Ref. Ares(2023)3906291 - 06/06/2023
Ref. Ares(2022)2162483 - 24/03/2022

VÖB german public banks

Priorities EU Banking Package

21 March 2022

Internal Ratings Based Approach (IRBA)

Permanent Partial Use for Exposures to certain Public Bodies

Proposal

Article 150 (1) (d) CRR:

Possibility to permanently exempt exposures to central governments, central banks, regional governments, local authorities and public sector entities that are risk weighted 0% under the CRSA is to be deleted.

Assessment

- Deletion would mean that general partial use rules would have to be applied.
- Institutions can either exempt all exposures to central governments, central banks or RGLA-PSE or immaterial parts thereof.
- There is a risk that the exposures will have to remain in the IRBA, where they cannot be assigned a risk weight of 0%.
- Refinancing for Federal Republic of Germany, Länder as well as municipalities and promotional banks in Germany becomes more expensive.

Solution

We propose to

continue possibility of permanent partial use for exposures to central governments, central banks, regional governments, local authorities and public sector entities, that receive a risk weight of 0% in the standardized approach to credit risk.

Internal Ratings Based Approach (IRBA)

Permanent Partial Use for Exposures within IPS

Proposal

Article 150 (1) (f) CRR:

Possibility of permanent exemption of exposures to institutions within the same institutional protection scheme (IPS) (risk weighted 0% under the CRSA) from the IRBA is to be removed.

Assessment

- Deletion would largely render application of Article 113 (7) CRR (0% risk weight for IPS exposures under the standardized approach) meaningless.
- In IPS institutions applying IRBA are responsible to a large extent for the allocation of liquidity and external refinancing. Therefore, those institutions have many exposures to other IPS institutions.
- EU legislator has already recognised that exposures within IPS do not entail any risk. This should not be counteracted by the partial use rules.

Solution

We propose to

continue the possibilty for a permanent partial use of exposures to institutions within the same IPS.

Exposures to RGLA-PSE

Treatment as exposures to central governments under the IRBA

Proposal

Article 147 (2) (a1); 151 (11) CRR:

Introducing a separate exposure class for exposures to regional governments, local authorities and public sector entities ('RGLA-PSE').

Applying rules for corporate exposures to RGLA-PSE.

Assessment

- Proposal deviates from Basel III.
- Could lead to a dramatic increase in capital requirements in those countries that treat exposures to RGLA-PSEs as exposures to central governments.
- Proposed PD input floor of 0.05% would result in a minimum risk weight of around 20%.
- Could make refinancing of Länder, municipalities and promotional banks in Germany as well as RGLA-PSE in many other EU member states significantly more expensive.

Solution

We propose to

maintain possibility of treating RGLA-PSEs as exposures to central governments under the IRBA if strict conditions apply (i.e. no difference between the risks of the positions concerned and the central government due to institutional requirements or appropriate guarantees).

Exposures to Banks

Recognising the risk-reducing effect of assigned receivables

Proposal

Article 121 CRR:

For exposures to unrated banks, the “home-country principle” is to be replaced by the “SCRA”.

I.e banks must determine risk weights based on supervisory criteria.

Assessment

- In Germany, promotional loans are mostly passed through by the client's "house bank". Therefore, promotional banks have many exposures to other (mostly unrated) banks.
- The capital requirements for these exposures would increase by more than 70% as a result of the SCRA.
- As a result, promotional banks could grant fewer promotional loans.
- Capital requirements do not reflect risk-reducing effect of assigned receivables.

Solution

We propose

- **to reduce risk weights to be applied to exposures to unrated banks in the pass-through business fully collateralised by assigned exposures (Grade A: 30%; Grade A well capitalized (Article 121 (2)(b)): 20%),**
- **consider the risk-reducing effect of assigned exposures in the pass-through business also for exposures to rated banks through an appropriate reduction of the corresponding risk weights.**

Transitional arrangements

Treatment of Certain Exposures to Corporates Secured by Mortgages

Proposal

Article 465 (3) CRR:

When calculating the output floor institutions my apply a risk weight of 65% for „exposures to corporates“ without external rating and a PD of no higher than 0.5%.

Assessment

- Provision relates to unsecured exposures to corporates.
- Capital requirements for these exposures can be further reduced by using collateral eligible under the CRSA.
- To comprehensively counter possible negative effects of the output floor on exposures to corporates, provision should be expanded to certain exposures to corporates that must be allocated to exposure class "exposures secured by mortgages on immovable property" under the Standardised Approach.

Solution

We porpose to

expand the transitional arrangement to

- **exposures that are treated as exposures to corporates for the purpose of determining risk weights (Article 126 (1) (b) CRR).**
- **"IPRE Exposures" secured by commercial real estate (Article 126 (2) CRR). Same risk profile as specialised lending exposures.**

Output Floor

Elimination of „Arithmetic Effect“

Proposal

Article 104a (6) (a); 133 (2a) (a) CRD:

P2R and SRB shall not increase due to an increase in TREA caused by the output floor (elimination of the "arithmetic effect").

