European Federation of Building Societies
Fédération Européenne d'Epargne et de Crédit pour le Logement
Europäische Bausparkassenvereinigung

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Comments by the European Federation of Building Societies (EFBS) on the European Commission's proposals concerning the implementation of the new Basel framework (Basel III) in European law (CRD IV and CRR)

On the occasion of the European Commission's legislative proposal (the directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and the regulation on prudential requirements for credit institutions and investment firms) which was published on 20th July 2011 the EFBS would like to convey the following comments.

The EFBS is an association of credit and other institutions promoting and supporting housing finance. As Europe moves towards political and economic integration, the Federation promotes the idea of home ownership. "Bausparen" (home savings and loan) was developed on the basis of the concept of solidarity self-help. The core of the concept is that a group of savers may accumulate funds by pooling their savings in order to finance their housing under usual terms in a shorter time than a single saver could achieve individually. Bausparkassen provide credit agreements relating to residential property for housing finance in large quantities. Aside from this business, building societies may invest available funds only in particularly safe forms of investment. For Bausparkassen, conditions are favourable to reliably determine through internal credit ratings the credit risks of the portfolio.

Various regulatory changes proposed by the European Commission would create considerable uncertainty in terms of the internal ratings based approach – in particular the binding introduction of a leverage ratio limit in the first pillar, the extension of the Basel I floor and the unlimited extension of the LGD floor (Articles 160, 416 ff., 441 and 476 of the proposal for a regulation). The IRB approach would become even less attractive for institutions such as Bausparkassen with a low-risk lending business. Therefore, we would welcome a review of the proposed measures which we present below after our comments on the **proposal for a directive.**

First of all, EFBS would like to mention the philosophy of the regulations of Basel to orientate the amount of assets held by an institution toward the taken risks. Bank supervisors suggest that only institutions which rely on prudentially reviewed internal procedures could in principle assume that the risk management procedure corresponds to the risk level of the existing business structure. The application of the IRB approach demands extensive requirements for credit institutions in conceptual terms and organizational implementation. For instance, internal ratings must play an essential role in the credit approval process, the risk management, the internal capital adequacy and corporate management.

Because of a high effort for internal procedures, EFBS is of the opinion that the choice between the IRB and the credit risk standard approach should remain to the credit institutions. In the past, the IRB Approach has been interesting for many institutions, not only because of the advantages of a more risk-sensitive management method but also because of the financial relief which an institution was able to obtain in terms of the own funds requirement due to the application of the more risk-adequate, though more complex IRB Approach.

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With regard to the proposal for a directive on the access to the activity of credit institutions and investment firms, we would like to quote Title VII (Prudential Supervision), Chapter 2 (Review Processes) as it follows:

According to Art. 76 (Internal approaches for calculating own funds requirements) paragraph 1, competent authorities shall ensure "that institutions take appropriate steps to develop internal ratings based approaches for calculating own funds requirements for credit risk where their exposures are material in absolute terms and where they have at the same time a large number of material counterparties."

For these reasons, we kindly ask to dispense paragraph 1 and the relevant regulatory standards yet to be prepared by the EBA, which can certainly not replace the institutions' own interest in an introduction of the IRB Approach.

In addition, we would like to submit the following comments on **the proposal for a regulation** on prudential requirements for credit institutions and investment firms:

- **Part 3 – Capital Requirements, Art. 160 (Loss Given Default – LGD)**

In paragraph 4, a lower limit of 10 per cent is introduced indefinitely for own average estimates of loss given defaults (LGDs) for all retail exposures secured by residential property and not benefiting from guarantees of central governments. For institutions which implement the IRB Approach, this prolongation would mean that they would have to provide higher own funds to cover the credit risks in the retail business above and beyond the current transitional period. The Bausparkassen, in particular, with their extremely low credit risks would then have to continue to adjust their own estimates of LGDs to this set LGD floor.

Since 2007, IRBA Bausparkassen have calculated their own loss given defaults by means of LGD models that have been accepted by the regulator and that are subject to continual validation. To this day – throughout the economic crisis – these models have produced loss given defaults at a low level with a high degree of stability. The planned establishment of a permanent LGD floor would practically cancel the effect of precisely measuring the risks, which is the purpose of the IRB Approach.

For this reason, we request to abandon the intention to introduce a permanent LGD floor.

- **Part 7 Leverage – Art. 416 (Calculation of the leverage ratio), 417 (Reporting Requirement)**
  Part 8 – Disclosure by Institutions - Art. 436 (Leverage)

According to the proposal, institutions are expected to submit their leverage ratios to the national regulatory authority, and to disclose their leverage ratios as of 2015. When the latter determines the adequacy of the leverage ratio of institutions in accordance with Art. 94 Paragraph 6 of the proposal for a Directive, the authority may take into account the business model of these institutions.

It is well known that the leverage ratio does not reflect the risks that are inherent in the businesses. However, the national regulatory authority is in a position to identify and assess a low-risk model of an institution. It can be assumed that the regulatory authority would not hamper the viability of the business model by imposing inadequate requirements with regard to the leverage ratio.

If the leverage ratio of institutions which have a low-risk business model was published, this would place them at a considerable disadvantage because it would hardly be possible for them to communicate to the public the interconnection with their businesses and the risk-adequate capital requirements.

The adoption of the leverage ratio in Pillar 1 might create an inflexible instrument with major negative impact on the mortgage market: the availability of credit might be reduced and the costs of mortgage lending might increase. In addition, the high-volume low-risk models might shift to riskier models. Finally, there is a risk, that differences in accounting standards will entail competitive distortions.

For this reason, we are strongly opposed to a publication of the leverage ratio. We also believe that it is counterproductive to introduce a limit for the leverage ratio in the first pillar, which has been scheduled for 2018. It would run counter to the objective of introducing capital requirements that are adequate to cover risk positions.

- **Part 9 Delegated and Implementing Acts – Art. 441 (Delegated Acts) Part 10 Transitional Provisions, Reports and Reviews – Art. 476 (Transitional Provisions - Basel I floor)**

Under Article 441, the Commission shall be empowered to adopt delegated acts on certain issues. More specifically, the Basel I floor, which will be extended to the end of 2015 anyway, may be prescribed for another year.

The planned extension of the Basel I floor, as well as a possible further extension, and other delegated acts would create considerable uncertainty among the institutions. The institutions fear that this would invalidate the investments they have made in the past few years to improve their risk management and to implement Basel II.

We therefore request that Art. 441, sentence 1, lit. (i) and Art. 476 will be deleted.