Vienna, 4th September 2009

Consultation on the Commission Services' suggestions on possible changes to the CRD relating to dynamic provisioning, residential mortgages denominated in a foreign currency, removal of national options and discretions and simplification of the bank branch accounts directive

Austrian Comments

Federal Ministry of Finance (BMF)
Financial Market Authority (FMA)
Oesterreichische Nationalbank (OeNB)

INTRODUCTION

Question 3: What is the optimal timing for these measures? Should their application be sequenced?

As already stated in our comments concerning the latest CRD III compromise proposal on 2 September 2009, we would be in favour of postponing the transposition date to a date that allows a prudent and diligent implementation of the new rules by the regulators and the banking industry in the course of the transposition process.

SECTION 1

DYNAMIC PROVISIONING

Question 4: The Commission services suggest that the through-the-cycle value adjustment should not count as regulatory capital (see ANNEX 1, suggested amendment to Article 57). Do you agree?

We agree. This accounting adjustment to profits must also reduce regulatory capital. Therefore, it should not be re-included in regulatory capital.

As the adjustments reduce regulatory capital, there is no further need for the excess/shortfall calculation and the deduction requirement in Art. 57 lit. (q) and Art. 63 Para. 3. The through-the-cycle value adjustment already covers all expected losses based on a broader perspective of one cycle, i.e. several years. It is therefore obsolete to deduct shortfalls based on the one year perspective (the expected one year loss would then be deducted twice).

Question 5: Should off-balance sheet items be captured under the formula for through-the-cycle expected loss provisioning, given that 'provisions' for off-balance sheet items are not recognised in all relevant accounting standards? Should only assets subject to an impairment test be subject to through-the-cycle expected loss provisioning? (See ANNEX 1, suggested Article 74a (2).)

Yes, off-balance sheet items should be included as additional cyclical effects can stem from them. Additionally, all assets should be subject to expected loss provisioning, irrespective of being subject to an impairment test.

Art. 20 Para. 1 of the Fourth Council Directive 78/660/EEC, which is also relevant for banks, requires provisions for contingent liabilities, which are off balance sheet items. It is therefore not true that off balance are not recognised in some accounting standards if those standards comply with the directives.

Question 6: At this point, the suggestion is not to include the option for competent authorities to allow internal methods to determine expected losses across an economic cycle. As an alternative to the regulatory approach to calculate counter-cyclical factors, would it be desirable to allow firms' internal methodologies (to be validated by supervisors)?

At this point, we do not support the use of internal models to determine expected losses, as the option might be misused by firms to arbitrarily increase or decrease reported profits. The regulatory approach instead establishes a level playing field for all banks in the EU and minimizes distortions in reported earnings and thus, in capital allocation. We further expect the regulatory approach to generate less compliance costs for banks than the option to use internal models. An option for national authorities to allow internal methods would create unnecessary potential for regulatory arbitrage by banks operating in the EU.

Question 7: Should the exposure class of Article 86 (i.e. for credit institutions subject to the IRB approach) be used irrespective of the fact that the credit institution may be under the Standardised approach? It may be noted that a mapping between exposures class under the Standardised approach and under the IRB is already used in the prudential reporting system of some Member States. As an alternative, should countercyclical parameters be defined for the 16 exposures classes under the Standardised approach? (See ANNEX 1, suggested Article 74a (1).)

For reasons of simplicity, we support the reference to the exposures classes set out in Article 86 of Directive 2006/48/EC. It is easier to map the exposure classes in the Standardised approach to the IRB-exposure classes than to map them vice versa.

Question 8: Please give your views on the following approaches:

1) the Spanish model of through-the-cycle expected loss provisioning

2) a 'simplified' Spanish model.

In particular, we would welcome views on the relative merits of both options in terms of the building up of provisions in a graduated manner over time (See ANNEX 1, suggested Annex IXb).

