German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the European Commission's public consultation on implementing the final Basel III reforms in the EU

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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1. Credit risk

1.1. Standardised approach (SA-CR)

1.1.1. General issues

1.1.1.1. External credit risk assessment approach (ECRA) vs. standardised credit risk assessment approach (SCRA)

Question 1. Views are sought on the relative costs and benefits of the ECRA provided by the final Basel III standards and the SCRA.

In particular, how do the two approaches compare in terms of risk-sensitivity, impact on risk-weighted assets (RWAs) and operational burden? Please specify the relative costs and benefits of the two approaches for exposures to institutions.

Please provide relevant evidence to substantiate your views.

We welcome the Basel Committee's decision to continue to allow the use of external ratings. A rating by a recognised rating agency contains much more information than the parameters proposed in the Basel Committee's original consultation paper on the standardised approach for credit risk would have been able to deliver. A major advantage of external ratings is that they consistently take certain forward-looking components into account. As a result, these ratings reflect the risk associated with an exposure much more accurately than supervisory parameters. Furthermore, uniform use of external ratings ensures the comparability of capital requirements. Supervisory arrangements in the EU should therefore continue to be based on external ratings as well.

The ECRA is not only more risk-sensitive than the SCRA, the SCRA would also normally be significantly more complex and time-consuming to apply when the financing to be assessed was not a "classic" loan. While there is personal customer contact where the latter is concerned and key metrics about the borrower are available for evaluation, this is often not the case when securities are being purchased, for example. In this case, the information provided by external rating agencies together with market indicators is normally sufficient to be able to decide whether or not to make the purchase. It would be much more costly and time-consuming to obtain and evaluate the data required under the SCRA. Take, for instance, a purchase of covered bonds – a classic securities transaction. Banks would find it highly onerous to conduct their own analysis of the bonds. In our opinion, the use of external ratings allows securities like these to be evaluated in a practicable and sufficiently risk-sensitive manner as long as rating agencies are strictly monitored. And this is adequately ensured by current European regulation, in our view.

Also where corporate exposures are concerned, we warmly welcome the Basel Committee's decision to continue to allow the use of external ratings.

Please specify the relative costs and benefits of the two approaches for exposures to covered bonds.

Please provide relevant evidence to substantiate your views.

We warmly welcome the Basel Committee's decision to continue to allow the use of external ratings for covered bonds, too. A rating by a recognised rating agency contains much more information than the parameters proposed in the consultation paper on the standardised approach for credit risk would be able to deliver. A major advantage of external ratings is that they consistently take certain forward-looking

components into account. As a result, such ratings reflect the risk associated with an exposure much more accurately than supervisory parameters. Furthermore, uniform use of external ratings ensures the comparability of capital requirements. Supervisory arrangements in the EU should therefore continue to be based on external ratings as well.

Please specify the relative costs and benefits of the two approaches for exposures to corporates.

Please provide relevant evidence to substantiate your views.

See our reply to Q 1.

Question 2. Would you deem refinements or clarifications necessary concerning the approach that you generally prefer?

- Yes
- No !!!!
- Don't know / no opinion / not relevant

1.1.1.2. Enhanced due diligence requirements

Question 3. Views are sought on the costs and benefits of implementing the various clarifications and specifications provided by the Basel III standards paragraph 4) in relation to the due diligence to be performed by institutions.

Please provide specific answers on each of the clarifications/specifications and support your view with relevant evidence.

We consider the existing European requirements governing due diligence and loan origination to be adequate and appropriate (see the EBA's 2019 guidelines on loan origination). Article 79 of the CRD already implements the general intention of paragraph 4, in our view. However, paragraph 6 goes on to propose that banks should have internal arrangements in place to analyse the borrower and assess the appropriateness of external ratings. We believe this imposes an unreasonable administrative burden on banks. Smaller banks, in particular, are likely to quickly reach the limits of their capabilities if they have to perform such due diligence themselves. The due diligence process for exposures to development banks, banks, covered bonds and corporates should not have to consist of comparing external ratings with a separate internal analysis for each individual borrower in the form of mapping, for example.

Question 4. Are you of the view that the CRR/D should be amended to clarify/specify the rules on due diligence requirements?

- Yes
- No
- Don't know / no opinion / not relevant

Question 4.1 If no, please elaborate on your response to question 4.

See our reply to Q 3.

Question 5. In your view, should the due-diligence requirements differentiate between exposures for which a rating exists and unrated exposures treated under the SCRA (see above 1.1.1.1.)?

- Yes
- No
- Don't know / no opinion / not relevant

Question 5.1 If yes, please explain why? Please specify and provide relevant evidence.

As mentioned above, there is no need to go beyond the existing due diligence requirements set out in Article 79 of the CRD to meet the Basle Committee's desired objectives. In our view, the due diligence requirements can only be adequately met by an external entity which has all the necessary information at its disposal as well as a corresponding ability to intervene. Only an entity of this kind is in a position to evaluate the fundamental appropriateness of ratings issued by a rating agency. The European regulation governing rating agencies (CRA Regulation) has already established a process requiring ESMA to continuously monitor the appropriateness of external ratings. In consequence, we believe the due diligence requirement can be dropped in Europe.

1.1.2. Exposures to institutions

Question 6. Views are sought on the costs and benefits of implementing the definition of grades under the SCRA provided by the Basel III standards (paragraphs 22-29).

Please provide relevant evidence to substantiate your views.

Many German banks have no external rating issued by a rating agency. Exposures to unrated banks are currently subject in the EU to the country of incorporation principle (Article 121 of the CRR). Bank exposures are assigned a risk weight in accordance with the credit quality step to which exposures to the central government of the jurisdiction in which the bank is incorporated are assigned. The risk weight of unrated German banks is currently 20%.

The revised standardised approach for credit risk includes a new procedure for calculating the risk weight of exposures to banks with no external rating (standardised credit risk assessment approach (SCRA)). Where all grade A criteria are met, a risk weight of 40% may be applied. For grade A, application of a risk weight of 30% is also possible provided that the bank has a CET1 ratio of 14% or higher and a leverage ratio of 5% or higher. Unfortunately, most banks do not meet these criteria, so the reduced risk weight will rarely be applied. Consequently, the risk weight for exposures to unrated German banks will usually double from currently 20% to 40%, which would not be commensurate with the risk involved. The existing country of incorporation principle should therefore be retained in the EU.

Question 7. In your view, are the quantitative and qualitative criteria for the classification of counterparties into grades sufficiently clear or do you consider more specifications necessary to ensure a harmonised application of these criteria throughout the Union?

- ○ the criteria are sufficiently clear
- ○ more specifications are necessary to ensure a harmonised application of these criteria throughout the Union
- ○ Don't know / no opinion / not relevant

Question 7.1 Please elaborate on your response to question 7. and provide relevant evidence.

As mentioned above, we consider it appropriate to continue to apply the country of incorporation principle to unrated banks. The process of assigning the three proposed grades will be much more onerous compared to the status quo due to the amount of data which will need to be collected. A significant increase in risk weights is also likely.

The question nevertheless arises as to how to differentiate between group and individual data when determining risk weights. Banks are supposed to classify unrated exposures to banks as Grade A, B or C on the basis of the extent to which the bank meets minimum regulatory requirements. Information about prudential ratios can be found in banks' Pillar 3 reports. The Basel framework only requires parent companies to publish disclosures on a consolidated basis, however. We consequently assume that classifications under the SCRA can be based on the parent company's data if no data from subsidiaries are disclosed.

It is not clear how risk weights are to be derived if the information needed to assign a grade remains unobtainable despite a bank's demonstrated best efforts. Take, for instance, information about banks in less developed countries. We would not consider it appropriate to automatically assign Grade C to all such exposures. The increased element of uncertainty can be adequately reflected by assigning Grade B.

The institutions' exposure class currently includes exposures to financial institutions that have been licensed and are supervised by competent authorities and are subject to prudential rules of comparable robustness to those of Grade A institutions. It is unclear on what basis and how these institutions are to be classified if it is confirmed that comparable prudential rules exist but the specific requirements are not known. We do not consider automatic allocation of these companies to Grade B to be risk appropriate.

Question 8. What are your views in relation to a potential clarification that also minimum capital and buffer requirements beyond the Basel minima (e.g. higher Pillar 1 requirements pursuant to Article 458 CRR or systemic buffers pursuant to Article 133) should be taken into account for the classification into grades, where applicable in the jurisdiction of the counterparty institution?

Paragraph 23 of the Basel III standards explicitly excludes certain Pillar 2 requirements from the minimum regulatory requirements for Grade A bank exposures. This should also be clearly spelled out in the respective article of CRR 3. We understand the currently proposed provision to mean that Pillar 2 requirements must always be fully taken into account, regardless of whether they have been made public or not. We do not consider this to be appropriate. It would create a major competitive disadvantage compared to banks where such an additional capital add-on has not been imposed by the national supervisor.

1.1.2.2. Identification of short-term exposures to institutions

Question 10. In your view, what are the relative costs and benefits of using the original maturity as opposed to the residual maturity for identifying short-term interbank exposures?

Please provide relevant arguments and evidence to substantiate your views.

We do not consider the original maturity to be appropriate from a risk perspective and recommend retaining the current criterion, which is based on residual maturities. It is the residual maturity which is relevant from a risk perspective and not the maturity originally envisaged for the transaction. The shorter the residual maturity, the lower the risk – regardless of the original maturity. On top of that, external ratings are continuously updated. An increase in risk during the term of a contract is therefore already reflected in the downgraded rating. As a result, the risk of a contract with an original maturity of three months is comparable with the risk of a contract with a longer original maturity but with a residual maturity of three months.

Under Article 120(2) of the CRR, the maturity for short-term exposures to banks of up to three months is to be determined on the basis of the residual maturity. This is the correct approach since both external rating agencies and banks monitor the creditworthiness of banks continuously. Both rating agencies and banks in Europe have to comply with the requirements of the CRA Regulation in the process. In Germany, BaFin's Minimum Requirements for Risk Management (MaRisk) also require banks to monitor creditworthiness on a continuous basis and make intra-year adjustments to credit assessments. Given the availability of up-to-date information, the risk of exposures to two banks with the same rating and risk profile, different original maturities but identical residual maturities, is comparable. With residual maturities of three months and an up-to-date rating, the period in which the risk may be realised is the same. It would make no sense to have to apply different risk weights to a comparable risk because of different residual maturities. Any increase in the risk of a longer loan would already have been taken into account during the life of the loan before the reporting date and would be reflected in adjustments to the external rating and internal risk assessment. In such a case, this would have already translated into a higher risk weight. The use of original maturity as a basis would lead to an inappropriate double counting of risk – once because of the maturity element and once because of the possible deterioration in the creditworthiness assessment.

Question 11. What are your views on the extension of the scope of the preferential treatment for short-term interbank exposures under Basel III from three to six months for exposures to institutions that arise from the movement of goods across national borders?

To what extent would the change in definition change the amount of exposures benefitting from the preferential treatment?

Please provide relevant evidence to substantiate your views.

We support the extension of the scope of the preferential treatment. The Basel text assigns a preferential risk weight to short-term exposures arising from the "movement of goods across national borders". The term "movement of goods" is undefined and unclear, however. We therefore recommend retaining the existing CRR term "trade finance" in Article 121(4) of the CRR, which is clearly defined.

1.1.3. Exposures to corporates

1.1.3.1. Treatment of unrated corporates

Question 13. Views are sought on the definition of 'investment grade' provided by the Basel III standards (paragraph 42).

In particular, would you deem further refinements or clarifications necessary in order to ensure a consistent application across the Union?

Please elaborate.

We consider the definition of "investment grade" in paragraph 42 of Basel III to be generally appropriate. The criterion "must have securities outstanding on a recognised securities exchange" should not be implemented in European law, however. Europe has a number of companies without an external rating which nevertheless have "an adequate capacity to meet [their] financial commitments in a timely manner and [their] ability to do so is assessed to be robust against adverse changes in the economic cycle". For various reasons, however, they do not tap the capital market for funding, so are unable to meet the criterion of being listed on a recognised exchange. Yet their creditworthiness is nevertheless good enough to justify a 65% risk weight.

Question 14. What other measures, if any, could be taken to increase the risk-sensitivity of the standardised RW treatment of corporate exposures which currently have no external rating?

Please elaborate and provide relevant evidence.

To date, European banks that use internal models have determined an average risk weight of 45% (EBA calculation) for unrated companies. Assigning a standardised risk weight of 100% therefore represents an enormous overestimation of risk, in our view. This is one of the central problems for banks using the IRB approach. For this reason, at least the following solutions should be implemented consistently across Europe.

To create a level playing field for all banks in Europe, the definition of "investment grade" – modified as described above – should be added to as follows.

For banks with prudentially recognised internal ratings, the internal rating should correspond to a probability of default of at least BBB. In addition to this requirement, a simple supervisory mapping system could be developed to determine investment grade. The system could be based on features such as amount of total assets, turnover, industry or similar.

For corporates that are subsidiaries in a group, moreover, the use of the parent company's external rating should be allowed. Subsidiaries rarely have their own external rating and will therefore be deemed unrated under the new Basel framework. The Basel III standards recognise this for the SCRA approach and allow corporate entities to use the listing of their parents. Allowing the use of parent external ratings for integrated subsidiaries (next to guaranteed) would align this framework with the CRSA approach.

Question 15. In your view, which other aspects, if any, should be considered in the context of revising the standardised treatment of corporate exposures?

Please elaborate.

Given that a large proportion of big European banks' total credit risk-weighted assets result from their corporate portfolio, and that corporate clients are usually unrated, the new standardised approach for credit risk could have serious unintended implications for lending to such entities. This is because, as regards exposures to unrated entities, the standardised approach for credit risk puts banks in jurisdictions that allow the use of external ratings for regulatory purposes (e.g. the EU) at a disadvantage compared to banks from countries where external ratings are not allowed for regulatory purposes (e.g. the US). The latter can assign investment grade corporate exposures a risk weight of 65%, whereas the former are required to apply a 100% risk weight to unrated entities. If corporate clients in different jurisdictions are subject to different risk weighting approaches, this may lead to regulatory arbitrage. What is more, it would hamper the ability to compare the credit risk of corporate clients worldwide. We therefore suggest that, if certain investment grade criteria are met, the application of a 65% risk weight should be allowed for unrated entities in Europe as well.

In addition, we believe that the financing of small and medium-sized enterprises should continue to be promoted. The bank loan remains the most important source of SME financing. This tried and tested form of SME financing should not be put at risk by more restrictive risk weights. The financing needs of small and medium-sized enterprises must continue to be taken into account. This is a prerequisite for strengthening the financing of the European economy, thus enabling more growth and employment. It is therefore essential to retain the SME factor in Article 501 of CRR 2.

In addition, collateral which is particularly important to SMEs and is eligible under the IRB approach should also be eligible under the standardised approach and lead to a reduced risk weight if the IRB conditions are met. To this end, a credit mitigation factor should be introduced and applied to the collateralised part of the exposure. This credit risk mitigation should be multiplied with the risk weight of the collateralised part of the exposure. The credit mitigation factor should be derived from the ratio of regulatory LGDs in the IRB foundation approach for secured and unsecured exposures, taking into account regulatory haircuts. Such an approach is also justified for institutions using only the standardised approach because these banks are regularly evaluated in the supervisory review process and subject to regular special audits. Supervisors are therefore able to review at any time whether or not these banks fulfil the credit risk mitigation requirements of the IRB foundation approach. In addition, it should be borne in mind that the IRB foundation approach only allows the use of internal estimates of PDs and not internally estimated LGDs. There are therefore sound arguments to allow the use of physical collateral, which is highly important to SMEs, under the standardised approach as long as the IRB foundation approach requirements are met.

On top of that, the rules for deducting non-performing exposures from CET1 capital should be harmonised for banks using the IRB and standardised approaches (see Article 47c of the CRR). This is because the level of deduction of secured non-performing exposures should depend not on which approach to credit risk is applied but on the classification as secured or unsecured. It is not appropriate that exposures regarded as secured at an IRB bank due to the recognition of IRB collateral should be considered unsecured at a bank using the standardised approach even if both institutions meet the IRB credit risk mitigation requirements. If IRB collateral is not recognised under the standardised approach, banks will in future have to deduct 100% of the portion of a non-performing loan secured with recoverable collateral from CET1 capital during the workout phase after three years at the latest. The secured portion will even have to be deducted from CET1 capital in full if the borrower posts new recoverable collateral during the workout phase as the deduction is calculated only on the basis of the length of the non-performing period. This is not appropriate and the extreme implications for CET1 capital will lead to banks using the

standardised approach being increasingly unwilling to support restructuring even if prospects appear promising in the medium term. The effect described results from the fact that under the German GAAP principle of loss-free valuation, a value adjustment is made only on the unsecured portion of a loan if the collateral is recoverable. Anything else would not correspond to a true and fair view and would therefore be inadmissible under German GAAP. Since the requirements for deducting non-performing loans from regulatory capital under the CRR did not come into force until 26 April 2019, they will have an impact on capital from 2022 onwards. Action is therefore urgently needed.

1.1.3.2. Treatment of specialised lending (SL)

Question 16. Views are sought on the costs and benefits of implementing the specific treatment of SL exposures provided by the Basel III standards (paragraphs 44-48).

In particular, how does this treatment compare with the current treatment in terms of risk-sensitivity, impact on RWAs and operational burden?

Please provide relevant evidence to substantiate your views.

The proposed system is insufficiently risk-sensitive, especially from the perspective of banks using the IRB approach. The proposed treatment should therefore be amended to include risk weight classes and classification criteria that take adequate account of better risks.

For users of the standardised approach, on the other hand, the introduction of the SL exposure class is new. Owing to a lack of relevant criteria in IT systems, loans that have to be assigned to this exposure class can only be identified manually, which is highly onerous. To enable appropriate automated classification, the assignment criteria must be simple and distinctions sufficiently clear.

In addition, grandfathering arrangements should apply to existing loans in order to minimise the processing burden, especially for small institutions.

Question 17. Would you deem further refinements or clarifications concerning the structure or calibration of the treatment for SL necessary?

- ◯ Yes
- ◯ No
- ◯ Don't know / no opinion / not relevant

Question 17.1 If yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

We take the view that, overall, the existing Basel proposals fail to take account of the diversity of European specialised lending. We assume that on closer examination of individual cases, there will be many open questions as to the dividing line between individual categories and regarding assessments commensurate with the risk involved. We therefore see an urgent need for further in-depth analysis of the issue. Below are some examples of open questions, which, however, are not intended to be exhaustive.

One open question, for example, is how to deal with mixed forms of various specialised lending. If, for example, a client takes over a company including its inventory in the course of a company succession, we

believe this is a mixed form of project and object finance. It is not clear at present which class the loan should be assigned to.

There is a need to adapt one of the criteria for recognising high-quality project finance, namely that creditors should be protected against losses that may result from a termination of a project. This criterion does not lend itself to non-recourse project finance structures, in particular. The condition should be worded to allow recognition as high-quality project finance at least for projects where the risk of termination is unlikely. Examples of these are energy projects in the operational phase where sales contracts have already been agreed, market-leading technology projects with a term longer than the funding period, and projects where there is an above-average chance of finding a new operator. Furthermore, allowance should be made for significant losses.

There is a danger with the second bullet point in paragraph 44 in that, if an entity is split into an operating and a holding company, the exposure to the holding company might have to be classified as "specialised lending". This would not be appropriate. In Germany, it is quite usual for SMEs to split into an operating and a holding company for tax reasons. The company premises are retained by the holding company and let to the operating company. The holding company receives rent; these payments depend completely on the operating company's creditworthiness. From a risk perspective, the two companies form a single economic unit which, from an economic point of view, does not differ in any way from a "normal" company. It would therefore not be appropriate, in our view, to assign a higher risk weight to the holding company on the basis of the split alone. For holding companies which are the result of a split and which receive rent from the operating company, the rules for general corporate exposures should apply.

Under paragraph 47, a distinction has to be made between the pre-operational and operational phases of project finance exposures. We agree with the Basel Committee's assessment that the pre-operational phase carries higher risks. It is important to clarify when the transition from pre-operational to operational occurs. This should not be defined as the point at which the project is "completed and fully operational" but should be an earlier point in time. Banks should be able to establish their own internal risk-based criteria for determining when the transition can be assumed to have occurred. This will ensure that the requirement can be applied with a certain amount of flexibility.

Question 18. In your view, what other measures should be taken to better reflect the particular characteristics of SL exposures (as compared to general corporate exposures) thereby increasing the risk-sensitivity of the SA-CR and improving consistency with the IRBA?

