragraph 3 is mentioned instead of paragraph 4).

Paragraph 2 describes as the required adjustments to reflect the forward-looking immovable property market development shall be based on: a) the historical evolution in the immovable property market, b) the expected evolution in immovable market prices and the expected volatility in those prices, including an assessment of the uncertainty around these expectations, c) the time horizon over which property market developments are expected to materialize, d) fundamental drives i.e. loan-to-value ratio and debt service-to-income ratio, e) structural and cyclical characteristics of the immovable property market, f) the impact in terms of increase of total risk-weighted exposure amounts for exposures secured by immovable properties.

According to what assessed in paragraph 3, the competent Authorities may be more conservative when there is high uncertainty around the expectation in immovable market and/or one or several indicators of losses experience of fundamental drivers (i.e. loan-to-value and debt service-to-income ratio) are not available over a sufficient long period.

This disposition risks to double the effects of the prudential adjustments required on the basis of a forward-looking analysis of the market, for the specific issues described in the above mentioned lett. b) and d). In addition, we would like to outline that debt service-to-income ratio is a fundamental indicator for personal lending and household mortgage lending, but not for commercial real estate lending and, as far as we know, in the not residential mortgage sector there are not publicly available statistics about debt service-to-income ratio.

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?

We agree with the two thresholds mechanisms for the standardised approach. Looking at the two possible methods used to calculate the initial threshold (page 23-24 of the document), the first one, based on the Basel 2 formula for the calculation of capital requirements and on the fact that capital would only be needed for absorbing Unexpected Losses (estimated at 4% for a 50% weighting for not residential real estate), seems to be the most appropriate. **We agree with the 2% benchmark of**

expected losses for a 50% weighting of not residential real estate leasing exposures and we would suggest a 6% benchmark as a limit for the 100% weighting of these exposures.

We think that the other method, based on the 0.3% level of losses mentioned in paragraph 3 (a) in Articles 125 and 126 CRR, is too prudential and not appropriate because it was introduced with another purpose, in order to derogate to the requirement according to which the risk of the borrower shall not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources.

In addition, in the second method, the assumption made at the beginning of the EBA's calculation is wrong as in the CRD I and CRD IV package applicable risk weights for RRE and CRE under the Standardised Approach are respectively 35% and 50% instead of 100%. This implies that the 0.105% lower bound of the loss interval proposed for RRE and the 0.15% respective bound for CRE are wrong, and should be 0.3% in both cases.

Notwithstanding of that, in our opinion, it is better to propose an higher benchmark than a wide range of benchmarks that could be approached differently by different National Authorities.

As far as the application of the indicative benchmarks for the assessment of the risk weight, we ask that the increase of the risk weighting is proportional to the increase in the losses, with a "gradual" adjustment process towards higher risks weights. As an example, a level of 2.5% expected losses in the market would not automatically lead to the maximum level of weighting for that class (100%), but only to proportional increase as respect to the 50% risk weighting. Therefore, we ask you to introduce, or to allow National Authorities to introduce, a proportional mechanism for the RE risk weighting assessment.

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

We agree with the principle according to which financial stability considerations shall deemed to exist for setting higher risk weights or higher minimum LGD values and we also agree with the specification of the term of "financial stability considerations" illustrated in Article 3 of the draft regulation.

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.)

We agree with the other conditions for setting of higher risk weights; as far as the indicative benchmarks specified in paragraphs 3 and 4, we estimated that, for the real estate leasing market, a loss expectation above 2%, but lower than 6% is generally appropriate for increasing the 50% risk exposures fully and completely secured by commercial immovable up to but below 100% and that a loss expectation equal to or above 6% is generally appropriate for increasing the 50% risk weight of such exposures to a risk weight ranging from 100% to 150%.

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?

We agree with the conditions for specification of the exposure weighted average LGD and the LGD expectation and with the adjustments allowed to be made to the average exposure weighted LGD on the basis of the forward-looking immovable property market developments. As mentioned referring to the standardised approach, also for the minimum LGD values the competent authorities may be more conservative when (Article 5, paragraph 5, even if probably there is a typing mistake and should be paragraph 3) there is high uncertainty around the expectation in immovable market and/or one or several indicators of losses experience of fundamental drivers (i.e. loan-to-value and debt service-to-income ratio) are not available over a sufficient long period. This disposition risks to double the effects of the prudential adjustments required on the basis of a forward-looking analysis of the market, for the specific issues described in paragraph 2, lett. b) and d).
We also 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?

We agree with the other conditions for the setting of higher minimum LGD values, especially regarding lett. c) requirement to assess the potential pro-cyclical effects of setting higher minimum LGD values in the current stage of the economic cycle on the financial stability considerations referred to increasing the minimum LGD in order to mitigate the financial stability considerations.

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

We agree with the decision to avoid to specify in this Regulation a list of wide set of data indicators that should be considered in the forward-looking analysis of the immovable property market. An eventual list wouldn’t help in pointing competent authorities to the essential variables and wouldn’t be appropriate for any immovable market and segment of market, considering that any national market differs from the others, that residential real estate mortgage market differs from not residential one and that not residential real estate mortgages’ market also differs from real estate leasing market.

As mentioned in answer to question 3, among the two different arguments proposed for the indicative benchmarks for setting higher risk weights, we consider the second one too conservative as not built for the final purpose of this Regulation.