Consultation regarding further possible changes to the Capital Requirements Directive (CRD) – the consolidated position of Ministry of Finance of Estonia, Bank of Estonia and the Estonian Financial Supervision Authority

I Liquidity standards

Question 1:

Comments are sought on the concept of the Liquidity Coverage Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex I. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure.

In principle, we support the concept of the Liquidity Reserve Requirement (LCR). However, we would prefer a more conservative approach, especially with respect to the eligibility of instruments. In Estonia, only the instruments assigned the factor of 100% according to Annex I are currently eligible for mandatory reserve requirement purposes. In addition, our local regulation stipulates that the financing should not be based on too short-term or limited sources. As we have presently also a high minimum reserve requirement ratio (15%), the proposed specification of the LCR is actually less prudent than our current regulation concerning the liquidity of banks.

The Estonian banking sector did not experience severe liquidity stress during the recent financial crisis. The impact of the crisis was limited and the Estonian banks were able to handle the situation with the help of the parent banks supplying additional liquidity. Only one Estonian bank experienced noteworthy liquidity issues stemming from the realization of reputational risk of its parent bank. The outflow of the deposits lasted over 30 days, in a significant amount for 20 days. The total deposits decreased during that period by 12%, including corporate deposits by more than 20% and private deposits by less than 10%.

Due to the current conservative mandatory reserve requirement, the LCR ratio of the Estonian banks would exceed 3. Because of the same reason, the implementation of the LCR regime would most likely not have a negative impact on the pricing of banking products.

Question 2:

In particular, views would be welcome on whether certain corporate and covered bonds should also be eligible for the buffer (see Annex I) and whether central bank eligibility should be mandatory for the buffer assets?

We support having the central bank eligibility to be the main criterion to ensure the high quality and liquidity of the buffer assets.

Question 3:
Views are also sought on the possible implications of including various financial instruments in the buffer and of their tentative factors (see Annex I) for the primary and secondary markets in which these products are traded and their participants.

We do not have relevant experience with that kind of instruments. In principle, we would prefer more conservative approach.

Question 4:
Comments are sought on the concept of the Net Stable Funding Requirement and its likely impact on institutions' resilience to liquidity risk. Quantitative and qualitative evidence is also sought on the types and severity of liquidity stress experienced by institutions during the financial crisis and – in the light of that evidence – on the appropriateness of the tentative calibration in Annex II. In particular, we would be interested in learning how the pricing of banking products would be affected by this measure.

We support the concept of the Net Stable Funding Requirement. In our market practice similar models have been adopted in the liquidity management process and financing planning. It is difficult to comment on the influence of the crisis since it was very limited in Estonia. Since our current regulatory framework on liquidity risk is already very conservative, we do not foresee any significant impact on the pricing of the banking products.

Question 5:
Comments are in particular sought on the merits of allowing less than 100% stable funding for commercial lending that has a contractual maturity of less than one year. Is it realistic to assume that lending is reduced under liquidity stress at the expense of risking established client relationships? Does such a differentiation between lending with more and with less than one year maturity set undesirable incentives that could discourage for instance long term funding of non-financial enterprises or encourage investment in marketable securities rather than loans?

Current proposal appears to embed a possible risk that banks' may respond by preferring to enter into shorter-term financing contracts with non-financial companies and also to increasingly prefer marketable securities over loans.

Question 6:
Views are sought on possible implications of inclusion and tentative "availability factors" (see Annex II) pertaining to various sources of stable funding for respective markets and funding suppliers. Would there be any implications of the tentative required degree of coverage for various asset categories for respective bank clients?

We do not support the described measures in principle due to their limiting nature.

Question 7:

Do you agree that all parameters should be transparently set at European level, possibly in the form of Technical Standards by the EBA where parameters need to reflect specific sub-categories of retail deposits?