Please elaborate and provide relevant evidence.

In line with our remarks on unrated corporates, the risk weights for unrated investment grade project finance should be adjusted (65% during the operational phase, 100% during the pre-operational phase).

Question 19. In your view, which other aspects, if any, should be considered in the context of revising the treatment of SL exposures?

It would be appropriate in our view to consider infrastructure finance in accordance with Article 501a of CRR 2 as a further subcategory of SL exposures and assign it a fixed risk weight of 75%. Initial experience shows that the required proof of compliance with the criteria laid down in Article 501a is so comprehensive, complex and challenging that it will only be possible in exceptional cases to apply the reduced capital requirements. We therefore see a need to adjust the criteria.

1.1.4. Equity and other capital instruments

1.1.4.1. Standard treatment of equity exposures

Question 20. In your view, are there any issues with the definition of equity exposures provided by the Basel III standards (paragraph 49) and the list of other instruments to be treated alike?

In particular, would you deem further refinements or clarifications necessary regarding the scope of the equity exposure class in order to ensure a consistent application across the Union?

Please elaborate.

As we understand it, one of the reasons for including the new subordinated debt exposure class in the Basel framework was to treat subordinated debt to banks and corporates equally under the standardised approach for credit risk. We were concerned to note that the final Basel document stipulates in paragraph 53 that any liabilities that meet the definition of "other TLAC liabilities" in paragraphs 66b and 66c of the amended version of Basel III set out in the TLAC holdings standard should be assigned to the new subordinated debt exposure and given a risk weight of 150%. In our view, two aspects urgently need to be taken into account for European implementation:

1. It is inappropriate to treat TLAC-eligible liabilities as subordinated debt under the standardised approach for credit risk. Fulfilment of the subordination criterion is essential for recognition as TLAC: according to this criterion, TLAC liabilities must generally be subordinated to non-TLAC liabilities. The liabilities are thus "non-senior" in the bail-in liability hierarchy, though this does not mean subordination in insolvency. Subordination in insolvency is, on the other hand, the defining criterion for the exposure class in the standardised approach for credit risk.
2. The reference in paragraph 53 of the Basel framework only covers instruments issued by G-SIBs that meet the specified criteria for classification as subordinated debt. We fail to see how this can be transposed appropriately into European law:

   - Restriction to investments in TLAC capital in G-SIBs is not plausible from a risk perspective: debt securities issued by different institutions that would have to be treated equally in resolution or insolvency because of the legal framework in a jurisdiction (e.g. debt securities issued by a G-SIB compared to a non-G-SIB) would be treated differently under supervisory law (classification in the standardised approach for credit risk exposure class).

   - Extension of the exposure class to include the MREL capital of all institutions would – for German banks, at any rate – be just as inappropriate. Because of the bail-in liability hierarchy (non-preferred status under Section 45f (6) of the German Banking Act (KWG)), which has been in force in Germany since 1 January 2017, all unsecured debt issued by German banks up to 21 July 2018 would all of a sudden be subject to the higher risk weight. We categorically reject this, as (i) the instruments, as explained under point 1 above, are not subordinated, (ii) this would lead to a clear overstatement of risk, and (iii) the liability ranking was set by German lawmakers under the Resolution Mechanism Act (AbwMechG) without any way for banks to subsequently influence it, and higher capital requirements for investing banks were not intended. The repeatedly cited formal "subordination" of German senior unsecured debt is also incorrect. There has been no change in the ranking of such debt in insolvency – also not in the course of the EU-wide harmonisation of the bail-in hierarchy under Article 108 of the BRRD (new version). Plain vanilla

senior unsecured debt still ranks above subordinated debt in the bail-in liability hierarchy under Section 39 of the German Insolvency Code (InsO).

We therefore see a need, first, for comprehensive grandfathering arrangements for existing instruments. Second, a risk weight of 150% should only be applied if there is a real risk of the institution defaulting and a real possibility of conversion into tier 2 capital or of receiving the same treatment as tier 2 capital. The rating could be used as a basis, for example, as it is likely to adequately reflect the liability cascade risk.

Question 21. Views are sought on the costs and benefits of the revised standard treatment for equity exposures under Basel III (paragraph 49 - 50).

In particular, would you consider any further differentiation among equity exposures (apart from "speculative unlisted equity exposures" and "national legislated programmes" – see 1.1.4.2. and 1.1.4.3.) warranted?

- Yes
- No
- Don't know / no opinion / not relevant

Question 21.1 If yes, how should this differentiation be made and what would be its prudential rationale?

Please elaborate and provide relevant evidence.

For strategic reasons, banks may have holdings in other entities or central institutions in their group. These holdings are of a long-term nature and do not serve to earn revenue from increases in the value of the entities or institutions. The proposed 2.5 factor increase in capital requirements for all strategic investments would raise capital requirements significantly without any justification from a risk perspective. We therefore believe that an adjustment would be appropriate. In our view, the current 100% risk weight should continue to be applied to such strategic investments. We recommend introducing a new category called "strategic, long-term equity".

This category should cover group and network structures (holdings in institutions belonging to the same institutional protection scheme, holdings in subsidiaries and parent companies within a supervised group) where these participations exist for reasons of joint decision-making and have their roots in history (i.e. are stable, have existed over many decades). A risk weight of 100% must be maintained for equity investments in members of the same group or institutional protection scheme.

On top of that, the 250% risk weight for publicly quoted shares does not reflect the actual risk involved. Risk weights should be differentiated along the lines of those for market risk according to the index where the shares are listed. We would consider the following appropriate:

- 150% for shares on major indices (EBA/ESMA list) and
- 250% for others/no index, other markets.

1.1.4.2. Treatment of 'speculative unlisted equity exposures'

Question 23. Do you agree that speculative unlisted equity exposures such as investments in private equity or venture capital firms should be subject to a relatively higher RW than other equity exposures?

- Yes
- No
- Don't know / no opinion / not relevant

Question 23.1 If you disagree, please explain and provide relevant evidence to substantiate your view.

Please elaborate and provide relevant evidence.

The Basel Committee essentially uses the speculative and thus short-term aspect to substantiate the increased risk. In principle, however, an equity investment made with the intention of making a profit should not attract a higher risk weight if the intention is initially to further the development of the company before realising a profit through a sale (medium to long-term investment horizon). After mentioning short-termism, the criterion of intent to make a profit is introduced, which admittedly can never be denied. But we do not consider the relevant criteria to be met above all in cases where such investments are held in the banking book in accordance with German GAAP. In our opinion, the existing 150% risk weight for "high risk items" remains appropriate.

Question 24. Views are sought on the definition of 'speculative unlisted equity exposures' provided by the Basel III standards (Paragraph 51 and footnote 31). In particular, would you deem further refinements or clarifications necessary?

- Yes
- No
- Don't know / no opinion / not relevant

Question 24.1 If yes, what should those be and what would be their prudential rationale?

Please elaborate and provide relevant evidence.

We assume that on closer examination of individual cases, there will be many open questions as to how to classify these cases and thus how to assign a weight commensurate with the risk involved. We therefore see an urgent need for further in-depth analysis of equity investments prevalent in Europe. Below are some examples of open questions, though these are not intended to be exhaustive.

In our view, further refinements to clarify the definition of speculative unlisted equity exposures are necessary as we do not consider long-term investments in venture capital/investment funds or even short-term investments in diversified funds to be "speculative". The nature of the exposure (type of investment, diversification level) and maturity (short-term vs. long-term) should therefore be considered in the definition of "speculative unlisted equity exposures".

There is also a need to clarify the treatment of indirect holding. If a bank holds a participation indirectly, does a capital requirement have to be calculated for the holding in the private equity company or does a look-through approach have to be applied?

The definition of "[intention] to establish a long-term business relationship" also needs to be clarified.

1.1.4.3. Treatment of equity holdings made pursuant to national legislated programmes

Question 26. In your view, should the discretion for "national legislated programmes" provided by the Basel III standards should be implemented in the Union?

- Yes
- No
- Don't know / no opinion / not relevant

Question 26.1 If you agree, please elaborate on your response to question 26.

We welcome the ability to assign a 100% risk weight to equity holdings pursuant to "national legislated programmes". To be of practical relevance, however, clear definitions and distinctions are needed: there should be a clear understanding of what is meant by "national legislated programme" (what precisely does "equity holding" mean at national level and what counts as a national programme). A need for ongoing individual checks by banks of the risk and implementation of risk-reducing measures should not be introduced, by contrast. Specifically, we would consider it appropriate for the CRR article to include holdings entered into together with municipalities or municipal enterprises or by development banks for the purposes of promoting trade and industry.

1.1.5. Retail exposures

1.1.5.1. Notion of 'transactors' and 'other retail'

Question 29. Views are sought on the costs and benefits of introducing the sub-asset class of transactors for regulatory retail exposures and specifying the treatment for other retail exposures.

In particular, how does the approach provided by the Basel III standards compare with the current approach in terms of risk- sensitivity, impact on RWAs and operational burden?

Please provide relevant evidence to substantiate your views.

We support the introduction of a "transactor" sub-asset class. The definition of "transactor" proposed by the Basel Committee also covers credit card business prevalent in Germany.

Question 32. In your view, which other aspects, if any, should be considered in the context of revising the treatment of retail exposures?

Please elaborate and provide relevant evidence.

To determine the probability of default, one of the main criteria that banks using the IRB approach apply is the client's net worth (assets and income). The PDs for high-asset clients and high-income clients (income > EUR 100,000 per year) are, statistically speaking, significantly lower than those for natural persons with a medium to low level of assets or income. In addition, there is normally a positive

correlation between PD and LGD. This statistically backed observation is reflected in the extraordinarily low proportion of specific credit risk adjustments in banks' high net worth individuals segment. It is also reflected in the terms on which institutions offer such clients (unsecured) loans. Based on the experience of institutions applying the IRB approach, we believe a 65% risk weight for high net worth individuals is appropriate.

Article 501 of the CRR provides for an adjustment of risk-weighted non-defaulted exposures to SMEs. The adjustment can be applied to exposures in the retail, corporate and secured by mortgages on property asset classes. We assume that in future the adjustment will also cover the regulatory retail, transactor and other retail sub-asset classes if the exposure is to an SME.

1.1.5.2. 'Granularity criterion' and additional measures to ensure diversification

Question 33. In your view, is the current CRR sufficiently clear to ensure a harmonised application of the "granularity criterion" or do you consider further guidance necessary?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 33.1 If no, please elaborate on your response to question 33.

We welcome the EBA's recommendation CR-SA 22 that the proposed granularity criterion of 0.2% of the overall regulatory retail portfolio is not necessary. We consider the current CRR requirements to be enough to ensure adequate diversification of banks' regulatory retail portfolios. There is no need to change the current CRR provisions in Article 123. Nor is it necessary to issue the EBA with a mandate to develop guidelines on adequate diversification methods. Smaller institutions have developed appropriate qualitative procedures in recent years to demonstrate adequate diversification in their portfolios. This tried and tested methodological freedom should be retained.

1.1.6. Real estate (RE) exposures

1.1.6.1. Implementation of loan splitting (LS) approach vs whole loan (WL) approach

Question 34. Views are sought on the relative costs and benefits of the LS approach and the WL approach provided by the final Basel III standard.

In particular, how do the two approaches compare in terms of risk-sensitivity, impact on RWAs and operational burden?

Please provide relevant evidence to substantiate your views.

In Germany the loan splitting approach has been used for many years. It will therefore be much less costly to retain the loan splitting approach than to introduce the new whole loan approach.

Owing to the cliff effects inherent in the whole loan approach on the border between the risk weight steps, the loan splitting approach reflects the actual risk more accurately. These cliff effects of the whole loan approach would be reduced at the portfolio level, however.

Question 35. Would you deem further refinements or clarifications necessary concerning the approach that you generally prefer?

- Yes
- No
- Don't know / no opinion / not relevant

Question 35.1 If yes, what would those be and what would be their prudential rationale?

Please elaborate and provide relevant evidence.

An unequivocally clear definition of the distinction between cash flow dependent and cash flow independent real estate finance should be set out in the CRR itself so that consistent application is ensured across all member states.

Irrespective of the approach used, the risk weights for commercial real estate lending would be significantly higher under the new Basel III standards than under the current regime.

We believe the calibration of the risk weights for commercial real estate finance is insufficiently granular in the standardised approach for credit risk. This applies both to loans where repayment depends on the income generated by the property as well as to loans where this is not the case. The proposed distribution of risk is far from appropriate, particularly in the low LTV buckets. For example, loans with an LTV ratio of ≤ 50% are assigned the same risk weight as loans with an LTV ratio of 60% (risk weight of 60% where independent of cash flows and 70% where dependent on cash flows). The risk weights need to be made more risk sensitive.

Risk weights should therefore be distributed over a granular LTV bucket structure to reflect the specific risk profile of different LTVs and to ensure a continuous risk-sensitive increase in risk weights. Risk weights could be differentiated along the following lines:

Cash-flow independent lending (to replace table 13 in paragraph 70 of Basel III)

	LTV ≤ 50%	50%<LTV≤60%	60%<LTV≤80%	80%<LTV≤90%	90%<LTV≤100%	LTV > 100%
Risk weight	30.00%	35.00%	45.00%	60.00%	75.00%	105.00%

Cash-flow dependent lending (to replace table 14 in paragraph 73 of Basel III)

	LTV≤50%	50%<LTV≤60%	60%<LTV≤80%	80%<LTV≤90%	LTV > 90%
Risk weight	45.00%	50.00%	65.00%	90.00%	110.00%

Like the whole loan approach, the loan-splitting approach would also have to be adjusted. This could, for example, be achieved by lowering the risk weight also to 50% for the part of the exposure that is regarded as secured (≤ 55% of the property value).

We welcome the fact that the hard test for commercial real estate exposures may be used as a substitute for the criterion that repayment of a loan should not be dependent on cash flows from real estate

collateral. As European banks are already required by the CRR to include in COREP reports loss data on real estate finance for all countries in which they grant loans, the necessary hard test data are available for all countries.

We believe it would be risk-appropriate if the criterion whereby repayment of a loan should not be dependent on cash flows from real estate collateral were substituted in European implementation by the hard test for residential real estate exposures as well.

Question 36. What would justify implementing both approaches in parallel from a risk perspective?

If both approaches were to be implemented and made available on discretionary basis, how would comparability across institutions be ensured and how would regulatory arbitrage as well as undue complexity be prevented in this case?

Europe's property markets are not homogeneous but differ in various respects. In Germany, for example, it is standard market practice for banks to agree an expanded collateral clause with borrowers. This clause means that the collateral covers all existing, future and conditional claims arising from the entire business relationship between the bank and the borrower. Banks in Germany therefore usually apply the loan-splitting approach to determine the risk weight for loan exposures. In other countries, on the other hand, this may not be necessary because of the lending culture there.

We therefore believe that both approaches can be justified from a risk perspective and recommend allowing banks to choose which to apply. Banks should be able to opt for one of the two approaches on a consistent basis. Should convincing reasons for a change of approach arise over time, it should be possible to reverse this decision in consultation with, and with the approval of, the competent authority.

Allowing banks to select the most suitable approach would also reduce the time and effort involved in implementing the new approaches. Since the two approaches are calibrated similarly, they result in comparable risk weights, at least at the level of the overall real estate lending portfolio. Significant divergence between the two is unlikely. There would consequently be no incentives for regulatory arbitrage, especially as the option would be exercised on behalf of the entire institution. Finally, we take the view that making both options available would not give rise to undue complexity for supervisors or other stakeholders. The lack of complexity would be enhanced by the fact that an approach, once chosen, would remain unchanged over time and be clearly disclosed under Pillar 3.

1.1.6.2. Treatment of exposures where the servicing of the loan materially depends on the cash flows generated by a portfolio of properties owned by the borrower

Question 37. Do you consider the assessment of the condition of "strong positive correlation" on a portfolio basis more appropriate than the assessment based on the individual RE exposure?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 37.1 If no, please elaborate on your response to question 37.

The risk of real estate exposures cannot be adequately reflected by assuming a positive correlation between the cash flows from all the borrower's properties. On the contrary, the diversification effects of a real estate portfolio mitigate the risk involved. For this reason, the analysis of whether a real estate loan is materially dependent on cash flows generated by the financed property should focus on that property alone. The first step is therefore to determine how much cash flow is generated by the financed property (CF_{RE}). The second step is then to calculate the total amount of cash flows generated for the borrower (CF_{Total}).

To determine CF_{RE}, only the cash flows from the property to be financed should be taken into account and not cash flows generated for the borrower by other properties.

To calculate CF_{Total}, all of the borrower's cash flows should be taken into account, including those from property which is not being financed.

Cash flow-dependent real estate financing should only be deemed to exist if CF_{RE} is more than 50% of CF_{Total}.

In our opinion, any other approach would unduly overstate the risk associated with the underlying real estate loan as the cash flows generated by other properties in the real estate portfolio are not linked to the cash flows from the property being financed. The cash flows generated by the real estate portfolio reduce the dependency of repayment on the financed property. This diversification effect reduces the risk, it does not increase it.

Question 38. If the assessment based on a portfolio basis were introduced, what are your views on whether it should be the only approach available in the Union or it should be an alternative approach to be applied at supervisory discretion on a case-by-case basis?

- it should be the only approach available in the Union it should be an
- alternative approach to be applied at supervisory discretion on a case-by-case basis
- Don't know opinion / not relevant / no

Question 38.1 Please explain your response to question 38.

The procedure for implementing footnote 50 to paragraph 73 described in our reply to Q 37 should apply uniformly throughout the EU to ensure a level playing field. Supervisory discretion would significantly increase complexity and administrative costs.

1.1.6.3. Eligibility of property under construction

Question 39. What are your views on the costs and benefits of implementing the preferential treatment for certain properties under construction as provided by the Basel III standards?

Please provide relevant evidence supporting your view.

The conditions proposed by the Basel Committee for granting preferential treatment to properties under construction, namely

- the borrower must be a natural person,

- the property must have a maximum of four residential units and
- the main residence of the borrower must be in the building to be constructed,

are excessively restrictive. The existing requirements of Article 125(1)(a) of the CRR should be retained. This means: no restriction to natural persons, no restriction to a maximum of four residential units, ability to let instead of own use (main residence). This will ensure that the very tense housing situation in many areas of high population density is not exacerbated further.

As regards the main residence criterion, the bank cannot influence whether borrowers may have to move their main residence for professional reasons, for instance. The bank would have to reclassify the loan. This would result in a significantly higher risk weight even though the move per se was not a reliable indicator of risk.

In addition, changing the requirements would give rise to considerable adjustment costs for banks. Since house building loans (especially in the ongoing low-interest environment) normally have very long terms, most existing business in this area would be affected.

Question 40. Do you consider the threshold of one-to-four family residential housing units appropriate?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 40.1 if not, which other threshold would you consider to be more appropriate? Please provide evidence supporting your view.

Please elaborate and provide relevant evidence.

The preferential treatment should not be restricted by limiting the size of the property. Areas of high population density, especially, suffer from a lack of living space. This could be exacerbated by the new Basel requirements as risk weights would increase dramatically.

The CRR allows a privileged risk weight of 35% even for properties with more than four residential units.

Under the new Basel requirements, the financing of such properties (i) where the borrower is a natural person will no longer be assigned to the real estate exposure class in and the risk weight will rise to 100% in accordance with the new Basel requirements for retail exposures (or 75% if the loan amount does not exceed 1 million euros and various other requirements are met). If the borrower is (ii) a company or special purpose vehicle, the new requirements for the sub-class of land acquisition, development and construction (ADC) exposures will have to be applied, resulting in a risk weight of 150% (or 100% if certain additional requirements are met). This extreme increase of up to 329% is not risk appropriate.

1.1.6.4. Prudently conservative valuation criteria

Question 41. Views are sought on the costs and benefits of the valuation criteria provided by the Basel III standards

In particular, how does this approach compare with the current approaches available under the CRR (MV and MLV) in terms of simplicity, comparability, risk-sensitivity, impact on RWAs and operational burden?

Please provide relevant evidence supporting your view.

The terms market value and mortgage lending value, which are currently enshrined in the CRR, are standardised valuation concepts that have been applied for many years at international, European and national level. Extensive data are available to national real estate markets based on these concepts, which form the basis of valuing real estate. Certifications at international and national level guarantee that qualified appraisers apply the relevant valuation standards robustly.

The introduction of a new valuation concept as proposed by Basel III would now lead to new valuation practices. The new Basel III definition of market value does not correspond to the current understanding, which defines market value as the value as at a specific date. The inclusion of sustainable aspects geared towards long-term market developments is more a part of the existing mortgage lending value concept.

