Brussels, 12 March 2015

EFBS position paper on the consultative document of the Basel Committee on Banking Supervision on revisions to the standardised approach for credit risk

The European Federation of Building Societies (EFBS) welcomes the opportunity to participate in the consultation organised by the Basel Committee on Banking Supervision on revisions to the standardised approach for credit risk.

The EFBS is an association of credit and other institutions promoting and supporting the financing of home ownership. Its purpose is to encourage the idea of acquiring home ownership in a Europe that is converging both politically and economically.

The members of the EFBS are specialised credit institutions established in eight European Union Member States. The business of the Bausparkassen is regulated by specific national Bausparkassen Acts. In compliance with the strict legal provisions, the Bausparkassen offer contractual savings schemes to their customers and grant them loans which must be secured by mortgage. They are not allowed to practise other forms of banking business. They may invest their excess liquidity only in particularly secure investment products, such as government bonds of EU Member States. Bausparkassen are subject to specific supervision by the national authorities. Interest rates on savings and loans in the context of Bausparen are fixed in advance and are usually lower than the market interest rate. In most Member States, Bausparkassen must obtain specific approval from the supervisory authority before offering new tariffs or new products on the market. As part of this product testing, Bausparkassen must prove the sustainability of their products and tariffs.

In the opinion of the Bausparkassen, the standardised approach for credit risk, with its risk weights laid down under supervisory law, has fundamentally proved its worth. We therefore suggest that the Basel Committee should envisage maintaining the present standardised approach permanently as an admissible variant.

We should like to make the following comments on the individual proposals of the Committee:

Exposures to banks and to corporates

In the view of the Bausparkassen, external ratings are in principle a suitable instrument to determine the probability of default of a bank or a corporate. No major problems have arisen from experience with external ratings.

Bausparkassen invest available funds which are not invested in mortgage lending business in particularly secure securities for which at present a risk weight of 20% is often applied. We cannot understand why the consultative document does not provide for this risk weight for exposures to banks (Annex 1 point 13, pages 30-31). In cases where the specified risk drivers cannot be determined from disclosure reports, provision is made for a risk weight of as much as 300%. The upshot for Bausparkassen, with the legal restrictions on their investment policy and therefore few fall-back possibilities, would be a significant rise in risk weights. We therefore urge provision to be made for risk weights at the same level as those applicable hitherto.

The Bausparkassen agree with the Basel Committee that it should be possible to implement a new standardised approach without undue burden (Principle 3). In this sense, the Basel Committee also states: "The standardised approach should not rely on internal modelled approaches" (Principle 4). Bausparkassen, even where they are IRB institutions, have decided generally not to undertake internal rating of their exposures to banks, corporates, sovereigns and central banks.

Q 1: What are respondents' views on the selection of the capital adequacy ratio? In particular, is the CET1 ratio superior to the Tier 1 ratio or the Leverage ratio? Do respondents agree that it is necessary to require calculations in accordance with Basel III in order to ensure a consistent implementation?

Q 2: Do respondents believe the net NPA ratio is an effective measure for distinguishing a bank exposure's credit risk? What alternative asset quality measure, if any, should be considered by the Committee?

The capital adequacy ratio and asset quality ratio can serve as indicators for the probability of default of a bank. Nevertheless, information on the ownership structure, the quality of the management and the business model, inter alia, would be disregarded. For this reason, we cannot agree to the proposal to make the risk weight dependent solely on the CET1 ratio and the net non-performing assets ratio and to blank out other information taken into account in the external rating.

We consider the leverage ratio of a bank to be totally unsuitable (see our letter to the Basel Committee of 18 September 2013 on the consultative document "Revised Basel III leverage ratio framework and disclosure requirements"). The leverage ratio is naturally lower for banks with low-risk business and makes the risk of default appear too large. It is therefore not a risk driver and considering it would make the refinancing of institutions with a low-risk business model considerably more difficult.

If the standardised approach is to be converted and based on risk drivers, it would be necessary to regulate for all legal systems in which medium and when the corresponding information is to be made accessible by the banks. For instance, information on the net NPA ratio is not usually publicised at present. In our view, determining risk drivers from disclosure reports does not seem either possible or desirable. In our opinion, it must be ensured for the institutions that the new standardised approach does not result in a burden equivalent to that for internal rating.

Q 7: Do respondents think that the risk sensitivity of the proposal can be further increased without introducing excessive complexity?

In our view, it is almost impossible to increase the risk sensitivity perceptibly for the corporates portfolio too under the standardised approach. Already under the present proposal, however, the approach would be distinctly more difficult and more costly – especially on account of the planned consultation of risk drivers.

Retail portfolio

Q 9: Can respondents suggest, and provide evidence on, how to increase the risk sensitivity of the regulatory retail exposures treatment, either by differentiating certain product subcategories for which a specific risk weight may be appropriate; or by suggesting simple risk drivers that could be used to assess the risk of all retail exposures?

In view of the cost of implementation for institutions, we strongly recommend refraining from the introduction of new criteria to define retail business.