We agree that all parameters of the liquidity requirements should be transparently set at European level, possibly by the EBA's Technical Standards. Although transparent minimum criteria might prove beneficial on the EU level, competent authorities of the Member States must remain equipped with adequate tools to ensure that market participants are holding adequate liquidity buffers at all times, as we are quite convinced that not all circumstances can be pre-seen and taken adequately into account by common minimum requirements.

Question 8:
In your view, what are the categories of deposits that require a different treatment from that in Annexes I and II and why? Please provide evidence relating to the behavior of such deposits under stress.

Especially smaller banks tend to have clients who act more like strategic investors than ordinary clients. In times of stress those clients offered support to the banks by making additional deposits and thus improving the bank's overall liquidity situation.

Question 9:
Comments are sought on the scope of application as set out above and in particular on the criteria referred to in point 17 for both domestic entities and entities located in another Member State.

We support the view that minimum liquidity requirements are to be applied at the level of separate legal entities on stand-alone basis. Legislation should still allow for sub-consolidated or consolidated fulfillment of the requirements in case the competent authorities of all the Member States concerned agree to this. The consent of the competent authorities of the host countries – for subsidiaries as well as branches – must be a prerequisite for allowing for sub-consolidated or consolidated fulfillment of the requirements, so as to ensure that financial stability concerns of all countries have been taken into account appropriately.

Question 10:
Should entities other than credit institutions and 730K investment firms be subject to stand-alone liquidity standards? Should other entities be included in the scope of consolidated liquidity requirements of a banking group even if not subject to stand-alone liquidity standards (i.e. financial institutions or 50K or 125K investment firms)?

50K and 125K investment firms in our jurisdiction should not have difficulties with meeting the proposed liquidity standards as it would require only some minor adjustments in their asset structure. However, we do not support applying the standards to the small investment firms because of the additional supervisory burden connected to monitoring the new requirements. In case those investment firms are a part of a consolidated group of a bigger entity subject to the liquidity standards, it would be sensible to include them into the scope of consolidated requirements. 50K and 125K investment firms have usually positive liquidity positions which can in fact be used to support other members of the group. Therefore, we do not support the exemption of the small investment firms from the scope of consolidated liquidity requirements even if they are exempted on a stand-alone basis.

Question 11:
Should the standard apply in a modified form to investment firms? Should all 730K investment firms be included in the scope, or are there some that should be exempted?

In principle, we support applying the liquidity standard also to 730K investment firms. The business model applied by the 730K investment firms in our jurisdiction is in line with the logic of the new liquidity standard. The only valid argument in favour of exempting investment firms from the standard is the low significance of liquidity risk in their risk profiles and considerations regarding supervisory burden.

Question 12:
Comments are sought on the different options and in particular for how they would operate for the treatment of intra-group loans and deposits and for intragroup commitments, respectively. Comments are also sought as to whether there should be a difference made between the liquidity coverage and the net stable funding ratio. For instance in the sense that an entity that has received an overnight deposit from another group entity could be allowed to assume that that deposit would be rolled over during the 30 days stress, but that that same entity would not be allowed to treat any monies due to other group entities during a one year period as an element of stable funding.

As of the application of the requirements to individual entities that form part of a group, we see that as a general requirement, reflecting the separate legal status of such entities, all intra-group positions and commitments should be treated as with third parties. Still, given that the competent authorities of all concerned Member States find it appropriate and thus fully agree on the matter, certain waivers from such approach should be allowed by regulation. A full consent of the competent authorities of all concerned Member States must be a prerequisite for all potential waivers.

Question 13:
Do stakeholders agree with the conclusion that for credit institutions with significant branches or cross-border services in another Member State, liquidity supervision should be the responsibility of the home Member State, in close collaboration with the host member States? Do you agree that separate liquidity standards at the level of branches could be lifted based on a harmonized standard and uniform reorganization and winding-up procedures?

