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EBIC contribution to the Public Consultation regarding further possible changes to the Capital Requirements Directive ("CRD 4")

The European Banking Industry Committee brings together European banking associations with a mandate to provide advice, assure a comprehensive consultation of market participants and ensure a representative industry view throughout the process of drafting, adopting, implementing and enforcing EU-financial legislation and thereby provide input for the European institutions and their relevant sectorial committees. It is amongst the declared aims of EBIC to advise the Commission on relevant legislative banking and cross-sectorial initiatives and any developments at Community level affecting the banking and financial services activities associated with the establishment of a European Single Market for financial services.

EBIC has been established by the main banking industry federations: the European Banking Federation (EBF), the European Savings Banks Group (ESBG), the European Association of Cooperative banks (EACB), the European Mortgage Federation (EMF), the European Federation of Building Societies (EFBS), the European Federation of Finance House Associations (Eurofinas)/ the European Federation of Leasing Company Associations (Leaseurope), and the European Association of Public Banks (EAPB).

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GENERAL REMARKS

EBIC **supports the overall objective** of strengthening the resilience of the banking sector.

Yet, vis-à-vis the present proposals, EBIC needs to raise **important concerns**. In broad terms, it seems that regulators' current approach lacks an overall vision of what a reformed banking sector should look like, also in the light of its function in the economy. EBIC also apprehends that not all parts of the proposal are equally well developed. Moreover they may lack internal and mutual consistency. EBIC also needs to emphasise that some parts of the proposal need substantial revisions.

With regard to the possible outcome of the reform process, EBIC is concerned that, in its present form, the reform package could **disproportionately affect** certain types of businesses and entities which proved robust during the crisis.

Moreover, certain proposals, especially the proposal to introduce a leverage ratio, suggest a move away from '**risk sensitiveness'** – a development not supported by EBIC, which, to the contrary, stresses the need for *more risk sensitiveness* through more accurate risk assessment.

Looking ahead, EBIC sees problems stemming from the fact that the Commission's proposal is based on the approach of the Basel Committee, which in EBIC's view, is biased against the classical banking model of intermediation. In an international context the reforms may become a **competitive disadvantage for the EU**, where this financing model is prominent.

EBIC emphasises that, in order for the reform package to fulfil its goals, **adequate calibration** of the envisaged rules is of vital importance. To achieve this, it is crucial to analyse potential outcomes along the different dimensions and hence to:

- Conduct Quantitative Impact Studies at entity level;
- Analyse the interplay of all the envisaged measures and thus their cumulative effects;
- Factor in measures introduced in the already approved CRD II (to be applied from 31 December 2010 onwards) and CRD III (presently under discussion in the EP and to be applied from 1 January 2011 onwards);
- Take account of the effects on the real economy and on the international level playing field.

In a more comprehensive undertaking it is crucial to assess the **macro-economic effects** the new rules will have – including in terms of credit available to the real economy.

EBIC would like to reiterate that **Quantitative Impact Studies** are absolutely vital given the numerous uncertainties surrounding the proposals. In addition to the current exercise at least one more round needs to be conducted based on a revised and finalised proposal., Equally essential is a **second round of consultation** in order to ensure quality and soundness of the new framework.

As regards the **timing of implementation**, EBIC stresses that the proposed changes should only be implemented once economic recovery is on its way and that appropriate grandfathering and transition arrangements should be devised. The timing of implementation also needs to take into account implementation of the Basel rules in other jurisdictions in light of global level-playing field considerations.

SECTION I – LIQUIDITY STANDARDS

The current proposals (Liquidity Coverage Requirement (LCR) and Net Stable Funding Requirement (NSFR)) set out to reduce the potential for a future liquidity crisis by improving financial institutions' liquidity management. This motivation is sound, but the present proposals have significant shortcomings.

As regards the general approach taken, EBIC would like to point out the following issues:

A central problem of the proposal is that regulators take a **one-size-fits-all approach**, i.e. they do not take into account the relevance of a firm's business model for liquidity management and risk. This needs to be remedied by either increasing the applicability of the proposals (fine-tuning and greater granularity) or giving sufficient flexibility in the way they are applied (including the use of internal models).

