Comments:

On the European Commission's "Exploratory consultation on the finalisation of Basel III"

Online Questionnaire

https://ec.europa.eu/eusurvey/runner/finance-2018-basel-3-finalisation?surveylanguage=en

Register of Interest Representatives
Identification number in the register: 52646912360-95

Our ref
Ref. GBIC: Basel III-EU
Ref. DSGV:7715

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Berlin, April 12, 2018

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-sector 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 more than 1,700 banks.

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0. General questions

0.1. What are your views on the impact of the revisions on financial stability?

Disclaimer: Due to the very short period allowed for the COM consultation, we are unable to make any detailed or extensively documented comments. Our responses are therefore in part no more than preliminary assessments and constitute rough rationales.

In the aftermath of the financial crisis, regulation has become not only more intensive and extensive, but also more complex. Standards of the Basel committee are intended for, and tailored to, large, complex, and internationally active financial institutions. As a result, the rules themselves have become large and extremely complex, and the "Finalisation of Basel III" (Basel IV) is no exception.

Although the Commission's consultation focuses on the impact of the Basel III finalization package, we also believe that the impact of the new market risk framework (FRTB) and the new methods for counterparty credit risk should be taken into account. In December 2017, it was decided at Basel level to postpone the implementation of FRTB and to extend the implementation date to 1 January 2022 (also entry into force of the Basel III finalisation package). The background to the postponement is the complexity of the new market risk framework, with a need to address certain specific issues through the BCBS.

Therefore, the Commission's proposal to transpose Basel FRTB standards into EU-law within the ongoing CRRII/CRDV package should be scrutinized. Since the future binding effect of BCBS recommendations remains unclear, a potential regulatory gap should not be widened. Transposition of the Basel IV package should be carried out in one piece.

The implementation of the new standards is likely to be challenging. These new standards imply significant changes in banks' internal processes that will now need to be adjusted. Moreover, the introduction of the aggregate output capital floor, with the need to disclose capital requirements under the standardised approach, also introduces significant compliance costs. Combining restrictions to parameters estimations, input floors and output floors can also end up introducing undue complexity to the framework.

Several impact assessments executed by the Basel Committee, audit and consultancy firms, associations and by EBA have come to the conclusion that the proposals will on average lead to a significant increase in European capital requirements. In individual cases the increase may even be more than significant. Additionally, it will come on top of a European capital base which has been already meaningfully augmented due to various post-crisis reforms. According to the ECB, significant institutions in Europe experienced in the 3rd quarter of 2017 an average CET 1 ratio of 14.74% as a consequence of pillar I, P2G and P2R, and management puffer requirements. This figure shows that the current capital base represents a solid pillar of European financial stability that does not need further enhancement. Any capital requirement on top of this will rather lead to less investor attractiveness due to low RoEs with the resulting consequences of capital inflows in the banking sector.

All available data so far indicate that the strongest impact of the reform will be triggered by the output floor of 72.5%. The European industry has strongly criticised the output floor for not being a suitable supervisory tool. In comparison to a model-based capital calculation, the floor increases the capital requirements of low risk portfolios since the supervisory standardised approaches cannot distinguish between lower and higher risks. Thus, it creates an incentive to invest in riskier assets since they promise higher yields than portfolios with a lower risk profile while requiring the same amount of regulatory capital. Therefore, the output floor will likely have a negative impact on financial stability in the end.

It is at least questionable whether the changes that have been made to the Basel framework will actually enhance financial stability. In our view, the BCBS has not been able so far to demonstrate that risks have been under- or overstated in the areas it is revising. In Germany, the German Banking Industry Committee has not been able to identify any inappropriate treatment of risks in the past in the areas being revised. It would therefore have made sense to use detailed quantitative impact studies to demonstrate the need for the individual revisions.

Quantitative Impact Study (QIS): We welcome the Commission's announcement that it will conduct a quantitative impact study in the EU to assess the impact of the revised framework. For Europe, the BCBS appears to have failed in its goal that the revision will not lead to any significant increase in RWAs. This is the conclusion of the European Banking Authority's first quantitative impact study of the Basel reform package. However, because of the limited data used for the study and its methodological structure (not all topics were included), we believe that the results of the EBA QIS are only meaningful to a limited extent.

The new QIS should look at all the revised approaches, including the revision of the market risk framework. This is of overriding importance. This should be designed in such a granular way that all important elements of the accord can be analysed individually. This especially includes all new definitions (asset classes and sub-asset classes), options and – in the case of the IRB – all individual floor elements. European specificities should be taken into account in the legislation, based on the QIS.

Proportionality: Ongoing regulatory initiatives are increasingly asymmetric in their impact on the banking landscape. Banking regulation after the global financial crisis has a strong tendency towards increasing the rift between "too-big-to-fail" banks on the one side and "too-small-to-survive" banks on the other. While mainly targeted at large, internationally active banks, Basel IV would again penalize smaller and medium-sized banks across Europe to no additional benefit. The rules tend to overburden small institutions. The main problem is the work involved in meeting the requirements and demonstrating that they've been met. Therefore, the new rules will make the regulatory burden even heavier and would act as an additional handicap for small banks. Banks that are already under pressure from many sides like the digitalisation of banking or the low-interest-rate environment.