Regarding potential needs for liquidity assistance, market participants' abilities to raise and authorities' possibilities to provide liquidity assistance in currencies in which liquidity might be needed must be considered in deciding upon adequate liquidity requirements and supervision of their fulfillment (e.g. in case of branches operating in Member States with legal tender other than Euro). Full consent of the host supervisor with an option for the host supervisor to withdraw such a delegation must remain a prerequisite for entrusting the liquidity supervision of branches and especially that of systemically important branches in host member state to the home supervisor. Thus we support an option of voluntary delegation of tasks if parties concerned so agree, as successfully implemented already in numerous cases in the EU.

Question 14:
Comments are sought on the merit of using harmonized Monitoring Tools, either in the context of Supervisory Review or as mandatory elements of a supervisory reporting framework for liquidity risk.

In our opinion, the issues relating to the Supervisory Review Process should be harmonized on Level 3. In general, our Supervisory Review Process addresses both quantitative and qualitative elements of the liquidity management considering also the specific characteristics of banks.

Question 15:
What could be considered a meaningful approach for monitoring intraday liquidity risk?

In our opinion, the monitoring of intra-day liquidity risk is necessary and justified only in the situation of a sever stress.

II Definition of capital

Question 16:
What are your views on the prudential appropriateness of eliminating the distinction between upper and lower Tier 2, and of eliminating Tier 3 capital?

The distinction between upper and lower Tier 2 was eliminated from the Estonian regulation already in 2007. Tier 3 capital is not utilized in our market. Therefore, we fully support both proposals.

Question 17:
Are the criteria proposed for Core Tier 1, non-Core Tier 1 and Tier 2 sufficiently robust and how might they be improved?

The proposed criteria are sufficiently robust for our market where hybrid capital instruments are not generally utilized.

Question 18:
In order to ensure the effective loss absorbency of non-Core Tier 1 capital, would it be appropriate under certain circumstances to require the write down of the principal amount of an instrument or its conversion to a Core Tier 1 instrument? To what extent

should the trigger for write-down / conversion be determined objectively or at the discretion of an institution or its supervisor?

We do not have enough practical experience with that type of instruments to form an opinion.

Question 19:
Which of the prudential adjustments proposed have the greatest impact? What alternative, robust treatments might be considered and what is their prudential rationale?

The adjustments concerning holdings in financial institutions, goodwill and unrealized gains on own use properties would have the greatest impact. Other adjustments would have insignificant impact in our market.

Question 20:
Are the proposed requirements in respect of calls for non-Core Tier 1 and Tier 2 sufficiently robust? Would it appropriate to apply in the CRD the same requirements to buy-backs as would apply to the call of such instruments? What restrictions on buy-backs should apply in respect of Core Tier 1 instruments?

We do not have enough practical experience with that type of instruments to form an opinion.

Question 21:
What are your views on the need for further review of the treatment of unrealised gains? What would be the most appropriate treatment of such gains?

The need for further review of the treatment of unrealised gains depends on the final version of the accounting rules currently under revision. However, the general treatment of unrealised gains and losses should be based on the concept of prudence, i.e. unrealised gains should be excluded from Tier 1 capital and unrealised losses should be included.

Question 22:
We would welcome comments on the appropriateness of reviewing the use of going concern Tier-1 capital for large exposures purposes. In this context, would it be necessary to review the basis of identification of large exposures (10% own funds) and the large exposures limit (25% own funds)?

We do not support the use of only Tier 1 capital for large exposure purposes on the grounds of divergence from the calculation of capital adequacy. Given that large exposures regime deals essentially with credit risk, we are of the opinion that it would not be appropriate to use Tier 1 capital for large exposures purposes and Tier 1 and Tier 2 capital for credit risk capital requirements purposes. The consistency between capital used for large exposures and solvency purposes has to be preserved. The limits on large exposures should be reviewed in the light of bringing them more in line with credit risk framework.

Question 23:
What is your view of the purpose of contingent capital? What forms and triggers would be most appropriate?

We do not have enough practical experience with that type of instruments to form an opinion.