In this context, EBIC also points out that the new regulation should be consistent with market data for liquidity management for the full range of business models. We believe the QIS-data will show present inconsistencies

As regards the application of the requirements for banking groups, and relating to intra-group loans, deposits and commitments, the Commission rightly recognizes the importance of a **symmetric treatment** and proposes two alternatives (one suiting banks which manage liquidity centrally and one which suits banks with more decentralized liquidity management). Given the variety of market conditions and organizational models in the EU, there should be sufficient flexibility for the different bank groups to find the approach which is most suitable to their model.

Concerning the use of the requirements, EBIC strongly advises against publicly disclosing banks' LCR and NSFR, given the danger of destabilizing effects (i.e. self-fulfilling prophecies).

EBIC remarks on specific aspects of the proposal:

1. The **LCR**: EBIC agrees with the necessity of improving short-term liquidity coverage, but stresses that the assumed stress scenario and the resulting parameters are overly severe. Hence several parts of the proposal need to be revised – for instance:

   Eligibility criteria for <u>buffer of high quality liquid assets</u> are too restrictive. They do not take account of different bank funding models, will give rise to shortages of available eligible assets, will cause distortions on asset markets, will lead to a drying up of bank financing on wholesale markets, increase the costs of holding companies, and will result in sub-optimally diversified liquidity portfolios.

   Concerning the possibility to require central bank eligibility as an additional characteristic, EBIC stresses that this would exclude automatically many asset classes which remained highly liquid during the crisis. At the same time, EBIC also emphasises that those assets, which the central banks are prepared to accept as collateral particularly in their normal "open market" operations, need to be included in the buffer.

Among (other) possible remedies, EBIC proposes to include Covered Bonds, in line with the Commission's considerations – however at substantially lower, market oriented haircuts than under the current, unjustifiably harsh treatment, which neglects actual credit quality, safety due to ring-fenced collateral and 'real' haircuts in repo-markets.

Net outflows to be covered are overestimated. Firstly, bank specific factors are completely neglected. Secondly, assumed run-off rates are excessive and reach levels not even observed during the 2008-9 crisis, i.e. run-off rates are not corroborated by quantitative observations. This applies especially to run-off rates of retail deposits and to the asymmetric treatment of liquidity/credit lines. It also concerns funding which investment funds provide usually to their custodian bank via their cash account and deposits. Thirdly,the ability to refinance Covered Bonds is not sufficiently taken into account. Hence, EBIC stresses that outflow-rates need to be revised and explained.

Furthermore, EBIC finds that, at present, the **'liquidity buffer' is not a real buffer.** At present it is foreseen that banks are to fulfil the LCR at all times (a possibility to temporarily fail on this requirement is considered, but not explained in sufficient clarity). Hence, the 'buffer' does not really serve as a buffer and means that even more eligible assets have to be held in excess of fulfilling the requirement.

The Working Document on CRD 4 suggests that banks which would fail to meet the requirements should provide supervisors in periods of stress with a plan outlining how they intend to restore compliance in the near future. However, the proposed solution can only work provided that there is no requirement to publish the ratios as any announcement indicating that a firm has fallen below the minimum will be self-defeating.

2. The **NSFR**: EBIC stresses that a NSFR set at 100% is **contrary to maturity transformation** as such.

In addition the present formulation is very inflexible and has several shortcomings as regards the assumptions on – for instance: 'Availability for funding' factors underestimate stable funding sources as well as the marketability of several relevant products. 'Required funding' rates are not only excessive, but also not sensitive to risk; they punish long-term commitments without any discretion as to their nature and quality. It follows that the concept of the NSFR, as it currently stands, is not sound: even perfectly matched positions (e.g. a < 1 year bond to finance a < 1 year corporate loan) would require additional stable funding. As a result of these weaknesses, EBIC expects that the NSFR will drive banks to transfer liquidity risk to their customers.

EBIC expects that the QIS calculations will confirm the need for a more market consistent approach to liquidity management. Possible remedies include. a revised calibration, allowing for the use of an internal models based approach, for instance for run-off rates. EBIC foresees that increasing flexibility and considering a comply-or-explain-approach could substantially improve the NSFR.

EBIC concludes that there is **need for a careful recalibration and reassessment** of many details proposed – otherwise there may be lasting damages to fundamental and necessary banking activities. In context of the wider reform process, a careful impact assessment of the full package covering its cumulative impact at the micro and the macro level is vital. For instance, the cumulative effect of the LCR and a leverage ratio (see below) is likely to be detrimental, underlining that any such steps need careful assessment against the background of the entire re-regulation initiative.

