7th of October 2015

Final EMF-ECBC Response to European Commission Consultation on Impact of CRR/CRD IV on Long-Term Financing

The European Mortgage Federation-European Covered Bond Council[1] (EMF-ECBC) is of the view that the CRR and CRD IV regulatory framework is generally reasonable. Many of the concerns in relation to the proposals for the Regulation and Directive were solved during the legislative process. Banks are focussing today on the final wording of pending regulation under the CRR and CRD IV framework as well as on potential future requirements. In this respect, the EMF-ECBC is concerned that the proposals generally tend not to take account of a risk-based approach.

The EMF-ECBC shares the view of the European Commission that an adjustment of any unintended consequences of the introduction of the CRR and CRD IV is a precondition for the building of a Capital Markets Union (CMU) and the successful revitalisation of the European economy.

Therefore, the evaluation of the impact of the new rules should be as comprehensive as possible and also take into consideration the new capital requirements and other central elements of the new regulation. This also includes the new short-term and long-term liquidity requirements (LCR and NSFR) and potentially binding leverage ratio requirements. Given the scope and complexity of the new legislation, several consequences need to be considered jointly, also with other pieces of legislation, in order to be able to appropriately evaluate the effects of interaction.

Our overall evaluation of the new regulation is as follows:

Capitalisation

1. The increased capital requirements laid down in the CRR have been the driving force of the recapitalisation of the financial sector.

2. Generally the regulatory approach has been "multi-layered" with buffers, leverage ratio requirements and liquidity rules, which may, to some extent, have resulted in several regulatory overlaps. An overall assessment by legislators of this "overlap effect" of multi-layered regulation has not yet been made.

3. Not all the capital requirements in the new regulation are based on banks' risk-weighted assets. For example, a decision to introduce a hard requirement for a leverage ratio will not take into consideration the actual risk. One possible impact is that the competitive conditions of low-risk business models are seriously impaired relative to those of business models with medium to high risk. If the leverage ratio requirement is set so high that the implied risk weight exceeds the average risk weight of a low-risk bank, the bank would end up having to hold more capital than needed when taking into account the actual risk related to its assets. A leverage ratio introduces a skewed incentive structure according to which high-risk lending will be more capital efficient than lending with low risk. The latter will be subject to the leverage requirement, the former with high risk will not.

[1]Established in 1967, the **European Mortgage Federation (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 €6.9 trillion at the end of 2014. In 2004, the EMF founded the **European Covered Bond Council (ECBC)**, which is a platform that brings together covered bond market participants. The EMF-ECBC is registered in the EU Transparency Register under **ID Number 24967486965-09**.

COVERED BOND & MORTGAGE COUNCIL (CBMC)
(EUROPEAN MORTGAGE FEDERATION – EUROPEAN COVERED BOND COUNCIL)
Rue de la Science 14 - 1040 Brussels - Belgium Tel: +32 2 285 40 30 TVA BE 411 583 173
www.hypo.org | emfinfo@hypo.org | ecbcinfo@hypo.org

Regulation

4. Generally, the introduction of new regulatory measures have contributed to a reduction in liquidity and an increase in volatility in the global financial markets – even in formerly very liquid markets, such as the markets for US and German government bonds. One reason is that because of the LCR requirement investors (i.e. bank treasuries) tend to hold large portions of the most liquid bonds, which in reality makes them less liquid. A lack of risk capacity and repo capacity among market participants has also contributed to the reduction in market liquidity. Another factor has been the various purchase programmes by the ECB and the Fed.

5. In several countries, the new liquidity requirements have distorted the relative value across asset classes and between the individual bond series/securities.

6. In addition, the requirements for series sizes in some asset classes have contributed to differentiating the costs within the individual asset class (cliff effect). Price differences resulting from series sizes are problematic from a mortgage finance perspective, as the mortgage security and the statutory framework are basically the same for large and small series. Thus, the series size requirement under the LCR has a direct and undesirable impact on the price structure in some markets for mortgage lending.

7. The long-term liquidity requirement (NSFR) may also impact some asset classes more than others to such an extent that it could be anti-competitive. If the NSFR is introduced in accordance with the recommendations of the Basel Committee, one of the consequences will be that loans secured by mortgages on real estate and funded by covered bonds, all other things being equal, will become significantly more expensive than, say, loans secured by mortgages on real estate that is not funded by covered bonds.

8. A requirement for series sizes under the NSFR, relative to the requirement of stable funding on the part of investors, will also result in price differences on covered bonds with different series sizes.

9. All in all, a number of the new rules are deemed to have, or potentially have, an adverse impact on the availability of cheap funding in the form of covered bonds. This means that the relative competitive advantage of business models based on covered bonds funding is affected in an unfortunate way by the new requirements. This is not compatible with the aim of creating a Capital Markets Union that can foster growth and employment.

Lending to SMEs

10. In our view, the reduced capital requirements on lending to SMEs (SME supporting factor) have the potential to change the limits for SMEs' access to funding. It is therefore important that banks can continue to apply the SME supporting factor.

11. However, the impact of the SME supporting factor has been limited by the uncertainty as to whether it will become permanent. This means that several banks do not factor in the discount in their capital planning and loan decisions. In order for the SME supporting factor to have the desired impact, it has to be a permanent measure.

12. It should also be noted that the extensive requirements for documentation of SMEs in the form of customer data may in practice significantly put a damper on the use – and thus the impact – of the reduced capital requirements on lending to SMEs.

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13. Lastly, it should be mentioned that, at least in the short term, the heavily increased capital requirements have to a large extent overshadowed any reduction of the capital charge for lending to SMEs.

Simplification and proportionality

14. Simplification and proportionality of the entire reporting requirements section of the CRR should be considered. The amount of detailed data is substantial and probably also larger than appropriate for some business models. Even on what was intended to be a simple metric such as the leverage ratio, the reporting requirement is substantial. The reporting scope has reached such proportions that transparency is lost. This also implies that it is virtually impossible to coordinate the reporting in different areas.

Long Term Finance

15. Whilst the promotion of long term finance of the European economy is conceived and promoted as a fundamental pillar of the Capital Market Union, it is eroded by continuing uncertainty as regards the final regulatory regime applicable to lenders. The recast of the Standardised Approach by Basel IV and other pending regulatory issues prevent credit institutions from taking long term positions. As long as banks cannot be certain that their exposures will be profitable over the longer term on the basis of a reliable and stable regulatory framework, they will not extend long term finance. We conceive the current regulatory uncertainty as a major threat to long term lending to the European economy.

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