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March 11, 2016

Mr. Frank Pierschel and Mr. Ong Chong Tee
Co-Chairs, Task Force on the Standardized Approach
Basel Committee on Banking Supervision
Centralbahnplatz 2, Basel
Switzerland

Dear Messrs. Pierschel and Ong,

Re: Comments on the second consultative document on revisions to the standardized approach for credit risk

Crédit Agricole welcomes the opportunity to respond to the Basel Committee's second consultation on revisions to the Standardized Approach (SA) for credit risk.

Crédit Agricole fully supports the positions expressed by the various banking associations as IIF / GFMA, EACB and FBF on this second consultation on the review of the standardized approach for credit risk, particularly for the Specialized lending and the off balance-sheet risk categories.

This response will focus on the main issue for our Group, namely the residential real estate category. Crédit Agricole is the leader in financing home loans funding and more broadly in the economy in France, and a major player in Europe. This note aims to present our views on the proposed measure of risk weighted asset on this portfolio.

We wish to emphasize that non-performing loans (NPL) gross rate of home loans in France is very low (source: ACPR "The housing finance in 2014"), between 0.89% and 1.45% from 2001 to 2013, which is why we are motivated to keep our model.

Our response is based on three points:

1. The Committee is wrong to in focus exclusively on the concept of loan-to-value, at least for our French funding model of the real estate.

a) It is widely recognized that there are different business models for home loans: the French one corresponds to the model "Loan-to-income / fixed rate".

It is based on 3 principles:

- The loan has a fixed rate: the client has no surprise related to amounts to repay the credit. Monthly payments are predetermined taking into account the amortization of the loan and he/she does not suffer from exposure/risk to market fluctuations.

- The decision is taken by the bank based on the ability of the client to repay the loan. The granting of credit occurs only if the client has sufficient income: in principle repayment of the loan cannot exceed 30% of its income calculated after tax. The focus is primarily on the client's capacity to repay the loan and not on the value of the house or apartment taken as collateral.

- The original loan-to-value, ie the value of the house or apartment, only comes to size the value of the cash portion of the loan that must be paid at the start of the loan to be accepted.

Loan-to-income and fixed rate are closely linked: the fixed rate payments ensure the stability. And the procedure is very safe for banks as well as for borrowers with very strong protection legally framed when granting the loan.

Thanks to these characteristics and insurances, this model Loan-to-income / fixed rate generates very low default rates.

b) Banking activities are primarily based on bank representatives knowing their clients and making decisions with expertise.

We believe banking is not just a simple distribution channel: instead it is primary adding value to a relationship with clients.

This concept of net income is inherent to our business model: the bank knows and closely follows its clients, their revenues and their expenses, so that their net income.

In this context, the bank is able to analyze the borrower's repayment capacity. This analysis is the core element of the decision, not the value of the financed house/flat. And this is in line with the basic principle of the Basel Committee: first client default probability and not the value of the collateral.

All this represents the great strength of the model loan-to-income / fixed rate that generates the lowest default rate of borrowers in Europe. It should be noted that the client probability of default is the great absent from the current proposal based on the unique parameter of Loan-to-value.

c) Academic studies show that Loan-to-value is only one factor among others and the borrower is at the heart of almost all other criteria

It is essential for the regulation to develop the concept of prediction of future financial difficulties rather than just the default prediction because the prudential measures intend to be forward looking.

And in this area, we quote the Financial Services Authority in its "Mortgage Market Review: Responsible Lending" 10/16 2010 which concluded:

The following factors were the strongest predictors of future financial difficulties:

- *impaired credit history of the borrower;*
- *higher LTV;*
- *self-employment;*
- *remortgage for debt consolidation; and*
- *where a social tenant exercised right-to-buy.*

The higher LTV is one factor among five predictors of future financial difficulties and the borrower is at the heart of almost all other criteria. This leads to conclude that obviously viability comes from providing loans only to those borrowers who are likely to repay their loans. This conclusion of the work of the UK Financial Services Authority (FSA) is even more relevant in our "Loan-to-income / fixed rate" business model.