It cannot be in the interest of European legislators to overburden smaller institutions with rules that were designed for their larger peers. This would effectively give an advantage to larger financial institutions and intensify the pressure to consolidate.

Internationally active banks in the era of the Banking Union: However, also larger and cross-border banks which have a group level model are facing challenges. Internationally active banks should be able to apply the rules at consolidated level for all entities which are supervised by a single competent authority, as emphasized by Basel itself. The implementation of the rules would therefore be fully aligned with the supervisory framework and would not infringe the prudential soundness of the capital and liquidity requirements. The Banking Union provides the supervisory framework which fits the line of Basel that coordination should be achieved for standards to be applied at consolidated level. This would furthermore allow banks effectively manage their capital and liquidity directing it where it is needed and thereby contributing to financial stability. The removal of barriers to the free flow of liquidity and capital is also of benefit to the wider EU economy, allowing banks to direct funds to where consumers and clients need it. This will contribute to the overall objectives of the European Union.

Options and discretions

The new Basel framework includes several national discretionary decisions and options for supervisory approvals that have to be decided on or specified at a European level, respectively. Therefore, based on the results of the European impact study the question should be decided how to make use of the national discretions and how to concretize potential supervisory approval processes.

0.2. What are your views on the impact of the revisions on the financing of the economy?

As a general rule European economies are characterized by 3 main features:

- Financing of the economy via the banking sector rather than capital markets (also new sectors financed via mezzanine financing or project and property finance)
- Long-term financing of real estate, but at the same time heterogeneous real estate markets when it comes to loss rates due to different jurisdictional systems and property rights definitions
- Large proportion of unrated companies

The revised Standardized Approach for Credit Risk (SA-CR) contains several elements that – depending on its application – may lead to capital increases. Evidence from different banks and countries suggests that this holds especially true for residential and commercial real estate finance based on the loan-to-value approaches, project and property finance, exposures involving externally unrated institutions and equity financing. The effect is strengthened by the output floor and/or the carve-out of several portfolios from the IRB approaches, with the SA-CR strongly determining the own funds requirements of all European banks. It is therefore highly likely that a comprehensive additional capital demand will have an adverse effect on credit supply.

The stated political will was that the finalisation of Basel III should not result in any significant increase in overall capital requirements. Taking into account the recalibration – especially the “output floor” - carried out by the Basel Committee in December, capital requirements for German banks may increase. German banks have a strong capital position and will comply with the new, stricter capital requirements. But it cannot be ruled out that there will be a negative impact on the banking industry’s lending capacity.

Although banks must be allowed to achieve the necessary profitability levels so that they can grow their capital base and continue expanding their lending to the real economy, the adoption of the proposed prudential measures would see the return on equity of European banks significantly drop further.

Therefore, many banks would no longer be able to perform their intermediation role. It would also lead to reduced dividends, impacting long-term savers, as banks would not easily be able to increase their capital through other means. Eventually, the combination of the factors already impeding bank profitability and additional capital requirements will undoubtedly entail, as an undesired consequence, a selective reduction of risk weighted assets and an increase in banks' costs, which will need to be passed on to customers, be it households, SMEs or corporates.

Any increase in the own funds requirements for individual customer groups is likely to result in more expensive loans for those borrowers. Conversely, reducing own funds requirements in certain segments is likely to cut credit costs. No precise quantification is possible at the present time.

For the calculation of the CVA risk capital charge, the current CRR includes several exemptions which are not part of the revised Basel framework. These exemptions, in particular the carve-out of non-financial counterparties, are necessary and important to ensure that the real economy can be given access to vital financial instruments. Therefore, abolishing these European specificities would most likely hamper economic growth (for detailed information see part 3, question 3.4).

1. Standardised approach for credit risk (SA-CR)

1.1. What are your views on the revisions to the SA-CR? Please provide details

We are aware that the goal originally set by the Basel Committee to keep the capital requirements stable compared to the current SA-CR has not been achieved to a large extent. For example, there is evidence that the capital requirements may increase altogether, in particular in the bank and corporate exposure classes, depending on the calculation method chosen for exposures secured by real estate and for off-balance sheet exposures. Hence, this is no longer just a shift of the capital requirements within the individual exposure classes. According to the systematics, the risk weights should not be used to increase the capital requirements altogether. Other instruments are implemented for this.

Moreover, it has to be borne in mind that, on the one hand, the changes to the SA-CR also have effects on other regulatory initiatives. For example, the TLAC/MREL requirements are calibrated on the basis of the leverage ratio and the RWAs. An increase in the capital requirements under the SA-CR might then make the overall capital requirements increase even further.

As already explained above, there is no evidence that the existing prudential framework is not appropriate for the risks, nor is this borne out by our practical experience to date. Especially in the areas of due diligence, equity holdings and the granularity criterion, we believe that the specificities of the German market were not sufficiently taken into account.