The method described in Method 2 is most convincing. Firstly, off-balance exposures carry a similar cyclical profile as on-balance exposures and should therefore be included. Secondly, the aim is to recognise dynamic provisions in the financial statements. Therefore, specific accounting impairments should be deducted. Furthermore, Method 2 is more easily applicable to calculations of dynamic provisions and data requirements for banks will be less than for Method 1.

However, it should be clear that incurred losses can only be deducted from dynamic provisions, if they are smaller than the dynamic provision relating to the loan. If, for example, a borrower defaults and the respective loan cannot be recovered, the loss must be realised in full.

Otherwise, the bank's capital would be overstated (e.g. a bank whose loans are in default and not recoverable would still show positive capital because it only deducts its dynamic provision from its capital, even though it is unable to finance its liabilities).

Question 9: Should new risk categories (as suggested above) be introduced along the lines of the Spanish system or, alternatively, should current risk categories of the CRD (e.g. credit quality steps in Annex VI) be used? (See ANNEX 1, suggested Annex IXb.)

We suggest using the current risk categories of the CRD.

Question 10: Is the 'location of the borrower' (as opposed to the booking of the exposure) the right approach, with a view to avoiding regulatory arbitrage? (See ANNEX 1, suggested Annex IXb 2.)

We agree. The location of the borrower (i.e. the economic origin of its risks) and not the country of the bank's formal incorporation should be relevant, although getting the relevant data for these categories will be difficult, notably for banks with numerous clients outside the EU (cp. Question 11).

Question 11: Will the data to determine counter-cyclical factors be easily available?

It will take considerable effort in assembling the required data for assessing the counter-cyclical factors for all relevant exposure classes. A precise evaluation of these will not be possible as long as CEBS has not determined the methodologies for calculating the ttc expected loss provisions.

Question 12: Please give your views on the methodologies for calculating the through-the-cycle expected loss provisions at consolidated level. (See ANNEX 1, amended Article 73.)

The methodology should be the same. There is no need for further guidance as existing accounting rules determine which exposures exist at consolidated level.

Question 13: Please give your views on the scope of disclosure requirements for through-the-cycle expected loss provisioning. (See ANNEX 1, suggested amendment to Annex XII (17).)

Given the early stadium of the discussion, we would suggest the following changes to the proposed disclosure requirement:

PART 2

General requirements

17. The following information shall be disclosed regarding compliance by the credit institution with the requirements laid down in Article 74a:

~~(a)~~ the ~~level~~ amounts of the through-the-cycle expected loss provision for each exposure class broken down by each risk category and how they differ from past experience.

~~(b) the exposures to which the countercyclical factors are applied for each Member States and third country in which borrowers are located, and for each risk category of Annex IXb.~~

~~(c) the changes in the through-the-cycle expected loss provision compared to the previous reporting period for each exposure class~~

We feel that the requirement in lit. (b) might hardly be feasible given the high number of borrowers' locations that many institutions face. We rather suggest to further break down the requirement in lit. (a) by risk category to increase transparency.

Furthermore, we suggest to clarify that the requirement in lit. (c) implies a qualitative discussion of the changes compared to previous periods.

The suggested wording would be close to the current wording in Annex XII, Part 3 Point 1 (g).

SECTION 2

RESIDENTIAL MORTGAGES DENOMINATED IN A FOREIGN CURRENCY

Question 14: Do you consider that the risk weights suggested will be effective in discouraging unsafe practices and irresponsible lending in foreign currency denominated housing loans?

Austrian authorities have repeatedly called attention to the risks inherent in foreign currency loans and loans with repayment vehicles and FMA/OeNB have put special emphasis on the topic in their supervisory activities (e.g. FMA minimum standards for granting and managing foreign currency loans / loans with repayment vehicles; targeted on-site inspections; special purpose analyses). We therefore generally support the proposal to significantly increase the risk weights for foreign currency housing loans as they indeed pose higher risks.

However, we fear that the proposal might increase procyclicality of capital requirements substantially. We suggest a simulation exercise based on data of the current crisis (and/or the crises in Asia and Latin America) which might shed light on the cyclicality and the proportionality of the proposed LTV/risk weights. The introduction of a review clause seems advisable.