2. The consequences will be dramatic:

a) proposals will result in less volume of housing loans for two reasons:

- the new standard method is more demanding in terms of capital for banks: It will significantly increase risk weights for exposures when the LTV is at 80% and over. This will require more capital for the same activity, thus reducing investment opportunities.
- definition of floors is another concern: if the granularity of the floors goes down to residential real estate category, the standard weighting rate being around 40 % to 50 % will be very widely over the IRB measures because the French weights in IRB are around 12 to 15%, and this even with a floor calibrated at 50%. It is therefore necessary to compare the current standard risk weighting with the future envisaged in the consultation (in this case 35% against 40-45%) but also to consider the possibility of setting a floor level for the residential real estate category.

b) The impact will be significant on the housing market and the overall economy

- This will affect in particular First-time buyers. Banks will have to make choices and it will be a function of the upfront cash payment. And the higher the cash amount, the lower the LTV involving lower risk weightings. This will penalize the distribution of loans to individuals with little or no cash on hand, including the First-time buyers with modest incomes. And this could definitely exclude the young clients.
- The rental property market, highly penalized by the proposed risk weightings, will reduce...
- This will impact the economy in general, real estate having significant effects on other sectors of the economy.

This dark view is shared by the representatives of real estate and building professionals (cf. in annex 1, letter of LCA-FFB, Les Constructeurs et Aménageurs de la Fédération Française du

Bâtiment, FNAIM, Fédération Nationale de l'Immobilier, FPI Fédération des Promoteurs Immobiliers)

c) Transfer from fixed interest rates to floating rates :

This may remove the fixed rate device that French clients prefer :

- Today, no increase in interest rates affects him and a rate decrease even generally allows him to enjoy additional income resulting from the renegotiation of the loan rate or the repayment with a low penalty. In this case the client is even more creditworthy because its purchasing power increases.

- Clients will have no more choice : in the current LTI/FR business model, the client has the choice to select a floating rate credit (with caps and floors) but this alternative is rarely used. In 2014, fixed rate loans represented 92.0% of new home loans in France. This proportion has remained stable over the last three years.

- The rate will also then be either higher fixed rate or floating rate of loans that is to say without protection for the borrower who would keep the market risk. Clients will only be able to bear interest rate risks, without access to any hedging instrument.

Furthermore additional costs associated with due diligence LTV calculations could be ultimately borne by clients.

This criticism is largely taken by consumer groups (see in annex 2 the letter of The European Consumer Organization).

3. Proposed solutions:

We recommend:

- a) A long period of phase-out : the new rules should be implemented very gradually on the basis that the impact on *current* borrowers is limited

- b) Also, at the very least, for the calibration of risk weights based on LTI, the weight of the calibrated risk for floating rate loans based on LTV should be corrected by cancelling the off-balance sheet exposure clients face because of their interest rate position between revenues and payments. According to the initial method, the EAD generated by a 20 years swap would be around 20% of the loan exposure, therefore the risk weight for a fixed rate loan should be 20% lower than a variable rate loan. Such approach is similar to the add-on approach for the risk weight of loan whose currency is different from the revenue of the client.

- c) More importantly, we make a proposal that has the advantage not to touch the standard achieved by the Task Force on LTV: indeed with standard methods on banks and corporate, the Task Force has opened the way for the possibility of options in the text. Hence the following request: could we assimilate the concept of Loan-to-income to the external

ratings? In other words, there would be two alternatives: either the jurisdiction / the country recognizes the concept of Loan-to-value as the key driver of the business model in the country or the jurisdiction / country does not recognize it.

And in this latter case, the Committee could allow the local regulators / supervisors to define appropriate risk weights that reflect the credit quality of the counterparty in which case it could lead to risk weights below or at 20 % for the least risky clients.

We hope the Task Force will reconsider the current proposal in this category of residential real estate.



translated version in English

Could the new prudential standards penalize the distribution of residential home loans ?

29/02/2016

by FNAIM, FPI and LCA-FFB

Professional federations LCA-FFB, FNAIM, FPI want to alert the public authorities about the consequences new prudential standards could have on the recovery of housing in France.

The Basel Committee is currently preparing a new recommendation on credit risk. If adopted as it is, this standard would penalize the distribution of home loans to individuals with little or no upfront cash payment , that particularly characterize first-time buyers with modest incomes and young families. Rental transactions would also be impacted.

This recommendation would increase the risk weights for capital requirements and may dissuade financial institutions to lend because of to the additional costs incurred.

This recommendation of the Basel Committee appears paradoxical in view of the very low level of default rates and losses in France, including in times of crisis, as evidenced by the figures contained in the various reports of the ACPR and the balance sheets of SGFGAS (Société de gestion du Fonds de Garantie de l'Accession Sociale).

The signatories, Professional federations, urged French authorities to support the specificity of housing finance in France so it is not penalized by the draft recommendation of the Basel Committee.

