POSITION PAPER

ESBG response to the EBA consultation on RTS on factors considered for the assessment of risk weights and loss given default (LDG) for exposures secured by immovable property

ESBG (European Savings and Retail Banking Group)

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ESBG

Dear Sir/Madam,

Thank you for the opportunity to comment on the EBA consultation on its draft Regulatory Technical Standards (RTS) specifying the types of factors to be considered for the assessment of appropriateness of risk weights and the conditions to be considered for the assessment of appropriateness of minimum loss given default (LGD) values for exposures secured by immovable property. We would like to share with you the following reflections that we hope will be considered by the EBA.

- **Article 1: Types of factors to be considered for the assessment of the appropriateness of the risk weights.**

<u>Question 1:</u> What is the respondents' view on the types of factors to be considered during the determination of the loss expectation for the appropriateness assessment of risk weights under the SA?

Using "expected evolution in immovable property market prices and the expected volatility in those prices, including an assessment of the uncertainty around these expectations" (Article 1(3)(e)) and "expected evolution in meaningful macroeconomic key variables that could affect the solvency of borrowers, including an assessment of the uncertainty around these expectations" (Article 1(3)(f)) seems rather unfeasible for a forward looking horizon of up to three years due to the unpredictability of sudden events (e.g. Corona outbreak in early 2020 and its consequences of the real estate markets that are unclear till today).

Further "other data indicators and sources" (Article 1(3)(i)) shall be specified in advance – otherwise ex-post observations cannot be included in the expectations.

<u>Question 2:</u> What is the respondents' view of the option of considering climate related risks in the determination of the loss expectation where the relevant authority was in a position to perform an appropriateness assessment to one or more parts of the territory of the Member State? What would for the respondent be the benefits and the challenges (costs) of such option?

We believe that including climate risks in the determination of the loss expectation for collateral (mainly real estate assets) would duplicate their consideration. Chronic climate risks have already to be included in the valuation of the collateral assets and are reflected in the market values used for the collateral in the credit decision process. Furthermore, several of these risks (mainly flood, landslide and avalanches) are covered by primary or secondary insurance of the collateral assets.

- **Article 2: Conditions to be taken into account for the assessment of the appropriateness of the minimum LGD values.**

<u>Question 3:</u> What is the respondents' view on the conditions when assessing the appropriateness of minimum LGD values (cf. paragraph 1 of Article 2)?

Pillar 1 risk estimates resulting from internal rating based (IRB) models are not intended to mimic a stress test but should still be appropriate for an economic downturn in accordance with Article 181(1)(b) CRR. In this context, Par. 1 of Article 2 should, in our view, clarify when introducing the concept of "macroeconomic imbalances impacting on LGD estimates beyond the economic cycle" that those are reasonably to be expected and not reflect severe stress scenarios.

<u>Question 4:</u> What is the respondents' view on the considerations to be taken into account when assessing the appropriateness of minimum LGD values (cf paragraph 2 of Article 2)?

In our view, the following considerations should additionally be considered when assessing the appropriateness of minimum LGD values according to Par. 2 of Article 2:

- The calibration of minimum LGD values should not be procyclical in nature as this may ultimately pose a risk to financial stability rather than supporting it;
- Apart from their adequacy for an economic downturn, in accordance with Article 181(1)(a) CRR, LGD estimates are calculated based on long-run averages of realized LGDs with historical observation periods as broad as possible containing data from various periods with differing economic circumstances. Additionally, according to Article 181(1)(e) CRR, LGD estimates considering the existence of collateral shall not be solely based on the collateral's estimated market value and take into account the effect of the potential inability of institutions to expeditiously gain control of their collateral and liquidate it. In this context it should be considered by the authorities in their assessment whether the macroprudential imbalances are already sufficiently reflected in the historical observation period or covered by the general requirements specific to own-LGD estimates, in which case they would already be reflected in the LGD estimation.

As regards Par. 2(e) of Article 2, the purpose of the benchmarking analysis should be better explained, i.e. is intended to identify unwarranted systematics in LGD estimates induced by the specific macroeconomic imbalances rather than by the banks' compliance with legal requirements on LGD estimation. In fact, banks should be encouraged to give priority to the remediation of potential deficiencies in the estimation of risk, while setting macroprudential requirements in such a situation would appear to be the wrong supervisory tool. Otherwise, unintended incentives could be set for the banks, impacting the further development of their underlying IRB models.

- **Article 3: Assessments for property segments or specific parts of the territory – use of other sources of data.**

<u>Question 5:</u> What is the respondents' view on the use of other data sources?

No comments.

<u>Question 6:</u> Do respondents want to raise other considerations relevant for the application of this article?

Due to various ongoing new regulatory reporting requirements (Basel III, Basel IV, response to Covid-19), we would like to avoid any additional new initiatives which increase the regulatory reporting burden on the banking sector.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

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