External ratings: We support the BCBS's decision to preserve external ratings. The European Commission should continue to rely on external ratings, too. A rating by a recognised rating agency includes far more information than the parameters suggested in the consultation paper can even begin to provide. An essential advantage of external ratings is the fact that they consistently take account of certain forward-looking components. Consequently, ratings reflect risks of an exposure much more precisely. That substantial added value is completely lost when indicators determined individually by banks are resorted to. Although external ratings were criticised in connection with the subprime crisis, the ratings of banks and corporates are fundamentally different kinds of rating methods. Also, the Basel Committee itself, when revising the securitisation framework, did not go so far as to completely do without external ratings.

Furthermore, the uniform use of external ratings guarantees comparability of capital requirements. This is not guaranteed for different risk drivers.

Exposure at Default (EaD) for derivatives transactions: Consequently, any weaknesses in the design of the new framework for Counterparty Credit Risk will negatively affect the outcomes of the SA-CR as well. Especially in the case of the Standardized Approach for Counterparty Credit Risk (SA-CCR) the design and calibration often leads to unjustifiably high exposures. Thus, not only the SA-CR itself but also the SA-CCR needs to be reviewed in order to account for actual risks in a more appropriate manner

Due diligence process: The proposed requirement for due diligence to verify external ratings constitutes a not inconsiderable administrative effort for the banks. Smaller institutions in particular are likely to quickly run into capacity problems if they conduct this due diligence themselves. The due diligence process in cases where ratings are used (exposures to MDBs, banks, covered bonds and corporates) cannot consist of comparing external ratings with a separate internal credit analysis for every single borrower in the form of mapping, for instance. We believe it should be sufficient to check at a higher level – e.g. certain homogeneous groups of borrowers, certain asset classes or possibly only per agency – that the risk weights assigned on the basis of external ratings are appropriate to the risk profile and characteristics of the borrowers. It should also be possible for a central unit to carry out these checks rather than requiring each individual bank to perform the task itself. Any other interpretation would lead to an enormous amount of additional work and expense which, for smaller banks in particular, would be virtually unmanageable. We would appreciate clarification of this point. For the reasons outlined above, we are opposed to due diligence in the form of analysis at the level of individual borrowers.

We understand the requirement to perform due diligence "on a regular basis (at least annually)" to mean only that the analysis has to be performed at regular intervals, not on an ad-hoc basis. We would ask for clarification of this point, too, in the interests of consistent implementation and handling.

1.2. How would the revisions to the SA-CR impact you / your business and, if applicable, your lending / borrowing behaviour? Please specify and provide relevant evidence

The proposed standardised approach will raise complexity and costs for all EU banks including small and mid-sized ones, which finance a large part of the economy in many EU countries.

The complexity of the envisaged standardised approach will rise significantly. This approach is increasingly granular due to the fact that it also serves to define the floors for the Internal Rating Based Approach (IRBA). This will lead to higher IT and compliance cost especially for those banks who would find it too costly to adopt internal models, and for whom the standardised approach was meant to be less complex.

An inherent feature of banks, that form a close network like in Germany the Cooperative Banking Group or the Savings Banks Finance Group, is that the institutions are invested in the companies and central banks in their network. The voting rights associated with the equity interests ensures uniform supervision and alignment in the association. These equity investments are of a long-term nature and do not serve to generate profits from increases in the value of the investees. The proposed increase in own funds requirements by a factor of 2.5 for all strategic investments would significantly increase the own funds requirements for institutions that are members of associated networks without any justification for this from risk aspects.

Specialised lending: Commercial banks have always performed a vital role in structuring and providing market making and underwriting services in debt finance to transactions. Hence European bank debt remains a critical means of meeting the expected future demand and facilitating the access of investors to specialised lending projects.

The Basel revisions to the credit risk framework would also adversely affect specialised lending. In the commercial real estate finance segment (e.g. HVCRE), many investment projects are specialised lending. The secured and structured nature of specialised lending transactions, together with the experience of dedicated teams, enables lenders to monitor closely the risk of these deals and benefit from low loss rates.

A significant rise in specialised lending weightings (e.g. for 80% risk weight for high quality projects) would force banks to allocate significant additional capital against those exposures, which could only be achieved through a combination of significant rises in pricing conditions, degradation of loan parameters (e.g. lower advance rates, shorter tenors). This process may ultimately lead to a material reduction in the volume of funds allocated to those activities by affected banks.

It is important that the criteria for high quality project finance and pre-operational vs operational phase are defined very clearly to avoid judgemental errors, given that the same product is delivered to different sets of counterparties in different jurisdictions, transforming the risk profile.

1.2.1. How does the revised SA-CR compare to the current approach in terms of capital requirements?

a) Please explain and specify the relevant revision(s)

b) Please provide an estimate if the positive or negative difference between the revised SA-CR and the current approach is significant in your view

For associations it is not possible to elaborate on this question in detail. The effects of the reforms are very portfolio specific and, due to the introduction of the output floor, will vary significantly between pure standardised and model banks. For this reason, we strongly support the idea of a thorough European quantitative impact study (QIS).

However, RWA increases are expected according to our comments made under question 1.1.

Apart we will clearly see a strong rise of RWA resulting from changes to the equity holdings exposure class. In addition, there will be significant increases in RWAs in the institutions exposure class because of the abolition of the home country principle. The risk weights will also increase in the specialised lending exposure class (differentiation of an increase in risk weights), subordinated transactions (increase in risk weights) and commercial real estate financing.

