FÉDÉRATION HYPOTHÉCAIRE EUROPÉENNE EUROPÄISCHER HYPOTHEKENVERBAND EUROPEAN MORTGAGE FEDERATION
Av. de la Joyeuse Entrée 14/2 - B-1040 Bruxelles - Tél. +32 2 285 40 30 - Fax. +32 2 285 40 31 - E-mail : emfinfo@hypo.org

Executive Summary

The European Mortgage Federation[1] has a number of comments on the Basel Committee's consultative document and they are summarised below. The comments focus on *mortgage credit related issues*.

Residential mortgage lending should continue to attract lower weightings

The Federation approves of the continued weighting of residential mortgage lending at 50%. Indeed, given the low level of losses and the presence of collateral, European mortgage lenders firmly believe that residential mortgage lending should, in fact, be weighted at lower than 50%.

Committee urged to adopt EU rules on commercial mortgage lending

The Federation notes the possibility to weight commercial real estate at 50% in exceptional circumstances. The revised standardised approach should be easy to apply by relatively unsophisticated banks. However, the current proposals are complicated and unlikely to be workable in most EU countries. The Federation therefore believes that the Committee should adopt its proposals in line with the strict conditions in the existing European legislation on commercial mortgage lending (EU Directive 98/32 modifying the Solvency Ratio Directive) which have been translated into national law by a number of EU countries.

Proposed treatment of rated asset securitisation issues welcomed

The Federation approves of the proposed treatment of rated asset securitisation issues in the Accord.

The Federation favours Option 1 for the risk weighting of bank claims

The Federation calls on the Committee to decide that option 1 – the risk weight for claims on a lender should be one category less favourable than the lender's country of incorporation – should be used for all banks in all countries.

[1] The European Mortgage Federation, based in Brussels, is the leading organisation representing mortgage lenders in Europe. Its members are mortgage banks, savings banks, building societies and

The higher risk categories weighting would triple own fund requirements for mortgage lenders

The Federation is very concerned about, and would welcome clarification on, both the suggestion that the unsecured portion of any asset that is past due more than 90 days must be weighted at 150% and the lack of recognition of mortgage collateral. It makes no sense, in particular, to treble own capital requirements for residential mortgage lending.

Inconsistencies in the revised standardised approach

In the supplement to the Accord, “construction and development loans (e.g. project finance)” are excluded from the possibility of receiving the exceptional treatment for commercial real estate lending under the revised standardised approach. The Federation believes “(e.g. project finance)” should be deleted and would welcome consistency in the definition of commercial real estate between the revised standardised approach and the foundation IRBA.

The Federation proposes a definition to clarify the meaning of project finance exposures in the Accord.

Not enough incentives for mortgage lenders to move to the IRBA

On the internal rating based approaches (IRBA), the Federation believes that much more needs to be done to make them attractive for mortgage lenders. The Federation believes that the proposed calibration of risk weights for mortgage lending (under both retail and corporate exposures) and, in particular, the proposed loss given default figures do not adequately reflect the low level of losses on mortgage lending and the existence of mortgage collateral and other credit risk mitigation techniques.

Maturity should not be an adverse factor in risk calibration

In addition, the Federation considers that maturity should not be an explicit adverse factor in the calibration of risk weights for mortgage lending. The long-term nature of mortgage markets in many European countries promotes stability and discourages volatility in national real estate markets (any punitive treatment of longer maturities would be a disincentive to long-term lending and could increase systemic risk).

Loans to small businesses should be included in retail exposures

The Federation supports the inclusion of lending to small businesses (including small business property lending) under retail exposures and the European Commission’s proposal on the partial use of the IRBA. The Federation believes that the value of a residential

---

insurance companies. Together, they grant over 70% of mortgage loans (residential and commercial loans) in Europe.

mortgage loan should not be used as a factor to determine whether or not such loans are considered to be retail loans. In addition, the Federation is against any unnecessary and counter-productive harmonisation on default since there are differences in the treatment of arrears, defaults and losses by mortgage lenders in Europe.

Second ranking mortgages should be recognised

The Federation notes that a bank should have a first claim on physical collateral and that no recognition will be given for second or subsequent claims. In a number of countries lenders are able to grant second or subsequent mortgages on a property within an established loan-to-value (LTV) framework for that property. Their legal systems give the holders of such mortgages a legal right to carry through a forced sale of the property. The Federation urges the Committee to recognise second and subsequent mortgages in the new Accord.

The Committtee should focus on LTV ratios instead of collateral/exposure ratios

The Federation considers that the loss given default figures (40%-50%) proposed do not adequately reflect the risk reducing nature of mortgage collateral and recommends that the Committee should focus on loan-to-value (LTV) ratios instead of the collateral/exposure (C/E) methodology in the Accord. The LTV ratios are used all over the world to measure the creditworthiness of mortgage lending. The concept of first claim and the C/E methodology means that the holder of a second mortgage would not benefit at all from the collateral held.

Rented commercial property should be recognised in the IRBA

In the revised standardised approach, the 50% weighting is linked to the fact that the property has rental income. In the foundation IRBA, this type of lending is excluded. The Federation urges that the definition of commercial real estate in the revised standardised approach should be incorporated into the definition of commercial real estate in the IRBA.

Rented residential property should be recognised throughout the Accord

This is not the case. In Europe (the Solvency Directive), rented residential buildings are viewed as residential buildings on account of the low risk of such buildings. In addition, rented residential property is included under the 50% weighting for residential property in the 1988 Basel Accord and in the revised standardised approach. No case has been made to erode the current 50% and thus far from making the new Accord more sensitive to risk, in this area, an approach is proposed which is less sensitive to different areas of lending and different risks.

The Federation believes that rented residential buildings should be treated as residential mortgage lending throughout the Accord otherwise there is a risk to a particular subset of rented residential buildings, social residential buildings, of clearly higher own capital requirements with potentially serious economic and social consequences.

Committee should use the concept of market value and mortgage lending value

In the foundation IRBA, the property valuation approach for commercial real estate is fixed as "objective market value". In the European Union, the 1998 Directive provides two options for the valuation of property – market value and mortgage lending value – both of which are equally applicable. The Federation requests the Committee to ensure that both options are recognised in the IRBA as methods for the valuation of physical collateral.

The concept of implicit support in asset securitisation needs to be clarified

The Federation would welcome clarification on what exactly is meant by implicit support and urges the Committee to develop even-handed criteria to be used by supervisors in determining the criteria for implicit support. In the case of a transfer of credit risk of a portfolio, the Federation believes that there should be equal treatment between a true-sale asset securitisation and a synthetic securitisation.

Operational risk charge could hurt specialised mortgage lenders

The Federation is concerned that for the overwhelming majority of mortgage lenders in Europe, whose well-run business is concentrated on residential mortgage lending where there is no change in the standardised approach to credit risk, the new capital charge for operational risk of 20% will be added and will <u>not</u> be counterbalanced by any reductions in capital charges for credit risk.

With respect to the standardised approach, the Federation would welcome further segmentation of the single business line for retail banking to reflect the low level of operational risk pertaining to the typically well-run business of mortgage lending.

In conclusion

Given that a number of the proposals in the Accord are preliminary, the Federation asks the Committee to provide for informal consultation on certain topics after the official deadline on May 31 and that further formal consultation will be scheduled once more complete information is available before the final proposals are published.