We can nevertheless understand the idea behind introducing a uniform valuation method in the interests of a level playing field. Since the value of the property is the central element determining the risk weight under the new rules, it must be ensured that all banks in Europe use the same valuation methods. The cost of switching to a **uniform valuation method** would be substantial, however. The first step would be to establish a clear definition of value, underpinned by transparent valuation standards applicable in all national property markets in Europe. Furthermore, the necessary data would need to be generated for European real estate markets – ideally retrospectively for a long period of time. Appraisers would have to be trained to use the new methodology and would need to gain practical experience. In the area of retail residential mortgage lending, in particular, valuations are to a large extent computer assisted. Extensive adjustments would be needed here. And last but not least, it would no longer be possible to compare values with "old" values in banks' portfolios.

The introduction of a new definition of value and valuation methodology would therefore necessitate substantial and time-consuming changes to banking processes and generate high costs for the banking industry. In addition to a lack of experience applying the new valuation method, another problem facing banks would be that a valid data basis, which is indispensable to valuations, would initially be lacking or at least have insufficient data.

On the other hand, however, retaining the current European valuation concepts can lead to massive distortions of competition between mortgage lending banks. This is because the current mortgage lending value is on average 20% lower than the market value. If banks or countries where the concept of mortgage lending value dominates use this for the new risk weighting procedures of the standardised approach for credit risk, they will face significantly higher capital requirements than users of the market value concept.

We see three ways of dealing with this situation.

1) First, a new valuation concept could be introduced that was binding on everyone. High implementation costs would be involved, however. Banks would have to hold and maintain data for three different valuation concepts for different purposes.
2) Alternatively, one of the two existing concepts could be made mandatory throughout Europe to avoid distorting competition. In this case, implementation costs would be lower for much of the European banking industry as the system would already be adequately established at some banks at least.
3) The risk weights of all permutations for the whole loan and loan splitting approach would have to be adjusted at least for users of the mortgage lending value. The objective of the adjustment would be to fully offset the lower valuation. The allocation of individual risk weights to the LTV buckets would have to be changed. A similar approach is already being pursued in the CRR for commercial real estate lending.

Question 42. Would you deem additional specifications necessary to clarify how the MV or the MLV currently used by institutions would need to be adjusted to meet the valuation criteria provided by the Basel III standards?

Would you deem further clarifications necessary to ensure a consistent application of the valuation criteria across the Union?

Please elaborate.

See our reply to Q 41.

Question 43. What other measures could be taken to ensure that the value of RE collateral is sustainable over the life of the loan?

Please elaborate and provide relevant evidence.

In our opinion, great importance should be attached to monitoring and verifying the value of real estate collateral. This is already the case under Article 208(3) of the CRR. In order to be able to identify at an early stage possible fluctuations in the value of residential real estate that could impact the collateral, the idea could be considered of aligning the requirements with those for commercial real estate (regular monitoring in accordance with Article 208 (3)(a) of the CRR).

1.1.6.5. (Re-)valuation: value at origination vs. current value

Question 45. Views are sought on the costs and benefits of capping the property value at loan origination.

In particular, how does the approach provided by the final Basel III standards compare with the current approach of the CRR in terms of possible cyclical effects on RWs, risk- sensitivity, impact on RWAs and operational burden?

Please provide relevant evidence to substantiate your views.

Article 208(3) of the CRR sets out comprehensive requirements for monitoring and verifying property values. Banks are **already** required to have clearly organised processes in place to track the concrete

effects of changes in value on real estate collateral. Against this backdrop, we see no benefit in capping the value at "value at loan origination".

The Basel requirement was adopted with the aim of curbing procyclicality in banks' balance sheets. In a global context this proposal may make good sense since in many countries real estate loans are subject to variable interest rates and/or have no fixed period of notice. In most European countries, by contrast, real estate loans have a lengthy fixed interest period and can only be terminated prematurely at a high cost to the customer. This means that, at these points at least, the lending bank has to carry out a robust revaluation. Once the fixed interest period has expired, however, this requirement would set a very clear incentive for the customer to switch banks if market values rise. Any procyclicality would only be transferred from one bank balance sheet to another. This would do nothing to prevent rising market values from being reflected in balance sheets. Banks should therefore be allowed in such cases to base their calculations on the current market value so it can offer the same conditions as a competitor wishing to begin financing the property. We are opposed to the idea of an upper limit on the value for reasons of competition.

In paragraphs 189-190 of its report "Policy advice on the Basel III reforms: credit risk", the EBA also rightly points out that a ban on upward adjustments could set adverse incentives for shorter minimum lending periods. In addition, the EBA rightly argues that fixing collateral value at the value at origination for long-term mortgage loans is unlikely to adequately reflect the risks to the bank over the life of the loan. The existing CRR requirements, which permit value at origination to be exceeded, better reflect the actual credit risk involved.

1.1.6.6. Land acquisition, development and construction (ADC) exposures – general treatment

Question 48. What are your views on the costs and benefits of replacing the existing treatment of 'speculative immovable property financing' with the treatment of ADC exposures as provided by the Basel III standards?

Depending on the exact type of financing, the new requirements would mostly lead to higher risk weights than those currently required under the CRR.

For properties where land acquisition, development and construction (ADC) are financed by loans to companies and special purpose vehicles, the new Basel III standards propose a risk weight of 150%.

The CRR does not require assignment to the "speculative immovable property financing" exposure class with the same risk weight of 150% if the property is to be used by the borrower themselves or rented out. Loans for future owner-occupied or rented residential property can receive a preferential risk weight of 35%. Future owner-occupied or rented commercial real estate financing are assigned a 100% risk weight (if the risk weight for the borrower is lower, this is applied). In these two cases, the new Basel requirements would result in excessive increases of 329% (residential) or at least 50% (commercial) of risk weights. Even in cases where the lower Basel ADC risk weight of 100% could be applied to residential real estate exposures (pre-lease or substantial equity at risk), this would still be 186% above the current CRR risk weight. The ADC exposure class should therefore be limited, like to CRR "speculative immovable property financing" class, to financing properties that are intended for sale.

Financing of properties that are intended for sale are only to be assigned to the "speculative immovable property financing" exposure class with a risk weight of 150% if no binding sale agreement has yet been concluded. Only in this case is there no difference between the new Basel and the current CRR risk weights.

If binding sales agreements have been agreed, the CRR risk weight in the real estate financing exposure class is 100%. (If the risk weight for the borrower is lower, this is applied.) The new Basel risk weight of 150% for exposures of this kind is significantly higher. The Basel risk weight can only also be lowered to 100% for residential real estate financing. This should be extended to commercial real estate financing so that risk weights comparable to those under the CRR can be used.

Certain conditions (pre-sale/lease or substantial equity at risk) must be met for the above-mentioned reduction from 150 to 100%. These conditions should only apply to cash flow-dependent ADC financing within the meaning of footnote 48 to paragraph 73 of the Basel III standards, however. In addition, the requirements concerning cash flow-dependent financing need to be defined in a risk-appropriate manner. With respect to footnote 52 to paragraph 75 of the Basel III standards, a 10% progress payment would be appropriate from a risk perspective for pre-sale/lease contracts or, alternatively, a 10% progress payment with respect to the borrower's substantial equity at risk.

For cash flow-independent ADC financing, reference should be made to the risk weights for the corporate exposure class. This will ensure that the property will be agreed as loan collateral and that this collateral will not be waived in order to be able to use a possibly lower risk weight from the corporate exposure class.

Question 49. Would you deem further refinements or clarifications necessary concerning the scope or definition of ADC exposures?

- ◉ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 49.1 If yes, what would those be and what would be their prudential rationale?

Please elaborate and provide relevant evidence.

Like the CRR "speculative immovable property financing" exposure class, the ADC exposure class should be limited to financing properties which are intended for sale. Otherwise, there will be an extreme increase in risk weights of up to 329%, which is not risk appropriate.

In addition, the ADC exposure class should only apply to cash flow-dependent ADC financing within the meaning of footnote 48 to paragraph 73 of the Basel III standards. Otherwise, the property will not be agreed as collateral for cash flow-independent ADC financing so that a possibly lower risk weight can be applied in accordance with the corporate exposure class.

1.1.6.7. ADC exposures – conditions for the application of 100% RW

Question 50. In relation to the condition for applying the preferential risk weight of 100% to certain ADC exposures, do you consider further specification necessary to ensure a harmonised application of this condition across the Union, for example by defining or quantifying any of the terms mentioned above?

Please elaborate and provide relevant evidence to substantiate your views.

It should be possible to apply the lower ADC risk weight of 100% not only to ADC residential property financing but also to ADC commercial property financing. The conditions (pre-sale or substantial equity at

risk) that must be met to apply the preferential risk weight justify a lower risk weight from a risk perspective.

The conditions (pre-sale or substantial equity at risk) could be specified for the purposes of footnote 52 to paragraph 75 of the Basel III standards as follows: pre-sale/lease contracts a 10% progress payment would be appropriate from a risk perspective or, alternatively, a 10% progress payment with respect to the borrower's substantial equity at risk.

1.1.8. Off-balance sheet (OBS) items

1.1.8.1. Definition of commitment

Question 55. What is your view on the national discretion to exempt certain arrangements for corporates and SMEs from the definition of commitments?

In your view, which arrangements should be exempted from the definition of commitment, if any?

Please provide relevant evidence to substantiate your views.

According to our information, loan commitments that may be unconditionally cancelled at any time are a very widespread form of finance for private individuals and businesses of all sizes in Europe. The lion's share of OBS items is accounted for by lending to retail clients and SMEs. Any increase in the CCF will therefore adversely affect banks' willingness to provide loans or lead to tighter terms and conditions for time-bound lending commitments. Since most enterprises in the EU are SMEs, the introduction of a CCF of 10% would create a major impediment to financing. The application of footnote 53 would not be helpful in this context, however, since the conditions are not normally met. It is true that banks can terminate the credit line from one day to the next. Individual drawdowns do not have to be applied for in advance, however. This condition therefore constitutes an obstacle to preferential treatment of SMEs.

We believe the conditions in footnote 53 are not necessary. Retail customers and SMEs tend to react more slowly than larger clients. As soon as the bank learns that a customer may be in financial difficulties, it can terminate a cancellable credit line. The bank is often aware of early indicators pointing to a possible drawdown, so the commitment can also be terminated in practice. With this in mind, we see no justification for applying a CCF, especially to credit lines for retail customers and SMEs. Article 166 of the CRR already sets out all the necessary conditions. To ensure adequate financing for European SMEs, the CCF of 0% should be retained.

1.1.9. Other provisions

Question 59. In your view, which other aspects, if any, should be considered in the context of revising the SA-CR?

Please elaborate and rank your answers from the most important to the least important aspect.

1. **Consideration of European specificities when implementing Basel III**
   We expressly call for the specificities of the European banking market to be taken into account when implementing the Basel III finalisation package. We believe that, as with previous European implementation, European specificities justify and require corresponding adjustment of

the Basel rules.

2. **Appropriate implementation of the new rules for banks not using models**
The Basel Committee's measures to reduce variability in the results delivered by internal models are aimed mainly at large, internationally active banks. The new framework – particularly the revised standardised approach for credit risk, which constitutes the basis for the output floor for internal models – will also have a significant impact on small and medium-sized banks throughout Europe, however. The standardised approach for credit risk was only slightly fine-tuned further under Basel II and could thus be used also by small and medium-sized banks to comply with the regulatory capital requirements for credit risk with a reasonable investment of time and effort. The revisions that have now been made increase the granularity and thus the complexity of the standardised approach, though without achieving sufficient risk sensitivity. This will lead to higher IT and compliance costs, particularly for banks for which the approach to measuring credit risk should be less complex. The growing complexity of regulation is burdening small banks to an increasing extent. The main problem is the effort required to comply with requirements and demonstrate that they have been complied with. The new rules will therefore simply add to the regulatory burden and constitute an additional obstacle for the small banks that play a major role in funding businesses in many EU countries. The process-related workload imposed by implementing the new standards is very high relative to the slight increase in risk sensitivity and delivers hardly any added value either to small and medium-sized banks or to large banks. With this in mind, we call for appropriate implementation of the new standardised approach for credit risk for all small and medium-sized banks. The additional burden on banks must be kept to a minimum. Supervisory law should not cause any collateral damage in the form of structural changes.

3. **Comprehensive transitional and grandfathering arrangements**
The new standardised approach for credit risk requires extensive changes to banks' IT systems. Exposures that have to be assigned to the new exposure classes can in some cases only be identified with considerable manual effort. This will quickly bring smaller banks, especially, to the limit of their capabilities. It should also be borne in mind that the majority of CRR 2 changes will not be implemented until mid-2021. It is simply not feasible for banks to be ready for CRR 3 to take effect on 1 January 2022 in line with the Basel Committee's expectations. We strongly recommend adequate transitional periods and grandfather arrangements. Depending on the scale of the new requirements, a sufficient implementation period should be granted of at least two years after the revised CRR has come into force. In addition, transitional periods of five years and a 25% cap on the increase in total RWAs as proposed in paragraphs 9/10 on the output floor are needed to avoid disruption in the financial industry and real economy.

1.1.10. Implementation challenges and administrative burden

Question 60. Which elements of the revised SA-CR, if any, would you deem particularly challenging to be implemented?

Please elaborate and rank your answers from the most challenging to the least challenging revision.

Please provide relevant evidence on the one-off costs to substantiate your views.

1) Possible introduction of a new market value concept

2) Possible changes due to "value at origination" requirement
3) Increase in risk weights for commercial real estate exposures
4) Introduction of four household criterion
5) Introduction of LTV bucket approach instead of retaining mortgage loan splitting
6) Treatment of unrated corporates because of competitive disadvantages compared to jurisdictions using the SCRA
7) ADC requirements for residential property finance for own use or let
8) As a result of the output floor, banks using the IRB approach will now have to fully implement the standardised approach in parallel with all the necessary adjustments to processes this entails. This will be hugely costly.
9) Dropping of country of incorporation principle for banks

Question 61. Which elements of the revised SA-CR, if any, would in your view cause additional administrative burden?

Introduction of SCRA for unrated banks and due diligence for externally rated bank portfolio if the due diligence has to be carried out by each individual bank and not by a central authority (e.g. ESMA), as we recommend.

Identification of specialised lending exposures

Both requirements represent a substantial challenge, particularly for small institutions. In addition to the new requirements for processes, the time and effort involved in re-designation vis-à-vis supervisors and changes in capital allocation should not be underestimated.

1.2. Internal ratings based approaches (IRBA)

1.2.1. Reduction of the scope of internal modelling

Question 62. What are your views on the costs and benefits of reducing the scope of internal modelling as described above?

In particular, how would this reform impact the robustness and levels of RWAs for the affected portfolios?

We believe it is neither necessary nor in any way sensible in Europe to reduce the scope of the internal ratings-based approach (IRBA). The European approach of reducing undesired RWA variability by targeting the underlying causes (IRBA repair, EBA benchmarking, TRIM) is both efficient and effective. By no means should it therefore act as a complement to disallowing advanced IRB approach (AIRBA) portfolios. On the contrary, this European approach removes the need to disallow aspects of the AIRBA.

As mentioned above, in Europe a cause-based approach focusing on model estimates themselves has been pursued for some time now to adequately address the variability problem. In our view, this is the right approach and an appropriate European response. Unlike input or output floors, it does not erode the meaningfulness of models. This approach aimed at reducing undue variability in the results delivered by models essentially comprises three elements:

1. EBA work on IRBA-related standardisation through regulatory technical standards (RTSs) and guidelines (GLs), e.g. on the definition of default, on PD and LGD parameter estimation along with uniform treatment of model uncertainties by way of margin of conservatism (MoC) requirements, downturn add-ons, comprehensive new acceptance criteria for approval to use the IRBA,
2. annual internal model benchmarking in accordance with CRD IV Article 78, and
3. ECB banking supervisors' TRIM exercise 2017-2019.

We therefore believe that the Basel Committee's envisaged restrictions on using the AIRBA should not be introduced in the EU.

We are especially critical of the withdrawal of permission to use the AIRBA for exposures to large corporates with annual revenues exceeding EUR 500 million and exposures in the bank asset class. This means that banks will have to apply the supervisory LGD to these exposures and that recognised credit risk mitigation techniques will be limited to the foundation IRB approach (FIRBA). This will, in turn, mean that the risk-mitigating effect of certain types of collateral can, if at all, only be taken into account to a limited extent.

It is undoubtedly challenging to reliably estimate LGDs for exposures in low-default portfolios. Since comparatively few defaults are recorded in these portfolios, there is little data available for the statistical analysis on which estimates are based.

Despite the scarcity of available data, we take the view that reliable internal LGDs can still be estimated for low-default portfolios.

A distinction needs to be made between reliability in individual cases and mean reliability. In individual cases, the loss in the event of default cannot be expected to occur exactly as predicted. When an individual borrower defaults, the proceeds from restructuring, resolution or the sale of assets depend on a number of factors that are difficult to predict before the default even in high-default portfolios (exception: collateral). When it comes to mean values, by contrast, LGD can also be reliably estimated for low-default portfolios. Even in segments with very few data points, it is possible to derive a mean value of realised loss rates which will subsequently prove robust even when compared with recent loss experience. From a statistical methodological point of view, this is because the mean value can be reliably identified even when sample sizes are small. In low-default portfolios, too, these mean value estimates are further differentiated by risk drivers of the loss rate (collateral, seniority, type of debtor). As a result, sound predictive power can be achieved even with a small number of data points.

The reliability of LGD estimation is further supported by measures over and above the mere statistical analysis of a bank's own loss data:

- Comprehensive data quality assurance to ensure the predictive value of the bank's own historical data with respect to future defaults (representativeness), as well as individual analysis of historical losses and of their different mechanisms and realisation channels following default.
- Additional plausibility checks with evaluation by specialists from the restructuring units, particularly regarding effects that it has not (yet) been possible to observe in the data.
- Safety margins to take adequate account of estimation uncertainty.
- Extension of the data basis through the use of pool data from companies such as Global Credit Data or CredaRate, which are maintained and constantly expanded specifically for the purpose of LGD estimation.

In addition to estimation methods for deriving mean values, collateral can also be taken into account as a major transaction-specific risk driver of the loss rate in low-default portfolios. The small number of realised losses notwithstanding, the stability of the collateral's value can be reliably demonstrated using

alternative data (such as market values). This gives these LGD estimates more predictive value for individual cases.

The current regulatory initiatives in the EU (TRIM, etc.) ensure that internal LGD estimates are subject to harmonised rules designed to optimise reliability, such as standards for safety margins (margin of conservatism) or for assessing the representativeness of data.

Overall, we therefore believe that the various challenges can be dealt with appropriately without forgoing the risk sensitivity of internal estimates, thus enabling banks to continue taking account of transaction characteristics such as a high level of collateralisation.

The Basel Committee criticises not only the scarcity of data in the above portfolios but also the big differences in LGD estimates across banks brought to light by supervisory benchmarking exercises. According to analysis of low-default portfolios by the EBA, the observed differences in RWAs can be explained to a very large extent by the proportion of defaulted exposures and by the composition of the portfolio.

Nevertheless, as mentioned above, the EBA's opinion on the implementation of the regulatory review of the IRBA marked the beginning of an extensive programme to harmonise the application of the requirements of the IRBA across the EU. This is supported by the ongoing Targeted Review of Internal Models (TRIM) currently being conducted by the ECB and EBA's benchmarking exercise.

We believe that the impact of this extensive work on the variability of LGDs should first be analysed before taking far-reaching decisions about the use of the AIRBA for low-default portfolios.

Question 63. What other measures could be put in place to improve the robustness of internal estimates for the relevant asset classes?

See answer to Question 62: EBA and ECB work to restore confidence in IRBA figures.

1.2.2. PD – increase of the input floor

Question 65. Views are sought on the costs and benefits of increasing the PD input floor to 0,05%. In particular, how does the increased floor compare with the current floor in terms of achieving the aim of decreased RWA variability? What is the impact of this change on RWA levels?

General remark on input floors:

GBIC takes the view that the input floors envisaged in the Basel III finalisation package will have adverse effects. Input floors for both PDs and LGDs make it considerably more difficult to analyse and manage portfolios. Differentiation between borrowers/risk positions below the floors will be severely impaired. The "equalisation" of borrowers and risk positions will, in addition, lead to less risk analysis (in the rating process, for example), which cannot possibly be the desired objective, in our view.

Question 66. In your view, how does the increased floor compare with the current floor in terms of achieving the aim of increased conservatism?

