ABI response to EBA consultation on draft Regulatory Technical Standards on the allocation of off-balance sheet items and UCC considerations

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Preliminary remarks

ABI welcomes the opportunity to express views on the Draft Regulatory Technical Standards (RTS) on the allocation of off-balance sheet (OBS) items and UCC considerations under article 111(8) of Regulation (EU) No 575/2013.

ABI acknowledges the importance of identifying clear rules to complement the Level 1 text in order to ensure a level playing field with regard to the treatment of those OBS items for which Annex I does not provide sufficient clarity, and to the identification of factors that may constrain banks' ability to cancel unconditionally cancellable commitments (UCCs).
Anyway, the draft RTS raise serious concerns as to the overly conservative approach proposed. The following comments are therefore aimed to highlight certain aspects of the draft RTS envisaging treatments for OBS items that are deemed not consistent with the underlying risk and/or with the general principles outlined in the Level 1 text.

In general, the draft RTS seem likely to result in a significant increase in the capital charge well beyond the overall balance achieved in the revised Level 1 text (Art 111 and Annex I of the forthcoming CRR3).
It has to be noted that the impact of the proposed rules has not been assessed, neither in absolute terms nor against the objective of 'no significant increase' of the capital requirements following to the banking package. The cost/benefit analysis accompanying the draft RTS does not actually consider any other concrete policy option.
Among other things, it is worth noting that not only the impact in terms of capital requirements should be considered, but also the possible effects stemming from the increase in the exposure associated to OBS items in the context of the large exposures framework.

As to the proposals, generally speaking, in ABI's view:
- the extremely wide formulation of the allocation criteria under Article 1 should be reconsidered in light of the mandate of categorizing items "*with the exception of items already included in Annex I*"
- the factors that may constrain unconditionally cancellable commitments should be clearly identified and pertain to concrete conditions, as the very general and wide-ranging assumptions of the current draft Article 2 would in practice result in disqualifying most UCCs from the classification in bucket 5 according to the CRR, and in any case create regulatory uncertainty.

In the responses to the following answers, the abovementioned points are better explained and accompanied with observations on specific items.

Answers to the questions for consultation

Question 1. Do you have any comment on the non-exhaustive list of examples provided?

As regards the list of examples, ABI notes that options on equity seem to be assigned to bucket 1. It might be worth clarifying that the positions of this kind, if classified in the trading book, are not in scope (as they are treated under the market risk framework).

In addition, it should be clarified that, in accordance with the treatment of other commercial financing products, a 20% factor is assigned to deferred payment letters of credit during the deferral period, even after the acceptance of the documents has been made.

Furthermore, Bucket 4 of Annex I lists:"– *Short-term, self-liquidating commercial letters of credit (L/Cs) arising from the movement of goods, in particular documentary credits collateralized by the underlying shipment, in the case of issuing institution or confirming institution;*" the wording 'in particular' does not limit the eligibility for the 20% CCF to collateralized L/Cs. Therefore, uncollateralized L/Cs are already listed as eligible for the 20% CCF treatment and should not be transferred to bucket 2.

Question 2. Which is the average period of time given to the client to accept the mortgage loan offer?

The period of time between the loan offer by the bank and the finalisation of the contract once the client has accepted vary depending on many aspects, including the type of counterpart (retail vs corporate vs wholesale) and contract. As regards consumer mortgages, the Mortgage Credit Directive allows the borrowers (i.e., natural persons) a right of reflection to examine the credit proposals and compare them with any other proposals. On top of that, there is the possibility that the mortgage is finally not extended in case the acquisition of the real estate property is not finalised by the client.

In light of the above, ABI does not agree with EBA interpretation that contractual arrangements both accepted and not yet accepted by the client should be allocated in bucket 1. This would mean that all mortgage loan offers should be applied a 100% factor, which implies the assumption that every offer made by a bank will be accepted by every client and give rise to a loan. This is not always true, given that the client can accept a proposal from another bank, and that, in any case, the actual drawing is conditional upon the acquisition of the real estate property.

A 100% CCF would therefore not reflect the actual risk that a bank bears before the mortgage is finally drawn and is, therefore, considered disproportionate.

Question 3. What is the applicable percentage that institution currently apply to these commitments?

[no comment]

Question 4. What is the average acceptance rate by the client of a mortgage loan offered by the bank?

[no comment]

Question 5. Do you have any comment on the allocation criteria proposed under Article 1?

