

EUROPEAN MORTGAGE FEDERATION-EUROPEAN COVERED BOND COUNCIL (EMF-ECBC)¹

Position Paper

24 May 2019

EBA Consultation Paper on draft Guidelines on Credit Risk Mitigation for institutions applying the IRB Approach with own estimates of LGDs

The EMF-ECBC is pleased to provide herewith some specific observations on the EBA's Consultation Paper (CP) on draft Guidelines on Credit Risk Mitigation (CRM) for institutions applying the IRB Approach with own estimates of LGDs. As a general comment, the EMF-ECBC supports the initiative to identify clearly the guidelines/principles to ensure the correct application of CRM in the context of the Advanced IRB Approach (AIRB).

However, we consider some proposed requirements too strict and overly disruptive in relation to current advanced internal ratings-based management strategies and best practices. More specifically, we are concerned about the requirements with respect to the eligibility of physical collaterals which are movable. We are concerned that Article 20 (d) could penalize important markets such as shipping, aviation and automotive.

Eligibility requirements for funded credit protection

Question 2: Do you agree with the proposed clarifications on the assessment of legal certainty of movable physical collateral? How do you currently perform the assessment of legal effectiveness and enforceability for movable physical collateral?

Regarding "movable" physical collaterals (e.g. cars, ships, airplanes, etc.), the EMF-ECBC considers the requirements to: (i) identify, in a "legal opinion", "the set of jurisdictions where the collateral could move during the lifetime of the loan according to the collateral agreement", and (ii) ensure that the collateral agreement is legally effective and enforceable in all of them, to be extremely burdensome.

As a general rule, it is not market practice to require assets to be operated or located within a limited number of jurisdictions. Furthermore, by their intrinsic nature, "movable" physical collaterals cannot be under the strict control of lenders and at the same time lenders cannot limit ex-ante the jurisdiction to which they could move. Rather it is more common to specify in which jurisdictions the asset may not be operated. As such, this requirement appears very difficult to fulfil, with the consequences that this kind of CRM technique will not be recognised. Uncertainty in the scope of application of the regulation could result in a general and significant

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 around 7 trillion EUR at the end of 2017. As of April 2019, the EMF has 16 members across 13 EU Member States as well as a number of observer members. In 2004 the EMF founded the [European Covered Bond Council \(ECBC\)](#), a platform bringing together covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. As of April 2019, the ECBC has 121 members across more than 30 active covered bond jurisdictions and many different market segments. ECBC members represent over 95% of covered bonds outstanding, which were worth nearly EUR 2.5 tn at the end of 2017

penalisation of entire sectors, such as those related to shipping, aviation or automotive, with negative impacts in terms of conditions and access to credit for the firms operating in this market, regardless of the intrinsic risk profile of that firm or operation. Furthermore, the risk linked to jurisdiction to which the property could be moved is usually embedded within LGD models through the geographical drivers, and the haircut internal estimations are more prescriptive for this type collateral.

We therefore propose to delete the requirement in Article 20(d) or, alternatively, to identify a set of prohibited jurisdictions.