Question 24:
How should the grandfathering requirements under CRD II interact with those for the new requirements? To what extent should the grandfathering provisions of CRD II be amended to bring them into line with those of the new capital requirements under CRD IV?

We do not have enough practical experience with that type of instruments to form an opinion.

III Leverage ratio

Question 25:
What should be the objective of a leverage ratio?

In our opinion such ratio should be only indicative and not introduced as a mandatory minimum. We support detailed impact assessment on the exact impact of the leverage ratio because it can slow the economic recovery and result in unjustified additional burden on banks. In case there is evidence of shortcomings in the methodology of risk valuation and capital adequacy calculation, those issues should be addressed directly and not through the introduction of a completely new non-risk-sensitive measure.

Question 26:
Which element of going concern capital do you consider would be a more appropriate basis for the leverage ratio? What is you rationale for this view?

The most appropriate basis for the leverage ratio would be Tier 1 and Tier 2 on the consolidated basis.

Question 27:
What is your view on the proposed options for capturing the overall extent of an institution's derivatives business in the denominator of the leverage ratio?

We prefer the option b (i.e., the replacement cost of a derivative contract) because the contract value may not reflect the actual risk.

Question 28:
What is your view of the proposed approach to capturing leverage arising from the credit derivatives?

We support the proposed approach.

Question 29:
How could the design of the leverage ratio ensure that it would act as an effective constraint only in benign economic conditions?

We are not convinced that the leverage ratio can be effectively calibrated that way.

Question 30:
What would be the appropriate calibration of a leverage ratio?

The decision on calibration should be done based on a thorough analysis (quantitative impact assessment). We have not conducted any analysis on that matter.

IV Counterparty credit risk

Question 31:
Views are sought on the suggested approach regarding the improved measurement or revised metric to better address counterparty credit risk. With respect to suggestion to incorporate - as an interim measure - a simple capital add-on by means of calculating the loan-equivalent CVA charge, views are sought on the implications of using VaR models for these purposes instead.

Due to the fact that trading activities of the Estonian banks are negligible, the issue is not relevant for us.

Question 32:
Stakeholders are invited to express views on whether the use of own-estimates of Alpha should continue to be permitted subject to supervisory approval and indicate any evidence in support of those views.

Due to the fact that trading activities of the Estonian banks are negligible, the issue is not relevant for us.

Question 33:
Views are sought on the suggested approach regarding the multiplier for the asset value correlation for large financial institutions, and in particular on the appropriate level of the proposed multiplier and the respective asset size threshold. In addition, comments are sought on the appropriate definitions for regulated and unregulated financial intermediaries.

Due to the fact that trading activities of the Estonian banks are negligible, the issue is not relevant for us.

Question 34:
Views are sought on the suggested approach regarding collateralised counterparties and margin period of risk. Views are particularly sought on the appropriate level of the new haircuts to be applied to repo-style transactions of (eligible) securitisations. In this context, what types of securitisation positions can, in your view, be treated as eligible collateral for purposes of the calculation of the regulatory requirements? Any qualitative and/or quantitative evidence supporting your arguments would be greatly appreciated.

Question 35:
Views are sought on the suggested approach regarding central counterparties and on the appropriate level of the risk weights to be applied to collateral and mark to market exposures to CCPs (on the assumptions that the CCP is run to defined strict standards) and to exposures arising from guarantee fund contributions.

Due to the fact that trading activities of the Estonian banks are negligible, the issue is not relevant for us.

Question 36:
Views are sought on the risk management elements that should be addressed in the strong standards for CCPs to be used for regulatory capital purposes discussed above. Furthermore, stakeholders are invited to express their views whether the respective strong standards for CCPs to be used for regulatory capital purposes should be the same as the enhanced CPSS-IOSCO standards.

Due to the fact that trading activities of the Estonian banks are negligible, the issue is not relevant for us.