Therefore, P2R and SRB are “frozen”.

Assessment

- Basel Committee does not require application of output floor to capital requirements that apply only in the EU ("EU buffers").
- We strongly support the EU Commission's proposal to eliminate the “arithmetic effect” in the P2R and SRB.
- However, for other EU buffers (P2G and O-SII buffers), the arithmetic effect would remain in place.

Solution

We propose to
eliminate the „arithmetic effect“ also for the Pillar 2 Guidance (P2G) and the capital buffer for other systemically important institutions (O-SII).

Standardised Approach for Operational Risk
Calculation methodology

Proposal

Article 314 CRR:

Fee and commission transactions in financial networks increase the service component at each stage of the value chain when institutions are regulated.

Assessment

- Financial groups with a branch structure and unregulated institutions are placed in a better position compared to non-consolidated financial networks with regulated institutions. This creates a wrong incentive.
- Current data does not justify a disproportionate consideration of the fee and commission business e. g. compared to the interest business, especially for institutional protection schemes.

Solution

We propose to

allow netting of fee and commission income and expenses for members of an institutional protection scheme (IPS) or for institutions that are consolidated under parent companies that are members of an IPS.

Standardised Approach for Operational Risk
Calculation methodology

Proposal

Article 313 CRR:

Own funds requirement independent of historical losses (ILM = 1).

Assessment

- Proposal creates a clear disincentive for institutions with ILM < 1 to maintain the quality of their OpRisk management. For institutions with ILM > 1 there is no incentive to improve their OpRisk management and benefit from lower ILM-levels in the long-term.
- Institutions that successfully managed their operational risks would be penalized for the benefit of institutions with high historical OpRisk-losses.

Solution

We propose to
introduce an option to apply the bank-specific ILM permanently.

ESG Risk Management
Definition

Proposal

Art. 4 (1) point 52 (d) CRR:
“environmental, social or governance (ESG) risk” means the risk of losses arising from any negative financial impact on the institution stemming from the current or prospective impacts of environmental, social or governance (ESG) factors on the institution’s counterparties or invested assets;

Assessment

- It is not made sufficiently clear that ESG risks are not to be treated as a separate risk category but as a risk driver within the framework for existing risk types.
- There is a consensus that ESG risks represent factors that materialise through the **traditional categories of risk**, like credit, operational and market risk, see e. g. EBA Report on Management and Supervision of ESG Risks (EBA/REP/2021/18, Definitions and Assessment Methodologies, page 10) or the BIS paper on Climate Related Risks and their Transmission Channels (April 2021, Executive Summary, page 2).

Solution

We propose to
- **clarify that ESG-risks are risk drivers within the framework for existing risk types.**
- **This could be achieved by adding wording along the following lines to Article 4 (1) point 52 (d): “In this context, ESG risks are drivers of existing risk categories, such as credit risk, operational risk and market risk.”**
- **Also in this context: Delete the proposed supervisory reporting requirements for exposures to ESG risks according to Art. 430 (1) (h) CRR***

*** All institutions will be subject to additional supervisory reporting requirements for exposures to ESG risks.**

ESG Risk Management

ICAAP and Time Horizons

Proposal

Art. 73 (1) and 74 (1) CRD:

Strategies and processes for assessing and maintaining internal capital (ICAAP) now refer to risks to which institutions are or might be exposed in the **short, medium and long-term time horizon**, including environmental, social and governance risks.

Assessment

- Individual risk types require different risk assessment horizons: this also applies to the risk driver category of ESG risks (long-term horizon important for E, open to question for S and G).
- Existing risk-bearing capacity assessments (ICAAP, financial plans, etc.) run from 3 to a maximum of 5 years. Detailed calculations are appropriate here but would not be meaningful or necessary beyond that time horizon since the uncertainties surrounding estimates are too high. Articles 76 (1), 87a(1) and 87a(2) of the proposal already envisage a specific definition of time horizons for ESG risks.
- Institutions should address relevant long-term developments and risks in a qualitative manner as part of developing their strategies.

Solution

We propose to

- **drop the specification of time horizons to avoid unnecessary implications for the ICAAP and an ensuing paradigm shift;**
- **consider requirements for longer time horizons in a more targeted manner, e. g. by taking account of specific climate risk drivers in institutions' strategies.**

ESG Risk Management

Business Models and Policy Objectives

Proposal

Art. 76 (2), 87a (4/5), 104 (1) m CRD:

Institutions are to design specific plans and quantifiable targets to monitor and address the risks arising […] from the **misalignment of the business model and strategy of the institutions, with the relevant Union policy objectives or broader transition trends** towards a sustainable economy […].