SECTION II - DEFINITION OF CAPITAL

EBIC supports as a matter of principle the efforts undertaken by European and international banking regulators to improve the quality, consistency and transparency of banks' capital base, as the financial crisis has demonstrated significant flaws in the existing capital adequacy framework, which need to be addressed. However, EBIC emphasizes that the lessons from the crisis do not call for an indiscriminate approach to capital (in terms of quality and quantity).

As such, EBIC supports the objective of simplifying the structure of own funds and achieving enhanced convergence on a global basis, which should reduce competitive distortions.

EBIC remarks on the different aspects of the proposal:

1. **Principles-oriented approach for defining capital**: EBIC supports the proposal to adopt a principles-based approach as a means to achieve European and international harmonisation of the definition of capital. EBIC accordingly supports the proposal to have a catalogue of criteria for the eligibility of capital instruments for regulatory purposes. However, the assessment process of an instrument should continue to focus on the three principles of permanence, loss absorption and flexibility of payments. Referring to the list of criteria proposed by the Commission, EBIC is concerned that some go beyond the three core principles. Emphasis as regards the definition of capital should be on the substance of the instrument, and therefore not on its form.

2. **Eligibility for Core Tier 1 capital**: EBIC considers the eligibility conditions for Core Tier 1 to be overly strict. For instance, in the case of joint stock companies, it is mentioned that Core Tier 1 should comprise common equity (as defined in footnote 18). EBIC considers that the legal form of an instrument should not have any relevance for its inclusion in Core Tier 1, as long as the proposed criteria are fulfilled in substance. Accordingly, in addition to common shares, other instruments should also be eligible for Core Tier 1 capital, if they fulfil the relevant criteria.

3. **Specificity of non-joint stock (NJS) companies and inappropriateness of designating common shares as the benchmark**: EBIC recalls that Europe's banking industry consists of banks of a variety of corporate structures and business models. EBIC therefore welcomes that the consultation paper confirms the approach which the Basel Committee has proposed and suggests taking into account the specific constitution and legal nature of mutuals, savings institutions and cooperatives in order to enable them to dispose of Core Tier 1 instruments as well.

4. **Minimum capital requirements and predominance**: The Commission proposes to introduce explicit higher minimum requirements for the minimum levels of the ratios of Core Tier 1, Tier 1 and total capital (net of deductions) to risk weighted assets. We dispute the assumption made by the European Commission that the outcome of the calibration to be made by the BCBS and by CEBS should necessarily result in higher minimum requirements: importantly, capital requirements will already be increased de facto, as a result of other measures changing the composition of capital itself (such as the regulatory deductions to be imposed on

Common Equity and the measures to enhance the quality of the eligible instruments). Moreover, no concrete figures are provided. As the proposals are likely to have a significant impact on the profitability and on the lending capacity of the banking sector, it is vital to find the right balance between the objective of increasing the sector's resistance to exceptional events and its normal operation on a day to day basis.

Also, in the light of the new qualitative requirements for core capital and hybrid instruments, which ensure the equivalence of the two capital instruments in terms of regulatory quality, as well as their common purpose as "going concern capital", a predominance of core Tier 1 capital beyond 50% would not be justified. This is moreover the case when considering that the Commission's proposals are likely to make hybrid Tier 1 Capital more equity-like and homogeneous, with a higher likelihood of coupons on future hybrids being cancelled in periods of stress. Consequently, EBIC assumes that predominance will mean above, but nevertheless close to 50%.

The Commission's proposal does not specifically refer to the possible eligibility of excess Tier 1 capital as Tier 2 capital. EBIC assumes that – in line with previous regulatory practice – eligible higher-quality capital instruments will be taken into account in the next capital category if the ratio-based restriction does not permit eligibility in its original capital category. This issue is of utmost importance, particularly since under the current proposal minority interest would no longer be eligible as core Tier 1 capital, but only as other Tier 1 capital. EBIC invites the Commission to insert a new provision whereby it explicitly provides for excess Tier 1 capital to be eligible as Tier 2 capital.