The impact assessment also depends on the exercise of national discretions. As a general principle, the Commission should implement the discretions of the Basel framework in the EU.

Additionally, the option in the area of commercial and residential real estate finance should be structured in line with the current rules governing the hard test. This allows to permit mortgage loans to be split and the more advantageous risk weighting to also be applied to income-generating real estate loans if the real estate market is classified as "stable" (which was regularly the case in Germany).

1.2.2. Do the revisions to the SA-CR affect certain assets/exposure classes more than others and – if applicable – which of the provisions of the revised framework may create these effects? Please support your view with specific evidence to the extent possible

Exposures to corporates: We appreciate that an important European feature, the recognition of the low risk of SMEs, has been introduced in the Basel accord. When it comes to SMEs the Basel framework allows a preferential risk weight of 85% to be applied to unrated exposures to corporate SMEs. Basel has not opted for the current European solution on this issue. We welcome the Basel Committee's recognition of the fact that such exposures carry less risk than do "normal" exposures to corporates. We nevertheless believe the reduction in the risk weight does not yet go far enough compared to the equivalent requirement in the EU, for example. We believe that our current systems to value these exposures have provided good results in the past years and there is no need to adapt it to the new proposal.

Externally unrated corporates: Given that a large portion of the total CR RWA excl. CCR is made up of the corporate portfolio of major European banks), the new standard may have very material unintended consequences on European banks being able to support this business.

This is because the standard penalises banks in jurisdictions that allow the use of external ratings for regulatory purposes (e.g. EU) as opposed to jurisdictions where external ratings are not allowed for regulatory purposes (e.g. US). In the latter case banks can assign a 65% RW to exposures to "investment grade" corporates, whereas in the former, they need to apply 100% RW for externally unrated corporate exposures. If corporate customers are subject to different measurement approaches across jurisdictions, it may result in regulatory arbitrage. Furthermore, it would hamper comparison of credit risk for corporate customers across the globe.

Retail exposures: We are opposed to a mandatory application of the granularity criterion (0.2% of the overall regulatory retail portfolio) for differentiating between "regulatory retail" and "other retail" exposures. In the past, the 0.2% limit was used only as an example of the granular retail business portfolio. Whereas larger institutions with retail portfolios of €500 million and more are not restricted by this limit, many small institutions today use qualitative differentiation criteria.

For smaller banks with a small retail portfolio, this mandatory criterion would translate into an extremely small maximum exposure amount, substantially undermining their competitiveness. If a bank had a retail portfolio of €200 million, for instance, its exposure to a single counterparty could not exceed €400,000. A rule of this kind would have an especially adverse effect on lending to SMEs. Loans to SMEs would become significantly more expensive and/or lending volumes would be significantly reduced. We therefore strongly recommend that it should be possible to demonstrate the diversification of a retail portfolio using methods other than the mandatory verification of the granularity criterion.

Real estate exposures: In our view the pivotal element of the revision of the Standardised Approach (SA) is the reform of the RWA calculation of real estate portfolios. Due to the fact that investments in real estate in Europe are predominantly financed by banks and remain on the balance sheets for long periods, these revisions will have major effects which have to be carefully analysed. Europe's real estate markets are not homogeneous. They especially differ in the following four aspects:

- Definition of property rights
- Enforceability of legal claims
- Analysis of creditworthiness
- Determination of the value of real estate

Because of these differences it might be worthwhile to consider the introduction of different approaches despite the verdict of homogeneous rules for capital requirements in Europe.

The final accord comprises two different methods to compute the RWA of real estate exposures: the LTV approach and the loan-splitting approach, which has been good practice in low loss risk countries like Germany, for example. In our opinion the LTV approach is not risk-sensitive enough in the lower LTV-buckets for exposures secured by commercial real estate or by income-producing residential real estate. Evidence of loss rates suggests that the specified risk weights are too high. In the course of European implementation, it should therefore be examined whether the LTV approach could be applied in a more granular and risk-sensitive way. Loss rates are collected in the

COREP reporting, so there is sufficient evidence on this issue in Europe. We recommend analysing this data in the coming months in order to possibly complement the Basel proposal.

Off-balance sheet items: The introduction of a CCF of 10% on commitments unconditionally cancellable at any time has to be analysed closely. Based on current evidence, unconditionally cancellable commitments are a very widespread form of financing for private persons and companies of all sizes in Europe. As already stated during the Basel consultation, we do not consider this element to be justified.

1.3. Where do you expect particular implementation challenges in the revisions to the SA-CR and why? Please specify

In addition to the due diligence process (see question 1.1), implementing the **loan-to-value** ratio represents a further challenge. LTV is the decisive criterion for risk weighting real estate loans. One problem is that the ratio has so far not existed in this form in the data repositories and processes. There are also many implementation issues, including with regard to the definition of the "value of the property" in paragraph 62 of the Basel requirements. The application of the LTV approach requires the determination of the property value to be aligned. If not, a major competitive issue among European countries and banks with strong home markets will evolve. However, the EBA's attempt to investigate this issue has shown that there are good reasons for different practices. Furthermore, the Basel framework contains important definitions of different real estate classes. A good example is the independence criterion for the repayment of cash flows generated by the property. If there are different national interpretations, strong competitive distortions will be the consequence. In the course of the European implementation, a suitable solution will have to be developed for this issue. Irrespective of this, we hold the view that a uniform international definition of the value of real estate would prevent distortions of competition.