Would you consider a floor that implicitly assumes that a default occurs once every 2000 years to be sufficiently prudent? Please explain.

The input floor of 0.05% is interpreted in the question as a default on a loan every 2,000 years. This is an individual loan-based approach. It means at the same time, however, that out of 2,000 loans one defaults within the course of a year. We regard this level of default inherent in the PD input floor of 0.05% as too conservative. In the CRR, a PD input floor is set for the "corporates", "institutions" and "retail" exposure classes. This is 0.03%. The new Basel III standards increase the input floor by 67% to 0.05%. In practice, relatively few borrowers are assigned a PD of less than 0.05%. However, there are demonstrably individual types of borrowers where the internally determined PD is below the input floor. The models on which this assessment is based are thoroughly vetted by supervisors (e.g. approval testing, TRIM) by way of numerous requirements (e.g. EBA guidelines) and, where necessary, allocated add-ons for estimation uncertainty (margin of conservatism). By increasing or introducing the input floor, the risk sensitivity for such borrowers would no longer be reflected in a differentiated capital requirement. In this area, assuming higher risks would no longer go hand in hand with higher capital requirements. Furthermore, it would reduce the incentives to conduct less risky business associated with lower margins.

Question 67. What other requirements or safeguards could be implemented in the area of PD estimation to achieve a minimum level of conservatism and/or reduce RWA variability?

In the EU, various measures leading to sufficiently conservative PD estimation and significantly reducing inexplicable RWA variability have already been/are being implemented at short notice (see answer to question 62). At present, it is unlikely that measures over and above these will be necessary. Rather, once the new requirements have fully taken effect, these measures should be reviewed to identify where they go beyond the desired objective and, for example, encourage herd behaviour by harmonising internal processes and undermine competition for the best processes.

Question 68. In your view, which other aspects, if any, should be considered in the context of revising the PD input floor?

The PD input floor reflects a distrust of the quality of internal processes. Thanks to the measures launched (EBA IRBA repair, EBA supervisory benchmarking, ECB TRIM), this is unjustified for Europe, however. The advantages of a conservative PD are already ensured through these measures. The disadvantages of the PD input floor (lower risk sensitivity of capital requirements, negative incentives for low-risk business) would thus no longer be offset by any advantages.

1.2.3. LGD – input floors under AIRBA

Question 69. Views are sought on the costs and benefits of exposure - level LGD input floors.

In particular, how do the floors compare with the current treatment in terms of achieving the aims of conservatism and RWA variability?

What is the impact of this change on RWAs? Please provide relevant evidence to substantiate your views.

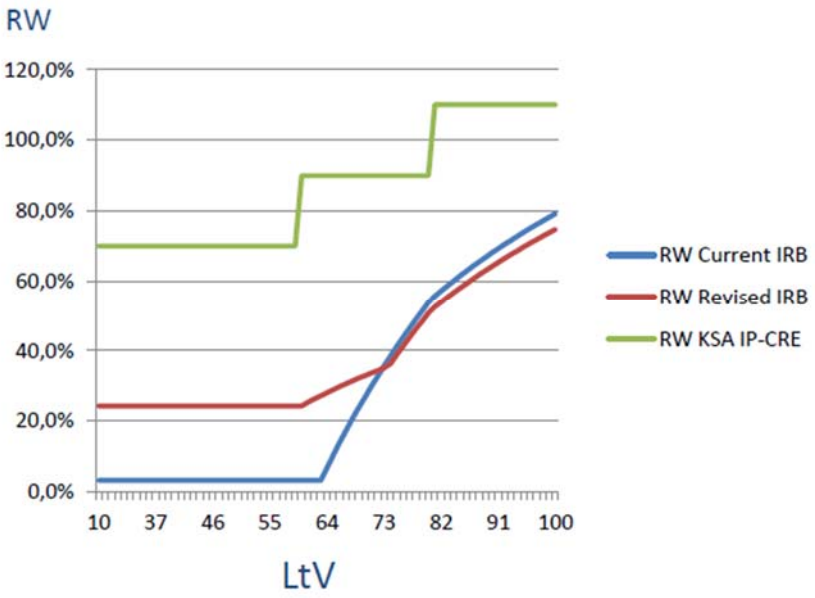
The CRR currently does not set any LGD input floors at individual exposure level. Merely for retail real estate finance does an LGD input floor of 10% (residential real estate) and 15% (commercial real estate) have to be complied with at portfolio level. In contrast, the new Basel III standard introduces an LGD input floor of 10% at individual transaction level: for exposures secured by immovable property, the LGD input floor is 10%. It should be borne in mind in this respect that the secured part of the exposure is limited to 60% of the property value, as a haircut of 40% on the property value has to be additionally applied. The property value exceeding 60% of the exposure amount is subject to an LGD input floor of 25%. The introduction of the LGD input floors is the main driver of the increase in risk weights in AIRBA portfolios. With the LGD input floors, the Basel Committee aims to limit inexplicable RWA variability. The LGD input floors naturally affect only particularly low-risk business, however. They therefore mean not only limiting any existing inexplicable RWA variability but also accepting a capital requirement not commensurate with the risk involved. To limit inexplicable RWA variability, the approach already adopted in the EU is more effective. Various measures leading to sufficiently conservative LGD estimation and significantly reducing inexplicable RWA variability – IRBA repair, EBA benchmarking, TRIM – have already been/are being implemented at short notice. Setting LGD input floors also leads to much greater modelling and data storage/processing complexity. The separate LGD input floor requirements for the individual types of collateral and the unsecured part of an exposure mean an enormous increase in costs for institutions. Under the CRR, splitting each exposure in this way was unnecessary. Instead, collateral has so far been taken directly into account in the LGD for the entire exposure amount. These new splitting requirements for determining the LGD input floor would lead to a wave of new modelling.

These new models would all have to be examined and approved by supervisors. What is more, there would be a massive increase in IT costs for holding and processing data as, instead of at transaction level, the data has to be delivered at granular level of the different types of collateral. For one thing, this adds to the complexity of the preliminary work required. For another, it increases data storage costs quite considerably, while also lengthening the time needed for processing reporting input. Given the need for permanent compliance with the requirements and the accompanying monitoring on a daily basis, this must be seen as a conflict of objectives.

Question 70. As regards the different types of exposures and collateral, to what extent do you consider that the LGD input floors maintain an adequate level of risk sensitivity with respect to the wide range of practices of EU institutions?

The combination of haircut and undifferentiated minimum LGD also means that, compared to economic loss experience, the input floor tends to kick in particularly in the low LTV range. As a result, banks with business models generating low risks and risk-averse banks will have to set aside a significant amount of additional capital for which there is no justification.

For this reason, the minimum LGD should be reduced in the lower LTV range. The following chart shows the perverse incentive set by the input floors as illustrated by a real estate loan with an assumed PD of 1.7% and a term of 2.5 years:



The chart shows that the Basel Committee's revised IRBA has two weaknesses. First, the level of the floor is far too high in the low-risk area, which significantly reduces the incentive to use models for portfolios with good collateral. Second, modelling is made more attractive for higher-risk exposures (unsecured exposures and high LTV ratios). One solution to this problem would be to differentiate input floors on the basis of several LTV buckets.

In addition, the CRR should specify that a floor of 10% may be applied for other physical collateral.

Question 71. What other requirements or safeguards could be implemented in the area of LGD estimation to achieve a minimum level of conservatism and/or reduce RWA variability?

In the EU, various measures (EBA IRBA repair, EBA supervisory benchmarking, ECB TRIM) leading to sufficiently conservative LGD estimation and significantly reducing inexplicable RWA variability have already been/are being implemented at short notice. At present, it is unlikely that measures over and above these will be necessary. Rather, once the new requirements have fully taken effect, these measures should be reviewed to identify where they go beyond the desired objective and, for example, encourage herd behaviour by harmonising internal processes and undermine competition for the best processes.

1.2.4. LGD – regulatory values under FIRBA

Question 73. Views are sought on the costs and benefits of the revised regulatory LGD values to be used under the FIRB Approach.

In particular, how does the approach provided by the Basel III standards compare with the Basel II standards in terms of risk-sensitivity, impact on RWAs and operational burden?

Please provide relevant evidence to substantiate your views.

The revised FIRBA calls for a collateral haircut of 40% and a LGD of 20% for the secured part and 40% for the unsecured part.

The combination of haircut and undifferentiated LGD of 20% for the secured part means that in the low LTV area the minimum risk weight of 20% penalises low-risk business. As a consequence, institutions with higher risks can continue to rely on their internal models producing risk-sensitive results, whereas in the case of risk-averse institutions the internal models do not deliver any sufficiently risk-sensitive results and thus lead to significant capital add-ons for which there is absolutely no justification.
The supervisory LGD should therefore be lowered in the lower LTV area.

Question 74. In your view, are the regulatory LGD values sufficiently prudent in light of the decrease of the regulatory LGD value for unsecured corporate exposures and the changes affecting secured exposures?

Please provide relevant evidence to substantiate your views.

Yes. We assume that this is substantiated by the analyses of the Basel Committee's expert group. In the case of exposures secured by immovable property, the lowering of the LGD is offset by the implicit increase in the haircut. Seen overall, the effect of the lowered LGD is greater, however. At the same time, the newly set parameters increase the risk sensitivity of lowly secured exposures (less than 30% secured). The resulting steering impetus has a positive effect on risk management. Compared with the AIRBA, the risk weights under the FIRBA are significantly higher particularly in low-risk business and thus continue to demonstrate a highly prudent calibration of LGD in conjunction with the haircut.

Question 75. In your view, which other aspects, if any, should be considered in the context of revising the regulatory LGD values to be used under the FIRB Approach?

At Basel Committee level, separate LGDs for covered bonds are not an issue. However, there is no reason why the current tried-and-tested arrangement in CRR Article 161 (1d), providing for an LGD value of 11.25%, should not be retained.

1.2.5. EAD – introduction of an input floor

Question 76. Views are sought on the costs and benefits of exposure-level EAD input floors:

In particular, how do the floors compare with the current treatment in terms of achieving the aims of conservatism and RWA variability?

What is the impact of this change on RWAs? Please provide relevant evidence to substantiate your views.

We are against the introduction of EAD input floors, as this would lead to a reduction in risk sensitivity. Furthermore, in the EU various measures leading to sufficiently conservative PD estimation and significantly reducing inexplicable RWA variability have already been/are being implemented at short notice:

- IRBA repair: EBA work on IRBA-related standardisation through regulatory technical standards (RTSs) and guidelines (GLs), e.g. on the definition of default, on PD and LGD parameter estimation along with uniform treatment of model uncertainties by way of margin of conservatism (MoC) requirements, downturn add-ons, comprehensive new acceptance criteria for approval to use the IRBA,
- EBA benchmarking: annual internal model benchmarking in accordance with CRD IV Article 78,
- TRIM ECB banking supervisors' exercise of targeted review of internal models 2017-2019.

1.2.8. Maturity factor – clarifications on the calculation of effective maturity

Question 86. In your view, which other aspects, if any, should be considered in the context of the treatment of the maturity parameter?

Please provide relevant evidence to substantiate your views.

To alleviate the negative consequences of cutting off the AIRBA for certain asset classes, institutions should be allowed, upon application to the competent authority, to continue opting for the explicit maturity treatment under FIRBA conditions as well. CRR Article 162 (1), second sentence, would have to be amended as follows: "At the institution's request, the institution may determine the effective maturity also for individual FIRBA exposures."

In our view, the approach providing for a fixed maturity under the FIRBA should be abandoned at least for exposures to institutions. This makes sense from a risk perspective, as the exposures are usually of a short-term nature. If the effective maturity may be set here, too, the negative impact of cutting off the AIRBA for exposures to institutions would at least be partly eliminated. Under the FIRBA for institutions, the provisions of CRR Article 162 (1) should be allowed to be applied in full (including all the maturities set out therein).

The current arrangement under CRR Article 162 (4) should be retained in view of the limitation of total assets to EUR 1 billion for corporates that own and let (non-speculative) residential property. For such corporates, AIRBA institutions thus may, like FIRBA institutions, apply a residual maturity of 2.5 years. This relief supports borrowing particularly by municipal, social and cooperative housing companies that operate in a low-risk business environment. Compared with many other sectors, such companies have much higher total assets. Retention of the current arrangement will exclude speculative real estate finance from preferential treatment.

1.2.10. Sovereign exposures – public sector entities (PSEs) and regional governments and local authorities (RGLAs)

Question 88. What are your views on the costs and benefits of the proposed treatment of PSEs and RGLAs resulting from the changes applicable to exposures to central governments and exposures to institutions compared to the current framework?

Please elaborate and provide relevant evidence.

According to the new Basel III standards (paragraph 19), there are to be no changes for PSEs and RGLAs under the IRBA compared with the Basel II standards. This means that a restriction of modelling envisaged by the Basel III standards for the "Institutions" exposure class may not be applied to PSEs and RGLAs. That goes irrespective of whether the PSEs and RGLAs are assigned under the current CRR arrangements to the IRBA "Central governments" or "Institutions" exposure class.

For implementation compliant with the Basel III standard, this means in practice that

- the AIRBA may continue to be applied to all PSEs and RGLAs,
- the present PD input floor of 0.03% for PSEs and RGLAs that are currently assigned to the IRBA "Institutions" exposure class may not be raised to 0.05% (relevant for the AIRBA und FIRBA); rather, the PD input floor requirement should be dropped, as the new Basel III standard does not set any PD input floor for these PSEs and RGLAs,
- no PD input floor may be introduced for PSEs and RGLAs that are currently assigned to the IRBA "Central governments" exposure class, and
- still no LGD input floor may be introduced for all PSEs and RGLAs under the AIRBA.

Question 89. In your view, are there other ways to achieve more robust RWA estimates for exposures to PSEs and RGLAs that would mitigate the potentially significant differences in treatment described above?

- ◯ Yes (X)
- ◯ No
- ◯ Don't know / no opinion / not relevant

Question 89.1 If yes, which are they and what would be their costs benefits and their prudential justification?

Please elaborate and provide relevant evidence.

In the EU, various measures (IRBA repair, EBA benchmarking, TRIM) leading to sufficiently conservative RWA estimation for PSEs and RGLAs and significantly reducing inexplicable RWA variability have already been/are being implemented at short notice.

1.2.12. Other provisions

Question 94. In your view, which other aspects, if any, should be considered in the context of revising the IRBA?

Please elaborate and rank your answers from the most important to the least important aspect.

Partial Use

Institutions that currently use the standardised approach for credit risk (SACR) are to be able in future to request to use the FIRBA and the AIRBA for one or more exposure classes on a permanent basis without having to present a roll-out plan for group-wide IRBA implementation across all exposure classes. The new Basel standards expressly allow this (cf. paragraph 44). In line with the Basel Committee rules, the roll-out plan requirements should be confined to the exposure class for which the IRBA is requested.

The current partial use arrangements, particularly if they are as stringent as in Germany, have in the past kept institutions from switching from the SACR to the IRBA although these institutions generally have IRBA-compliant rating and parameter estimation processes for their large portfolios in place and would be able to switch relatively easily to the FIRBA or AIRBA. However, for institutions with many smaller, heterogeneous portfolios, in conjunction with portfolios for which reliable internal risk modelling is not possible, the required coverage levels that have to be demonstrated to date in an IRBA implementation plan are currently an insurmountable obstacle to switching to the IRBA. For these portfolios, the use of an IRBA-compliant rating process for internal risk management purposes does not generate any added value, so that IRBA implementation at an economically reasonable cost is not possible. The use of rating results and IRBA parameters is, it is true, the condition for permission to use the IRBA. Yet the guiding principle and starting point should be whether an institution uses a rating process, including its parameter estimations, effectively in risk management and whether this leads to reliable and robust risk assessment, so that this can then also be used for application of the IRBA.

We therefore expressly welcome it that the Basel Committee has decided not to call for implementation of the IRBA for all portfolios in accordance with an IRBA implementation plan and instead grants permission to use the IRBA geared to exposure classes. This option should be implemented in any event to support proliferation of IRBAs based on reliable rating and parameter estimation processes in the EU. In addition, permission to use the IRBA within an exposure class should revolve around rating systems separated from each other by way of an institution's verifiable internal criteria. In the process, subject to the approval of the competent supervisory authority, an exemption for immaterial sub-portfolios where use of the IRBA is uneconomical and for sub-portfolios for which no reliable risk assessment is possible should be allowed on a permanent basis.

We recommend integrating the Basel requirements (paragraph 44) into the existing provisions of Articles 147(2) and 148 of the CRR so that it would reflect the logic of the Basel document. The new exposure classes in Article 147(2) would be as follows:

(a) exposures to central governments and central banks;

(b) public sector entities and regional governments and local authorities

(c) exposures to institutions;

(d) exposures to corporates (excluding specialised lending and purchased receivables);

(e) specialised lending;

(f) corporate purchased receivables;

(g) qualifying revolving retail exposures;

(h) retail residential mortgages;

(i) other retail (excluding retail purchased receivables);

(j) retail purchased receivables;

(k) items representing securitisation positions;

(l) other non credit-obligation assets.

For (e) – specialised lending – consideration could also be given to raising the SL sub-asset classes to the highest level to open up the option of partial use here, too.

However, to ensure consistency between the approaches, the definition of specialised lending should – in keeping with the proposal for only three categories now within the revised SACR – be applied in the revised IRBA, too. As there is no reason why income-producing real estate (IPRE) should be treated differently within the revised SACR and the revised IRBA, the "Real estate" exposure class should be introduced in the IRBA as well and include both real estate finance dependent on cash flows (IPRE) and real estate finance not dependent on cash flows (general treatment).

The conditions for use of the IRBA under CRR Article 148 should then cover the exposure classes applied for by the institution in accordance with Article 147 (2).

Reversion to a less sophisticated approach

When adjusting the CRR requirements for reverting to a less sophisticated approach, the following two guiding principles should apply:

1. The new IRBA regime represents a fundamental overhaul of the existing requirements for accessing the approach. "Old" IRBA users should therefore no longer be bound by their application for permission to use, and the approval granted to use, the IRBA, both of which will normally have been processed many years ago. Banks currently using the IRBA to value their entire portfolio must have the right to decide freely to which individual exposure classes they wish to continue applying the IRBA under the revised requirements.
2. Existing IRBA users should not be disadvantaged compared to new users.

According to paragraph 48 of the Basel Committee document, reversion to the FIRBA or SACR (from the AIRBA) or to the SACR (from the FIRBA) is only possible in extraordinary circumstances. As the new IRBA regime represents a fundamental overhaul of the IRBA, we believe it is appropriate to apply the assumption of extraordinary circumstances for the purposes of this provision. In this way, the first of the principles mentioned above is also respected. Reversion to a less sophisticated approach should be possible individually for institutions for each approved rating process.

Banks should not be required to demonstrate that reversion to less sophisticated approaches is not motivated by a desire to reduce their own funds requirements. This would enable the second principle to be respected. New users will not need to furnish proof of this kind. In our view, moreover, decisions to use the IRBA for a particular asset class need to be based on a thorough cost-benefit analysis, which will not focus solely or even primarily on capital requirements.

Unlike in other European jurisdictions, the requirement for an extremely high degree of coverage of IRBA systems (at least 92% under the German Solvency Regulation) meant that banks were forced to introduce IRBA systems even for very small portfolios where this made no economic sense. Obstacles to switching to the SACR would once again put German institutions at a structural disadvantage.

HVCRE finance

Generally increasing risk weights for all HVRCE finance under the IRBA by setting a separate risk weight function is inappropriate in our view, given the wide range of different HVCRE. We therefore suggest exempting HVRE finance from application of the special risk weight function subject to the following conditions and instead applying the risk weight function set for the other classes of specialised lending:

- LTV ≤ 80%
- Equity input into project ≥ 15% of total project value

1.2.13. Implementation challenges and administrative burden

Question 95. Which elements of the revised IRBA, if any, would you deem particularly challenging to be implemented?

Please elaborate and rank your answers from the most challenging to the least challenging revision.

Please provide relevant evidence on the one-off costs to substantiate your views.

The most onerous requirement in the revised AIRBA is calculating the LGD input floor at individual exposure level, as exposures have to be split into the different secured parts and the unsecured part to in this way determine the floor.

Question 96. Which elements of the revised IRBA, if any, would in your view cause additional administrative burden?

Please elaborate and provide relevant evidence on the expected recurring costs.

To ensure consistency between the revised IRBA and the revised SACR, which gains special relevance for IRBA institutions because of the output floor requirements, the definition of the IRBA "Specialised lending (SL)" exposure class should correspond to the SL exposure class under the SACR. Accordingly, the SL exposure class in the revised IRBA should, like that in the revised SACR, include the following three sub-categories: project finance, object finance und commodities finance.