Furthermore, we would like to point out that the formal restriction of lending in foreign currency denominated housing loans bears the possibility to circumvent these provisions by using other forms of collaterals or splitting the loan.

Technical remarks:

(1) In Section 3 of the working document an LTV-ratio of 40 % is suggested as precondition for the more lenient risk weight of 35 % for exposures secured by mortgages on residential property (Annex I Part 1 Point 48 (d) CRD; see also our remarks to question 17). Therefore, in the formula given in Annex 2, RW_A (the risk assigned according to letter a)) can only be 100 %.

(2) It should be made clear (Annex VI, Part 1 Point 50a (c) CRD), that in cases where the exposure exceeds 100 % of the market value of the property, a general risk weight of 1250 % applies to the part that exceeds [50 %] of the market value (i.e. no incremental increase of risk weights in the range of 50 to 100 % LTV).

Question 15: Do you consider a loan to value ratio of 50% or less is sufficient objective evidence that the borrower has sufficient private wealth to withstand currency movements and potentially correlated movements in property prices?

Without further data analysis, a final statement with regard to the adequacy of the 50 % threshold seems not possible. Given the additional risks (F/X-risk / refinancing risk) that detrimentally affect the borrower's debt servicing capacity, we fear a strong procyclical effect.

However, we support the introduction of the proposed ratio as the more conservative treatment seems a step in the right direction. In any case, the chosen threshold should be aligned with the treatment of mortgages denominated in the local currency (see Question 17 below) and reviewed in due course. This is, we suggest introducing a review clause to assess the prudentiality of the treatment based on market evidence.

<u>Question</u>:

FX-loans are often arranged as bullet loans linked to repayment vehicles (RPV). During the life of the loan only interest is paid, whereas instalments are invested in re-payment vehicles, usually life-insurance policies and mutual funds. At maturity, these payments and the returns earned on the paid-in capital are used to pay back the principal. The RPV adds additional risks to loans (be it in foreign or local currency). Does the Commission plan to deal with this issue?

SECTION 3

REMOVAL OF NATIONAL OPTIONS AND DISCRETIONS

Question 16: Is this suggested scope of maximum harmonisation in 2006/48/EC and 2006/49/EC appropriate?

First of all, we would like to express our support for the harmonisation efforts undertaken so far. However, we want to reiterate our strong concerns with regard to the deletion of national discretions that are rooted in local market specificities or the national legal frameworks, especially where the resulting different treatment does not impinge upon the level playing field.

Question 17: Is the suggested prudential treatment for both residential and commercial real estate sufficiently sound?

In general, we do support the proposed treatment for both residential and commercial real estate (alignment of the two regimes, broader role of hard test, introduction of LTV-ratio). However, an LTV-ratio of 40 % seems overly conservative. Given the proposed treatment of F/X-residential mortgages (LTV-ratio of 50 %, Section 2 of the working document), the "basis scenario" (residential mortgages denominated in local currency) should not be subject to stricter conditions for a preferential treatment.

Question 18: Is the suggested timeline (2012) for a single definition of default (i.e. 90 days) appropriate?

We strongly support a harmonised definition of default (90 days). We would also support a shorter timeline.

Specific Remarks

Annex VI, Part 1, Point 63, 64 and 67 CRD

We would like to reiterate our concerns regarding the deletion of these requirements. The reduced risk weight given value adjustments were made seems to be sufficiently prudent. We feel reluctant to completely delete the requirement after the proposed expiration date as it constitutes an incentive for credit institutions to make adequate value adjustments. We therefore suggest turning the provision into an option for credit institutions.

Article 154.6 CRD

We object the proposal to shorten the transition period.