In addition, the **qualitative criteria for real estate collateral eligibility** lead to administrative effort. The legal and contractual details of the collateral have to be reviewed. As a result, collateral could be deemed to be ineligible due to formally stricter criteria – compared with the status quo – without any change in the economic quality of the collateral. The current requirements for real estate collateral in line with the CRR constitute sound, everyday practice. We are therefore in favour of preserving the current rules. This avoids unnecessary, complex reviews of the existing business with regard to formal criteria.

As a general rule, **all transactions will have to be reviewed with regard to the many new requirements**. This applies, for example, to the demarcation of real estate loans that belong in the third category of Land Acquisition, Development and Construction. The Basel definition is based solely on the criterion of completion, leaving many questions open (including a new review and categorisation after completion of the property). We believe there is a risk here that, in cases of doubt, too many transactions could be classified in this category and be penalised by the high risk weight of 150%.

2. Internal ratings-based (IRB) approaches for credit risk

2.1. What are your views on the revisions to the IRB approaches? Please provide details

We would like to encourage the initiatives to move ahead towards a more harmonised interpretation and application of the IRB approach reducing differences in RWA which are not explained by distinct risk profiles or management practices. When saying this, we recommend being mindful in terms of the burden for banks, implementation timelines, and to follow the principle of proportionality. Besides that, we propose aligning with other regulatory, but also accounting, requirements such as the guidance on accounting for expected credit losses.

The EBA has already launched a comprehensive project to revise the IRB approach in the shape of the "Future of the IRBA". The amendments relate to:

- prudential assessment of IRB requirements,
- definition of default,
- estimating risk parameters and
- credit risk mitigation techniques.

All revisions are expected to have been implemented by the institutions no later than the end of 2020.

Improving RWA comparability is a valid objective that needs to be achieved. But it is important to be aware that in the search of comparability of capital ratios across banks and jurisdictions there may be a loss in risk sensitivity in banks' capital framework. It is necessary to evaluate if the adequate risk sensitivity of capital requirements has been preserved and to continue reinforcing the use of internal models as a management tool.

When implementing the BCBS requirements, it will be necessary to pay attention to ensure that the individual issues do not conflict with the technical standards and guidelines in the EU. We are therefore urging a careful view of the extent to which individual BCBS requirements – such as those affecting the risk parameters – actually have to be transposed into the CRR. In our opinion, the first step should be to implement the results of the EBA's work and to evaluate their impact before making more changes to the approaches.

Among other things, restricting the scope of the A-IRB approach means that not all economically recoverable collateral will then be eligible for various portfolios. This would also tend to disadvantage transactions that are highly collateralised. The consequence is not only rising own funds requirements, but also lower risk sensitivity of the IRB approach. In addition, the proposed amendments would see Pillar I and Pillar II drifting apart.

2.2. How would the revisions to the IRB approaches impact you / your business and, if applicable, your lending / borrowing behaviour? Please specify and provide relevant evidence

As already pointed out the question cannot generally be answered.

2.2.1. How do the revised IRB approaches compare to the current approach in terms of capital requirements?

a) ***Please explain and specify the relevant revision(s)***

b) Please provide an estimate if the positive or negative difference between the revised IRB approaches and the current one is significant in your view

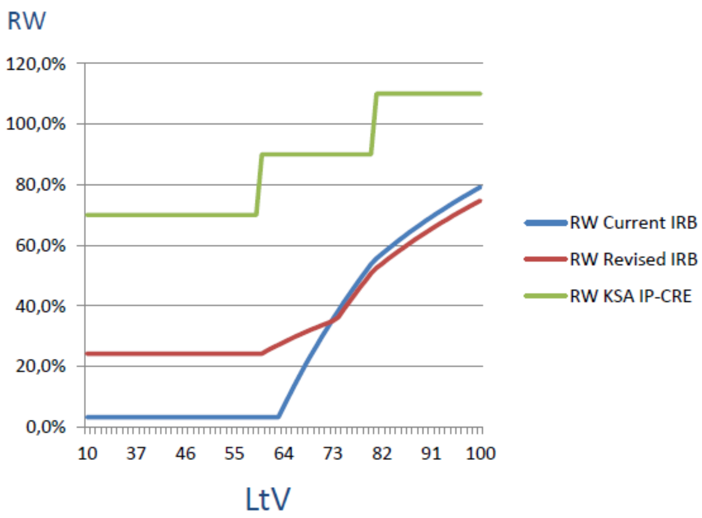
No Comments.

2.2.2. Do the revisions to the IRB approaches affect certain assets/exposure classes more than others and – if applicable – which of the provisions of the revised framework may create these effects? Please support your view with specific evidence to the extent possible

We would like to give an example regarding the interaction of minimum LGD and supervisory haircuts for real estate exposures that illustrates the negative effect of the proposal very well.

- The result of the combination of the haircut and the undifferentiated minimum LGD is that the input floor applies in particular to low LTV ranges compared with the economic LGD. Consequently, institutions with higher risks can continue to use their internal models, whereas more risk-adverse Pfandbrief banks are penalized by substantial capital add-ons without any justification whatsoever.