At the same time, like in the revised SACR, the "Real estate (RE)" exposure class, including both real estate finance dependent on cash flows (IPRE) and (general) real estate finance not dependent on cash flows, should be introduced in the revised IRBA. This would reduce the additional administrative burden significantly.

1.3. Credit risk mitigation – SA-CR

1.3.4. Other provisions

Question 102. In your view, which other aspects, if any, should be considered in the context of revising the CRM framework under the SA-CR? Please specify and rank your answers from the most important to the least important aspect.

One reason for the low risk sensitivity of the standardised approach for credit risk is the highly restrictive criteria governing the eligibility of collateral. In our opinion, banks should at least be allowed to take account of other physical collateral under the same conditions as in the IRB foundation approach. This would be appropriate and enable loans secured by other physical collateral to be assigned a lower risk weight commensurate with the lower risk involved. Such a rule would particularly benefit loans to SMEs secured by other physical collateral.

Under paragraph 70 of the revised requirements for the IRB approach, unsecured exposures will be assigned a 40% LGD, whilst under paragraph 75 loans secured by physical collateral will be assigned only a 25% LGD. The difference in LGD is based solely on collateralisation and the reduced LGD is produced by the adjustment factor of 25/40 = 0.625. If this approach is applied to the risk weight under the standardised approach for credit risk, it means that the risk weight of the secured part of a loan would have to be 73.2% after application of the haircuts in accordance with paragraphs 74 and 75 of the Basel document (see footnote for calculation).1

We therefore suggest that the lower risk of non-defaulted loans secured with other physical collateral be reflected by applying a factor of 0.732 to the risk weight of non-defaulted loans to corporate and retail clients secured with physical collateral. This approach would, first, significantly reduce the large discrepancy in the capital requirements for loans secured with prudentially recognised physical collateral under the foundation and advanced IRB approaches, on the one hand, and the standardised approach, on the other. Second, it would make it easier for banks using the standardised approach for credit risk to transition to the foundation IRB approach. Another possible solution would be to apply a correspondingly lower risk weight to the part of the loan secured with other physical collateral.

It is also important for collateral eligible under the IRB approach to be eligible under the standardised approach as well. Otherwise, non-performing exposures will have to be treated as unsecured for the purposes of Article 47c of the CRR. Even if a loan is secured with recoverable collateral, banks will have to deduct 100% of the secured portion of a non-performing loan from CET1 capital during the workout phase after three years at the latest. The secured portion will even have to be deducted from CET1 capital in full if the borrower posts new recoverable collateral during the workout phase as the deduction is calculated only on the basis of the length of the non-performing period. This is not appropriate and will lead to banks using the standardised approach being increasingly unwilling to support restructuring even if prospects appear promising in the medium term. The effect described results from the fact that under the German GAAP principle of loss-free valuation, a value adjustment is made only on the unsecured portion of a loan if the collateral is recoverable. Anything else would not correspond to a true and fair view and would therefore be inadmissible under German GAAP. Since the requirements for deducting non-performing loans from regulatory capital under the CRR did not come into force until 26 April 2019, they will have an impact on capital from 2022 onwards. Action is therefore urgently needed.

[1] The adjusted LGD for physical collateral in accordance with paragraph 74 after application of the haircuts in paragraph 75 is:
LGD (fully secured) = (0.25 x (1/1.4) + 0.4 x (0.4/1.4) = 29.3%. The credit risk mitigation factor would have to be calculated as follows:
LGD (fully secured)/LGD (non-secured) = 0.732 (0.293/0.4).

2. Securities financing transactions (SFTs)

2.1. Minimum haircut floors for certain SFTs

Question 112. How do you view the potential effectiveness of minimum haircut floors with regard to achieving their prudential objectives?

Would the incentive provided by the framework be sufficient to encourage institutions to meet the minimum level of over- collateralisation?

The proposed haircut floors for non-centrally cleared securities financing transactions (SFTs) with certain counterparties are unduly conservative and thus lead to unjustifiably high capital requirements for some transactions. Above all, there is no reason from a risk perspective to treat transactions that do not meet the minimum haircut criteria in the same way as wholly unsecured exposures.

In addition, section 2.1 of the consultation paper justifies the proposed floors by stating that they would restrain the build-up of excessive leverage. It should be borne in mind that excessive leverage is already restrained by the mechanism of the leverage ratio, where SFTs are already subject to highly restrictive treatment. Loaned cash is treated in virtually the same way as an unsecured loan because, first, received collateral is not recognised and, second, the conditions in Article 429b(5) of CRR2 for netting cash liabilities are so restrictive that the offsetting effect is more or less zero. We therefore believe that the issue of limiting excessive leverage is sufficiently addressed by the leverage ratio requirement.

Question 115. As an alternative option to implementing minimum haircut floors for in-scope SFTs in the prudential framework as provided by the Basel III standards, such floors could be implemented via a market regulation.

How would you compare the two alternative options in terms of achieving the prudential objectives?

Would one of the two options affect more significantly the SFTs market?

Please provide relevant evidence to substantiate your views.

We support the EBA's recommendation not to implement minimum haircut floors for SFTs for the time being and instead consider a possible market regulation after further analysis. Whichever measure is ultimately taken, it is crucially important in the interests of a level playing field that it applies consistently across all jurisdictions worldwide.

3. Operational risk

3.1. Discretion to set the ILM equal to 1

Question 123. How would exercising the discretion affect the link between capital incentives and management of operational risks?

Please elaborate.

In our view, the ILM should be introduced with a cap of 1 in the EU for all institutions. Further, institutions with a BI < EUR 1 billion should – as set out as a national option in the Basel text – have the option of whether to apply the ILM or not.

Overall, this would mean that only ILM values of less than 1 would be factored into the calculation of own funds requirements. This approach would set a positive incentive to mitigate operational risks effectively and to avoid losses. At the same time, it would moderate the overall increase in own funds requirements in the EU resulting from the Basel reform package.

Question 124. Would you deem it necessary to mitigate possible cliff effects that might derive from the introduction of an institution-specific ILM?

- ◉ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 124.1 If yes, which measures should be considered, for how long should they be applicable, and what would be the prudential rationale to implement them? Please elaborate.

If the possibility of an institution-specific ILM larger than 1 was introduced in the framework, the OR-SA should be gradually phased-in in order to make the capital effects for bucket 2 and 3 institutions manageable. As proposed by EBA, a phase-in method for the Loss Component should be used that is aligned with the phase-in of the output floor.

3.3. Discretion to use the ILM for bucket 1 institutions

Question 128. What are your views on how this discretion might affect the overall level of own funds for operational risk of bucket 1 institutions and the comparability within bucket 1?

Because application of the ILM is associated with a high (and also ongoing) level of effort and expense, we welcome in the first instance the fact that bucket 1 institutions will not be automatically forced to apply it. As a general rule, including it voluntarily in the calculation of capital requirements is only likely to be an attractive option for bucket 1 institutions whose ILM < 1. If a bucket 1 institution identifies an ILM >1, it will most likely not apply it voluntarily. For this reason, it can be assumed that, if the discretion is introduced, the capital requirement in bucket 1 will tend to be lower overall than if there is a fixed target of ILM=1.

Nevertheless, we support introduction of this discretion (see response to Question 123). In our view, bucket 1 institutions that are willing to incur the necessary effort and expense to refuse to apply ILM across the board would suffer an unjustified disadvantage compared with bucket 2 and 3 institutions.

(see response to Question 123)

Question 129. If the discretion was retained, which conditions and criteria should be introduced in order to ensure a level playing field in its application by supervisors?

It should be possible to implement the discretion once, with any modification subject to approval by the supervisors.

3.4. Discretion to request institutions to use less than five years when the ILM is greater than 1

Question 131. What are your views on the discretion for supervisory authorities to request the institutions to use less than 5 years of loss data (when the ILM >1)?

In which circumstances would such a request be justified? Please elaborate and provide relevant evidence.

If the possibility of an ILM larger than 1 was introduced in the framework, the supervisory discretion should be limited to the above mentioned case of newly established institutions. In principle, to ensure a level playing field within the EU, the prescribed 10 year window (or 5 year window, respectively) should apply equally to all affected institutions.

3.5. Exclusion of certain operational risk loss events

3.5.2. Minimum retention period

Question 133. What would be in your view an appropriate minimum retention period for the losses that will be excluded from the loss dataset?

What would be an appropriate starting point of this period?

Please explain and provide relevant evidence to substantiate your views.

The option of excluding certain operational loss events from the loss history (paragraph 27 of the section on operational risk) is, in principle, appropriate, in our view. We see no reason to include events or positions in the calculation that have become irrelevant to a bank's risk profile. In particular, no minimum retention period should be applied to losses stemming from divested businesses.

3.6. Other operational risk topics

3.6.1. Governance and organisational requirements

Question 134. What are your views on retaining the aforementioned CRR provisions and adapting the corresponding CDR provisions with a view to maintain their binding status?

We would like to point out that the above mentioned CDR specifies the assessment methodology under which competent authorities permit institutions to use Advanced Measurement Approaches. Therefore, we see no justification to apply the respective requirements to all institutions in the future. As EBA points out in their recommendations, the principle of proportionality must be upheld here.

3.6.2. ICAAP and Pillar 2

Question 137. What are your views on requiring the inclusion of the abovementioned elements (internal loss data, scenarios, external loss data and key risk indicators) in the ICAAP for operational risk?

Institutions currently use methods for the ICAAP that are appropriate to their size and risk profile. We understand that it will make sense for large, in particular current AMA institutions to keep some of the above mentioned elements in order to ensure continued risk-adequate OR management when the ILM is capped at 1. In particular a combination of internal loss data on the one hand to allow past loss experience to be reflected, and the use of forward-looking data based on scenarios on the other, has proven its worth. However, the new Pillar I framework does in our view not justify to impose stricter mandatory requirements than already in place with regard to the ICAAP of small and medium-sized institutions.

The principle of proportionality needs to be upheld within the Pillar II framework.

Question 138. Would you deem further refinements or clarifications necessary concerning the ICAAP for operational risk?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 138.1. If no, please elaborate on your response to question 138.

See response to Question 137: Today's generally principle-based requirements are adequate and should not be reinforced further by prescriptive requirements, as this is the only way to ensure that the enhancement of operational risk management is geared towards the risk profile. If not, there would be a risk that requirements would have to be implemented that do not generate any value added for the institution in question but trigger disproportionate costs.

3.6.3. Identifying BIC items in Financial Reporting (FINREP)

Question 140. What are your views on the costs and benefits of using FINREP templates as a reference for a harmonised identification of BIC items in the EU?

Please substantiate your views with relevant evidence.

In general, we think that standardised requirements based on FINREP reporting templates would restrict the scope for interpretation in calculating the Business Indicator Component (BIC). This would support rapid implementation, ensure the comparability of risk and financial data and ensure that existing "reporting" flows are used instead of developing a separate "OpRisk" reporting flow.

Question 142. In your view, which other aspects, if any, should be considered in the context of mapping BIC components and FINREP items?
Please elaborate.

It should be considered that the CRR only requires FINREP reporting for IFRS preparers. FINREP reporting was extended to all institutions by ECB Regulation 2015/534. The reporting requirements differ depending on the size and significance of the institutions. If a mapping table is introduced, it is therefore vital to clarify that the mapping table requirements are definitive. If data from the FINREP data repository is not available for smaller institutions, there should be no requirement to calculate it separately for determining the BIC. For example, two data points in the mapping table in Annex 3 of the EBA report on operational risk are based on template F43.00 Provisions, which must only be reported for "FULL FINREP" institutions. Institutions that are classified as "simplified", "oversimplified" or data point reporters are not required to report the data and therefore do not have the data available in their data repository.

3.7. Other provisions

Question 143. In your view, which other aspects, if any, should be considered in the context of revising the operational risk framework?

Please elaborate and rank your answers from the most important to the least important aspect.

Service component:

a) As things currently stand, the new standardised approach for measuring operational risk will place business models geared towards fee and commission-earning operations at a disadvantage, in the form of higher capital requirements, compared to business models geared more towards interest-earning business. We consider this discrimination to be unjustified, especially in times of extremely low interest rates, when many banks are increasingly adapting their business model to make it less dependent on interest income.

b) There is an additional element of competitive distortion in the services component as the capital requirements for a transaction that arise across the entire value chain increase each time an additional regulated institution is included in the chain. If, on the other hand, there are entities in the value chain which are not subject to the new capital requirements, the overall capital requirements for the same transaction will be lower across the chain. This would also apply to

groups of institutions at which this income/expense is eliminated in the course of group consolidation. The calculation requirement for the service component therefore discriminates against financial networks with fragmented entities that prepare their own financial statements to an even greater extent compared with unregulated market participants and consolidated groups of institutions.

c) In our view, both of these undesirable effects should be avoided or moderated by offsetting income and expenses in the service component (in the same way as the calculation of the other components).

Level of application:

d) It is not totally clear from the Basel Committee's final document whether the operational risk capital requirement should be calculated for an entire group as a whole or as the sum of the requirements of individual subsidiaries. In the interests of consistency and comparability, it should be made clear in the course of European implementation that calculations should take place at group level only.

3.8. Implementation challenges and administrative burden

Question 144. Which elements of the revised SA-OR, if any, would you deem particularly challenging to be implemented?

Please elaborate and rank your answers from the most challenging to the least challenging revision.

Please provide relevant evidence on the one-off costs to substantiate your views.

For institutions reporting under national GAAP, capturing the correct data with regard to the Business Indicator is extremely problematic (because, as we have already stated, it is IFRS-based and there is no mapping to national GAAP). For example, it is not clear how the "P&L Banking Book" is calculated, and how it can be derived from national GAAP. Any mandatory parallel application of IFRSs solely for the purposes of calculating the Business Indicator would trigger an enormous effort and expense and should therefore be avoided at all costs (see response to Question 142).

Collection and reporting of losses:

e) The new requirements for collecting and disclosing losses differ from the existing rules. It would be extremely costly to implement the new accounting logic required by the standardised approach in addition to COREP and existing methods of identifying and recording losses. In particular, we do not consider it feasible to retroactively collect accounting information about all historical losses. Nor, in our view, will this information deliver any concrete added value in terms of risk management. What is more, the different approaches will lead to inconsistent reports/disclosures. This will make it more difficult and time-consuming for supervisors to evaluate the information. In the interests of all parties involved, a solution should be sought in Europe which will result in the greatest possible consistency of loss data. Banks that already take account of loss data in Pillar I should be allowed to continue to use their existing systems for collecting loss data under the standardised approach. Banks that currently take an economic perspective on recording loss events under Pillar II should also be allowed to retain this practice for the standardised approach. This will have the added

advantage of enabling a much more realistic representation of loss levels to be achieved. The option of excluding certain operational loss events from the loss history (paragraph 27 of the section on operational risk) is, in principle, appropriate, in our view. We see no reason to include events or positions in the calculation that have become irrelevant to a bank's risk profile.

4. Market risk

4.1. Converting the reporting requirement into an own funds requirement

Question 146. What considerations should be taken into account regarding the implementation of the revised trading book boundary?

RBC25.18-20, 28, 29 has been implemented in Article 4(1)(96) in conjunction with Article 106 of CRR2. The Basel text focuses on avoiding regulatory arbitrage with regard to capital requirements. To reflect this objective, Article 4(1)(96) should clearly spell out – in line with the Basel text – that "between two trading desks" refers to regulatory trading desks in accordance with Article 104b of CRR2. It should likewise be clarified in Article 4(1)(144) of CRR2 (definition of trading desk) that this is a regulatory trading desk in accordance with Article 104b of CRR2.

It should also be clarified that Article 106 of CRR2 (to be applied from June 2023) does not apply to existing positions since this would not always be totally feasible. Take, for instance, the handling of interest rate risk transfer: among other things, Article 106(5)(c) of CRR2 requires banks to fully document how the position mitigates the interest rate risk arising from banking book positions. Retroactive documentation would not be possible. An example: on 1 April 2012, the bank executed an internal hedge in the form of a swap with a term of 15 years between the banking book and the trading book. The purpose of the hedge was to reduce interest rate risk in the banking book. For technical reasons alone, the hedging effect that arose on 1 April 2012 can no longer be demonstrated retrospectively (daily historical data are not stored for a period of years). In addition, documentation would constitute a huge administrative burden since banks that manage interest rate risk in the banking book by means of transfers to the trading book conclude such transactions on a large scale (in some cases several times a day). These are not individual cases. Furthermore, retroactive documentation would have no discernible benefit.

The FRTB introduces a rebuttable presumption of what should be in the trading book. It is essential to avoid banks having to assign certain positions to the trading book contrary to their intention/assessment simply because there is insufficient time or no mechanism in place to obtain supervisory approval to assign them to the banking book. NCAs must therefore establish and communicate standardised reporting and verification procedures and have adequate resources in place in good time before the new trading book boundary takes effect. Certain approvals should possibly be granted "en bloc" rather than bilaterally between supervisors and each individual bank. Moreover, for practical reasons a documentation and reporting requirement instead of a supervisory approval process deems to be sufficient.

Question 147. What considerations should be taken into account in implementing any other revised elements of the FRTB framework, finalised by the BCBS in 2019? Please specify and provide relevant evidence to substantiate your views.

With respect to carbon certificates (European emission allowances, EUAs), we are concerned that the implementation of the FRTB and amendments to CRR2 will have a significant negative impact on liquidity in the European Emissions Trading System (EU ETS).

This would fly in the face of the "Union's objectives to move towards a low-carbon, climate-resilient and circular economy" as set out in recital 61 of CRR2.

Banks play an important role in the EU ETS, which is a cornerstone of the EU's policy to combat climate

change and its key tool for reducing greenhouse gas emissions cost-effectively. They are typically the counterparties – by selling EUAs forward to utilities or industrial installations and hedging their exposure with spot EUAs bought in the market and through auctions. They play a major role in mediating the mismatch between spot supply (e.g. auctions) and forward demand (power hedge or strategic purchases) that helps to minimise the transaction costs of compliance for utilities and industrial installations.

Both long and short positions are at a fixed price, so positions are refinanced and closed. There is no inherent commodity risk. The sensitivities-based standardised approach does not take this into account.

Capital requirements calculated under the sensitivities-based standardised approach in the FRTB framework lead to a significant overestimation of commodity risk (resulting from spot purchases and forward selling).

Assigning carbon certificates to the same bucket as electricity does not reflect the nature of EU carbon allowances. EU carbon allowances are more comparable to goods or equities as they are storable (at no cost since they are electronic certificates) and do not change in character and/or quality. In addition, the generally defined tenor correlation for commodities is far too conservative for carbon certificates.

To establish an appropriate capital requirement for the specific commodity risk associated with carbon certificates, we suggest applying the requirements of the simplified standardised approach in footnote [25] of MAR40.65 to MAR21.81 ff. and integrating it into the CRR. Footnote [25] of MAR40.65 correctly takes account of the very special situation of stock financing (physical stock being sold forward) with regard to commodity risk.

Standardised approach: the Basel standard MAR21.17 requires banks to derive sensitivities under the sensitivities-based method on the basis of pricing models used to report market risks or profits and losses to senior management. Article 325t (1) of CRR2 just refers to pricing models for reporting profit and loss. When the provision is implemented, this restriction may lead to interpretation uncertainties, making implementation more costly and time-consuming. We recommend adjusting the wording to reflect the international requirements.

To avoid planning uncertainty for banks, the future reporting threshold above which the FRTB SA must be applied should correspond to the current reporting threshold for pre-emptive FRTB SA reporting (Article 325a of CRR2).

For the sensitivities-based standardised approach for market risk (SA-MR), we recommend retaining the risk weight of 1% introduced under CRR2 for the credit spread risk associated with covered bonds, such as Pfandbriefe, with a good rating (credit quality steps 1 to 3). For Pfandbriefe without an external rating, the external rating of the Pfandbrief issuer should be used.

With respect to default risk in the SA-MR, the LGD should be reduced from 25% to 11.25%. This lower amount would then be consistent with the LGD requirement in the F-IRB approach (in accordance with Article 161(1)(d) of the CRR).

4.2. Introduction of the simplified standardised approach

Question 148. What are your views on the introduction of the simplified SA-MR, in particular the revised calibration proposed by the BCBS?

We welcome the ability to continue using the existing standardised approach for market risk in the form of the simplified SA-MR. This will avoid imposing disproportionately high implementation costs on smaller banks.