An earlier end of the transition period could lead to the fact that several investments will become uneconomic in the eyes of the investors because of the higher capital costs. A possible reaction of this issue could be that the investmnets will be sold by their owners. This could lead to uncertainties in the markets. Keeping the end of the transitional period at the 31 December 2017 might mitigate this issue since the return of the investments should increase until the end of 2017.

Technical remarks

ANNEX 3:

DRAFT TEXT FOR AMENDMENTS TO THE CRD TO REMOVE

NATIONAL OPTIONS AND DISCRETIONS

minor wording suggestion:

5. The second subparagraph of Article 84 (2) is replaced by the following:
"Where an EU parent credit institution and its subsidiaries or an EU parent financial holding company and its subsidiaries use the IRB Approach on a unified basis, the competent authorities, working together in accordance with Article 129(2), ~~may~~ shall allow, in a way consistent with ~~of~~ the structure of the group and its risk management processes and methodologies, minimum requirements of Annex VII, Part 4 to be met by the parent and its subsidiaries considered together."

minor wording suggestion (to streamline wording with Article 82(2)):

8. Article 98(2) is replaced by the following:
"2. ~~When the competent authorities of a Member State have made a determination under paragraph 1, the competent authorities of other Member States may recognise that determination without carrying out their own determination process.~~ For ECAIs referred to in Article 97(3), the Committee of European Banking Supervisor shall make the determination ~~process~~ referred to in paragraph (1).".

minor wording suggestion:

17. Annex VI, Part 1 is amended as follows:

(a) [...]

(b) Point 11 is replaced by the following:
"11. When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the Community treat exposures to regional governments and local authorities as exposures to their central government and there is no difference in risk between such exposures owing to the specific revenue-raising powers of regional government and local authorities and to specific institutional arrangements to reduce the risk of default ~~exist~~, the competent authorities shall allow their credit institutions to risk weight exposures to such regional governments and local authorities in the same manner. To this end, the Committee of European Banking Supervisors shall conduct an assessment of the supervisory and regulatory arrangements of the third country in question.";

reference to criteria of Point 53a instead of duplication:

58. ~~Competent authorities~~ Credit institutions may dispense with the condition contained in point 54(b) for exposures fully and completely secured by mortgages on commercial property which is situated within the ~~their~~ territory of a Member State, if the competent authority of that Member State has decided based on ~~they have~~ evidence that a well-developed and long-established residential real estate market is

present in ~~their~~ that territory with loss rates which do not exceed the ~~following~~ limits given in Point 53a:
~~(a) losses stemming from lending collateralised by commercial real estate property up to 5 40 % of the market value (or where applicable and if lower 6 50 % of the mortgage lending value (MLV)) do not exceed 0,3 % of the outstanding loans collateralised by commercial real estate property in any given year; and~~
~~(b) overall losses stemming from lending collateralised by commercial real estate property must not exceed 0,5 % of the outstanding loans collateralised by commercial real estate property in any given year.~~

With regard to Annex VII, Part 2 we want to reiterate our strong doubts concerning "outsourcing" legal requirements. As CEBS guidelines are currently not legally binding (and often merely principles-based), national legislation cannot refer to them (especially in cases where such guidelines not even exist yet).

Besides, we feel that an explicit disclosure requirement of the reasoning behind a prudential approach is on the one hand redundant in the light of CEBS guidelines and on the other hand supervisory disclosure should not be used for justification of supervisory practice:

(f) Point 20 is replaced by the following:
"20. Unfunded credit protection may be recognised as eligible by adjusting PDs subject to point 22. For dilution risk, where credit institutions do not use own estimates of LGD, this shall be subject to compliance with articles 90 to 93; for this purpose, on the basis of guidelines established by the Committee of European Banking Supervisor, competent authorities may recognise as eligible unfunded protection providers other than those indicated in Annex VIII, Part 1. To this end, competent authorities shall publish the list of those other eligible protection providers ~~together with the reasons why these are considered suitable for this purpose~~.";

minor wording suggestion (collateral is not "recognised" by credit institutions):

22. In Annex VIII, Part 1 is amended as follows:
(a) Points 15 to 19 are replaced by the following:
"15. ~~The competent authorities may also authorise their c~~ Credit institutions may also ~~to~~ ~~recognise~~ use as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation as commercial real estate collateral, provided that these conditions are met.