5. **Different classes of shares**: Corporate law has always permitted and supported the existence of different classes of shares, whereby different rights and privileges counterbalance certain specific features of particular shares (e.g. the privileged payment of dividends compensates for the lack of voting rights). Such rights and privileges do not interfere with the substance of the criteria for the definition of capital, and especially they do not impinge on the loss absorbency capacity of the instrument.

   EBIC fears that some of the proposals of the Commission could question this general approach by excluding certain instruments from the definition of Core Tier 1. This is in our view not appropriate. As an example, we would argue that, given that shares with non-cumulative preferential distributions fully comply with the criteria for Common Equity, they should be explicitly included in the Core Tier 1 capital.

   Along the same lines, it seems irrelevant to distinguish between classes of equity capital depending on whether some instruments have precedence in dividends and/or in ranking in the event of liquidation. Excessively strict and irrelevant conditions for eligibility in Core Tier 1 Capital will affect banks' access to capital markets, particularly in stressed situations. Ultimately, this would contradict the aim of enhancing financial stability.

6. **Implications for large exposures**: the effect of using only core capital as an assessment base for the limits applicable in case of large exposures would be an increase in the number of large exposures and a frequent overstepping of the large exposures limits, which would need supervisory approval and would imply a capital deduction. Such non-observance of the large exposures limit would weigh even more in the light of the revision of the definition of capital.

   In this context, EBIC takes the view that no changes should be undertaken to the Large Exposures regime as a consequence of the amendment of the definition of own funds. The CRD 2 provisions on large exposures are sufficiently strict and already assume a worst-case scenario. A further tightening through a change in the basis of calculation from own funds to Tier 1 capital would result in additional restraints to the banks' lending capacity.

7. **EBIC opposes a deduction of minority interest** from the common equity component of Tier 1 Capital, at it will have a very negative impact on the composition and capitalisation of banking groups, especially if an asymmetric approach is chosen. As long as the group effectively has shared control over the minority shares on the basis of the majority holding, these minority shares are also freely available for the absorption of loss at the group level. In any event, the overall effect of minority interest deductions as well as the possible alternative approaches to this measure should be properly assessed within the framework of the impact assessment

8. With respect to the **deduction of participations in financial institutions**, EBIC urges to restrict the scope of this deduction to cases where there is no calculation of own funds on a consolidated basis due to specific provisions of the CRD. Especially as regards participations in insurance companies, the full deduction is not the right answer, when there is supplementary supervision according to Directive 2002/87/EC. The Conglomerates Directive (2002/87/EC) is especially aiming at the elimination of multiple gearing of own funds instruments.

9. **Deferred tax assets**: EBIC supports the Commission's goal to set clear and transparent rules at international level to avoid undue reliance on deferred tax assets in regulatory capital. While EBIC recognises that a certain degree of prudence is required when allowing deferred tax assets in regulatory capital, EBIC does not support the proposal that deferred tax assets, which rely on future profitability to be realised, should be deducted from Core Tier 1. Such a treatment fails to take into proper consideration the various categories of deferred tax assets and the real value of deferred tax assets on a going concern basis - since capitalisation of deferred tax assets is subject to exacting recognition and valuation conditions.

10. **Grandfathering**: in EBIC's view the new requirements under CRD 4 should be in line with the implementation time tables and grandfathering clauses in CRD 2.

SECTION III - LEVERAGE RATIO

Regulators take the view that excessive leverage in certain corners of the financial industry has led to excessive risk. It is therefore discussed to introduce a leverage ratio (LR) on top of the risk-weighted capital requirements and of imposing liquidity standards. EBIC understands the motivation to reign in bank leverage, but fundamentally rejects the introduction of a LR, especially should such a ratio be defined as a Pillar 1 measure. Specifically, EBIC believes that imposing a mandatory LR at EU level is NOT an appropriate tool for the following reasons:

1. A LR is **not compatible with a risk-based framework**: It is difficult to combine effectively a risk-based approach with a non risk-based one, especially if the two approaches are supposed to be constraining. This is even more difficult since the Basel II risk-based requirements are currently undergoing a substantial review in order to strengthen banking sector resilience; this means in particular that the requirements applicable to the most risky financial activities are being reinforced. A non-risk based LR could ultimately override risk-based capital requirements and therefore mean that banks' capital needs will no longer be determined by the riskiness of their activities. Particular problems are likely to arise if the leverage ratio has a more limiting effect than do capital requirements. The capacity to lend to the economy would be further restricted.