With regard to the proposed scaling factors per risk type proposed, it is appropriate to base them on capital requirements under the FRTB standardised approach with slightly more conservative capitalisation.

The increase in capital requirements based on the envisaged scaling factors still seems excessively high, however, compared with the existing calibration.

An investment strategy in equities which are currently assigned to the banking book on a permanent basis but which may in future have to be assigned to the trading book and could justify a lower assumption of volatility must be assessed differently from an equities trading strategy. This should be taken into account in the calibrations. We view the big increase in capital requirements for raw materials, especially, as highly problematic.

It is unclear what scaling factors are to be applied in the special case of the flat 32%/40% CIU capital requirements if these paragraphs are to be retained. This needs to be clarified.

What would be the impact on RWAs and which types of activities or transactions, if any, would be particularly affected by the revised calibration?

Footnote [25]2 of MAR40.65 correctly takes account of the very special situation of stock financing (physical stock being sold forward) with regard to market risk. Unfortunately, this method is not available to banks which have to choose the sensitivities-based standardised approach. The sensitivities-based standardised approach basically treats carbon like electricity, which we disagree with due to the very different natures of these products.

Banks' role in the carbon market is intermediation between spot auctioning (by governments) and forward selling to customers, which results in a physical stock position (spot long – forward short). Both the long and short position are at a fixed price, so the position is refinanced and closed. There is no inherent market risk, only counterparty risk, which is measured separately. The new standardised approach does not take this into account. The proposed method would lead to a significant increase in RWAs (RWAs > nominal, fivefold increase in RWAs). To establish an appropriate capital requirement for market risk in this special case we suggest applying the requirements of the simplified standardised approach in footnote [25] of MAR40.65 to MAR21.81 ff. and integrating it into the CRR.

[2] Basel Committee on Banking Supervision, Minimum capital requirements for market risk, January 2019 (rev. February 2019): Where a commodity is part of a forward contract (quantity of commodities to be received or to be delivered), any interest rate or foreign currency exposure from the other leg of the contract should be reported as set out in [MAR40.3] to MAR40.40] and *[MAR40.53] to [MAR40.62]. Positions which are purely stock financing (i.e. a physical stock has been sold forward and the cost of funding has been locked in until the date of the forward sale) may be omitted from the commodities risk calculation although they will be subject to interest rate and counterparty risk requirements.*

4.3. Treatment of investments in collective investment undertakings (CIUS)

Question 151. What are the proportion and characteristics of the CIUs traded in the EU for which the mandate of the CIU is available and daily price quotes can be obtained?

The mandate-based approach does not play any role in practice (requirements are virtually impossible to fulfil) and the look-through approach is generally used for investment funds.

4.5. Other provisions

Question 156. In your view, which other aspects, if any, should be considered in the context of revising the market risk framework?
Please specify and rank your answers from the most important to the least important aspect.

Standardised approach: Article 325i of the proposal for the delegated act envisages a treatment of diversified and liquid indices for which no look-through is required. This will simplify the mapping of highly diversified indices with many constituents. The proposed treatment of default risk sets out no corresponding arrangement for handling indices without look-through, however. To simplify the overall handling of indices of this kind, a provision should be added that takes account of the low default risk of highly diversified indices.

5. Credit valuation adjustment (CVA) risk

5.1. Revised CVA framework

Question 159. Views are sought on the cost and benefits of implementing the revised CVA framework in the EU.

In particular, how do the approaches provided by the final Basel III standards compare with the current approach of the CRR in terms of impacts on RWAs and operational burden?

Please provide relevant evidence to substantiate your views.

The BA-CVA is calibrated excessively conservatively compared to the existing, methodologically comparable standardised method of the CRR. The specified risk weights are generally much higher, meaning that capital requirements will rise dramatically. In practice, most exposures arising from OTC derivatives contracts are to the financial sector. The risk weight to be applied for investment grade counterparties in this sector is a blanket 5%, which would increase capital requirements for CVA risk at least fivefold compared to the existing standardised method (0.7-1.0% for credit quality steps 1 to 3). In the absence of any empirical evidence indicating that the CVA capital requirement calculated under the existing standardised method significantly underestimates actual CVA risk, there is no justification for such an increase.

Question 161.1 If yes, which ones and what are the potential solutions to address them prudentially?

Please provide relevant evidence to substantiate your views.
(See reply to Q 159).

It would be more appropriate to retain the rating-related weights of the existing standardised method set out in Article 384 of the CRR for the BA-CVA. In its review of the standardised approach for credit risk, the Basel Committee reverted to a rating-related method of risk assessment under stricter conditions, such as the due diligence requirement. Adopting a graded rating-related assessment in the BA-CVA would establish regulatory consistency with the revised standardised approach for credit risk.

The SA-CVA is based on the sensitivities-based standardised approach for market risk. After the CVA framework had been finalised, the market risk framework was revised at Basel level, including a recalibration of risk weights. In the interests of consistency, these recalibrations should be reflected in the SA-CVA as well.

We would like to point out that the BCBS is currently consulting on this approach and that changes in the Basel framework might have to be considered in EU implementation. Furthermore, the treatment of indirect hedges in the SA-CVA is not appropriate (c.f. reply to Q 162.2)

Question 162. The final Basel III standards extend the scope of CVA risks subject to the framework.

In this context, what are your views on the capacity of institutions in the EU to manage and hedge all CVA risks?

Are CVA hedges under the SA-CVA and BA-CVA appropriately recognised?

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 162.1 If not, what are the potential solutions to better recognize them prudentially?

Please provide relevant evidence to substantiate your views.

Under the SA-CVA, the use of proxy hedging (indirect hedging with correlated instruments against the default of counterparties for which there is no internal default insurance coverage [illiquid counterparties]) generates higher capital requirements than would be the case if there was no hedging at all. This is counterintuitive and unjustified given that proxy hedging reduces risk.

As a result, the use of the SA-CVA can sometimes lead to higher capital requirements than the use of the BA-CVA even though the SA-CVA is significantly more complex and risk-sensitive than the BA-CVA. All other things being equal, however, a more advanced approach should not result in higher capital requirements than a simpler one.

It is highly unlikely that above two effects are desired and they should therefore be eliminated when the requirements are implemented in Europe.

5.2. Exemptions under the CRR

Question 166. In your view, which clarifications, if any, should be provided regarding the definition of the current exemptions, should these exemptions be retained under the CRR?

Please provide relevant evidence to substantiate your views.

When implementing the new framework in the EU, it is essential that the counterparties currently exempted from capital requirements for CVA risk under Article 382 of the CRR remain outside the scope. Article 382 of the CRR exempts from the CVA charge, among other things, intragroup derivative transactions, transactions between members of the same institutional protection scheme, and transactions with non-financial institutions provided that the clearing threshold under EMIR is not exceeded. Also exempt – along the same lines as under the standardised approach for credit risk – are derivative transactions with regional and local authorities as well as with central governments and central banks. We consider these exceptions to be important and justified.

The exceptions were introduced after careful consideration and for good reasons. If they were not retained, banks would in future have to set aside regulatory capital to cover the CVA risk associated with interest rate and currency hedges entered into with local and central governments or non-financial firms. There is a danger of the CVA charge making such derivative transactions hugely more difficult and

expensive. It is therefore open to question whether local authorities, governments and companies would be willing and able to carry out hedging transactions at all in the future. Since the US dollar is still the most widely used currency for international payments, European companies and other counterparties are particularly exposed to FX risk – to a far greater extent than their US competitors, for example. As a result, their need for tailored hedging solutions is particularly high. If the costs of such business with corporate clients were to be driven up, this would have adverse effects on the European real economy.

Intragroup derivative transactions and transactions between members of the same institutional protection scheme would also be adversely impacted even though these transactions serve, among other things, to reduce risk as part of a group-wide risk management strategy (interest rate, currency, liquidity and credit risk management). It is essential to avoid such effects.

5.3. Proportionality in the CVA framework

Question 169. Views are sought on the appropriateness of the EUR 100 billion threshold for allowing institutions to use the simplified approach.

How would this threshold compare to the eligibility criteria for the use of the existing simplified approach to calculate the own funds requirements for CVA risks under Article 385 of the CRR?

How would the EUR 100 billion threshold compare to the eligibility criteria for the use of the simplified methods to calculate the exposure value for counterparty credit risk under Article 273a CRR?

Please provide relevant evidence to substantiate your views.

The conditions for applying the simplified approach (i.e. determination of the CVA charge as a simple multiplier of the capital requirement for counterparty credit risk) should on no account be subject to any gold-plating. As things stand, we assume that more banks comply with the Basel threshold (€100bn notional amount of non-centrally cleared derivatives) than with the simplified SA-CCR thresholds set out in Article 273a of CRR2.

5.6. Other provisions

Question 174. In your view, which other aspects, if any, should be considered in the context of revising the CVA framework?

Please specify and rank your answers from the most important to the least important aspect.

We welcome the fact that the new CVA framework permits partial use of the SA-CVA by allowing any number of netting sets to be carved out from the SA-CVA calculation and transferred to the BA-CVA. We believe, however, that it should also be possible to split individual netting sets – into tangible and intangible transactions, for instance. The requirement to apply either the SA-CVA or the BA-CVA to a complete netting set will otherwise lead to disproportionate time and effort being spent on the calculation of risks which are in part intangible (SA-CVA) or to less risk-sensitive capital requirements for risks which are in part tangible (BA-CVA).

6. Output floor (OF)

6.1. Material scope of application

Question 177. What are your views on the relative costs and benefits of including in the calculation of the OF more own funds requirements than those explicitly mentioned in the Basel III standards?

In particular, how would such broader material scope compare to the scope required by the Basel III standards in terms of impact on RWAs, risk-sensitivity, comparability, complexity and operational burden?

Please provide relevant evidence to substantiate your views.

We take the view that the inclusion of additional capital requirements (over and above those explicitly mentioned in the Basel standards) would give rise to huge costs which would not be balanced by any benefit to speak of. As the EBA calculated in its report to the European Commission of 2 August 2019, the inclusion of additional capital requirements in the calculation of the output floor would raise the already very high increase in capital requirements by more than two percentage points from 22.4 to 24.5. Since German banks will be particularly hard hit by the output floor, we are concerned that the increase in additional capital requirements would also be above average for German banks. We urge the European Commission to analyse the effects on individual member states as part of its own impact study on implementing the final Basel package.

We strongly recommend refraining from gold-plating the Basel standards by including additional capital requirements. In our view, the problems described by the EBA in its August 2019 report in terms of the complexity and lack of transparency that such an approach would entail will only arise if the Basel output floor requirements are implemented in the form of a single group of capital requirements (the EBA's "alternative approach"), with some capital requirements calculated on the basis of RWAfloored and others on the basis of RWApre-floored.

This additional complexity and lack of transparency can be avoided if the output floor, as proposed by us, is designed as a backstop to risk-adjusted capital requirements (referred to by the EBA as the "parallel stacks approach"). While the leverage ratio is a backstop for all risk-adjusted capital requirements, the output floor should be an additional backstop for banks that use internal models to calculate their capital requirements. The output floor requirements should therefore be regarded as a third, separate capital requirement alongside the "normal" capital requirements based on pre-floor RWAs and the leverage ratio. The actual regulatory capital requirement would then be the highest of the three.

Specifically, we recommend implementing the risk-based Basel capital requirements in European law in two separate groups of minimum capital requirements:

- The minimum capital requirements relating to the approaches for which the bank has received supervisory approval (pre-floor RWAs) should remain in Article 92 of the CRR.
- In addition, the same minimum capital ratios in relation to floored RWAs should be set out elsewhere (e.g. Article 500 of the CRR). To implement the Basel requirements in full, the bank-specific countercyclical capital buffer requirement and the capital conservation buffer requirement of 2.5 per cent of CET1 capital would have to be added to the floored RWAs at this point. For G-SIBs, the capital buffer for globally systemically important institutions and the TLAC requirement would also need to be added.

We believe that, contrary to what the EBA claims in its August 2019 report, such an approach would be consistent with the wording of the Basel output floor requirements. We will go into this in more detail in our reply to Q 185.

Effects on RWAs

According to the EBA impact study mentioned above, the RWAs of EU banks would increase by an average of 24.5% if all capital requirements were included in the calculation of the output floor ("full stack approach"). This would be accompanied by a similarly high increase in minimum capital requirements (+24.4%). A recent study by Copenhagen Economics3 concludes that the implementation of the output floor as a second backstop would reduce the overall effect of the Basel reforms on minimum capital requirements by around 8 to 9 percentage points.

Risk sensitivity

The problems of the output floor become clear in its interaction with the standardised approaches (e.g. the standardised approach for credit risk). From the perspective of banks using the IRB approach, the standardised approach is still not sufficiently risk sensitive. One of the reasons for the lack of risk sensitivity is that the borrower's creditworthiness plays no role in the risk weighting of many exposures. In addition, the standardised approach does not recognise certain types of collateral, such as movable physical collateral, which can be recognised as mitigating risk in the IRB approach. Internal rating systems, especially given that banks have built up extensive data histories that also cover a financial crisis, are likely to be able to capture an institution's risks very accurately. This means that when the output floor is triggered, there will be a considerable loss of risk sensitivity in determining capital requirements. Conversely, this means that the lower the probability of the output floor being triggered, the more likely it is that the highest possible degree of risk sensitivity can be maintained. Since the second backstop approach will only be triggered in the event of a greater discrepancy between RWAs calculated with the help of internal models and those determined using standardised approaches than is the case under the full stack approach, it is preferable in the interests of retaining the highest possible degree of risk sensitivity.

The use of insufficiently risk-sensitive standardised approaches in combination with the application of the output floor will also set undesirable incentives for banks. This is mainly because the capital requirements determined using standardised approaches respond less strongly or not at all to changes in the risk associated with an exposure. Under the IRB approach, by contrast, ratings must always be adjusted when new information about a borrower becomes available to the bank. If the output floor is triggered, i.e. if the level of risk estimated by an internal model is well below the level specified by the output floor, the bank could assume higher risks without this being reflected in a higher capital requirement (e.g. in the case of non-rating dependent RWAs in the standardised approach to credit risk). This effect is due above all to the typical overstatement of risk by the standardised approaches in combination with the very high output floor of 72.5 per cent.

Comparability

The second backstop is far superior to the full stack approach when it comes to the comparability of capital requirements, especially in an international context. For European banks, integrating the P2R, the O-SII buffer and the systemic risk buffer would tilt the playing field in favour of institutions in jurisdictions that are not subject to these requirements (especially the US) and therefore do not have to include them in the calculation of the output floor. Comparability can only be achieved if the output floor is limited to Basel capital requirements that apply worldwide.

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[3] Næss-Schmidt, Bjarke Jensen, Ehmann, Christiansen (2019): EU IMPLEMENTATION OF THE FINAL BASEL III FRAMEWORK - Impact on the banking market and the real economy, Copenhagen https://www.copenhageneconomics.com/dyn/resources/Publication/publicationPDF/0/510/1574257984/191122_copenhagen-economics_final-basel-iii-evaluation.pdf

Complexity

The EBA argues that the second backstop would lead to greater complexity: "Furthermore, it seems that this stacks approach would create confusion about trigger levels, such as that of the AT1 or those associated with the MDA, as these levels would be calculated both in the RWA_IM stack as well as in the RWA_OF stack."

The alleged confusion about trigger levels can be eliminated by clarifying in Article 54(1) of the CRR that the value triggering a write-down or conversion refers to CET1 capital ratio based on floored RWAs. The Basel standards for disclosure (BCBS 455, section 7, template KM1) require this value to be regularly made public.

Two metrics are essentially relevant when it comes to the constraint on distributions:

- CET1 capital ratio based on floored RWAs in accordance with the Basel disclosure requirements (BCBS 455, section 9, template CDC [capital distribution constraints]), and
- total capital requirements (total capital ratio plus Pillar 2 requirement plus combined capital buffer requirements based on pre-floor RWAs in accordance with supervisory reporting requirements (ITS on supervisory reporting, annex 1, template CA3 ID 14).

All in all, we believe any additional complexity caused by the second backstop approach is a negligible factor when making an overall assessment of implementation options.

Question 178. Would you deem further refinements or clarifications necessary concerning the material scope of the OF?

- Yes
- No
- Don't know / no opinion / not relevant

Question 178.1 If yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

It should be borne in mind that in the context of Basel III monitoring, different "standardised" approaches are to be used in floor calculations for securitisation exposures handled using the external ratings-based approach (SEC-ERBA) and the internal assessment approach (IAA). While for SEC-ERBA exposures this approach may be retained for calculating RWAs under the standardised approach as well, the standardised approach for securitisations (SEC-SA) is to be used for IAA exposures. There is no justification for this unequal treatment, in our view. The IAA also uses the SEC-ERBA ratings table. In addition, banks' internal ratings are based on the methodologies of external rating agencies and are adjusted once a year to reflect any changes in these methods. On top of that, internal rating approaches must be approved by supervisors and are reviewed by them on an ongoing basis. There is therefore no qualitative difference between the external and internal ratings. For this reason, the output floor should be calculated on the basis of the SEC-ERBA, also for exposures valued using the IAA.

6.2. Level of application

Question 179. Views are sought on the relative costs and benefits of applying the OF at all levels of the banking group (i. e. individual, sub-consolidated and consolidated) or solely at the highest level of consolidation in the EU.

In particular, how do the two approaches compare in terms of impact on RWAs, comparability, complexity and operational burden?

Please provide relevant evidence to substantiate your views.

It should be ensured that the output floor only needs to be applied at the highest level of consolidation. Application at the level of individual institutions within a group could lead to evasive action to take advantage of arbitrage opportunities and thus to an increase in, or concentration of, risk (see reply to Q 180).

Question 180. In your view, how would the two approaches affect the internal risk allocation across banking groups, in particular those with specific group structures or business models at subsidiary level?

A situation may, for instance, arise where the output floor is triggered at a subsidiary but not at the parent company. In this case, there would be an incentive to transfer low-risk business, which is particularly penalised by the output floor, to the parent company. This is because the same business would then attract significantly lower capital requirements and thus also capital costs. The result would be that the subsidiary would assume higher risks than if it did not have to comply with the output floor at solo level. Especially in member states where a large proportion of banks are subsidiaries whose parent company is located in another state, this could lead to an overall increase in risk in the domestic banking sector.

6.3. Transitional measures

Question 182. In your view, should both of the transitional measures provided by the Basel III standards be implemented in the EU?

- Yes
- No
- Don't know / no opinion / not relevant

Question 182.1. If yes, please elaborate on your response to question 182.

Both transitional arrangements should be implemented as they would at least give banks a bit more time to ensure compliance with the regulatory minimum capital ratios. It should be borne in mind, however, that transitional arrangements offer only very limited help as markets tend to anticipate new rules, putting banks under considerable pressure in practice to meet future requirements as early as possible. We would also like to stress that transitional arrangements will not really mitigate the problems associated with the reforms but only delay them. At the end of the transitional period at the latest, we will see the feared decline in lending as a result of the reforms. Only permanent arrangements have a

permanent effect. Transitional arrangements should therefore always be seen merely as measures to complement sustainable solutions. They are by no means a substitute for them.

Question 183. Would you deem further refinements or clarifications necessary concerning the transitional measures?

- Yes
- No
- Don't know / no opinion / not relevant

Question 183.1. If yes, what would be their prudential rationale? Please elaborate and provide relevant evidence.

In the EU, the transitional arrangement limiting the maximum increase in RWAs should relate to the overall increase in capital requirements as a result of the new Basel III standards and should not be limited to the effect of the output floor alone.

The five-year transitional period should begin two years after the entry into force of the newly revised CRR.

6.4. Other provisions

Question 185. In your view, which other aspects, if any, should be considered in the context of implementing the OF?

In its report of 2019 on implementing the Basel standards in the EU, the European Banking Authority described our preferred second backstop approach to implementing the output floor (see reply to Q 177) as non-compliant with the Basel Committee's requirements. For this reason, the EBA – contrary to previous undertakings – did not publish the impact on capital requirements in the EU associated with this approach.

We would like to explain below why, in our view, it would be wrong to reject our implementation proposal. We will discuss the following aspects

1. Basel compliance
2. Role of EU-specific capital requirements
3. Effects of the second backstop approach

We would also like to explain why we consider the output floor to be not complementary to, but inconsistent with, the existing cause-based approach (IRB repair, TRIM) to increasing the comparability of capital requirements in the EU.