Question 37:
Views are sought on the suggested approach regarding enhanced counterparty credit risk management requirements. Do the above proposed changes to the counterparty credit risk framework (in general, i.e. not only related to stress testing and backtesting) address fully the observed weaknesses in the area of risk measurement and management of the counterparty credit risk exposures (both bilateral and exposures to CCPs)?

Due to the fact that trading activities of the Estonian banks are negligible, the issue is not relevant for us.

V Countercyclical measures

Question 38:
The Commission services invite stakeholders to perform a comparative assessment of the three different methods (ie ECF, incurred loss and IRB expected loss if it could be used

for financial reporting) for credit loss provisioning from 2002 onwards based on their own data.

We do not have sufficiently detailed data to perform such analysis. Only the market participants themselves are able to perform a meaningful comparative assessment of the three different methods.

Question 39:
Views are sought on the suggested IRB based approach with respect to the through-the-cycle provisioning for expected losses as outlined above.

Although in principle we support lining loan provisioning more closely with credit risk assessment methodologies, we are somewhat concerned about the technicalities of the IRB based approach with respect to the through-the-cycle provisioning. Using expected LGD estimates instead of downturn LGD estimates used for capital adequacy calculations requires essentially developing additional LGD models by banks. Since those models are not to be approved by the supervisory authorities as the models used for capital adequacy purposes, it raises a concern about the transparency of loan loss provisions. In addition, based on the experience from our market, there are still shortcomings in the robustness of LGD models due to data quantity and quality issues which raises a question whether it is prudent to be employ those models for additional purposes. Taking into account that some sort of calibration of IRB parameters is required in order to used the parameters for provisioning purposes, the calibration could prove to be unreasonably complex and, most of all, arbitrary. Finally, the question arises about the level playing field for IRB and Standardized Approach banks and also Foundation IRB and Advanced IRB banks.

With respect to the concern that through-the-cycle provisioning requires ‘expected’ LGD rather than ‘down-turn’ LGD, the simple dissection of expected loss formula indicates that simply multiplying expected (TtC) PD by expected LGD underestimates the true level of expected losses as long as PDs and LGDs are positively correlated. This is quite common finding in empirical works.

$$E(L) = E(PD * LGD) = E(PD) * E(LGD) + \mathrm{cov}(PD, LGD)$$

To compensate for the possible correlation effect, something more conservative is needed instead simple ‘expected’ LGD.

Portfolio growth may also play an important role when applying the expected loss rate to portfolio in order to calculate necessary amounts of provisions. Empirics hint that portfolios grow during the cyclical upturn and majority of risks (losses) realize during the peak level of portfolio. Taking this and previous point into account, the ‘down-turn’ LGD might still be appropriate for calculating TtC expected losses. Still, if calibration exercises/impact analyses indicate excessive conservativeness then this could be tackled with some kind of adjustment factor. On the other hand, the excessive conservativeness could also serve the purpose to build up buffer to cover (partly) the ‘stressed’ losses (an alternative/supplement to counter-cyclical capital buffer).

In the following attached file, there is a simple exercise on how the expected loss approach could work in the case of Estonia using mortgage portfolio data.

IRB dynamic provisioning__.xls

Question 40:
Do you agree with the proposed dual structure of the capital buffers? In particular, we would welcome your views on the effectiveness of the conservation buffer and the counter-cyclical buffer, separately and taken together, in terms of enhancing the resilience of banking sector going into economic downturn and ensuring the flow of bank credit to the "real economy" throughout economic cycle.

With respect to the proposed dual structure of the capital buffers, our main concern is that introduction of such methodology could fundamentally undermine the idea of individually assessed risk-based capital requirements under Pillar 2 framework. It is not clear to us how the proposed capital conservation buffer and counter-cyclical capital buffer relate to Pillar 2 philosophy.

Question 41:
Which elements should be subject to distribution restrictions for both elements of the proposed capital buffers and why?

In our opinion, constraints on capital distributions should be limited to dividend payments.

