



European Banking Industry Committee

European Banking Federation (EBF) • European Savings Banks Group (ESBG) • European Association of Cooperative Banks (EACB) European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS)
European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope)
European Association of Public Banks (EAPB)

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LDR

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Brussels, 7 September 2009

Re: EBIC Comments on the Commission's Public Consultation regarding further possible changes to the Capital Requirements Directive ("CRD 4")

Dear Mr. Holmquist,

On behalf of the European Banking Industry Committee (EBIC), we would like to thank you for the possibility to comment on the Commission's consultation document issued in July 2009 on further possible changes to the Capital Requirements Directive (CRD).

You shall find attached the EBIC response to the consultation.

We remain at your entire disposal for any question or remark you may have on the issues addressed in our contribution to the Commission's work.

Yours sincerely,

Karl-Peter SCHACKMANN-FALLIS
EBIC Chair

Peter KONESNY
Chair EBIC Working Group on
Supervisory Practices

7 September 2009

**EBIC RESPONSE TO THE PUBLIC CONSULTATION ON THE
COMMISSION SERVICES STAFF WORKING DOCUMENT FROM
JULY 2009 ON POSSIBLE FURTHER CHANGES TO THE CRD
("CRD 4")**

The European Banking Industry Committee brings together European banking associations with a mandate to provide advice, assure a comprehensive consultation of market participants and ensure a representative industry view throughout the process of drafting, adopting, implementing and enforcing EU-financial legislation and thereby provide input for the European institutions and their relevant sectoral committees. It is amongst the declared aims of EBIC to advise the Commission on relevant legislative banking and cross-sectoral initiatives and any developments at Community level affecting the banking and financial services activities associated with the establishment of a European Single Market for financial services.

EBIC has been established by the main banking industry federations: the European Banking Federation (EBF), the European Savings Banks Group (ESBG), the European Association of Cooperative banks (EACB), the European Mortgage Federation (EMF), the European Federation of Building Societies (EFBS), the European Federation of Finance House Associations (Eurofinas) / the European Federation of Leasing Company Associations (Leaseurope), and the European Association of Public Banks (EAPB).

The European Banking Industry Committee (EBIC) welcomes the opportunity to respond to the Commission's public consultation regarding further possible changes to the Capital Requirements Directive (CRD).

EBIC has consistently underlined the importance of the dialogue between EU policy- and rule-makers and the banking industry, as an essential instrument for producing good quality regulation and facilitating its smooth implementation. However, since the beginning of the crisis regulatory reactions often tend to disregard the better regulation principles to which EU institutions had committed. Whilst rapid regulatory action is justified in view of repairing some of the most problematic gaps and shortcomings in legislation revealed by the crisis, this practice of rushed regulatory measures should in no way be generalised. EBIC regrets that it has been applied again in the case of the current consultation. This consultation contains aspects of high relevance for the banking industry, with potential substantial impact and therefore, they should be thoroughly discussed by all stakeholders. **Imposing a shortened consultation period of only about one month during the summer holiday season is unfortunate** Importantly, such urgency is not justified, as most of the topics addressed are either not linked to the crisis (e.g. national discretions) or they represent part of the long-term changes to be brought to the system, which need to be thoroughly thought-over (e.g. dynamic provisioning).

Commission's general questions

During the short consultation period and taking into account the lack of detail concerning some of the proposals made, it was not possible to determine the precise impact of each of the changes proposed by the Commission. However, the banking industry is unanimous in maintaining that **the aggregate impact will inevitably entail increased compliance costs, as well as higher costs in relation to capital**. This in turn will impact on banks lending capacity.

EBIC would like to highlight the importance of **an objective impact assessment to be conducted by the Commission**. This is imperative before putting forward any regulatory proposals, especially as regards the dynamic provisioning and the proposed amendments on residential mortgages denominated in a foreign currency. For the industry it would be particularly difficult to assess the impact of the proposals on dynamic provisioning, especially as long as the parameters (α and β) are not clarified.

In light of the perceived substantial impact of the proposed measures on capital requirements and the likelihood that they reduce banks' lending capacity, **EBIC suggests that their implementation be postponed in consideration of the evolution of economic realities**. More specifically, such implementation should definitely occur after the end of the crisis, but also not too early during the recovery period, when the banking industry will be mostly required to finance economic growth. Furthermore, the finalisation of the Commission's proposals on dynamic provisioning should await the outcome of the work of the IASB. It needs to be observed, finally, that the implementation in Europe of measures which are being prepared at a global level, should also take into consideration the timing of their implementation in the USA.

It needs to be borne in mind, moreover, that the proposed changes are additional to CRD modifications that have already been enacted or proposed by the Commission and that will significantly increase capital

charges such as the 5% retention clause on securitisation, increased risk weights for re-securitisation exposures, increased charges for market risk exposures, potential leverage constraints, forthcoming new (stricter) definition of the concept of “Own Funds”, potential requirements for additional liquidity buffers, etc. We acknowledge the ongoing discussions on reconsidering the overall level of capital. In this context, there is a need for some form of high level coordination to ensure that the cumulative impact of all these measures be proportionate to the risks involved and, moreover, that their aggregate impact and effect on the global economy be carefully assessed and fully understood. A comprehensive analysis of the magnitude of the effects that each of these changes will produce as well of their cumulative impact needs to be made undertaken, preferably by the Basel Committee for Banking Supervision, before moving forward. A piecemeal introduction of new requirements would in any event not be likely to achieve a well-balanced framework.