Criticism of the EBA's arguments

1) Basel compliance

In paragraph 3 of its policy advice on the output floor, the EBA states: "In terms of mechanics of the output floor, paragraph 1 of the revised framework text clarifies that it is directly applied to risk-weighted assets, which indicates that floored RWAs generally need to be used for all further purposes." While the first part of the sentence is unquestionably true, it is not clear how the indication referred to in the second part of the sentence – namely that floored RWAs need to be used for all other purposes – has been inferred. Paragraph 1 of the Basel text on the output floor says nothing at this stage about the use of floored RWAs.

Paragraph 6 of the EBA's advice then goes on to say: "As paragraph 4 [of the BCBS text] refers to 'the requirements set out in paragraphs 2 to 3', it is clear that the Basel document requires an application of the increased RWAs to the calculation of the requirements therein listed, namely the 4.5% CET1/RWA minimum, the 6% T1/RWA minimum, the 8% total capital (TC) minimum, the 2.5% capital conservation buffer requirement, the countercyclical capital buffer requirement, the global systemically important institution (G-SII) add-on and the total loss absorption capacity (TLAC) requirements. Jurisdiction-specific capital layers, such as the SRB requirement or the P2R requirements, are not mentioned. However, as mentioned in paragraph 3, the revised framework text (paragraph1) suggests a wide application of floored RWAs."

In our opinion, the key decision on which requirements the output floor should be applied to in the EU should on no account be made on the basis of what the EBA perceives as indications and suggestions. EU implementation should follow the actual Basel text and not indulge in gold-plating. Nor do we understand the EBA's line of argument. A general statement in paragraph 1 of the Basel text is invoked to relativise a subsequent, more specific statement in paragraph 4. Since paragraph 4 comes after paragraph 1, this makes no sense, in our opinion. Paragraph 1 of the Basel text makes only a general reference to "capital requirements". Paragraphs 2 and 3 then specify what these requirements are. Finally, paragraph 4 explicitly clarifies that it is precisely these requirements that have to be calculated on the basis of floored RWAs. For good reasons, in our view, the Basel Committee consciously refrained from including in the output floor requirement the capital buffer for domestic systemically important banks (D-SIB) introduced by Basel III. Likewise, no reference is made to additional Pillar 2 capital requirements. Neither of these requirements is specified in detail by the Basel Committee but it is left to the relevant jurisdiction to flesh out the specifics within the parameters of the Basel framework. Principle 3 on Pillar 2 simply calls on supervisors to: "[…] typically require (or encourage) banks to operate with a buffer, over and above the Pillar 1 standard". As for the capital buffer for O-SIIs, principle 8 calls for O-SIIs to have greater loss-absorbing capacity: "The level of HLA calibrated for D-SIBs should be informed by quantitative methodologies (where available) and country-specific factors without prejudice to the use of supervisory judgement." Nowhere does the Basel framework say that the capital buffers under Pillar 2 and for O-SIIs should be based on the level of RWAs.

The concrete design of all requirements that are not explicitly mentioned by the Basel Committee in connection with the output floor are consequently up to individual jurisdictions. It is therefore logical to assume that the decision about which RWAs these requirements are to be based on is outside the remit of the Basel Committee, which, for precisely this reason, makes no reference to these requirements in the context of the output floor. The question as to whether it is Basel-compliant to calculate these other requirements differently and not include them in the output floor does not, therefore, ultimately arise at all. If a capital requirement is jurisdiction-specific, then so is the basis of its calculation. That means the procedure currently practised should be retained and the overall view of all capital requirements (including Pillar 2 and for O-SIIs) should be based on pre-floor RWAs. In parallel, a second backstop should be calculated on the basis of floored RWAs.

2) Role of EU-specific buffers

Paragraph 100 of the EBA report says: "[…] for institutions for which the output floor requirement leads to the highest amount of capital requirements, there may be no changes in capital requirement stemming from the introduction of EU-specific buffers. This would render these buffer requirements irrelevant, and hence this approach may incentivise institutions to pursue aggressive modelling techniques, in contradiction to what the output floor aims to achieve." It is true that there may be cases where EU-specific buffers will not influence the ultimate capital requirement if it is determined by the output floor. This would not make those buffers irrelevant, however. The minimum level of capital resulting from these buffers would still have to be held. The buffer requirements would not be irrelevant, they would merely be met automatically if the output floor requirement were met.

What is more, the situation described above can also occur today if the leverage ratio requirement is triggered and thus determines the regulatory minimum capital requirement. This therefore begs the question as to why this should pose a problem in connection with the output floor.

Nor is it clear to what extent the described situation would create an incentive to pursue aggressive modelling. If the output floor has been triggered, the bank will no longer be able to reduce capital requirements by changing its internal modelling. Furthermore, figure 10 of the EBA's report shows that the second backstop would not be triggered at an institution with relatively conservative modelling, though it would be at an institution that models aggressively. This is precisely the objective of the output floor and it is obviously achieved by the second backstop.

3) Effects of the second backstop

In paragraph 97 of its report, the EBA argues that "This interpretation results in only a very minor role for the output floor requirement, with the RWAIM-based requirement continuing to be based on the RWA resulting from internal-model-based approaches (and does not take the floored RWA into account)."

First, it is simply not correct that the second backstop approach would not take floored RWAs into account. On the contrary, they are taken into account (i.e. used) precisely as explicitly prescribed by the Basel Committee (see above). Nor is the reduced role of the output floor requirement a meaningful argument against the second backstop, as we see it. The EBA itself repeatedly refers to the output floor as a "backstop". A backstop, by its very definition, is a measure that only takes effect in certain cases. It is therefore perfectly natural that it will not always automatically have an effect. We would also like to reiterate that the aim of the Basel reforms is to increase the comparability, and not the absolute level, of capital requirements. It therefore cannot legitimately be argued that the output floor's role is to generate the biggest possible increase in capital requirements.

Inconsistency with the existing cause-based approach in the EU

We consider the objective of reducing the variability of risk estimates that cannot be explained by differences in banks' portfolios to be legitimate, sensible and worthy of support. Views differ, however, on the best way to achieve this objective. Europe has for some time been pursuing a cause-based approach which addresses the variability problem by focusing on the model estimates themselves. This is the right way forward, in our view, and an appropriate European response. The cause-based approach is essentially made up of three elements:

1. EBA work on standardisation of the IRB approach with the help of regulatory technical standards (RTS) and guidelines on the definition of default, the estimation of PD and LGD parameters, etc. combined with a consistent approach to model uncertainties using MoC requirements (safety margin for anticipated estimation errors), downturn surcharges and extensive new criteria for approval to apply the IRB approach.

2. Annual supervisory comparison of calculations using internal models (so-called benchmarking) in accordance with Article 78 of CRD IV.
3. A targeted review of internal models (TRIM) from 2017 to 2019 by the ECB's banking supervision arm.

The introduction of the output floor will retroactively render all these measures worthless. It makes no sense whatsoever to first require supervisors and banks to expend considerable time and effort trying to reduce the variability of risk estimates through greater harmonisation of the minimum requirements, only to devalue the results of these efforts with a blunt and inaccurate instrument like the output floor. In our view, therefore, the output floor is not only not complementary to, or compatible with, the cause-related approach in the EU, but runs totally counter to it. And the stricter the design of the output floor, the greater this inconsistency will be.

6.5. Implementation challenges and administrative burden

Question 186. Which elements of the OF, if any, would you deem particularly challenging to be implemented?

Please elaborate and rank your answers from the most challenging to the least challenging revision.

Please provide relevant evidence on the expected one-off costs to substantiate your views.

For banks using internal models, substantial costs and effort will be generated by the need to implement and apply the standardised approach for credit risk on an ongoing basis alongside their internal model. Take, for instance, the requirements to perform a due diligence analysis of external ratings, which, depending on their precise form, may place a disproportionate additional burden on banks (cf. our comments on section 1).

Question 187. Which elements of the OF, if any, would in your view cause additional administrative burden?

Please elaborate and provide relevant evidence on the expected recurring costs.

If the output floor to be applied at aggregated level is triggered, it will be extremely difficult to disaggregate the ultimately relevant total RWAs again. As the EBA correctly points out in paragraph 53 of its advice, total RWAs need to be broken down to a more granular level to determine certain buffer requirements, for instance. The example shown in table 8 highlights the problem. Let us assume that the floor has the effect of increasing RWAs by a factor of x at aggregated level. If this increase is simply reassigned back to individual portfolios or transactions, i.e. if the initial RWAs of the individual positions/portfolios are also increased by x, they will indeed add up to the correct floored RWA total. But the resulting RWAs at granular level will be counterintuitive in some cases. For example, higher RWAs would be shown for positions or even entire risk types for which the RWAs calculated by the model were not below the threshold of 72.5% of standardised-approach RWAs.

We would also like to point out that this problem does not only affect the buffer requirements mentioned by the EBA. To apply the SME supporting factor, RWAs must be shown at the level of individual borrowers. In addition, it is generally necessary to break down RWAs by individual transactions and contracts for pricing purposes. Finding suitable distribution mechanisms will be highly challenging for banks.

7. Centralised supervisory reporting and pillar 3 disclosures

Question 188. Once EUCLID is fully implemented, would you support that the EBA, on the basis of the collected supervisory data from all institutions established in the Union, centrally discloses the information of all those institutions that are subject to disclosure requirements under CRR/D, thereby relieving institutions from mandatory disclosures?

- ◉ Yes
- ◉ No
- ◉ Don't know / no opinion / not relevant

We are in favour of providing possible relief for banks by harmonising disclosure and reporting requirements (see also the current EBA consultations EBA-CP-2019-09 and EBA-CP-2019-10 and our comments for more details). However, we would only support automatic generation of pillar 3 information from reported supervisory data under the following conditions (see also our reply to Q 190):

- Pillar 3 disclosure by banks should be dropped (quantitative data).
- As for the (probably still necessary?) provision of qualitative information, only information that is subject to ongoing changes should have to be regularly provided/updated by banks. All other qualitative information should only have to be updated once a year.
- Due to the possible need to make subsequent adjustments to supervisory data (to reflect differences between unaudited and audited accounts) and with the influence of these adjustments on the pillar 3 disclosures in mind, there should be a time lag between supervisory reporting and central disclosure.
- The EBA's annual Transparency Exercise should be dropped.
- Banks which are not publicly traded (especially, small, non-complex, non-publicly traded banks) should only need to annually disclose key metrics; there is no need for qualitative data from these banks.

Question 189. If you support centralising disclosures at the EBA, please explain: 189.1 Whether in your view stakeholders (investors, etc.) would have the benefit in accessing disclosures of all institutions in one internet place?

This might be advantageous, though we believe there is generally very little interest in pillar 3 disclosures. This is demonstrated, for instance, by the fact that pillar 3 disclosures are very rarely retrieved from banks' websites.

189.2 Whether in your view a single location policy should be applicable to all type of institutions: small non-complex, large and other institutions?

Equal treatment of all institutions will probably increase transparency. We see no need as things stand for different location policies for different types of institution.

189.3 How responsibilities for the disclosed information should be shared between institutions, competent authorities and the EBA?

Since, according to the EBA's ITS on disclosure, the information to be disclosed will in future be based exclusively on supervisory data, data exchange between the competent authorities and EBA might make good sense so that banks do not have to fulfil duplicate reporting requirements. All in all, however, it seems to us that the details of the proposal for centralised disclosure have not yet been sufficiently fleshed out to be able to properly assess benefits and drawbacks. We wonder whether centralisation might result in a separation of quantitative and qualitative information and what effect that might have on the overall informative value of pillar 3 disclosure.

A centralised solution only makes sense if this significantly streamlines procedures and processes for banks (see also our reply to Q 190).

Question 190. If you do not support centralising disclosures at the EBA, please explain why.

In principle, we welcome the idea of a centralised disclosure process through EUCLID replacing the parallel requirements of disclosure, supervisory reporting and the transparency exercise. Our final assessment, however, will depend very much on the design of the future process.

The main objective of the pillar 3 disclosure requirements in the Basel framework is to promote transparency and market discipline. The purpose of these requirements is to make key information about a bank's capital and risk exposures available to market participants. There is no firm evidence, however, that market participants make much use of this source of information before taking investment decisions. Due to the extremely high granularity of the data, pillar 3 disclosures are of little value to investors with limited knowledge of banking supervisory law. And analysts and institutional investors, who would be able to analyse the data, prefer to focus on information published when presenting annual and interim financial results or in the context of new issuances.

With this in mind, we would appreciate a streamlining of the information provided instead of more formalised templates and tables.

We assume that only institutional investors, analysts and competitors (other banks) will benefit from a central location where they can find the disclosure templates of numerous banks. This will make comparisons easier. For "normal" investors, the publication of the templates on the EBA website will be an additional hurdle. Another difficulty for investors might be the language of publication. We assume this would be English only and not the local language of the bank as well.

There are also some challenges regarding practical implementation:

- In addition to fixed templates, disclosure also includes various tables that can be filled with free text. This cannot be derived from supervisory data. As templates and tables should be published simultaneously, a separate process would be needed for delivering the tables.
- Our only experience to date as regards the publication of data by the banking authority is with the transparency exercises. Here, the issue of shared responsibility is solved by a confirmation process. Banks confirm the accuracy and correctness of their data. From a bank's perspective, the disadvantage of a confirmation process like this is the loss of control. If, for example, mapping in the EBA's software is changed during the confirmation process, banks have to renew their confirmation even if their data are not affected by the change. Past experience shows a reconfirmation process of this kind may take place several times.

Both the second delivery process for data tables not included in supervisory reporting and the loss of control over the process could generate an additional burden that partly or fully offset any possible relief.

8. Sustainable Finance

Question 191. In your view, which further measures, if any, could be taken to incorporate ESG risks into prudential regulation without pre-empting ongoing work as set out above?

Please elaborate and provide relevant evidence to substantiate your view.

Climate change is a major socio-political issue that is already directly affecting or will directly affect every individual. The German Banking Industry Committee is therefore very aware of the resulting consequences and of the challenges of combating climate change. For this reason, we stand ready to take on the responsibility of participating in the design of a sustainable finance strategy. We welcome the fact that further concrete steps are being taken towards a financial sector geared to sustainability considerations.

At the same time, however, we wish to emphasise that we have strong reservations about the idea of mixing overarching political objectives and regulatory requirements. Over the years, adjustments to the regulatory framework have always been made with a view to better reflecting the risks in the financial system and, with the principle of proportionality naturally in mind, taking appropriate steps to reduce these risks. Aspects of risks arising from environmental, social and governance (ESG) issues should therefore be taken into account in the regulatory framework if this is justified from a risk perspective. Matters become dangerous when "green" is equated with "low risk". Sustainable business can be low risk while also being associated with very high risks for banks.

The partially differing definitions of sustainability currently under parallel discussion in various projects – such as the Taxonomy and Disclosure Regulations – are at odds with the political goal of a uniform understanding of sustainability set out in the Commission's action plan. It is therefore all the more important that the work of the EBA be carried out in close coordination with the other legislative measures and plans of the European Commission so that a consistent basic understanding can be established in the long term.

The report of the Technical Expert Group with its technical screening criteria raises concerns that an excessive amount of bureaucracy is being created which will not be able to keep pace with rapid technological progress in the area of sustainable economic activities and will be extremely costly and time-consuming for small and medium-sized enterprises, especially, to deal with. This is a problem, since the taxonomy will serve as a basis for further building blocks of the sustainable finance agenda, such as the EU Green Bond Standard or EU Ecolabel.

It should also be borne in mind that various aspects of sustainability may well have conflicting objectives. A balance will often need to be struck between environmental concerns and social goals (prosperity and employment), for example. The taxonomy should provide clear guidance on how to deal with such conflicts.

Having said this, we would now like to look at possible regulatory options.

Pillar 1

During the negotiations on the risk reduction package, the possibility was discussed for the first time of granting privileged regulatory treatment to sustainable financing via a green support factor (GSF). The CRR mandates the EBA to analyse the extent to which privileged treatment of green assets would be justified from a risk perspective.

GBIC supports EBA's assessment whether a dedicated prudential treatment is justified and the idea of

lower capital requirements if those assets verifiably have a lower risk.

By contrast, we strongly warn against the idea of imposing a "penalising factor" on "brown" assets. It may seem logical at first glance that a factor of this kind will act as a corresponding disincentive. But it would not, in fact, cause brown industries to shift to lower CO2 emitting activities. High interest rates on loans will actually prevent high CO2 emitting companies from taking steps to reduce their carbon footprint. Yet creating so-called transformation paths should be a top priority for sustainable finance as this is the only way to achieve large-scale CO2 savings in the economy.

Pillar 2 / SREP

German banks have a long tradition of effectively identifying, measuring and managing risks under Pillar 2. The principle of materiality plays a key role in this respect. Risk management can only be successful if it concentrates on essential issues and on those risks that pose a potential threat to a bank. If the focus were too broad with the expectation that insignificant risks would also be taken into account, risk management would lose its primary function and the organisation and reporting system would be overloaded with unnecessary and thus misleading information. This could ultimately lead to the wrong decisions being taken.

For this reason, institutions carry out a risk inventory to identify which risks could potentially do material damage and therefore need to be carefully managed. This is why it is only necessary and only makes sense to include sustainability aspects in a bank's risk management if they pose material risks to the institution.

In our view, sustainability risks are not a separate, definable type of risk to be considered in isolation. Rather, we believe these risks by their very nature affect other (traditional) types of risk. Physical or transition risks, for instance, materialise in credit risk when collateral needs to be revalued or a borrower's probability of default changes. They can also have effects on market risk, operational risk and reputational risk.

Sustainability risks are thus elements of risk types which are already familiar and already addressed by risk management. They act as risk drivers, so to speak, of familiar (material) risk types and do not constitute risks in their own right. It would therefore serve no useful purpose to consider them separately: they can only be seen in the context of the relevant material risk type. For this reason, it is also not possible to quantify sustainability aspects independently. Banks where the risks arising from sustainability aspects are material must take appropriate account of this risk driver when managing their material risks.

In order to avoid from the outset the perception that this is a separate type of risk, we strongly recommend consistently referring to sustainability aspects, not sustainability risks.

In the SREP, too, sustainability should be considered only as a risk driver – and only if this driver poses a material risk to an institution.

9. Fit and proper

9.1. Key function holders

Question 192. What would be the benefits and drawbacks of including the requirement for competent authorities to perform a fit and proper assessment of at least some key function holders in the CRD?

We oppose extending the notification and assessment requirement for key functions to all institutions. We do not see any need for this. It should remain the responsibility of the institutions to assess whether a candidate for and/or holder of a key function meets the institution-specific (job) requirements for a position. We also wish to point out that, even after the latest revision of Article 91 of the CRD by Directive (EU) 2019/878, only members of the management body are required to be assessed. The decision by the European lawmakers should be respected. Specifically, we wish to note the following:

Any extension of the requirements applicable to key function holders at significant institutions previously governed by paragraphs 170 and 171 of EBA GL 2017/12 to key function holders at LSIs would run counter to the principle of proportionality (see also paragraph 18 of EBA GL 2017/11). There is no need to extend any of the criteria and procedures. The European Commission does not explain why such an extension would be suitable in the first place for achieving the supervisory purposes, in particular relating to LSIs. The EU banking package (especially CRD V and CRR II) has just created the fundamentals of a "small banking box" with the aim of implementing greater proportionality in banking supervision. Most recently, the Federal Financial

Supervisory Authority in Germany (BaFin) has correctly noted that the path towards greater proportionality should be systematically pursued further (see BaFin-Journal 12/2018, page 30).

The principle of proportionality cuts both ways: in regulation and in its application in supervisory practice. In light of this, there is no need to extend the existing rules for SIs by tightening the CRD requirements. Even if the finding that the existing rules are applied inconsistently at the SIs were proved to be correct, no justification is given, and nor is it evident in light of the aims of the Europe-wide single supervisory mechanisms why any differences in application could not be accepted. In this respect, the coherence addressed by the European Commission is not a supervisory value in itself, not least because it would result in considerable additional supervisory effort.

Key function holders are not members of management bodies, but employees of the institutions. Appointments to these functions are solely the responsibility of the board of management, which has executive responsibility for managing the institution. Under section 25a of the German Banking Act (*Kreditwesengesetz* – KWG), it is responsible for ensuring a proper system of governance. If a notification requirement for the institution were to be introduced with regard to key function holders, together with a corresponding assessment requirement for the competent authority, responsibility for appointments to these functions would be removed in part from the board of management. By contrast, the model of risk-based supervision that is aligned with free market principles provides that management is responsible for the business policies (see also Article 88(1) of CRD IV, paragraph 20 of EBA GL 2017/11). This responsibility would, ultimately, be shifted to the supervisory authorities themselves by stipulating very detailed processes for assessing key functions, counter to established practice.