- For this reason, the minimum LGD should be reduced for lower LTV ranges. The following graphic shows the potential for management errors resulting from the input floor for an illustrative real estate loan with an assumed PD of 1.7% and a term of 2.5 years:



- The graphic shows firstly that the current structure has two weak points. On the one hand, the level in the low-risk range is set considerably too high, which considerably reduces the modelling incentive in well collateralised portfolios, and on the other, modelling for more risky portfolios (unsecured exposures and high LTVs) becomes attractive.

- One potential solution for this problem could be to define the input floors differentiated by granular LTV buckets (whole loan approach).

2.3. Where do you expect particular implementation challenges in the revisions to the IRB approaches and why? Please specify

In this context we would like to point out that there is a difference between the asset class definition of specialised lending in the Standardised Approach and the IRB Approach. As a consequence the respective portfolios would have to be separated and treated differently in the calculation systems for the different approaches. Apart from the fact that this requires unnecessarily costly IT adjustments in the front office systems, it will lead to distortions in the management of the respective portfolios. We therefore recommend aligning the IRB definition with the SA definition by introducing the asset class "real estate", distinguishing between cash flow-independent and cash flow-dependent real estate financing.

We welcome Basel's approach of only requiring IRBA implementation for each asset class and thus significantly extending the possibilities for permanent partial use. This should also set an example in Europe. However, to avoid banks having to implement IRBA rating systems for a small number of exposures and consequently with little default and loss data, a materiality threshold also makes sense within an asset class. The definition of this threshold should be regulated by authorising a corresponding RTS. Implementing the new requirement of IRBA per asset class will necessitate that institutions already measuring their complete portfolio on the basis of IRBA would be given the right to freely decide whether to continue with the IRBA for all asset classes.

3. CVA risk framework

3.1. What are your views on the revisions to the CVA framework? Please provide details

Improvements to the standard are needed as the final text generally disincentives proactive and more risk sensitive risk management.

This, on the one hand, can be witnessed when it comes to proxy hedging. The SA-CVA disincentives prudent risk management, as proxy hedging of CVA P&L of counterparties without CDS results in higher SA-CVA capital charges than if the exposure was unhedged. We do not believe this was the intention of the BCBS, as proxy hedging reduces the systematic credit risk a bank is exposed to. This issue can be addressed by permitting mapping of illiquid counterparty sensitivities to proxy entities and using the R factor to account for the degree of proxy hedging.

On the other hand, when not applying hedging, the BA-CVA results in lower capital requirements then the SA-CVA approach. In principle, a more sophisticated approach should logically lead to lower requirements. The current CVA standard, in conclusion creates incentives for improper risk management.

We would welcome an option for supervisory partial use in order to allow a larger number of institutions to use the more risk-sensitive and more advanced method. This is already provided for in paragraph 6 of the BCBS document, under which any number of netting sets can be carved out from the SA-CVA and then calculated using the BA-CVA. A realistic ability to implement an SA-CVA approach for medium-sized institutions as well would create incentives for better management and hedging of CVA risks, as only these risks are fully eligible in the SA-CVA and are in line with economic CVA management.

3.2. How would the revisions to the CVA framework impact you / your business and, if applicable, your provision of / access to services in the derivatives market? Please specify and provide relevant evidence

The revised CVA framework cannot be viewed in isolation from other Basel proposals or decisions. Again, as mentioned above concerning the SA-CR, the new Standardised Approach for Counterparty Credit Risk (SA-CCR) directly affects the resulting CVA charge when the BA-CVA is applied.

The general tightening of the CVA charge per se increases the costs of hedging interest rate risk, which in turn can trigger undesirable incentives (interest rate hedges become more expensive).

There is a theoretical option in the BA-CVA to include hedging effects of suitable hedging transactions. However, because of the associated costs of such hedges, we believe this will be made considerably more complicated in practice.

In our view, the overall expected additional burden (whether from increased own funds requirements or costs of hedges) is a disproportionate realignment of the CVA charge.

3.2.1. How does the current CVA framework compare to the revised one in terms of capital requirements?

a) ***Please explain and specify the relevant revision(s)***

b) Please provide an estimate if the positive or negative difference between the current CVA framework and the revised one is significant in your view

Because of the significant increase in the weighting factors to be applied (supervisory risk weights RW_c) compared with the existing Standardised Approach under Article 384 of the CRR, the BA-CVA leads to significantly higher own funds charges from the CVA charge. Financials are assigned the highest risk weights here, rising by a factor of 10 compared with the status quo. Long maturities and a lack of collateral also have a negative effect. As a consequence, application of the BA-CVA to transactions subject to the CVA charge as at 31 December 2017 results in an 80% higher own funds requirements for CVA risk at some institutions compared with the current Standardised Approach. We do not believe that there is any valid basis for this extremely conservative calibration of the BA-CVA.

3.3. Where do you expect particular implementation challenges in the revisions to the CVA framework and why? Please specify

The difficulty in implementing the SA-CVA lies in the high number of sensitivities to be calculated compared with the prescribed prudential risk factors. Especially for collateralized derivatives the calculation of CVA sensitivities is very time and resource consuming and therefore not feasible for most banks.