Commission’s proposals on through-the-cycle loss provisioning

This topic is of utmost importance and constitutes part of the measures to be taken in order to fix the regulatory framework in the long run. Therefore it needs to be discussed in detail and in light of the envisaged changes to IFRS standards. An accurate impact assessment is imperative.

EBIC notes that, so far, it is **not clear from the Commission’s consultation paper how the proposed counter-cyclical measures could achieve their intended objective**. The language used in several parts of the proposal is very confusing; many questions as to how the methodology would work are not answered; it remains uncertain how the proposal would tie in with the accounting regime.

Commission’s proposals on residential mortgages denominated in a foreign currency

EBIC noted with surprise and opposes the proposed amendments aiming to introduce specific capital requirements for residential property loans in a foreign currency.

It would need to be examined if the proposed measure can be reconciled with the Internal Market principles including the principle of free circulation of capital enshrined in the EC Treaty, as well as with international treaties.

The concern that substantial foreign currency lending to households may expose the borrower to foreign exchange risk, can not be **regarded as a prudential issue but rather as a matter for consumer protection pertaining to** responsible lending (and therefore conduct of business rules). Tackling this issue under prudential rules is not appropriate in EBIC’s view. The loan-to value ratio does not indicate the creditworthiness of the borrower. Moreover, the proposal would generate capital requirements that are not proportionate to the underlying foreign-exchange risk. It is in any event neither justifiable nor understandable why, for purposes of capital requirements, the value of residential property should depend on whether the purchase is externally financed in domestic or foreign currency. Furthermore, the proposal introduces a flavour of standardisation into the models of IRB Advanced banks. We are of the opinion that such solutions should not be sought. Instead banks estimations of PDs and LGDs should take into account this issue since through-the-cycle data should be used.

The Commission’s proposal **would trigger unreasonably high capital requirements**. EBIC regrets that the proposals are not supported by relevant data and ignore that in most markets such residential mortgages continue to be granted in a responsible and cautious manner. Institutions which are established in non-euro Member States will in particular be hit by the proposed increase of

capital requirements. The impact of the proposals on some new Member States with small domestic currencies and undeveloped financial markets that rely on foreign exchange flows may be devastating. Increased capital requirements will drastically limit the flow of foreign capital to these countries. The high costs of imposing new regulation where national regulation already exists and has been implemented by lenders in the form of IT systems, creditability assessments etc also needs to be duly considered.

The requirement that banks need to prove, based on a downside sensitivity scenario analysis, that the customer has a sustainable and freely available income in this currency is unreasonably burdensome, particularly as the demand for loans with these characteristics is low. It is also unclear to us if this sensitivity analysis should be performed on a customer level or portfolio level. What is certain is that such a requirement will increase the administrative costs to the detriment of consumers.

Finally, the proposed structure of the additional capital requirement may enforce substantial procyclicality in markets where retail mortgage lending in foreign currencies is common practice. In an economic downturn, real estate prices may fall, as the recent developments in several European countries confirm, pushing loan to value ratios upwards. Such a development may, if the proposal is implemented, result in significant increases of the additional capital required in countries where residential mortgage lending in foreign currencies remains significant. At the same time, this is likely to force the banks concerned to reduce their lending during economical downturns, which in turn will amplify the downturn.

Commission's proposals for the removal of national options and discretions

EBIC has in the past contributed to the work on reviewing the options and discretions in the CRD and has repeatedly expressed concerns about the negative effects caused by many of them. Therefore, during CEBS work on these issues, EBIC has provided a comprehensive view on the various relevant provisions in the CRD, which in our view is generally still valid

EBIC has consistently stressed the importance that the industry attaches to the issue of national discretions. We are particularly concerned about level playing field distortions and the administrative burden mainly resulting from gold-plating in those areas where full harmonisation has been achieved. For this reason, **EBIC welcomes the Commission's intention to abolish gold-plating**. However, EBIC would like also to draw attention that **in certain situations a different treatment is justified by national specificities**. In these latter cases mutual recognition could be agreed.

More specifically EBIC would like to emphasise the following aspects in the Commission's proposals:

- Article 154(6) Directive 2006/48/EC

EBIC maintains that the exemption from the IRB treatment of certain equity exposures should be maintained and turned into a general rule.

- Directive 2006/48/EC Annex VI, Part 1, points 45-60:

EBIC strongly disagrees with the proposed tightening of the relevant loan-to-value conditions. As CEBS pointed out in its Second Advice on Options and National Discretions, the CRD already contains provisions to ensure that real estate collateral is prudently and frequently valued. Indeed, we share CEBS's view that, as long as property values are appropriately revalued, even if higher losses

occur on real estate markets during weaker economic conditions, there would not be an increase in losses for the parts of exposures that are recognised as fully and completely secured by collateral as these will be appropriately reduced. This does not imply that higher losses for the unsecured part of an exposure may not occur under downturn conditions. However, with respect to these unsecured portions of exposures where there is no collateral to take into account, amendments to credit risk mitigation requirements are irrelevant.