19. ~~The competent authorities of a Member State may recognise as eligible collateral commercial real estate property recognised as eligible collateral in another Member~~

~~State by virtue of the waiver provided for in point 17.~~ When the competent authority of a Member State has taken a positive decision in respect of the relevant market in the territory of that State in accordance with point 58,, credit institutions in of another Member States may ~~recognise~~ use as eligible collateral those mortgages on residential or commercial property situated within that territory.";

"20. ~~The competent authorities~~Credit institutions may ~~recognise~~ use as eligible collateral amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year. Eligible receivables do not include those associated with securitisations, sub-participations or credit derivatives or amounts owed by affiliated parties.";

minor wording suggestion (otherwise sentence incomplete):

25. Annex IX, Part 4 is amended as follows:
[...]
(c) Last paragraph of point 53 is replaced by the following:
"For securitisations involving retail exposures, ~~the competent authorities may permit~~ the Supervisory Formula Method ~~to be implemented~~ may be implemented using the simplifications: h=0 and v=0, provided that the institution applies this approach consistently.".

minor wording suggestion ("directive" would be too far reaching):

27. Point 11 of Annex X, Part 3 is replaced by the following:
"11. Correlations in operational risk losses across individual operational risk estimates shall ~~may~~ be recognised only if credit institutions can demonstrate to the satisfaction of the competent authorities that their systems for measuring correlations are sound, implemented with integrity, and take into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress. The credit institution must validate its correlation assumptions using appropriate quantitative and qualitative techniques. The Committee of European Banking Supervisors shall establish guidelines on all supervisory decisions taken by the competent authorities to implement this ~~Directive~~ provision with a view to ensuring the convergence of supervisory practices.".

Proposal seems unclear: We understand the following proposal as the deletion of the former national discretion; turning the requirement into an option of the credit institution: The credit institution can chose either to apply the non-trading book rules (Annex VI, Part 1 Point 71 CRD), i.e. different risk weights (20, 50, 100, 150 %) corresponding to the risk weight assigned to senior unsecured exposures to the credit institution which issues them, or to apply a general risk weight of 100% (the wording then should be: “as 8 % of the exposure amounts”).

2. Article 19 is amended as follows:
(a) Paragraph 2 is replaced by the following:
"2. By way of derogation from points 13 and 14 of Annex I, ~~Member States~~ credit institutions may calculate the ~~set a~~ specific risk requirement for ~~any~~ bonds falling within points 68 to 70 of Part 1 of Annex VI to Directive 2006/48/EC as 8% of the ~~risk-weighted~~ exposure amounts or applying a weighting of 8% of the risk weight, as applicable in the same institution's non-trading book ~~which shall be equal to the specific risk requirement for a qualifying item with the same residual maturity as such bonds and reduced in accordance with the percentages given in point 71 of Part 1 to Annex VI to that Directive~~.";

SECTION 4

SIMPLIFICATION OF THE BANK ACCOUNTS DIRECTIVE

Question 19: Do you agree that the Bank Branch accounts Directive 89/117/EEC should be amended so that Member States can no longer require the publication of additional information by branches of credit institutions established in other Member States?

Austria has made use of the national discretion in Art. 2 Para. 4 of Directive 89/117/EEC and requires branches to publish additional information according to Para. 4 (only one item is excluded). We would be in favour of keeping the discretion to require the publication of additional information according to the first, second and fourth indent of Para. 4. We deem the additional publication necessary for supervisory purposes, particularly in MS with branches holding large deposits, as it allows for a continuous, comprehensive on-going supervision on the basis of readily available, audited data. Eliminating the discretion would imply that the information would be delivered without the additional safeguard of an auditor. Therefore, we would prefer to retain the possibility of having the relevant data at our disposal.