

Final European Mortgage Federation-European Covered Bond Council (EMF-ECBC) comments in context of CRR/CRD Trilogue Negotiations

31 March 2023

Introduction

The housing and broader real estate sectors are key to the EU achieving its goal of reducing greenhouse gas emissions and energy dependency over a medium to short-term horizon. The scale of the investment needed to meet the EU's renovation needs is huge and cannot be achieved by the public sector alone. Today, the EU's mortgage markets equate to almost 50% of EU GDP and therefore have a central role to play in this regard.

Mortgage lending needs to be strategically oriented towards fostering GDP growth and job creation, as well as to defending consumers' disposable income and purchasing power from inflationary trends linked to energy prices. It is therefore of paramount importance to consider the knock-on effects of the Basel III implementation on the housing, broader real estate and energy sectors as well as on the investments needed to support the Next Generation EU, the EU Green Deal and RePowerEU.

With these and other financial stability-related issues at stake, the EMF-ECBC has consistently advocated for a proportionate approach to the treatment of mortgages in the implementation of the final Basel III Framework, particularly taking account of the principle of risk-sensitivity which is considerably challenged by the Output Floor and reflecting the on-balance sheet nature of the European mortgage business.

In the context of the current trilogue negotiations between Member States and the European Parliament, we would like to highlight the following points which we believe are critical in securing the capacity of the mortgage industry to continue financing the real economy and scale-up its financing of the climate transition:

Article 465(5) – Transitional Arrangements

- We welcome the broad alignment of the co-legislators on the application of transitional arrangements for residential mortgage exposures meeting certain conditions. These arrangements are absolutely crucial in order to mitigate the potential for serious systemic and competitive consequences, such as the increase of off-balance funding mechanisms, a shift of mortgage business from regulated to non- or less regulated lenders (growing shadow banking), weakening of long-term funding instruments such as covered bonds and securitisations, and reduce the potentially negative knock-on consequences for consumers.
- We regret however that the transitional arrangements have not been made permanent and are concerned about the time limit placed on any potential extension of these arrangements by the European Parliament. Indeed, there is no more robust and objective a tool for the measurement of the 'real' risk profile of exposures than loss rates ('hard test' requirement in Art. 465). In case of compliance, we do not see convincing supervisory arguments to subject the proposed treatment under Art. 465(5) CRR to time limits.
- Furthermore, the national discretion involved could lead to an unlevel playing field in the Union as not all qualifying Member States may decide to apply the measure.

- ⇒ **We therefore favour the approach taken by the European Commission and supported by the Council to: (1) monitor the use of the transitional arrangements and the appropriateness of the associated risk weights and (2) empower the European Commission to submit a legislative proposal, where appropriate, on the basis of this monitoring and analysis. In our view, this approach is a very appropriate way of mitigating the risks linked to the output floor calculations highlighted above, whilst monitoring and determining the extent to which this treatment is justified on an ongoing basis, subject to the necessary conditions and supervision.**
- In relation to the ‘hard test’ requirement itself, we strongly favour the 6-year loss reporting period proposed by the European Commission and supported by the Council as adequate and proportionate. We do not see a case for an extension of this period by a further two years, as proposed by the European Parliament.
- ⇒ **We therefore strongly recommend maintaining the 6-year loss reporting period as proposed by the European Commission and supported by the Council.**

Article 126(1) – Treatment of Commercial Real Estate Exposures

- We strongly support the proposal of the European Parliament to provide a mandate to the European Banking Authority (EBA) to assess, by December 2027, the appropriateness of adjusting the treatment of commercial real estate exposures.
 - Indeed, under the proposed treatment, IRB commercial mortgage exposures will be subject to an, in our view, incommensurate average capital increase of 44%, representing a material burden for the funding of the real economy. Many economic sectors and their growth capacities will be affected.
 - There is evidence that default rates of commercial mortgages evolve in a similar low range to residential mortgages, justifying the EBA mandate proposed by the European Parliament.
- ⇒ **We therefore strongly recommend integrating this mandate into the final agreement.**

Articles 208 & Article 229 – Property Valuation

- We take note of the different approaches proposed by the European Commission and the co-legislators. It is our view that the Council’s proposals with respect to Articles 208 and 229 represent a proportionate approach to implementing the Basel III recommendations, whilst ensuring the ability of lending institutions to make use of advanced statistical valuation models i.e. the status quo. Indeed, these models are an established tool used by valuers and banks, alongside a variety of other tools, as a valuable source of comparative data in the context of their valuation activities. These statistical models have furthermore proved extremely reliable and in the absence of evidence of deficiencies or weaknesses, it is justified to maintain current practices and therefore the status quo. This is also in the interest of customers, who would be required to allow more physical inspections of their property if the Parliament’s position is adopted. Finally, these statistical models have an important place in a digitalised mortgage business and a cross-border mortgage market.
- We would however strongly recommend that it be made clear in Article 229(1)(d) that the ‘average value’ only has to be determined in the case of increases in value above the value at origination. This is entirely aligned with the European Commission’s intention in its original Proposal in Article 208 and provides appropriate clarity to the article.

- We would finally like to highlight a concern regarding a timing problem in the Council's proposal to provide a mandate to the EBA relating to the term "comparable property". Indeed, the EBA is required to deliver its RTS by 31 December 2026. This time frame combined with the general entry into force of the new rules from 1 January 2025 – and despite the transitional period in the new Article 495f proposed by the Council - means that, during the phase-in period, financial institutions will potentially have to adjust their property values several times which would be extremely burdensome.
 - It should also be clarified in Art 208 or 229 that the cap on upwards valuation only applies to calculations made under the Standardised Approach and not to calculations for Internal Ratings-Based (IRB) models.
- ⇒ **With these considerations in mind, we strongly recommend that the Council's proposals regarding Articles 208 and 229 be retained in the final agreement, subject to the clarifications noted above. We furthermore recommend that the EBA mandate on 'comparable property' not be retained in the final agreement.**

Article 495(f) - Transitional arrangements for property revaluation requirements

- We are concerned by the European Commission's proposal that the requirements will apply not only to newly originated exposures but also to the stock of existing exposures for calculating capital requirements. This would require that the whole stock of exposures would have to be revalued by 31 December 2024, including those properties for which there is no reason for revaluation.
 - We recognise Member States' acknowledgement of this concern and the subsequent proposal to introduce a three-year transition period to mitigate impacts, however, the Industry's concern remains as such a transitional period does not sufficiently address the enormous burden for lending institutions, especially in the retail business of private housing finance.
- ⇒ **We therefore propose that the requirements apply only to newly originated exposures and in case of revaluation. This could be achieved with the following amendment:**

'Article 495e Transitional arrangements for property revaluation requirements

*By way of derogation from Article 229(1), for exposures secured by residential property or commercial immovable property granted before [OP please insert date = date of application of this amending Regulation], institutions may continue to value residential property or the commercial immovable property at or less than the market value, or in those Member States that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions, the mortgage lending value of that property, until a review of the property value is required in accordance with Article 208(3), **and the review of the property value results in a revaluation being necessary.***

Article 400(2)(a) - Large Exposure Exemptions

- We support the amendment proposed by the Council regarding large exposures and the amended reference to covered bonds.
- ⇒ **We therefore strongly recommend integrating this amendment into the final agreement.**