Although acknowledging that EBA proposed approach has merits, anyway ABI does not agree with the proposed wording of Article 1 as the scope of the proposed approach is considered too wide, encompassing any financing commitment (not assigned to a bucket according to Annex I) whose possible drawdown does not depend on the materialization of a non-credit event.
In ABI's view the approach envisaged in Article 1 should only address OBS items in the form of contingent commitments, not any form of financing commitments.

This would be more consistent with the general statement in Annex I that commitments not included in the other buckets should be assigned to bucket 3.

In any case, specificities of certain categories of items should be taken into account.

For example, those arrangements, qualifying as commitment pursuant to Article 5(9), where the conditions are still to be satisfied (thus the credit cannot be drawn) and the bank has the possibility to cancel the commitment in case of default or major deterioration in a borrower's creditworthiness, should be assigned to Bucket 5 (10%) as OBS items carrying a similar risk as UCCs. In this regard, it has to be taken into account that, for example in case of complex corporate operations, such phase can take months and that during this period the creditworthiness of clients is carefully monitored.

Moreover, Article 1(2) should be amended in order to better clarify that also the sentence "*Where all the non-credit risk related events have occurred, the item shall be assigned to the bucket 1"* only applies to off-balance sheet items not already included in Annex I, in order not to leave room for misunderstanding that all commitments that are contingent to non-credit risk related events (including those assigned to other buckets according to Annex I) shall be assigned to the bucket 1 once the events have occurred.

Question 6. Do you have any suggestion regarding allocation criteria for buckets 4 and 5?

[no comment]

Question 7. Do you have any comment on the factors that may constrain unconditionally cancellable commitments proposed under Article 2?

The factors identified in the draft RTS as potentially constraining banks' ability to cancel unconditionally cancellable commitments (UCCs) are not deemed appropriate.

The proposed factors are extremely general, and their assessment would be discretionary and highly subjective. This means, on one hand, that it would be in practice very complex to demonstrate their presence or absence. For example, it would be virtually impossible for a bank to demonstrate that possible risk of litigation is excluded with regard to any arrangement (whether unconditionally cancellable or not). This would result in disqualifying a disproportionate amount of UCCs from being assigned to bucket 5. In any case, the inherent subjectivity of the assessment would determine regulatory uncertainty, due to possible criticism from the supervisors about the classification of UCCs, as well as different interpretations (and consequent unlevel playing field) among banks.

Moreover, some of the factors listed in draft Article 2 of the RTS were already identified by the Basel Committee as the reasons for the CCF increase for UCCs from 0% to 10%[1]. This means that such elements are already factored in the Level 1 treatment transposing the Basel standards, hence a further increase of the applicable percentage from 10% to 40% based on the same reasons would represent a double counting.

It is wort reminding that, under the Basel Committee standards, national supervisors are expected to "*evaluate various factors in the jurisdiction, which may constrain banks' ability to cancel the commitments in practice […]*". Hence, in ABI's view, the CRR mandate has to be intended as aimed to identifying possible factors, that may constrain UCCs cancellation, specific of the EU jurisdiction and further to those that the BCBS has already factored in.

In any case, the factors identified should be sufficiently clear and precise, not to give rise to uncertainties in application and to a disproportionate impact in terms of capital charge for UCCs compared to the overall balance achieved in the Level 1 text.

Question 8. Do you have any comment on the notification process proposed under Article 3?

[no comment]

Question 9. For credit institutions:

[1] BCBS consultative document, revisions to the standardised approach 2014: "*Commitments that a bank may cancel unconditionally and at any time without prior notice, or that effectively provide for automatic cancellation due to the deterioration in a borrower's creditworthiness, currently receive a 0% CCF. However, consumer protection laws, risk management capabilities and reputational risk considerations may constrain banks' ability to cancel such commitments. For this reason, the Committee believes a 0% CCF is inappropriate and proposes a new CCF of 10% for such exposures.*"

What is the materiality in your institution of the off-balance sheet items that would fall under the categories “Other off-balance sheet items carrying similar risk and as communicated to EBA” listed in each bucket of Annex I?

Do you identify any specific item you may hold off-balance sheet that is currently classified as “Other off-balance sheet items carrying similar risk and as communicated to EBA” and that may experience a change in bucket allocation based on the criteria listed in Article 1 of these RTS? What would be the related change in the associated percentage as per article 111(2)?

[no comment]