EBIC opposes the proposal for introducing a hard test when applying the 35% risk weight to exposures secured by mortgages on residential property and the introduction of limits to the part of the exposure to which the 35% can apply (in points 48(d) and 49 a and b (new) CRD Annex VI, Part 1). Residential property entails, in principle, lower risk than commercial real estate, as well as a lower value fluctuation. The introduction of a hard test for the high-volume business involving residential property would impose on institutions an immense administrative burden, which is likely to spill over into tighter credit conditions. On the contrary, no supervisory added value can be identified.

Residential real estate markets are different from one Member State to another: some are more speculative whilst others are more conservative. They differ in their shares of fixed and variable interest loans, average loan-to-value ratios and many other factors. **A unique loan-to value figure across the EU would, therefore, not be appropriate.** We would prefer maintaining the current wording in point 48 (d): “the value of the property exceeds the exposures by a substantial margin.”

The **envisaged tightening of the limits applicable to exposures secured by commercial mortgages (40% of the market value and 50% of the mortgage lending value) cannot be accepted** (point 55 CRD Annex VI, Part 1). The rates of value fluctuation are very different in the Member States. This is valid for both residential and commercial real estate.

EBIC opposes the proposal for introducing a hard test as a condition for the preferential treatment of exposures secured by commercial real estate (point 53a new). Non-compliance with hard tests would result in a 100% risk weight of commercial mortgages, thus fully ignoring the diversity of commercial property markets and the risk mitigating effect of the mortgage security. This could particularly produce adverse effects on the funding of SME’s in the European Union. Instead, qualitative criteria shall be developed by competent authorities along the lines of point 44a (new) with respect to the existence of well-developed commercial real estate markets.

EBIC supports the replacement of the current supervisory discretion in point 58 with an option for credit institutions. The CRD currently gives competent authorities the possibility to dispense with the condition that the risk of the borrower does not materially rely on the performance of the underlying property for commercial real estate if there are well-developed and long-established commercial real estate markets together with the existing loss rate requirements for commercial real estate (50% of the market value and 60% of the mortgage lending value). However, these conditions should not be tightened as explained above.

Despite all harmonisation efforts in this field, it needs to be accepted that the real estate markets are not sufficiently homogeneous and therefore the current rules should continue to apply. The Commission’s proposal is not based on pertinent reasoning and evidence and therefore is not appropriate.

- Directive 2006/48/EC, Annex VI, Part 1, Point 63

EBIC originally proposed turning this option into a general rule. However, given that the discretion is not applied by 83% of the MS, we **can support proposals of deleting this provision entirely**

only after a long transition period. EBIC suggests that this be **end-2019**, not end 2012 as proposed by the Commission.

- Directive 2006/48/EC, Annex VI, Part 1, Point 64

We have difficulties understanding the rationale regarding the proposed limitation of the application of this provision until end 2012, as **value adjustments of at least 20% and the existence of collateral that fully secures the nominal amount of the outstanding loan facility are strong safeguards**, that clearly lower the exposure at risk and justify lower risk weights. Furthermore, residential properties can be thoroughly valued, allowing a detailed calculation of proceeds from forced sale procedures. EBIC therefore suggests that this **provision should apply as a general rule**, and should be combined with **binding mutual recognition**.

- Directive 2006/48/EC, Annex VIII, Part 1, Point 21

EBIC welcomes the Commission's proposal to transform this discretion into a general rule. Indeed, the recognition of other physical (i.e. non real estate) collateral under the CRD is crucial for leasing, as well as for other forms of secured lending. In a lease, the lessor maintains the ownership of the leased asset throughout the contract term and thus benefits from its security. It should therefore be allowed to recognise this protection as long as the relevant conditions relating to the quality of the collateral set out in the CRD are respected. If local supervisory authorities are satisfied these conditions are fulfilled, we can see no justification for them to disallow the recognition of this collateral. Moreover, we wish to point out that the recognition of other physical collateral is clearly integrated into the Basel II capital adequacy framework and should therefore be included the CRD as a non-discretionary provision.

In addition to the removal of the discretion, the Commission is proposing that the criteria provided in Annex VIII, Part 1, Point 21 be further elaborated as suggested by CEBS in their Second Advice on Options and National Discretions. CEBS's proposal is based on a "quick stock take of the national transposition of this discretion". While EBIC supports all attempts to harmonise the criteria supervisors use to determine whether other physical collateral is eligible, we do however have the following remarks:

- The results of this stock taking exercise have not been shared with industry nor was industry consulted by CEBS on this issue before publication of their second advice. This was however the case for other elements of their proposal.
- For the most part, while providing some clarification on what constitutes a liquid market for other physical collateral, the expansion of the other criteria appears to be superfluous with the existing minimum requirements for the recognition of other physical collateral set out in Annex VIII, Part 2, Points 10 and 11. We therefore question whether they are a real improvement on the current situation.