3.4. What are your views on the revised CVA framework to capture CVA risks arising from counterparties currently exempted from the own fund requirements for CVA risks under Article 382 of the CRR?

The exemptions under Article 382 were incorporated after due deliberation and for valid reasons. We do not see why these reasons should have become obsolete.

Especially in the **case of non-financial counterparties (NFCs)** the exemption is vital to avoid adverse effects on employment and growth. Due to their nature, an efficient management of collateral is more than challenging for corporates and standardized instruments often fail to match their specific needs. Therefore, OTC derivatives are usually the only option for corporates to hedge risks that inevitably arise from their businesses. The use of those derivatives is even more important for European corporates than for American corporates because of the structural difference in FX exposure these European counterparties face. The US dollar still is the main trading currency in global markets. European corporates and other counterparties therefore face a higher FX risk exposure than their peers across the globe. The result is that these European counterparties have a higher demand for hedging solutions than for instance American corporates (who can trade solely in their own currency). This structural difference therefore penalises proactive risk management by these counterparties, with real economic impacts.

Furthermore, it is important to note that NFCs are much less interconnected than financial counterparties and therefore do not pose any significant systemic risk to the financial system. In addition, bilateral OTC derivative arrangements with NFCs are already subject to own funds requirements in the area of Counterparty Credit Risk. An additional capital charge for CVA risk would force banks – especially in times of already low profitability – to pass the additional costs on to their counterparties. This, in turn, would most likely result in corporates either not hedging their risks anymore or even refraining from certain business activities completely. Both consequences would be highly undesirable.

Moreover, the CRR should be kept consistent with other European regulations, for example EMIR. For the exact same reasons mentioned above, EMIR excludes NFCs with a volume of OTC derivative contracts below a certain threshold from the clearing obligation. It is only a logical consequence that counterparties exempted from clearing obligations under EMIR should analogously be exempted from the CVA Risk Capital Charge.

In this regard, we furthermore support the position the European Commission defines in recital 6 of its EMIR 2 proposal: "(6) Financial counterparties with a volume of activity in OTC derivatives markets that is too low to present an important systemic risk for the financial system and is too low for central clearing to be economically viable should be exempted from the clearing obligation [...]" For these small financial counterparties (SFCs) the CRR should also be aligned with EMIR in a way that SFCs exempted from the clearing obligation should also be exempted from the CVA Charge.

We are also expressly urging that the exemptions in Article 382 of the CRR for **intragroup transactions** should be preserved. It is critically important for us to preserve the exemption for transactions with counterparties that are classified as intragroup or that belong to the same institutional protection scheme (IPS). A large proportion of the derivative transactions of institutions that are members of an IPS are entered into within the network.

4. Operational risk framework

4.1. What are your views on the revisions to the operational risk framework? Please provide details

Capital requirements calculated using the SMA consider only information about the past, both in the BI and in the ILM. As a result, the present design of the loss component is loss sensitive rather than risk sensitive. Steps taken by management to reduce the bank's operational risk are not directly taken into account. First and foremost for banks currently using the AMA the proposed SMA therefore constitutes a huge step back in measuring and depicting actual risks.

In our view, the suggested possibility of supervisory approvals to exclude certain past losses from the loss component and certain divested businesses from the business indicator is very reasonable as there is no reason to include events or positions in the calculations that have become irrelevant for the institution's risk profile. In this matter, we would favour a rather flexible approval process enabling case by case decisions over an all too mechanistic solution. In particular, in the case of exempting past losses, AMA banks and their supervisors have already established good practices and it should be ensured that these practices can be retained in the future.

4.2. How would the revisions to the operational risk framework impact you / your business? Please specify and provide relevant evidence

No comments.

4.2.1. Which approach for the calculation of the operational risk requirement do you use at the moment?

No comments.

4.2.2. How does the new operational risk approach compare to your current approach in terms of capital requirements?

a) Please explain and specify the relevant revision(s)

b) Please provide an estimate if the positive or negative difference between the new operational risk approach and the current one is significant in your view

When it comes to capital requirements, it has become apparent that especially banks currently using the AMA will face significant increases in own funds requirements. For the European implementation of the new Basel rules, it is important to note that they hit European AMA banks much harder than particularly their US peers.

Furthermore, not only current AMA banks but also banks now using simpler approaches will be confronted with increased capital requirements. First and foremost those institutions that more focused on commission business than on interest-bearing business will be negatively affected by the new rules. In times of ultra-low interest rates, however, for some banks the only option to be profitable is to rely on fees and commissions instead of interest income. Consequently, profitability is going to be penalised under the new framework. As profitability is one major keystone for financial stability this adverse effect is very undesirable. Therefore, the calculation methodology of the business indicator should be re-evaluated before its implementation into European law.

Moreover, the final standard reduced the BI buckets from 5 to 3, which leads to a capital increase especially for medium sized banks.

4.3. Where do you expect particular implementation challenges in the revisions to the operational risk framework and why? Please specify

Implementation challenges are especially expected for the loss multiplier, as the standards for the loss data are not in line with the current standards. However, in order to calculate the loss multiplier a 10 year data history is needed. Especially the need to apply a strict accounting view is not in line with the current approach.