This French peculiarity is based on analysis by banks that which are mainly based on the borrower's repayment capacity and not on the value of housing financed as in more Anglo-Saxon models of financing. This is necessary to maintai the sustainable recovery of habitat, essential to meet the housing needs of our citizens and the economic and employment recovery.



The Consumer Voice in Europe

Mr. William Coen
Secretary General
Basel Committee on Banking
Supervision
Centralbahnplatz 2
Basel
CH-4002 Switzerland

Ref.: BEUC-L-2014-287/MGO/sc

02 October 2014

Dear Mr. Coen,

I am writing to you on behalf of BEUC, The European Consumer Organisation, which has a membership of 40 well respected, independent national consumer organisations from 31 European countries. We have recently become aware that the Basel Committee is currently reviewing its *Principles for the Management and Supervision of Interest Rate Risk*. According to our information, one of the main changes expected is to impose higher capital requirements on banks that lend predominantly at fixed interest rates, which would have as a consequence that banks will be encouraged to massively switch to variable rate home loans. This issue has had substantial media coverage in the past few months.

Such a policy change would have a tremendous negative impact on consumers in countries with mostly fixed rate home loans because we see a risk that the whole credit risks would be passed on the borrowers. Therefore, we would highly appreciate if you could clarify your approach before possible publication of the above-mentioned Principles, while taking due account of the following questions and considerations.

Fixed rate home loans are widespread in many European Member States and consumers in those countries are particularly attached to this product because it allows them to realise one of the most important projects in their lives – buying a home. Fixed rates are preferred by consumers over variable rates as they guarantee certainty in the long run with fixed monthly repayments. Many households prefer not to opt for variable rate loans, and will probably not borrow if the offer of fixed rates shrinks. Has the Basel Committee assessed the potential negative impact of a shift to variable rates on consumer expectations and confidence?

As far as we understand, the main rationale for the Committee's expected recommendation is that fixed rate loans undermine the financial stability of banks because of mismatch between banks' lending and borrowing activities. While we are aware of the underlying arguments such as liquidity risk and interest rate risk faced by banks, we are not convinced that in practice the transmission channel of the risk is as straightforward and simple as presented by the Committee. In particular, is there evidence that the banking sector in countries with predominantly fixed interest rates is more vulnerable and unstable than in countries with predominantly variable rates? Is there any data suggesting that the recent financial turmoil was mostly caused by and impacted more strongly the resilience of the financial sector in fixed rate countries? We notice the opposite – the financial crisis originated in the US and strongly impacted countries such as Spain and UK, where variable rates are dominant.

Therefore, in our view, no conclusions can be drawn regarding a causality link between the type of interest rates and banks' stability¹.

From the point of view of The European Consumer Organisation the key requirement of a stable home-loan market is to make lending practices more responsible in order to ensure banks and other creditors provide credit only to those borrowers who are likely to repay their debts. The principles of responsible lending are properly enforced, e.g. in countries like France and Belgium, where fixed rate mortgages are dominant and the share of unpaid loans is very low.

Furthermore, as testified by bank representatives, the mismatch between the rates at which a bank borrows and lends is not necessarily negative for the bank: *"A rising interest rate environment can work to banks' advantage because it provides them with the opportunity to invest non/low-interest bearing deposit liabilities at higher rates."*² It is worth mentioning here that consumers' current account balances are usually not remunerated, hence banks benefit from an additional and free of charge funding source.

Also, as banks' cost-benefit structure is complex, one cannot assess their lending and borrowing activity in isolation, without taking into account other activities carried out by banks. It is widely known, that in many national markets home loans play the role of a gateway allowing banks to attract new customers and gain their loyalty. In the long run, most consumers purchase several financial products from their lender, such as current account, savings and investment products, insurances, payment instruments. This means that banking activity is usually widely profitable. As consumer representative, we are not opposed to this business model, providing that consumers always have a choice to take out additional financial products - we do not support tying practices and conditional sales that are often detrimental for consumers.

Furthermore, financial institutions have a wide array of tools at their disposal to hedge against their losses, which is not the case of a consumer who cannot afford to take financial risks all over 15 to 30 years.

We do hope that the consumer perspective will always be taken into account by the Basel Committee when considering any policy measures susceptible of impacting consumer rights and protection.

Yours faithfully,



Monique Goyens
Director General

¹ The Basel Committee's original Principles for the Management and Supervision of Interest Rate Risk (2004) equally point to numerous factors and assumptions that may impact the interest rate risk measurement.

² Letter by the Institute of International Finance and International Banking Federation addressed to the Basel Committee on Banking Supervision, 12 February 2014: www.iif.com/download.php?id=iLf3EcjoKXU=