Assessment

- It is reasonable to require institutions to consider sustainability aspects in their decisions. Although risks could arise from a misalignment of their strategy with the Union's policy objectives, these may be acceptable to an institution in the context of its ICAAP. Determining a bank's strategy and business model is the responsibility of the management body, which is ultimately liable for all business policy decisions.
- Supervisory powers such as the ability to require adjustments to the business model or to penalise misalignments with the Union's policy objectives are too far-reaching, as supervisors could interfere more or less arbitrarily in the business policy of institutions.

Solution

We propose to

- **focus regulation on strategic aspects in the context of ESG risks.**
- **refrain from hindering institutions to take risks which they can manage and bear under their ICAAP and business model.**
- **delete references and supervisory powers with regard to misalignments with the Union's policy objectives.**

Fit and Proper
Members of the management body

Proposal

Art. 91a CRD:

Suitability assessment of members of the management body by institution: Ex ante as a rule.

Art. 91b CRD:

Suitability assessment by competent authority within 120 working days: Ex ante only for large institutions.

Assessment

- Any ex-ante assessment procedure of members of the management body in its supervisory function (supervisory board) carried out by the institutions themselves (Article 91a) or by the competent authorities (Art. 91b) would be unfeasible to comply with for institutions that have practically no influence on the recruitment process of members of the supervisory board.
- Furthermore, the proposed deadline for suitability assessment by the competent authority (six months assessment period, cf. Article 91b (4)) is too long.

Solution

We propose to

- **delete Article 91a and Article 91b CRD.**

At least, the following changes are required:

- **Article 91a (2) and Article 91b (8): Exemption for institutions that have no or hardly any influence on the recruitment process of members in accordance with Article 88 (2) subpara. 5 CRD.**
- **Regardless of this, the limitation to members of the management body in its management function (management board) seems sufficient.**
- **Reduction of the assessment period for the competent authority to maximum of one to two months.**

Fit and Proper

Key Function Holders (KFH)

Proposal

Art. 91c CRD:

Institutions have primary responsibility for suitable KFH, ex ante assessment

Art. 91d CRD:

Ex ante suitability assessment by the competent authority for large institutions

Assessment

- Key function holders are not members of management bodies, but employees of the institutions. Applying suitability standards comparable to those for members of the board in their executive function to KFH would be disproportionate. The requirements and profiles designated in the institutions for recruitment to such positions are sufficient.
- In addition, the assessment by the competent authority would cause a considerable effort for all large institutions and their subsidiaries - this applies to both: ex post and ex ante. Moreover, an ex-ante assessment would also lead to long vacancies.

Solution

We propose

- **to delete Articles 91c and 91d CRD: no suitability assessment by the competent authority at all (neither ex ante, nor ex post). The responsibility for KFH should remain with the institution,**
- **to at least significantly reduce the assessment period for the competent authority to a maximum of one to two months (20 to 40 working days).**

Reversal from IRBA to CRSA

„Simplified Procedure“

Proposal

Article 494d CRR:

IRBA institutions are allowed to revert to Standardised Approach (CRSA) for entire asset classes within a 3-year transitional phase within the framework of a “simplified procedure”.

Assessment

- Use of the “simplified procedure” is restricted to whole exposure classes.
- In some countries, institutions - to reach a certain minimum coverage of the portfolio - had to apply IRBA also to types of exposures for which development and application of rating systems is uneconomical or for which little data was available. Institutions should be allowed to switch to the CRSA for these types of exposures.
- Furthermore, “simplified procedure” is only allowed for transition from IRBA to the CRSA - not from the A-IRBA to the F-IRBA.
- EBA has recognised that implementation of Basel III constitutes an "exceptional circumstance" which justifies the return from A-IRBA to F-IRBA.

Solution

We propose to

- **open use of “simplified procedure” also for individual rating systems (Article 142 (1) (1) CRR) within exposure classes.**
- **to apply “simplified procedure” also for transition from A-IRBA to the F-IRBA.**

Stress Testing

Exchange of information

Proposal

Art. 100 (3) CRD:

Parties are required to refrain from various kinds of activities, including the exchange of information and the optimisation of their submissions in stress tests.

Assessment

- The new paragraph casts general and unreasonable suspicion on institutions, advisers and associations.
- The complexity of the EU-wide stress test and the partial lack of coherence of rules and methodologies often make it necessary for institutions to exchange information in order to make meaningful calculations. Small and medium-sized institutions, especially, do not normally have sufficient resources at their disposal and require external support from associations and other parties.
- Moreover, optimisations do not necessarily consist in window dressing but often in a meaningful and appropriate presentation of risks. Optimisations of this kind are sensible and necessary.

Solution

We propose to

- **change the wording in a targeted manner so that an exchange of information between institutions and third parties will remain possible while preventing any benchmarking analysis regarding final stress test outcomes or other forms of manipulation.**