5. Output floor

5.1. What are your views on the revisions to the output floor? Please provide details

The output floor also has a direct impact on internal capital management: changes in the RWA for a single risk type or exposure class do not necessarily lead to identical changes in total capital requirements. This complicates the capital requirements planning and also the causal allocation of the (net) impact on the total capital. Equally, a risk-adjusted pricing of transactions is made more difficult.

While the introduction of a floor at the total RWA level is better than a floor at the level of risk types or exposure classes, we believe that introducing this floor restricts the generally sensible risk sensitivity of internal models. If the floor materialises, this also generally reduces the incentives to introduce internal models for calculating own funds requirements.

As pointed out above, we do not consider the output floor to be a suitable supervisory tool. It disincentives investments in low risk exposures because it raises the capital requirement of such exposures.

Moreover, we consider the disclosure requirements to be highly counterproductive for 2 reasons:

a) In order to smoothen the impact of the floor, it will be introduced with phasing-in periods. The disclosure proposals include a direct benchmarking of the two credit risk approaches along asset classes. This will enable the market to analyse the individual difference from the final floor target per portfolio. We have learned from the experience of the Basel 3 reform of the capital definition that such a transparency will only make the market anticipate the final own funds requirements according to the final rule. As a consequence banks will de facto be required to bring forward the necessary capital right from the beginning which fundamentally contradicts with the idea of the phasing-in.

b) Benchmarking of supervisory standard approaches and model approaches will inevitably show differences because the supervisory standard is not risk-sensitive enough. The supervisory standard might often lead to higher RWAs. We fear that the results of the standardised approaches could be deemed to capture the true risk, despite the fact that internal models produce much more reliable results reflecting the risk situation of the institution much more appropriately than standardised approaches.

Furthermore, banks can use different options for calculation of the floor for CVA. The final standard allows flexibility to use SA-CVA, BA-CVA or 100% of a bank's own funds requirements for CCR (depending on which approach the bank is eligible for and uses for CVA risk). This will lead to different outcomes.

Finally, the capital floor regime should apply at the level of the consolidated group. Member States should have the option to disapply the capital floor at lower levels of consolidation where it is appropriate to do so, for example, where structural separation has been required and therefore diversification benefits cannot be taken.

5.2. How would the revisions to the output floor impact you / your business and, if applicable, your provision of / access to (bank) financing? Please specify and provide relevant evidence

The application of a floor applicable to all total RWAs will significantly increase the RWAs of institutions that use internal models. Among other things, this will mean that it is no longer worthwhile to use an internal market risk model.

It can also be assumed that the floor – in the same way as the leverage ratio – will significantly reduce the risk sensitivity of the own funds requirements. In consequence, in particular long-term business and low-risk business will be prudentially disadvantaged and penalised.

Moreover, the output floor methodology represents a challenge for managing RWAs and calculating transactions because overall own funds requirements are linked to the standardised approaches.

Last but not least, we assume that, despite the long transition period, the floor will also negatively impact the existing business because financing arrangements are entered into as long-term transactions.

In the case of the few institutions at which the floor will not impact RWAs at consolidated level, one of the reasons for this is the fact that the scope of the A-IRB approach will be restricted for large parts of the portfolio and hence recoverable collateral will no longer be eligible for risk mitigation. This will increase the capital requirements in the IRB approach, with the result that the floor no longer increases total RWAs.

5.2.1. What would be the impact of the revised output floor in terms of capital requirements when compared to the application of the revised internally modelled approaches?

a) ***Please explain and specify the relevant revision(s)***

b) Please provide an estimate if the positive or negative difference between the revised output floor and the application of the revised internally modelled approaches is significant in your view

As pointed out before, it is not feasible for associations to elaborate on this question in detail. However, there is strong evidence from member institution that the output floor raises the capital requirements of model banks significantly.

A European QIS needs to be carried out in order to obtain a clear picture. It is important to point out that a reliable estimate of the consequences of the output floor will only be achieved by including the effects of the Fundamental Review of the Trading Book. There is no sense in analysing the market risk requirements based on current rules as the ongoing CRR reform will change the final outcome significantly.

5.2.2. *Does the application of the revised output floor affect certain assets/exposure classes more than others and – if applicable – which of the provisions of the revised framework may create these effects? Please support your view with specific evidence to the extent possible*

We expect the output floor to have consequences on all model based portfolios as long as banks operate in a low risk environment. This will vary from bank to bank. However, as a result of earlier impact studies we consider it highly likely that real estate and specialised lending portfolios will be especially affected since the proposals of the standardised approach are not risk-sensitive enough.

5.3. Where do you expect particular implementation challenges in the revisions to the output floor and why? Please specify

The implementation effort can be regarded as very high. Based on the prudential standardised approaches, the output floor defines a lower limit for RWAs that have to be backed by own funds. Institutions that use internal models for calculating own funds requirements for credit or market risk must also calculate the capital requirements in these areas using the relevant standardised approaches. The institutions are therefore forced to implement the relevant standardised approaches for the entire portfolio alongside the internal models. In addition, the standardised approaches also have to be included and monitored in internal management and risk management.