EBA - European Banking Authority

Copenhagen, 06 October 2015

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| EBA/CP/2015/12 - Draft Regulatory Technical Standards on the conditions that competent authorities shall take into account when determining higher risk-weights, in particular the term of “financial stability considerations” under Article 124(4)(b) CRR and the conditions that competent authorities shall take into account when determining higher minimum LGD values under Article 164(6) CRR |

## Ad-hoc macro prudential measures must be applied with prudence

We welcome the opportunity to comment on the consultation on the draft Regulatory Technical Standards (RTS) regarding the conditions that Competent Authorities have to take into account.

## General comments

We support the principle-based approach applied in the draft RTS. We are also encouraged by the prescribed lists of conditions that competent authorities must take into account. In addition, we are pleased to find that the competent authorities explicitly are required to acknowledge already effected risk-mitigating achievements.

While we recognize that overly restrictive conditions for raising risk-weights and/or LGD-values might prove insufficient for dealing with changing economic environments, we are uneasy with the lack of boundaries in the draft RTS. Specifically, indicative limits on the maximum allowed 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.

It's challenge to apply ad-hoc macro prudential measures in a timely, well-proportioned and properly scoped manner. Combined with the principle-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 considerable parts of expert judgement. Such heavy reliance on non-quantifiable input must be reduced.

Basically, non-quantifiable inputs, such as supervisory judgement, overrides the underlying assumptions of the risk-model - hampering 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 unreliable.

Therefore, we must stress the vital need for the competent authorities to carefully and respectfully consider the potential effects of raising the risk-weights or minimum LGD-values. In this respect a comprehensive attention to industry comments, conflicting outlooks and different theoretical approaches must be mandatory.

Finally, we welcome the requirements for the competent authorities to publicly describe and justify potential changes in the minimum values of LGD.

## Answers to the questions

(also inserted directly in the web-solution)

*Question 1: Do you agree with the three main categories of conditions specified for the setting of higher risk weights (paragraph 1) and the setting of higher minimum LGD values* (paragraph 2)?

No comments

*Question 2: Do you agree with the conditions for specification of the loss experience and the loss expectations? Do you agree with the adjustments allowed to be made to the loss experience on the basis of the forward-looking immovable property market developments?*

*Question 3: Do you agree with the indicative benchmarks for the assessment of the appropriateness of the risk weights and to guide the setting of higher risk weights across immovable property markets in different member states as specified in Article 4(3) and 4(4)? What levels of these indicative benchmarks would be most appropriate and why?*

*Question 4: Do you agree with the specification of the term of “financial stability considerations”?*

No comments

*Question 5: Do you agree with the other conditions for the setting of higher risk weights? (Please provide your feedback related to the indicative benchmarks (in Article 3(3) and 3(4)) in your response to Question 3 above.)*

*Question 6: Do you agree with the conditions for specification of the exposure weighted average LGD and the LGD expectation? Do you agree with the adjustments allowed to be made to the average exposure weighted LGD on the basis of the forward-looking immovable property market developments? Do you agree that it is not appropriate to set indicative benchmarks for the setting of higher minimum LGD values because of the specificities of national immovable property markets and because of the relationship of the LGD parameter with the other internal model parameters?*

We are cautious towards the competent authorities raising minimum LGD values. This is due to the fact, that such an instrument, even if applied with due care, can turn out to have severe and unforeseen consequences to the level playing field of IRB-institutions. As mentioned there should also be an upper limit to the adjustment of the minimum LGD values.

In addition it is imperative, that such instrument will not be used as an alternative to requirements for adjustment to poor performing internal models. For example, would a "muting" of the risk sensitivity of a IRB-model by raising the minimum LGD value be of little use, with potentially quite severe side effects, to a IRB-model which is performing poorly due to model specific details.

We also would like to stress that a substantial increase in the amount of data to be provided by the institutions could be a prerequisite to facilitate the detailed analysis required for competent. This result would be conflicting with the EU Commissions' current objective of reducing the burden on the European financial institutions.

*Question 7: Do you agree with the other conditions for the setting of higher minimum LGD values?*

We welcome the requirements for the competent authorities to publicly describe and justify the expected effects of a potential increase in minimum LGD-values, which eventually should lead to enhanced harmonisation.

 *Question 8: Do you have any suggestions on the Impact Assessment?*

No comments

Kind regards,

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