2. **Some institutions would be discriminated more than others – but not necessarily the most risky ones**: as a logical consequence of the previous point, EBIC is concerned that some institutions would be discriminated more than others, although not necessarily those that have a higher risk profile. This could be the case for banks with high volume - low risk activities - with direct consequences in terms of lending to the economy. The leverage ratio should not make it impossible for low-risk business models to function.

3. A LR constructed as a simple **'one-size-fits-all' indicator** cannot be a basis for meaningful comparisons across the financial sector, especially in a diverse market as the EU. For instance, banks with special business models (promotional banks, funding agencies, private bankers, guarantee banks compared with other deposit banks) have different refinancing structures. Applying the same ratio to all banks, irrespectively of their business model or specific national circumstances does not yield meaningful insights. To the contrary it could mislead investors and other market participants.

4. Comparability and consistency are also impeded by **differences between accounting frameworks** (at worldwide level IFRS vs. US-GAAP, at EU level IFRS vs. national GAAPs). While the proposed netting adjustments address one of the important causes in accounting differences, there are further accounting differences that influence the amount of own funds and the measure of exposure for balance sheet and off-balance sheet items.

EBIC strongly opposes the introduction of a LR as a Pillar I instrument. With respect to the use of a LR under Pillar 2 as a non-binding indicator and among a range of other key indicators, this decision should be left to the national competent authorities, who should decide on its appropriateness and on its proper use depending on the structure of the banking market they are in charge of. Because of its inappropriateness for comparability purposes at national and international level the LR should not be subject to the disclosure requirement under Pillar 3.

SECTION IV – COUNTERPARTY RISK

EBIC understands the need to address the assessment of counterparty risk. In relation to the proposals on the table, EBIC underlines the following:

1. The potential for **derivative transactions** to effectively contribute to well functioning financial markets must be reconfirmed; yet the causes for undue risk must be identified and capped, in light of the experiences resulting from the recent financial market crisis.

2. The responsibility of market participants to understand and monitor the **risk management methodologies** they choose to implement, and of supervisors to assess both the said methodologies and their effective implementation (in the frame of the Supervisory Review Process), should be reconfirmed.

3. The **counterparty valuation adjustment** and other related proposals should be performed within the scope of Pillar 2.

4. The important role of **OTC derivatives** in offering efficient financial hedging to commercial transactions would be put at risk by all the newly proposed measures. EBIC advocates for the creation of incentives for using CCPs without penalizing OTC derivatives, notably those linked to international commerce.

5. EBIC believes that the European Commission and the Basel Committee shall not take a step backwards in the improvement of risk assessment by removing the use of **external ratings** in the standardised approach for credit risk, as this would only put smaller banks at a disadvantage. There are different ways to overcome the specific problems of the ECAIs mainly in the areas of governance and control. Moreover, the potential non-eligibility of ECAIs ratings of emerging countries would reduce investment, thus hindering the integration process of Eastern European countries.

SECTION V – COUNTERCYCLICAL MEASURES

Conceptually, EBIC agrees to the need to find appropriate ways to address the problem of excessive procyclicality. However, given the complexity of the issues at stake, and of the consequences of mistakes, it is key to have the process right: the elements that lead to excessive procyclicality need to be perfectly understood first, and appropriate responses need to be devised subsequently.

EBIC's main concern at this stage is that attempts are being made to address a unique problem (excessive procyclicality) from several angles simultaneously. In our view, it is necessary **to limit the number of changes introduced** to address the specific concern of procyclicality. In addition, whatever the solution opted for, it is vital to calibrate it appropriately in view of avoiding unintended consequences, such as a decrease in the volume of bank lending.

EBIC comments below on some of the proposals currently on the table:

1. **Provisioning**: EBIC supports in principle the objective of moving towards a system of loan/loss provisioning, which would be based on an Expected Loss (EL) model and would capture the economic reality of the lending activities of financial institutions. EBIC agrees that the EL model would need to be developed in line with the BIS six principles. We expect the forward-looking element of the loan/loss provisioning system to contribute to mitigating procyclicality as a consequence.