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<u>Exposures secured by residential real estate</u>

The Bausparkassen welcome the declaration by the Basel Committee that "increasing overall capital requirements under the standardised approach for credit risk is not an objective". However, if the proposals in the consultative document were to be implemented in the present form, there would generally speaking be a considerable increase in the capital requirements imposed on Bausparkassen which follow the standardised approach. The explanation lies in their main business of granting retail loans secured by residential property with a loan-to-value ratio of up to 80%. The risk weight of 35% applicable to such loans under the present standardised approach is on average exceeded by the range of risk weights in the table proposed instead (Annex 1, point 38/page 36). For the Bausparkassen, which mainly grant loans secured by residential property with a loan-to-value ratio of between 60% and 80%, the risk weight applied to these loans would rise by more than 14% (from 35% to 40%).

In the European Union, pursuant to Regulation (EU) No 575/2013 (CRR, Article 125), a loan to which a risk weight of 35% is assigned may not exceed 80% of the mortgage lending value of the property. The Member States have laid down strict requirements in laws, regulations and administrative provisions to determine the mortgage lending value. The CRR (Article 101) has imposed specific reporting requirements on institutions with respect to the residential property market. The competent authorities publish the results annually on an aggregated basis. Accordingly, housing finance with a loan-to-value ratio of up to 80% can be considered to be sufficiently secure.

For the Bausparkassen, loans secured by residential property have resulted in losses from loan defaults in the past 10 years in Germany of about 0.2% of the asset value and in Austria even of less than 0.1% of the asset value. In our view, this proves that the loan-to-value model laid down by the CRR represents a very conservative method of determining the risk weights.

We cannot therefore understand the planned increase in risk weights for loans secured by residential property. Bausparkassen, wishing to maintain the present capital cover would have to confine themselves to financing with lower loan-to-value ratios. We therefore urge that provision be made for a risk weight of 35% for cases where the loan-to-value ratio (LVT ratio) is higher than 60% but below 80%.

Q 10: Do respondents agree that LTV and/or DSC ratios (as defined in Annex 1 paragraphs 40 and 41) have sufficient predictive power of loan default and/or loss incurred for exposures secured on residential real estate?

In principle, the LTV and debt-service coverage ratios are conceivable risk drivers. However, it should be possible to continue to implement and use the standardised approach without undue burden.

Introducing a threshold for the debt-service coverage ratio in the European Union will maybe further decrease the default values but at cost which - in our opinion by far - outweighs the chance to suffer less credit loss. Therefore a DSC ratio should not be included at all in any risk weighing model (not to speak of repeating exercises). Thus for a Bausparkasse with a local customer base it seems quite obvious that the suggested approach will result in a much more time-consuming credit process and significant additional administrative costs.

Q 11: Do respondents have views about the measurement of the LTV and DSC ratios? (In particular, as regards keeping the value of the property constant as measured at origination in the calculation of the LTV ratio; and not updating the DSC ratio over time.)

The LTV ratio should be measured as simply as possible. Re-evaluation of property value should be done as rarely as possible and property value should be allowed to remain at the amount calculated at the time of granting the loan (respectively completion of construction if the loan is disbursed in tranches following milestones in terms of construction value). DSC ratios should not be calculated at all.

For regular determination of a risk driver, a process would have to be introduced in the institutions to collect the necessary data regularly and store and maintain them in the systems. This would lead to ongoing expenses which, in relation to the credit amounts in retail business, would be disproportionately high and, in view of the low losses from credit defaults for very many years, unjustifiable.

Q 12: Do respondents have views on whether the use of a fixed threshold for the DSC ratio is an appropriate way for differentiating risks and ensuring comparability across jurisdictions? If not, what reasonably simple alternatives or modifications would respondents propose while maintaining consistent outcomes?

Q 13: Do respondents propose any alternative/additional risk drivers for the Committee's consideration in order to improve the risk sensitivity in this approach without unduly increasing complexity?

From the point of view of the Bausparkassen, no requirement of any kind should be made to impose a DSC ratio. No proposals are made for additional or alternative risk drivers.

Exposures secured by commercial real estate

Q 14: Which of the two options above is viewed as the most suitable for determining the risk-weight treatment for exposures secured on commercial real estate?

Q 15: What other options might prudently increase the risk sensitivity of the commercial real estate treatment without unduly increasing complexity?

The proportion of loans used to finance building projects of a commercial nature of the total exposures from loans of a Bausparkasse is generally speaking very small. In Germany, the proportion is limited to 3% under the Bausparkassen Act. In the past, no significant problems have arisen here in connection with lending.

Past-due loans

Q 19: What are respondents' views on the alternative treatments currently envisaged for past-due loans?

The Bausparkassen do not consider a change in the treatment of past-due loans to be necessary.

Exposures to multilateral development banks

Q 20: Do respondents agree with the proposed treatment for MDBs?

The Bausparkassen consider it appropriate to maintain the risk weight of 0% for exposures to multilateral development banks.