

European Mortgage Federation (EMF)- European Covered Bond Council (ECBC) Consultation Response July 2018

Response to European Banking Authority's Consultation on guidelines on specification of types of exposures to be associated with high risk under art. 128 of Regulation (EU) n. 575/2013

Brussels, 19 July 2018

1. Introduction

Article 128(3) of Regulation (EU) No 575/2013 (CRR) provides a mandate to EBA to draft guidelines (GLs) specifying which types of exposures are to be associated with particularly high risk and under which circumstances.

Article 128 CRR of Regulation (EU) n. 575/2013 (CRR)

1. Institutions shall assign a 150 % risk weight to exposures, including exposures in the form of shares or units in a CIU that are associated with particularly high risks, where appropriate.

2. Exposures with particularly high risks shall include any of the following exposures:

(a) investments in venture capital firms;

(b) investments in AIFs as defined in Article 4(1)(a) of Directive 2011/61/EU except where the mandate of the fund does not allow a leverage higher than that required under Article 51(3) of Directive 2009/65/EC;

(c) investments in private equity;

(d) speculative immovable property financing.

3. When assessing whether an exposure other than exposures referred to in paragraph 2 is associated with particularly high risks, institutions shall take into account the following risk characteristics:

(a) there is a high risk of loss as a result of a default of the obligor;

(b) it is impossible to assess adequately whether the exposure falls under point (a).

EBA shall issue guidelines specifying which types of exposures are associated with particularly high risk and under which circumstances.

Those guidelines shall be adopted in accordance with Article 16 of Regulation (EU) No 1093/2010.

The proposed Guidelines consist of two sections. The first section aims at clarifying the notion of investments in venture capital firms and private equity as referred to in Article 128(2) CRR, points (a) and (c); the second section specifies which other types of exposures should be considered as high risk and under which circumstances by way of application of Article 128(3) CRR.

In its Consultation Paper, the EBA recognises that the revised Standardised Approach (SA) for credit risk agreed by the Basel Committee on Banking Supervision as part of its Basel III finalisation in December 2017 no longer includes provisions on “higher risk exposures” as the Basel II standard currently does. However, it nevertheless considers it as beneficial to issue these GLs in order to ensure detection of high risk within banks before transposition of Basel 3 in the EU legislative framework and a harmonised and consistent application of Article 128(2) and (3) of the CRR until any revision of these provisions has to be applied by institutions, noting that the Basel Committee only requires the framework to apply from 2022.

2. General Comments

The EMF-ECBC welcomes the EBA consultation on its draft guidelines on specification of types to be associated with high risk under article 128 of Regulation (EU) n. 575/2013 (CRR).

We support the initiative to identify clearly the guidelines/principles to ensure the correct application of art. 128 of the CRR to the exposures that, in the Standardised Approach, are penalised with a risk weight factor of 150%. This risk weight is similar to the one envisaged for the unsecured portion of impaired exposures not hedged by adjustments equal to at least 20% of the exposures themselves.

Being aware that EBA mandate for the proposed Guidelines is attached to Art. 128 (3) CRR and therefore covers exposures other than those referred to in Art. 128 (2) CRR associated with particularly high risks, the EMF-ECBC nevertheless agrees with the need to identify principles/requirements that allow a correct classification of **all** “high risk” exposures and not just those referred to in Art. 128 (3) of the CRR.

The EMF-ECBC supports EBA’s statement in not identifying generally as “high risk” exposures such as “exposures to central governments”, “individual exposures”, “Exposures towards SMEs” and “exposures secured by mortgage on immovable property” as stated in EBA’s Consultation paper (page 14).

3. Guidelines’ Second Section (Section 4.2 of the Consultation Paper): Other types of exposures to be considered high risk exposures

Question 2: Do you agree that the identification of high risk items is particularly relevant for some of the existing exposure classes?

The EMF-ECBC supports EBA’s statement in not identifying generally as “high risk” exposures such as “exposures to central governments”, “individual exposures”, “Exposures towards SMEs” and “exposures secured by mortgage on immovable property” as stated in the section 4.2 of the Consultation paper.

However, EMF-ECBC shares the view that the **following specific real-estate exposures should not** be identified as high-risk exposures under Art. 128 (2) CRR but can be classified and assessed following the criteria in section 2 of the proposed Guidelines (section 4.2 in the Consultation Paper).

- **financing for the construction of immovable properties for which there are purchasers already contractually obligated;**
- **financing for the construction of immovable properties, when a large part thereof has already been sold;**

Similarly, clarification is needed regarding exposures to property construction/development, for which repayment depends to a large extent on the proceeds from future sale of the immovable property to third parties once built or purchased, that are as of today classified as high risk pursuant to Art. 128(2)(d) (*speculative immovable property financing*). The following

exposures should be assessed following the principles and pre-conditions in section 2 of the proposed Guidelines (section 4.2 of the Consultation Paper):

- loans to residential building cooperatives;
- loans to construction firms that build property on the land of the purchaser of future property, on the basis of a work contract;
- financing under leases;
- loans to real estate companies within the scope of consolidation of a banking group and operating for instrumental purposes;

Question 5: Should there be a notification mechanism as proposed in paragraph 6 (b)? Based on the current portfolio of exposures, would you expect that your institution (the institutions represented by you) would need to provide a notification?

According to Par.6(b), Institutions should “*identify any other relevant types of exposures carrying a particularly high risk of loss due to Article 128 (3) CRR and **which are not identified according to paragraph 5 or 6 (a)**. In case such a type of exposure is identified it should be notified to EBA including a brief description of its main characteristics.*”

The EMF-ECBC suggests that institutions should concentrate their analysis on exposures reported in **paragraph 5**, and avoid burdensome evaluation for all the other portfolios where the eventuality of being “high risk” is very unlikely.