2. **Downturn probability of default**: EBIC does not believe that a downturn probability of default should be implemented within the Pillar 1 framework. Instead, we urge the Commission to consider this measure in the Pillar 2 within the scope of the stress testing process and its supervisory review.

3. **Restriction to the payment of dividends**: EBIC opposes restrictions to dividend pay-outs which would put the banking industry at a disadvantage vis-à-vis other economic sectors.

4. **Excessive credit growth**: EBIC shares policy makers' concern about the excessive credit growth during the upside of the economic cycle. As such, the banking industry looks forward to participating in the outlining of measures geared to enhance stability, recognizing however the difficulty to define the most suitable macro variable (or group of variables) to adequately fulfil this objective.

SECTION VI - SYSTEMICALLY IMPORTANT FINANCIAL INSTITUTIONS

EBIC understands and shares general concerns regarding the risks associated with systemically important financial institutions (SIFIs), repeatedly expressed by the G20, the European Commission and national governments. However, EBIC is highly sceptical as regards the current trends of the discussion to remedy the associated problems – in particular the trend to strictly distinguish between SIFIs and other institutions.

EBIC would also like to highlight that the idea of imposing a premium on SIFIs was launched in the US where large banks that needed and received government support have not been sanctioned in any way. The situation is, however, different in the EU where – in contrast to the US – competition authorities are taking action to re-establish a level playing field between banks that have received government support and those that have not. This reduces the moral hazard dimension of the systemic relevance issue.

EBIC moreover calls to attention that the significant reforms presently discussed will already substantially reduce risks arising from systemic importance.

EBIC is aware that at present no concrete approach specifically targeting systemic importance has been developed. This being said, EBIC takes the following general views:

1. **EBIC opposes a 'binary' approach** which would consist in strictly identifying SIFIs (distinguishing between SIFIs and 'the rest') and singling them out for special measures or treatment. Such an approach would even be unfeasible in the European environment, characterised by institutions of all types, namely different sizes, structures and business orientations.

   EBIC therefore points out that the identification of 'SIFI' is fraught with difficulties – in particular since there is not even clarity on the appropriate reference market (i.e. regional, national, EU-level, global) for systemic importance. Furthermore, publicly signalling which financial institutions are considered systemic will only propagate moral hazard, and may result in sizable competitive disadvantages for other financial institutions on the one hand, and in significantly greater risks for the financial system as a whole on the other hand. In addition, a 'binary approach' could mean a significant set-back to the EU level-playing field for competition.

2. As a possible alternative, EBIC sees greater promise in a more risk-based, more gradual and more **outcome-oriented approach**. EBIC finds that the regulators' focus should be on systemic risk rather than on systemic institutions.

   Here, important criteria are to choose an approach which incorporates that systemic importance is dynamic and cannot be nailed down in terms of quantitative criteria. These factors could be captured by a principles-based, non-binary, indicator for systemic relevance. When focusing on systemic risk, EBIC sees scope for more risk-based regulation, with greater weight given to the riskiness of banks' business models and business activities. This approach would effectively also reduce the wider risks associated with systemic relevance.

SECTION VII - SINGLE RULE BOOK

EBIC supports in principle the objective of reducing the number of options and discretions in the CRD, in view of facilitating the creation of a single rulebook. However, it needs to be considered that Member States' retail banking markets are not homogeneous and that there are areas of regulation where it is important to maintain differences and grant national discretion given the local specificities.

Along these lines, EBIC welcomes the Commission's explanation that "a single rule book does not mean uniform rules regardless of specific national circumstances. Rather it should encompass the necessary differentiation according to national or product circumstances." This reflects the so-called "gold plating" prohibition, which precludes Member States from introducing additional requirements in fully harmonised areas, and thereby contributes to maintaining the level playing field.

On the proposals at hand, EBIC takes the following views:

1. **On mortgage credit**: EBIC is of the opinion that 'maximum harmonisation' is NOT recommended in the area of mortgage credit risk given the fundamental differences in market structure (consumer demand/behavior, dominant funding models and historical loss rates) and price volatility across Member States. As recognised by CEBS on a number of occasions, national supervisors are in the best position to adapt the provisions of the CRD on mortgage lending exposures to the national circumstances, through the use of national options and discretions.