Question 42:
What is the appropriate timing – following the breach of capital buffer targets – for the restriction to capital distributions to start? Should the time limits for reaching capital buffer targets be determined by supervisors on a case-by-case basis or harmonised across EU?

The restrictions on capital distribution should come into effect as soon as the breach of capital buffers has occurred. We are of the opinion that it is more appropriate to set the time limits for reaching capital buffer target on a case-by-case basis subject to the supervisory discretion.

Question 43:
What is the most suitable macro variable (or group of variables) that may be used in the counter-cyclical buffer to measure the dynamics of macro-level risks pertinent to the banking sector activities?

An alternative to using macro variables could be using the IRB parameters. Using IRB parameters might be more appropriate than using macro aggregates as they take into account the risk profile of individual banks (including the differences in the rating philosophy). Nevertheless, some macro-variable based measure could serve as valuable benchmark and could also be applied to banks not using the IRB methodology.

Question 44:
What are the relative merits and drawbacks of capital buffers versus through-the-cycle provisioning for expected losses with respect to minimising Procyclical effects of current EU banking regulation?

On a general level, through-the-cycle provisioning has a potential to reflect more accurately the underlying risks of individual banks while capital buffers seem to represent the one-size-fits-all approach.

Question 45:
Do you consider that it would be too early to fully assess the cyclicality of the minimum capital requirement?

Considering the fact that credit losses have so far materialized in a relatively insignificant levels, it is too early to draw any conclusions with respect to the cyclicality of the minimum capital requirements. Reliable data on the level of actual credit losses occurred during the recent downturn will become available in 1-2 years time.

VI Systemically important financial institutions

Question 46:
What is your view of the most appropriate means of measuring and addressing systemic importance?

Measuring systemic importance
Assessment of systemic importance of a credit institution should be based on both micro- and macro prudential considerations and should not rely solely on the size of an institution. Such assessment should adequately consider the structure and activities of credit institutions as well as macroeconomic environment. In order to achieve this, the systemic risks need to be monitored continuously and assessment regarding the specific institutions should be adjusted accordingly.

Although establishing general reference criteria for assessment of systemic importance might prove beneficiary, these guiding principles should provide sufficient flexibility to allow to take into account specific features, which make an institution systemically significant in given circumstances.

Measuring systemic importance could be guided by the current CRD Article 42(a), which specifies criteria for assessing systemic relevance of branches (including whether the market share of the credit institution or its branch exceeds 2% in terms of deposit in relevant Member State; the likely impact of a suspension or closure of the operations of the credit institution on the payment and clearing and settlement systems in relevant Member States; and the size and the importance of the institution or branch of the institution in terms of number of clients within the context of the banking or financial system of relevant Member States).

Classification of an institution as systemically important should not be fully automatic and the decision on the systemic importance of an institution should be taken by the competent authority of the Member State where it operates. It is very important to take into account that a credit institution, which might not to be considered systemically important in one member state, may be systemically very important in another member state. Thus, the final decision regarding the systemic importance of credit institution in a particular Member State should remain with that particular Member State.

Addressing systemic importance
A number of possible measures have already been proposed to address risks to financial stability that can arise from systemically important institutions, such as more stringent capital requirements and other stricter prudential requirements. Measures to address systemic risks should be sufficiently flexible and include general tools to be implemented at the level of financial system, but also possibilities to apply additional institution specific measures. We consider it very important that competent authorities of member states are equipped with adequate tools and implementation powers to address the risks arising from systemic credit institutions as well as systemic risks arising from several institutions which separately may not appear to be of systemic importance, in line with the current division of responsibilities for addressing the implications arising from the materialisation of such risks.

Question 47:
How could the Commission services ensure a consistent prudential treatment of systemic importance across financial sectors and markets?

In general, we support moving toward establishing a European single rule book applicable to all financial institutions in the Single Market.

