

EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL’S RESPONSE TO THE EUROPEAN COMMISSION’S CONSULTATION PAPER ON THE REVIEW OF THE EU MACRO-PRUDENTIAL FRAMEWORK

Brussels, 27th October 2016

1.2. SCOPE OF THE REVIEW

1. Do you consider the degree of coordination between the different authorities in the current framework (i.e. ESRB, national macro-prudential authorities, Commission, Council, etc.) appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC)¹ welcomes the European Commission’s new Consultation Document for the review of the EU macro-prudential policy framework.

We support a simplification of the rulebook regarding buffers etc. For example, we are concerned about the latitude accorded to Member States to choose between using either the Buffer for Other Systemically Important Institutions or the Systemic Risk Buffer when addressing institute specific risks.

We also support a closer clarification on the use of pillar 2, which is deployed very differently in the individual Member States.

2. (a) Would you consider appropriate to expand the macro-prudential framework beyond banking? [Please rank your answer from 1 (fully appropriate) to 5 (fully inappropriate), and explain your scoring.] (b) If deemed appropriate, what kind of systemic risks should be targeted and how?

The rise of shadow banking, i.e. non-banks offering banking services, poses an obvious concern from a risk standpoint. In addition, a level playing field is needed in order to ensure fair competition in financial services.

2.1. MACRO-PRUDENTIAL APPLICATION OF MICRO-PRUDENTIAL INSTRUMENTS

3. Do you see a need to strengthen the coordination between designated and competent authorities when using stricter Pillar 1 measures for real estate exposures to address systemic risks? [Please rank your answer from 1 (strong need) to 5 (no need), and explain your scoring.] If you see a need, how should their coordination be strengthened?

There are significant differences between real estate markets in the 28 Member States and, with this in mind, stricter Pillar 1 measures should take account of the risk profile of each domestic market and be tailor made. Rather than strengthening coordination, it is our view that a high level of transparency

¹ Established in 1967, the EMF is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The EMF provides data and information on European mortgage markets, which were worth over 7.0 trillion EUR at the end of 2015. As of October 2016, the EMF has 19 members across 14 EU Member States as well as a number of observer members. In 2004 the EMF founded the ECBC, a platform bringing together covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. As of October 2016, the ECBC has over 100 members across 26 active covered bond jurisdictions and many different market segments. ECBC members represent over 95% of covered bonds outstanding, which were worth nearly 2.5 trillion EUR at the end of 2015. The EMF-ECBC is registered in the EU Transparency Register under the ID Number 24967486965-09.

of the system (which is already the case) is the key element.

2.2. FOCUS AND SCOPE OF ACTIVITY-BASED EU MACRO-PRUDENTIAL INSTRUMENTS

4. Do activity-based instruments in the current framework allow to effectively tackle risks stemming from specific risk exposures? [Please rank your answer from 1 (fully agree) to 5 (fully disagree), and explain your scoring.]

Given the activity-based instruments available as a result of CRR 124 and 164, LGD floors should be deployed with the utmost care and an upper limit should be applied. Such instruments should not be used as an alternative to making adjustments in internal models to address potential inconsistencies.

5. Do you consider a CCB for sectoral imbalances (e.g. in the real estate sector) a useful complementary instrument? [Please rank your answer from 1 (necessary complement) to 5 (useless complement), and explain your scoring.] If yes, how would you see the interaction of this sectoral CCB with the CCB already in place?

We would be concerned about the introduction of a CCB for sectoral imbalances, for very similar reasons to those explaining our concerns regarding the LGD floors outlined in our answer to question 4.

We would like to emphasise that sectoral CCBs, compared to general CCBs, significantly increase the need for sound judgement, of the national competent authorities so as to ensure that the buffers are applied and calibrated correctly.

A sound application of a sectoral CCB would not only depend upon the documentation of adverse effects in an economy (i.e. an asset bubble). Evidence of causalities and dynamics which justify the "pin-pointing" of a certain sector, for which the general costs of business must be increased, would also be required.