2. **More stringent requirements?**: In relation to the envisaged solutions, EBIC has not identified any concrete area, where a more stringent treatment would need to be generalised and incorporated in the single rule book. In our view, the instruments available under Pillar 2 to national supervisors for imposing more stringent requirements are sufficient to address national specificities in individual cases. EBIC takes the view that a European harmonisation of Pillar 2 requirements is not necessary.

3. **Principle of better regulation**: Any new regulation in the area of mortgage lending should benefit from the principles of Better Regulation. We expect a comprehensive impact assessment on the proposed measures, should the Commission decide to go ahead with its proposals. This comment applies in particular for the section on 'treatment of real-estate lending through the economic cycle' where there is a real risk of introducing costly and burdensome measures with little scope for realistically achieving an effective framework which would prevent market excesses and asset bubbles.

4. **Proposals on Residential real-estate:**

   - Hard test as a condition for the preferential treatment: EBIC does not support the proposed introduction of a hard test for the preferential treatment, which has no added value.
     - In this context, it should be reminded that the majority of residential loans in the EU are taken out with a view to the owner occupying the

property, and thus no cashflow is generated from the purchase of the property. A hard test would be redundant;

- Many national real estate markets have constantly shown solidity and loss rates below the limits requested by the Commission so far, and it may reasonably be assumed that the product and market structures will not undergo significant changes in the future. For such markets, the introduction of an additional hard test would be disproportionate and inappropriate.
- Conclusion: the proposed introduction of a mandatory hard test at EU level would be costly and burdensome, requiring regular data collection, without adding much from a risk perspective.

o Additional indicator (such as LTI): EBIC does not support the proposed introduction of a specific maximum harmonised Loan-to-Income (LTI) ratio and/or other indicators as an additional precondition for the application of the preferential treatment of exposures secured by residential real estate:

EBIC does not share the view that a simple LTI measure introduced at EU level would effectively minimize credit risk through its application on the preferential risk treatment: markets are too diverse and complex for such an approach to work. More importantly, there is no evidence that the preferential risk weightings as applied to residential lending today require any further restrictions, as demonstrated by the low loss rates experienced in residential lending in most national real estate markets. Finally, LTI ratios are already examined as part of creditworthiness assessments, and they belong more naturally to the retail side.

5. **Proposals on Commercial real estate:**

o Hard test as a condition for the preferential treatment: EBIC opposes the introduction of hard tests as a general condition for preferential treatment of exposures secured by mortgages on commercial real-estate due to (1) significant divergences in structures; (2) price volatility and functioning of European commercial property markets and; (3) the serious procyclical bias this would create. More concretely on the latter: requiring credit institutions to double their capital requirements in the downside part of the cycle would only trigger pro-cyclical effects, which is precisely what the Commission seeks to avoid in another major part of the proposal.

o No need to amend existing levels of Loan-to-Value (LTV) and introduce other indicators: EBIC sees no reason justifying amendments to the existing levels of the LTV and/or mortgage lending value benchmarks. Nor is there any compelling evidence of the need to introduce any other indicators as additional preconditions for the application of the preferential treatment of exposures secured by mortgages on commercial real-estate.

6. Treatment of **real-estate lending throughout** the economic cycle: EBIC does not support the proposal to introduce additional provisions at EU level in order to address the treatment of real-estate lending throughout the economic cycle.

In addition, the Commission is considering measures to address procyclicality-related concerns (see section V) that refer to the complete bank portfolio, thus including also exposures secured by real-estate. Introducing separate requirements specifically targeting the area of real estate financing would yield no added value.

7. As regards **physical collateral** (see Annex XII): EBIC has in the past very much welcomed proposals from the European Commission to transform the existing national discretion in the CRD Annex VIII, Part 1, Point 21, relating to the recognition of other (i.e. non real-estate) physical collateral into a general rule provided that relevant conditions relating to the quality of the collateral are fulfilled.

   Currently, supervisory practice as regards the recognition of other physical collateral is not harmonized throughout the EU (for instance, certain national supervisors restrict the recognition of collateral to certain, limited asset classes while others do not) and is not transparent (for instance, supervisors are not required to disclose their criteria for allowing or refusing the recognition of certain collateral). We therefore are supportive of the Commission's suggestion in the present consultation that the new European Banking Authority (EBA) develop a technical standard to further specify the criteria provided in the context of CEBS' second technical advice on options and national discretions.

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