Further, direct access to the key function holders for the supervisory authorities would trigger serious employment law issues. This would be the case in particular if employees were to be rejected by the supervisory authority. The reason is that employment law has barely been addressed to date by European harmonisation measures. At present, the relationship between overriding mandatory provisions, for example in the German KWG governing remuneration, and requirements of employment law, has by no

means been conclusively clarified. We therefore oppose the notification of key functions as a matter of principle.

From a practical perspective, too, the introduction of a suitability assessment for key function holders below the executive level, in particular for the heads of internal control functions (risk management, compliance and internal audit functions) is superfluous. In particular it is not clear what additional value added such a suitability assessment is supposed to offer. In the final analysis, a suitability assessment would merely lead to massive additional bureaucratic effort at the institutions that would not be balanced by any evident supervisory benefits. It is not apparent that an assessment by the supervisory authority based on the documents submitted will lead to any greater insight as regards suitability than an assessment by the institution itself, which generally already knows the person in question from their existing employment at the institution, or at least from the recruitment process.

The requirements and profiles designated in the institutions for recruitment to such positions are sufficient. All institutions are likely to be aware of the particular importance of the key functions, with the result that they will already ensure in their own best interests that the relevant key function holders meet all of the requirements as fit and proper persons. It will not be possible to avoid function holders who prove to be unsuitable after the event by introducing a suitability assessment.

The key function holders play a major role in ensuring good governance. A properly functioning organisation, and not merely the staff appointments, is also decisive here.

If, despite our fundamental concerns, the European Commission decides to continue with this approach, the notification requirements should be limited to significant institutions for reasons of proportionality. Like the requirement to identify risk takers, the threshold for classification as a significant institution should be total assets of EUR 15 billion.

Question 193. In your view, would it be useful to identify key function holders in a descriptive manner, and/or to specify certain roles as belonging, by default, to the set of key function holders?

Please consider the practical implications of each option and the need for clarity and consistent application across institutions and competent authorities.

- ○ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 193.1 Please elaborate on your response to question 193 and provide evidence.

In light of the necessary legal certainty and coherent EU-wide application, it would be appropriate to define positions/roles to be classified as key functions clearly and conclusively.

Question 194. Were the CRD to specify a number of roles that would be considered, by their very nature, to be occupied by key function holders, which specific roles should, in your view, be included in this list?

In the context of functional and organisational (not staff!) requirements, the existing EBA requirements (heads of the internal control functions: compliance, risk management and internal audit) would be useful. For proportionality considerations alone, these requirements should only apply to significant

institutions (see our response to Question 192).

Question 195. Views are also sought as to whether the scope of key function holders subject to fit and proper assessment should be limited to those holding these positions at group level or whether it should also include key function holders at the level of each institution?
Please elaborate and provide evidence.

If, despite our fundamental concerns, it is considered necessary to introduce a notification and assessment requirement, it should apply at group level. The relevant persons at group level possess the significant influence on the direction of the group and the institutions belonging to the group that is necessary for their classification as key function holders.

Question 196. Should the key function holders be subject to fit and proper assessments by competent authorities, on what criteria could this assessment be performed?

Experience and specialist expertise should be the determining factors here (register extracts are not necessary as they are already adequately taken into account in the context of the employment law requirements).

9.2. Competent authorities' assessment of the suitability of members of the management body

9.2.1. Supervisory procedure

9.2.1.1. Ex ante and ex post approval and ex post notification

Question 197. Please explain what you consider to be the advantages and disadvantages of competent authorities conducting ex ante and ex post approval, respectively, of suitability of members of the management body.

The Commission states that it is difficult to remove unsuitable members. Our response to this is that, also in the course of the ongoing/periodic suitability assessment, conclusions have to be drawn that result in the removal of the function holder. The associated practical difficulties accepted by the body developing the guidelines are no different to the difficulties encountered when having to remove, ex post, an already appointed holder of a key or management function following the initial assessment. Also in light of the existing rules contained in EBA GL 2017/12 (see e.g. paragraphs 175 and 176), the ex post procedure is logical and guarantees the seamless staffing of management and key functions. This is already necessary in order to safeguard the ability of the governing bodies to act, e.g. including in cases where several new appointments have to be made at the same time or in direct succession.

In the two-tier system that exists in Germany, a distinction also has to be made between management board members/executive directors on the one hand and members of the supervisory body on the other:

For management board members, there is already an ex ante assessment in Germany in the form of an informal preliminary inquiry, which should also be retained in its present form. The option to make a preliminary inquiry ensures that the qualification of a management board member is assessed before a

management board member is appointed, and the institution has had an opportunity to sound out the supervisory authority about any potential concerns. The notification of intent must be submitted immediately after the resolution on the appointment by the supervisory board. As a rule, there is a sufficiently generous period of time between the notification of intent and the planned commencement of the management board member's activity, with the result that the contract of employment is only signed once the supervisory authority has provided its feedback about the eligibility of the candidate to serve as a management board member. If the supervisory authority does, indeed, voice concerns, there is still time to react.

The existing practice of the supervisory board members to perform the suitability assessment only following the appointment (ex post) has also proven its worth. If the supervisory authority makes critical ex post remarks that there are concerns with regard to expertise, the person can also attend seminars to eliminate any deficits following their appointment. If the supervisory board member is dismissed at the request of the supervisory authority, a deputy is available in the first instance.

National rules must also be observed when supervisory board members are appointed, stipulating that employee representatives, shareholder representatives or representatives of the municipal trustee / public bodies must be appointed.

Specifically, any ex ante assessment of supervisory board members of public-law institutions in Germany is practically impossible because of existing legal requirements governing the election procedures for members of the supervisory board: some of the members are elected by the municipal council (representative body of the municipal trustee / "Trägerversammlung"), others by the employees of the institutions. Lists are prepared containing a range of persons, and – as is normally the case with elections – it is not possible in advance to predict which persons will actually then be elected to the supervisory board.

If the intention is to perform an ex ante assessment, on the one hand all candidates on the electoral lists would have to submit the documents, from their CV down to the extract from the Central Trade and Industry Register and the certificate of good conduct, to BaFin, although only a fraction of those candidates would subsequently actually serve as members of a governing body. In order to give BaFin enough time for the assessment, the notifications would probably also have to be submitted well before the commencement of the supervisory board activity. In particular after the local authority elections, which of course generate a higher volume of assessments, there would be a long period between the political vote and the decision. We believe that this is not really feasible in practice, nor is it actually necessary. It would trigger effort and expenses that are not proportionate to the expected benefits.

In addition, there is the question of the timing of the submission of documents and what impact that would have on the election procedure. In order to actually achieve an ex ante assessment, every person who is even just considering standing for election to the supervisory board would already have to have their suitability assessed by BaFin at this point, as there would not be sufficient time to do this between the preparation of the electoral lists and the conduct of the election. Alternatively, electoral lists would have to be prepared and the election "put on hold" until all candidates had been assessed in order to make any necessary changes to the electoral lists and subsequently conduct the election. Both procedures are neither practicable nor compatible with the existing statutory requirements governing the election procedures.

Additionally, any ex ante assessment is not possible for supervisory board members who are statutory ex officio members of the supervisory body because of their primary appointment (e.g. mayor), due to national rules that serve to ensure the fulfilment of the corporate purpose of the undertaking or of the public mandate.

Finally, we view any ex ante assessment as unworkable for reasons of legal certainty and a lack of compliance with the principles of (German) company law. In extreme cases, it can mean that the

institutions would lose both their active and their passive ability to act because the management and representative body would not have any members. The legal ability to act would not only be lost if the management and representative body has no members at all (conceivable in catastrophic scenarios such as an aircraft crash, but also following the resignation of all the members), but also generally if individual positions in a collectively acting body are not filled.

Question 198. If, in your jurisdiction, institutions are required to request approval for the appointment of members of the management body only after they take up their position, please explain what, if anything, would make it difficult for you to adapt to an ex ante system.

A switch to a system of ex ante approval of management board members would be possible in principle for the standard case of "normal" staff turnover, although long-term personnel planning would have to be intensified; however, as a rule there would have to be longer periods in particular between the appointment resolution and the actual commencement of the activity, and arrangements such as provisional allocations of responsibilities would have to be put in place in the event of non-approval by the competent authority by the scheduled commencement of the activity.

In the case of members of supervisory bodies of public-law credit institutions, there would probably be longer vacancies, depending on the willingness and ability of the appointing public authorities to implement advance personnel planning. However, as set out in our comments on Question 197, national rules mean that an ex ante assessment at public-law credit institutions is virtually impossible to implement or simply not possible in certain scenarios.

And in the extreme case of the complete vacancy of the management and/or supervisory body, it will not be possible in a system of ex ante assessment to arrive at a solution for restoring the ability of the institution to act in the necessary short period of time.

We wish to refer in other respects to our comments on Question 197.

Question 199. One issue that has been raised in the past in relation to ex ante assessment is avoiding vacant positions on the board.

Please explain, based on your experience, to what extent this can be overcome (if it is an issue in the first place) giving examples and making reference where appropriate to succession planning and procedures in place for identifying skills/experience that could be particularly difficult to replace.

See response to Question 197.

Question 200. Which specific positions within the board and/or senior management of institutions do you believe should be considered as art of an ex ante assessment, given the responsibilities they hold and the risks they may pose?

Please provide evidence and/or examples to support your views.

In the two-tier governance system (separate management and supervisory bodies), only the members of the management board should be assessed ex ante, as in the past.

See response to Question 197.

9.2.1.2. Processing of applications for fit and proper approval

Question 201. Considering a scenario in which at least some fit and proper assessments were to be conducted by competent authorities ex ante, what would be, for you, the costs and benefits of a deadline for the assessment of proposed board members being set in the CRD?

What would you consider a reasonable period of time for the assessment?

If, contrary to the fundamental concerns we have stated, an additional suitability assessment for key function holders were to be introduced and an ex ante procedure were to be applied, at least in part, we would have no objections to a system of tacit approval. For reasons of legal certainty, the comment period for the supervisory authority would, of course, have to be short, e.g. two weeks.

Question 202. Do you currently use, or have you envisaged, other timelines for approval, e.g. whereby institutions only have a limited time to provide the additional information requested, or where the length of the assessment period depends on the specific type of position?

- Yes
- No
- Don't know / no opinion / not relevant

Question 203. If competent authorities had a fixed time period for giving their approval to proposed new board appointments, would you nonetheless consider it preferable for a decision to be issued in cases where the competent authority decides to approve a candidate?

- Yes
- No
- Don't know / no opinion / not relevant

Question 203.1 Could you instead envisage a system of "tacit approval" (i.e. whereby, if no decision has been issued by the deadline, the institution can consider the candidate approved)?

- Yes
- No
- Don't know / no opinion / not relevant

Question 203.2 Please elaborate on your response to question 203 and 203.1.

If a fixed period is stipulated, a system of "tacit approval" would, in principle, also be acceptable.

However, we would prefer an explicit notification of approval (including informally, e.g. by email). This would give the institutions legal certainty. In particular for notifications of intent for management board members, an explicit notification within a fixed period that is as short as possible would also make sense.

In the case of "tacit approval", the period would necessarily always be utilised until the end. By contrast, experience with the existing practice shows that the notification by the competent authority (BaFin) is always made very quickly in unproblematic cases of appointments of management board members. As a rule, requests by the supervisory authority are also received in just a few weeks in the case of notifications of elections of new supervisory board members, for which the existing practice is "tacit approval", meaning that the supervisory authority only contacts the association or the institution concerned if it has questions or concerns.

"Tacit approval" with longer defined periods (for example two or three months) for the suitability assessment by the supervisory authority would therefore generally represent a change for the worse compared with the existing practice.

If, contrary to the fundamental concerns we have stated, an additional suitability assessment for key function holders were to be introduced and an ex ante procedure were to be applied, at least in part, we would have no objections in this case to a system of tacit approval. For reasons of legal certainty, the comment period for the supervisory authority would, of course, have to be short, e.g. two weeks.

9.2.2. Proportionality

Question 204. Should the scope and format of fit and proper assessments be adapted to take into account the principle of proportionality, including in relation to any new provisions such as those discussed in Sections 9.2.1.1. and 9.2.1.2.?

- ◉ Yes
- ○ No
- ○ Don't know / no opinion / not relevant

Question 204.1 Please elaborate on your reply to question 204 and provide examples.

If the European Commission sticks to the idea of subjecting key function holders to a supervisory suitability assessment, this requirement should only apply to significant institutions. Like the requirement to identify risk takers, the treshold for classification as a significant institution should be total assets of EUR 15 billion.

Differentiation is necessary. A lack of differentiation does not do justice to the requirements for proportionality and the different fact patterns (two-tier/single-tier system).

Question 205. What specific criteria would you consider appropriate as a basis for allowing some degree of proportionality in the fit and proper assessment, including in relation to any new provisions such as those discussed in Sections 9.2.1.1 and 9.2.1.2?

Views are also sought on the possibility of granting competent authorities the right to apply supervisory judgement to enlarge the scope of their assessment based on the risk profile of the institution / role.

Professional expertise (theoretical knowledge), practical experience and leadership experience should be the decisive criteria, in all cases depending on the size of the institution and the risk classification of the business model. This approach has proven its worth.

Question 206. What specific risks do you see in allowing some degree of proportionality in the application of any new provisions, such as those discussed in Sections 9.2.1.1. and 9.2.1.2., on the timing of the approval of board members by competent authorities and of key function holders?

Proportionality is a constitutional principle in both the European Union and national law. Of course, proportionality must be applied in way that does not generate any additional risks. This also applies to the appointment of management and supervisory board members. In the past, however, there was not a problem of the intensity of supervision of small non-complex institutions being too low. Rather, the original policy of standardising supervisory law in Europe tended to result in disproportionate overstressing of regional institutions. This applies in particular to the appointment of supervisory board members, where regulatory requirements governing disclosure (e.g. with regard to available time) may already appear to be questionable today. No specific risks are apparent here as a result of proportionality.

9.2.3. Roles on the management body, individual and collective suitability

Question 207. What would be the benefits and drawbacks of designing an accountability regime whereby the management body of each institution would be required to draw up a statement of responsibilities of each of its members clearly identifying the activities for which they are responsible, beyond the sole responsibilities linked to their membership of specialised committees (e.g. risk committee, remuneration committee)?

All members of the management body are collectively responsible in their supervisory function. It should not be possible for a single member to dominate decision-making (see paragraph 22 of EBA GL 2017/11). The allocation of certain responsibilities would lead to such a domination, namely in conjunction with the treatment of matters that fall within the relevant (sole) area of responsibility of a particular member. Collective responsibility in particular is a suitable differentiation criterion for the management function, in which internal areas of responsibility are generally defined, even if the management function is collectively responsible for the management of the institution. Applying corresponding defined responsibilities to the supervisory function would result in the harmonisation of the supervisory function with the management function, which runs counter to established practice and is also not intended by the body developing the guidelines (see paragraph 21 of EBA GL 2017/11). Any arrangement in which there are descriptions of responsibilities means introducing a structure by the back door that is close to a system of committees. This should not be mandatory, in particular for the LSIs.

Preparing a description of responsibilities would not have any advantages. It would not affect the collective working procedure in the governing bodies. Additionally, such an approach would run counter to the idea of easing the burdens on smaller and medium-sized institutions. In other respects, the small size of the management body at smaller institutions (often only two or three management board members) means that a regulatory or even statutory definition of responsibilities is hardly workable in practice.

The obligations and responsibilities of the members of the management boards of the institutions are already stipulated by law (KWG), the articles of association of the institution and the rules of procedure for the management board, which define – among other things – the competencies of individual members and the management board as a whole. These are assigned individually by the allocation of responsibilities in the management board, although this does not affect the non-negotiable collective responsibility of the management board (see also AT 3 of BaFin's MaRisk). The responsibilities of the

individual management board members are also reflected in the organisational chart and other internal documents used to organise working practices. There is therefore no need for further statutory or regulatory requirements. And at least in the case of management boards consisting of only two or three persons, nor does it make any sense.

Additionally, the duties of key function holders are already governed by the EBA Guidelines on Internal Governance and by statutory provisions.

For the supervisory board, the allocation of responsibilities to individual members with corresponding descriptions of responsibilities is not reasonably possible because the obligations and responsibilities of the member of a supervisory body are fundamentally different to those of a member of a management board. Under German law, the members of supervisory bodies do not act as managers and are therefore not integrated into the institution's operating business, part of which involves a clear division of responsibilities based on the principles of a proper system of governance. Rather, their task is to supervise the management board. Correspondingly, the supervisory board acts as a body, and its decisions are discussed and voted on in meetings. As a rule, individual members do not have any decision-making powers. The duties of the governing body are at the same time the duties of the individual member of the governing body. Specialisation normally happens when committees are established (e.g. credit committee, audit committee). In these cases as well, however, the individual members do not have decision-making powers, but rather the committee either votes on decisions or it merely prepares the decisions of the full supervisory board (e.g. the audit committee for the resolution on adopting the annual financial statements). Defining individual responsibilities would therefore contradict the working practices of supervisory bodies of credit institutions defined in company law and the articles of association. Implementation in practice would also lead to considerable difficulties (e.g. suitability assessment, votes, quorums, deputisation arrangements, liability, D&O insurance).

If certain responsibilities were to be allocated, one or more vacancies would severely restrict the supervisory body, not least in conjunction with the idea of an ex ante assessment of supervisory board members. By contrast, the potential addition of "deputised responsibilities" would weaken the approach, increase complexity immeasurably and hence run counter to the actual purpose of strengthening the governing body.

Question 208. How might the collective functioning of the board be affected by the introduction of a system where each individual has a defined set of responsibilities?

See response to Question 207.

Question 209. What would be the benefits and drawbacks of designing a similar accountability regime for key function holders (e.g. information on key function holders, their responsibilities, details of the firm's governance and structure)?

There are already job descriptions, requirements profiles, working instructions and similar documentation for corresponding key positions at the institutions. The responsibilities of the key function holders are therefore already clearly defined. Further requirements in this direction would not bring any advantages.

Question 210. Would the assessment of individuals proposed for positions on the board or as key function holders be more accurate and/or reliable if the responsibilities the individual would be taking on were clearly defined, including in relation to any new provisions, such as those discussed in Sections 9.2.1.1 and 9.2.1.2?

- Yes
- No
- Don't know / no opinion / not relevant

9.2.4. Cultural factors influencing conduct

Question 211. Do you consider that corporate culture could and should be taken into consideration as part of the fit and proper assessment?

- Yes
- No
- Don't know / no opinion / not relevant

Question 211.1 If no, please elaborate on your response to question 211.

Any greater consideration of corporate culture would have to satisfy the principle of (double) proportionality. In line with the risk-based approach of the supervisory authorities and the principle of management accountability, it is important to avoid any prescription of detailed rules, e.g. about the management style or other aspects of corporate culture that may be desired by the supervisor. Corporate cultures are also based on certain historical developments and regional specificities. The question of whether a member of the governing bodies or a key function holder is a good fit with the relevant corporate culture is something that should be assessed and decided by the responsible bodies themselves – including by reference to the institution's own strategic positioning.

This is also how the German supervisor sees things. In its letter accompanying the 5th revision of MaRisk (letter to the banking industry associations dated 27 October 2017, page 4), BaFin states that it is very difficult to measure the issue of risk culture, that an appropriate risk culture has to be lived out in practice and that there are limits here to the regulatory framework as well as to the assessment tool. We agree with this. This applies all the more to the still more comprehensive issue of corporate culture.

We cannot identify any concrete criteria that can be singled out from an institution's corporate culture and that could be assessed as part of the suitability assessment of a new governing body member, i.e. before that member actually starts working at the institution. The supervisory assessment should therefore be limited to meeting the applicable legal requirements (e.g. theoretical and practical knowledge, leadership experience of a potential management board member).

Even if concrete goals – not prescribed by law – are anchored in an institution's corporate culture (for example, encouraging women, striving to achieve a particular age structure in the body), the question of how these goals will be achieved must remain at the discretion of the relevant governing bodies, and it is their responsibility, for example, to select from several candidates the one who appears to be most suitable for an appointment to the relevant position in the institution's governing body. Provided that the

candidate chosen by the institution's governing body meets the "hard" criteria for the function in question at the institution, it would be unacceptable if the supervisory authority were at this point to replace the reflections of the responsible governing body of the institution by its own because it would prefer another candidate to be appointed.

Question 212. What do you consider would be the benefits of, and/or difficulties encountered in, including the ability to create and promote the organisation's desired culture as part of the "fit and proper" assessment of members of the management body?

See response to Question 211.1