Febelfin position on the EU Banking Package proposal

December 2021

General remarks

The EU Banking Package proposal is a positive starting point**.** Multiple banking industry requests are considered, albeit sometimes partially and temporarily.

We recognise the efforts of the Commission to consider the European specificities via maintenance of the existing CVA exemptions, SME supporting factor, Infrastructure supporting factor and the LGD% for covered bonds as well as the introduction of transitional preferential treatments for low-risk residential mortgages and unrated corporates. However, some of the preferential treatments are subject to national discretion of Member States even when the conditions for such preferential risk weights are met, risking to create an unlevel playing field in the EU.

Many aspects of the proposal are unpredictable right now due to the many EBA-mandates to provide further clarification and interpretation. It is the first time the Commission is giving that much power to the EBA, even to judge whether the Commission's work is appropriate or not. As a result, the package is extremely complex, and it is very difficult for institutions to estimate the ultimate capital impact and prepare for the EU Banking Package implementation.

Summary of Belgian priorities

- **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 the Belgian law. Also the EBA confirms in its Q&A 2019_4721 that Belgian mortgage mandates are considered as eligible immovable property collateral.

  Despite this recognition, the EBA also concludes that the value of the protection of a mortgage mandate is equal to zero for banks that calculate their credit RWAs based on the SA or IRB without own estimates of LGD. This is an extremely penalising treatment for exposures whereby - in more than 95% of the cases - the bank can gain control of the collateral and liquidate it. **Febelfin advocates for an appropriate haircut for mortgage mandates for banks under SA and F-IRB instead of a full reduction of the value of the protection to zero.** Such haircut can reflect the risk that the bank would not be able to liquidate the collateral. The quantification of this haircut could be based on historical data of loss rates related to Belgian mortgage mandates as determined by the national competent authority.

  In addition, the new CRR Article 4(75) proposal introduces the term **"economicaly equivalent to mortgages"** when defining an exposure secured by residential or commercial property, which might hamper the recognition of mortgage mandates in general and contradicts the recognition by the EBA. **Febelfin requests formal confirmation that mortgage mandates are considered "economically equivalent" 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 ensure that Belgian mortgage mandates remain eligible as immovable property collateral in line with the EBA opinion.

- ➔ This key priority is further addressed via the separate Febelfin position regarding the recognition of mortgage mandates in the prudential framework.

- The transitional arrangement introduced for **low-risk residential mortgages** is welcomed whereby Member States may allow institutions to apply a preferential risk weight of 10% to the secured part of the exposure up to 55% of the property value (until December 2032), and a risk weight of 45% to the remaining part of the exposure up to 80% of the property value (until December 2029, afterwards gradually increasing to 75% risk weight by 2033) provided that the low-risk conditions are met and verified by the competent authority. To avoid an unlevel playing-field in the EU, **this treatment should apply as soon as the low-risk conditions are met in a permanent manner without intervention from Member States.**
- The transitional arrangement introduced in relation to the output floor for **unrated corporates** is welcomed. Thereby, institutions under the IRB approach can apply a preferential risk weight of 65% to their exposures to corporates that do not have an external rating irrespective of whether they are listed or not, provided that those exposures have a PD of less than or equal to 0.5%. However, this transitional arrangement is only temporarily introduced until 2032 in a context to mitigate any penalising impact of the application of the output floor whereas **this element reflects a specificity of the European and Belgian banking business and should therefore be made permanent**.
- The new provisions on **trade finance** (for example: performance bonds, bid bonds, warranties, trade standby letters of credit related to particular transactions) are very penalising as the Credit Conversion Factor (CCF) was increased from 20% to 50%. **We advocate to maintain current Trade Finance CCF setting as per CRR2 on 20%** to avoid upward pressure on the pricing of technical guarantees for clients, thereby increasing the costs of exports for Belgian and European businesses.
- **In relation to equity exposures, Febelfin stresses the importance of the "Danish compromise" for the Belgian conglomerates**. This principle must remain applicable to support the Bank-Insurance business model which reduces risks through diversification. Today, Belgian Conglomerates apply a risk weighting of 370% of their insurance participations which will evolve towards a risk weighting of 250% aligned with the standard equity weighting. There is unfortunately an **unlevel playing field created in the EU as conglomerates currently applying a 100% risk weight for their insurance participation under the SA can maintain this risk weight according to the current proposal.** A level playing field should be ensured while not questioning the Danish compromise, which has proven its prudential relevance.
- The Commission proposal foresees that the minimum own funds requirements for **operational risk** will be solely based on the so-called "business indicator". **In order to introduce more proportionality, Febelfin advocates for a ceiling approach rather than a total offset of the internal loss multiplier (ILM).** In this approach, the ILM would be capped at 1,

allowing banks with a low operational loss history to benefit from the risk sensitiveness of the Basel formula.

- The calculation of the **Fundamental Review of the Trading Book (FRTB) sensitivities** on risk systems is not foreseen under the current proposal as it is required that these are calculated on PnL systems. **As the final Basel standard allows the calculation on both PnL and risk systems, Febelfin advocates that both options are foreseen in the CRR** in accordance with the Basel intention. In addition, we believe the proposal should include **the possibility for banks to voluntary start official reporting under FRTB sooner than the currently foreseen implementation date of 1 January 2025**. This would accommodate issues with regard to IT systems becoming end of life before (note that there have been multiple postponements of FRTB implementation) and would avoid investments with a very temporary effect.
- Febelfin welcomes the newly created exposure class for **regional and local authorities (RGLA) as well as to public sector entities (PSE)**, however the proposal envisages their treatment as regular corporate exposures. We believe that the preferential input floor of 0.03% and Loss Given Default (LGD) of 5% of sovereign exposures would more accurately reflect the higher creditworthiness of the borrowers in this asset class.
- **Febelfin advocates to apply the output floor only at the highest level of consolidation** for each banking group as assumed by the Basel framework, thereby avoiding the complex distribution to the sub-consolidated levels**.** Furthermore, the Commission indicates an issue of double counted risks due to the output floor. To solve this problem, the proposal relies on supervisors and national authorities to reconsider the appropriate level of pillar 2 and systemic risk buffer, respectively. **We believe that double counting should be avoided by regulation**.