VII Single rule book

Question 48:
In which areas are more stringent general requirements needed given national or other circumstances? Is Pillar 2 a sufficient tool to address specific negative circumstances at credit institutions and if not, how could it be strengthened?

We are of a strong view that as long as financial stability is a national responsibility, Member States should be entitled to apply more stringent requirements to financial institutions than the common harmonised minimum requirements, if necessitated by financial stability concerns and a need to prevent a build-up of related fiscal risks.

We are not convinced that the possibility for more stringent national requirements should be limited to Pillar 2 measures only. For instance, in Estonia one of the most important and successfully implemented financial stability measures has been the application of 10% minimum capital requirement for all credit institutions and the increase of mortgage credit risk weight from 50% to 100% in 2006 in the capital adequacy framework to mitigate the build-up of risks during the period of high credit growth. To provide level playing field the home supervisors of foreign banks operating in Estonia via branches were asked to apply similar risk weighting to mortgage loans issued in Estonia. Countercyclical application of above measures ensured the build up of adequate capital buffers for Estonian banking system and provided necessary resilience during recent global financial sector turbulences and economic downturn. Financial sector in Estonia has continued to provide services without the need to inject taxpayers' funds despite the materialisation of forecasted specific risks, which have been further magnified by global economic downturn.

It is essential that the development of financial stability tools and reorganisation of supervisory powers must be in balance with national obligations regarding financial stability. Therefore the considerations for the appropriate timeline for aiming maximum harmonization should be balanced with developments in pan-European crisis management and burden sharing frameworks. Obligations and responsibilities must be in balance with supervisory powers and available tools.

Regarding supervisory powers also the cost efficiency of their application from authorities' perspective not just from institutions' perspective (i.e. Pillar I versus Pillar II) must be considered. The implementation of measures aimed at strengthening the overall resilience of the financial sector to specific risks is quite likely to be far more costly and legally more cumbersome through Pillar II framework as compared to Pillar I.

Question 49:
What is your view of the suggested prudential treatment for exposures secured by mortgages on residential property outlined above? What indicators and their respective values do you consider appropriate as possible preconditions for the application of the preferential treatment of exposures secured by mortgages on residential property?

In principle, we agree that both LTV and LTI are important risk drivers in residential real estate lending. With respect to LTV, we propose 70% to be the maximum value. As regards LTI, harmonization may be more difficult to achieve. In practice, bank use different accepted values for different income buckets the average LTI value being 40%. However, we are somewhat concerned about the practicalities regarding the ongoing monitoring of LTI values, especially in terms of proportionality of additional costs.

Question 50:

What is your view of the suggested prudential treatment for exposures secured by mortgages on commercial real estate outlined above? What indicators and their respective values do you consider appropriate as possible preconditions for the application of the preferential treatment of exposures secured by mortgages on commercial real estate? In particular, are additional preconditions needed to ensure the soundness of this treatment? Do you believe that the existing preferential risk weight applied to exposures secured by mortgages on commercial real estate should be increased?

In general, we do not support preferential treatment with respect to commercial real estate due to difficulties related to the evaluation of commercial real estate, especially during the period of low economic activity.

Question 51:
Should the prudential treatment for exposures secured by mortgages on residential property be different from the prudential treatment for exposures secured by mortgages on commercial real estate? If so, in which areas and why?

We are of opinion that the prudential treatment for exposures secured by mortgages on residential property should be different from the prudential treatment for exposures secured by mortgages on commercial real estate on the grounds of different risk levels.

Question 52:
What is your view of the merits of introducing measures that would help to address real lending throughout the economic cycle? Which measures could be used for such purposes? What is your view about the effectiveness of the possible measures outlined above?

Real estate market cycles are not homogenous across all Member States. Therefore it could prove difficult to apply specific adjustment to property values through Pillar I. However, Member State authorities should have a possibility to apply more stringent national requirements under Pillar I as well as specific measures under Pillar II to avoid possible build-up of risks.