6. Do you see a need for adjusting measures targeting risks associated with banks' real estate exposures? If so, please explain your answer.

We see the need for further delineation of the scope and prerequisites for the application of the LGD floors available in CRR 124 and CRR 164.

In this respect, we support the principles-based approach applied in the draft RTS on conditions for capital requirements for mortgage exposures (EBA/CP/2015/12) on which the EBA consulted stakeholders in the autumn of 2015.

We are also encouraged by the prescribed lists of conditions that national competent authorities must take into account. In addition, we are pleased to note that national competent authorities are explicitly required to acknowledge risk-mitigating measures which have already been taken.

While we recognise that overly restrictive conditions for raising risk-weights and/or LGD-values might prove insufficient to deal with changing economic environments, we are concerned about the lack of boundaries in the draft RTS. Specifically, indicative limits on the maximum permitted imposed changes to LGD minimum values should be defined as an analogue to the definition of indicative benchmark for the assessment of setting higher risk-weights.

In addition, it would be challenging to apply ad-hoc macro-prudential measures in a timely, well-proportioned and properly scoped manner. Combined with the principles-based approach, which we support, the link between historical and forward-looking indicators consequently becomes very vague in the draft RTS. There is a risk that it will lead to decisions based on a significant degree of expert judgement. Such heavy reliance on non-quantifiable input must be reduced.

Essentially, non-quantifiable inputs, such as supervisory judgement, override the underlying assumptions of the risk-model and therefore hamper the use of the model as a tool for measuring

risk. As a consequence, excessive use of expert/supervisory judgement will reduce the attention given to the predictive capabilities of a quantitative risk-model.

It is therefore vital that national competent authorities carefully consider the potential effects of raising risk-weights or minimum LGD-values. In this respect, it is crucial to consult with Industry and take account of conflicting outlooks, different theoretical approaches and the specific structures, traditions and risk profiles of the domestic real estate markets in question.

9. Do you see the need to better frame either the focus (targeted risks) or the scope of the SRB (i.e. applicability to the entire stock only or also to subsets of exposures)? If so, please explain your answer.

We believe that authorities in general should document and publish the basis of their decisions in order to ensure transparency. We would therefore welcome a further delineation and specification of this in the revised macro-prudential policy framework.

2.4. ADEQUACY OF EU MACRO-PRUDENTIAL INSTRUMENTS FOR BANKS

17. Do you see a need for developing additional harmonized macro-prudential instruments? If yes, what type of new instrument would you deem necessary and why?

Discussions are ongoing in certain EU Member States about national LTV and LTI limits according to the specificities of the relevant markets. As indicated above, there are significant differences between real estate markets and borrower profiles across the EU and it would therefore be inappropriate to harmonise lending limits of this kind across the Member States.

2.5. ACTIVATION MECHANISMS OF EU MACRO-PRUDENTIAL INSTRUMENTS

19. Do you consider the current hierarchy of instruments ('pecking order') as appropriate? [Please rank your answer from 1 (fully appropriate) to 5 (not appropriate at all), and explain your scoring.]

In our view, the simpler activation process of a macro-prudential instrument should not become the predominant motive to use it. For example, as described in the consultation document there is a significant difference in the extent of activation measures for the instruments in the CRR article 124 and 164 compared with the 'pure' macro-prudential instrument in the CRR article 458, section. 2, d (vi). In our view, it is imperative that such differences must not lead to the result that CRR's article 124 and 164 are used as a substitute for CRR's article 458, section 2, d (vi), if a greater general tightening is needed to decrease the risk level in the financial sector.

3.2. ESRB POWERS

33. How do you assess the instruments and powers of the ESRB? In particular, do you see the need for the ESRB's powers to explicitly include 'soft power' tools with a view to fulfil its mandate?

We believe there is a key role for soft power tools in safeguarding financial stability, not least because they leave more room for flexibility than hard law measures and can be adapted more quickly to economic and market realities.