Febelfin position regarding the recognition of mortgage mandates in the prudential framework

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Background

The key priority for the **Belgian banking sector is the recognition of the Belgian-specific mortgage mandates.** Such mortgage mandates are a common type of immovable property security, as foreseen by Belgian law. A mandate grants the bank the irrevocable power to establish a mortgage registration at any point in time for the amount agreed in the mandate.

These mandates are widely used in the Belgian market. Based on year-end 2020 figures, the total real estate exposure (both residential and commercial) was for 61% covered by a mortgage registration whereas 39% was covered by a mortgage mandate. The main driver for the use of mandates in Belgium is the beneficial fiscal treatment: it is less costly for the borrower than a full mortgage registration.

The possibility for a bank to quickly proceed to effective mortgage registration, without having to provide any justification, explains the intrinsic value of a mandate as a security instrument. The EBA has also confirmed in its Q&A 2019_4721 that Belgian mortgage mandates, to the extent that under Belgian law they are enforceable, are considered to meet the essential legal certainty criteria to be considered as eligible immovable property collateral.

Lack of recognition of mortgage mandates in the prudential framework

Despite the recognition from the EBA that mortgage mandates are considered as eligible immovable property collateral, the EBA also concludes that the value of the protection of a mortgage mandate is equal to zero for banks that calculate their risk weighted assets (RWAs) based on the Standardised Approach (SA) or Internal Ratings-based approach (IRB) without own estimates of LGD.

The reason is that these approaches neither foresee an appropriate haircut nor allow institutions to model the risk of prior liens. As a result, under the loan-splitting standardised approach, the exposure secured by real estate only represents the part covered by the mortgage registration because the part covered by a mortgage mandate is considered to be an unsecured exposure. Also, under the IRB approach without own estimates of LGD, the part covered by a mortgage mandate is to be considered an unsecured exposure and hence receives significantly higher LGDs than the part covered by the mortgage registration. Due to the high risk weight of mortgage mandates under the SA/F-IRB approaches and their low risk weight under the A-IRB approach**,** the introduction of the output floor and – to a lesser extent – the mandatory move to IRB-Foundation for certain portfolios under Basel IV, also negatively impacts the RWAs of A-IRB banks.

This is an extremely penalising prudential treatment, for exposures where - in more than 95% of the cases – Belgian banks can gain control of the collateral and liquidate it without difficulties.

On top of that, the new CRR Article 4(75) e and f as amended via the EU Banking Package proposal defines an exposure secured by residential or commercial property as "an exposure secured by a mortgage on residential or commercial property or secured by any other mechanisms other than mortgages, but which are economically equivalent to mortgages and recognised as collateral on residential property under the applicable national law setting out the conditions for the establishment of those mechanisms".

The term "economically equivalent to mortgages" is nowhere defined in the regulation and a conservative interpretation might hamper the recognition of mandates in general. It must be noted that the second part of the definition is certainly fulfilled for mandates as they are recognised as collateral on residential property under Belgian law. **The conservative interpretation that mandates would not be economically equivalent to mortgages would contradict the EBA opinion that mortgage mandates are considered as eligible immovable property collateral as well as the applicable national law.**

To summarise, the prudential treatment of mortgage mandates is considered disproportionate in relation to the risk that the bank would not be able to liquidate the collateral**.** Higher RWAs due to this treatment will lead to higher minimum capital requirements and consequently to a higher cost of capital. This could potentially have an impact on clients if the additional cost is being passed on. Simulations also show that this penalising mandate treatment gives rise to higher RWAs for less risky clients whereas the prudential framework strives for a risk-sensitive dynamic in RWA calculations.

Proposed way forward

The following complementary solutions are proposed:

- ➔ The Belgian banking sector should receive a **formal confirmation that mortgage mandates are considered economically equivalent to mortgages and remain eligible as an "exposure secured by real estate"** also implying that the lower LGD floors and haircuts applicable to exposures secured by real estate can be applied for mandates. If not, an amendment of the text is necessary to assure that Belgian mortgage mandates remain eligible as immovable property collateral, in line with the EBA opinion. This is crucial both in the context of residential real estate as well as commercial real estate.
- ➔ Febelfin advocates for **an appropriate haircut for mortgage mandates** under CRR3 for banks under SA and F-IRB instead of a full reduction of the value of protection to zero. **Such haircut should reflect the risk that the bank would not be able to liquidate the collateral thereby covering the "prior lien" risk.** The quantification of the haircut could be based on historical data of loss rates related to Belgian mortgage mandates as defined by the National Competent Authority.