EMF CRD IV AMENDMENTS	**10 February 2012**

Executive Summary

The Mortgage Credit Industry fully supports the goal of CRD IV in reinforcing the resilience of the banking sector, a pre-condition for fulfilling its essential role in **sustaining the economic recovery** and **providing wider access to housing** in Europe.

However, the Commission's CRD IV Proposal contains a number of elements that we believe risk harming the mortgage credit industry and its customers, by jeopardising some long-standing business models, as well as severely constraining the ability of others to lend for housing.

At the same time, they may also impose considerable costs on the broader economy and restrict consumers' access to mortgages. According to ECB research, a 5% decline in credit growth leads to a 0.4% decline in GDP in the short-run, rising to a 1.6% decline in the medium term.

Additionally, we fear that the combined impact of the Commission's changes will have a destabilising procyclical impact on mortgage markets, nullifying some of the stability elements of CRD IV such as the counter-cyclical buffer.

Therefore, the European Mortgage Federation would like to present several constructive amendments to the Commission's CRD IV Proposal concerning the **treatment of mortgages**, **the leverage ratio** and **liquidity**.

Treatment of mortgages

The combined impact of changes to the treatment of mortgages will have a procyclical effect and reduce the availability of lending, with negative consequences for both consumers and real growth.

The Leverage Ratio

The design of the current leverage ratio did not take into account the low-risk characteristics of the European mortgage credit industry. As such, it is likely to encourage a shift towards riskier and more expensive mortgage lending as well as to jeopardise the existence of some long-standing business models, without any obvious benefits in terms of stability or resilience, therefore, the EMF calls for a full review of the potential impact of the leverage ratio on European mortgage lending and strongly recommends that any eventual leverage ratio be implemented as a Pillar II measure.

Liquidity

The liquidity proposals, as they currently, stand do not address the specificities of European covered bonds, which play an essential role in the funding of mortgages across Europe.

These issues and their solution are summarised on pages 3-5, followed by a more detailed technical presentation of the proposed amendments.

Proposed Amendments

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Mortgage Risk Weights EMF Proposals for Amendments to Articles 96, 120 (2), 160 (4) and 174			
Issue: mortgage loss data is not comparable across Member States (Art. 96).	**Issue: Credit institutions must provide 'suitable evidence' of a borrower's income to prove that it is independent from the property** (Art. 120 2b).	**Issue: Article 160 Loss Given Default (LGD) sets a permanent floor for property exposures which can create unintended, negative consequences.**	**Issue: defining default in terms of days by 90 days will reduce lending appetite and increase the cost of lending** (Art 174).
Reason: the mortgage loss data, which is to be used for the upward revision of mortgage risk weights, has **no uniform or harmonised definition**. Revised risk weights based on the different national interpretations or different market practices will not be comparable. (see case study 3.1 on mortgage losses)	**Reason**: The hard test adds no value, and would be costly to administer for owner occupied properties, which represent 70% of all houses. The hard test discriminates against mortgages secured against rental properties. This could reduce the supply of rental properties, with significant social and economic impact. Competent authorities already have the flexibility to impose different risk weights or stricter criteria for owner-occupied and buy-to-let properties.	**Reason**: An LGD floor runs against the principle of creating a risk sensitive framework and would discourage bank's investment in IRB models. As with all pre-defined parameters under the IRB approach, values should be calibrated in order to ensure that they are accurate and do not introduce either unintended consequences or inconsistency into the model. In this case, the LGD floor penalises those markets that are relatively safer, leading to increased lending costs.	**Reason**: CRD I included a national discretion under the IRB approach for retail exposures and public sector entities which allowed lenders to define default as having taken place when the borrower is 180 days or more overdue with a loan payment, rather than 90 days. In practice many loans which go past 90 days overdue are brought into good standing before they reach 180 days overdue. Note: in the US a mortgage loan is considered in default after 180 days. A clear case to retain subsidiarity.
Solution: EBA should be given a greater role in establishing a uniform and comparable definition of losses stemming from mortgage lending.	**Solution: Delete this requirement**	**Solution: Removal of the LGD floor.**	**Solution: Maintenance of the existing definitions of default in terms of days past due.**
The combined impact of these issues re-introduces procyclicality and will reduce mortgage availability.			

Leverage Ratio and mortgage lending EMF proposal for Amendments to Recital 68 and Articles 416, 482 and 487			
Issue: The Leverage Ratio (LR) will put low risk, prudent mortgage lenders at a competitive disadvantage, resulting in a negative impact on consumers (Article 482). **Reason**: The "one size fits all" approach penalises low risk, low margin, high volume business models. In addition to supervision by competent authorities, prudent and conservative mortgage lending policies are encouraged by a triple layer of regulation – at conduct of business level by the Mortgage Credit Directive, at micro-prudential level by the CRD (Articles 119-120) and at the macroprudential level by the ESRB. A Pillar I Leverage Ratio will encourage European mortgage lenders to turn towards riskier business models and increase the cost of lending. **Solution: Special treatment for mortgages based on prudent mortgage lending rules.**	**Issue: The Leverage Ratio as a Pillar I measure in any form penalises low risk business models therefore reducing lending and choice for consumers** (Article 482). **Reason**: One size, quite simply, does not fit all – regional and business model differences need to be taken into account. A hard – Pillar I – leverage ratio will encourage lenders to shift to riskier, higher margin lending (as absolute lending volumes will be restricted) and will encourage a shift towards riskier business models and off-balance sheet funding. The local supervisor is best placed to ensure the most appropriate application of a Leverage Ratio. **Solution: Leverage Ratio should be implemented as a Pillar II measure.**	**Issue: Timing of the public disclosure obligation will result in uncertainty and encourage deleveraging resulting in a credit contraction and slowdown of the real economy** (Art. 487). **Reason**: Public disclosure of the LR in 2015, before the final form of the LR is known, is likely to create market pressures for deleveraging without any clarity to which level this should be done, encouraging institutions to over-react. Deleveraging is likely to lead to a significant reduction of lending and to a shift from long term lending to short term lending. **Solution: Public disclosure of the Leverage Ratio should be delayed until the results of the LR review are available.**	**Issue: European mortgage lenders are placed at a competitive disadvantage due to accounting differences, which will weigh on future growth prospects** (Article 482). **Reason**: difference between accounting standards used in the US and EU and the treatment of derivative netting. Unlike US mortgage funding models which are mainly based on securitisation as well as having recourse to Fannie Mae and Freddy Mac, most EU mortgage lending activities result in the assets being kept on balance sheet. **Solution: Adjustments in the calculation of the LR.**
A Pillar I Leverage Ratio will encourage longstanding low risk, low margin business models			

to shift to riskier lending, reduce consumer choice and raise costs.

<table>
<tr><th colspan="4">Liquidity, Covered Bonds and Mortgage Lending
EMF proposal for Amendments to Recitals 85 & 89 and Articles 404, 405, 413, 444 & 481</th></tr>
<tr><td>Issue: The final form of the Liquidity Coverage Requirement (LCR) and Stable Funding (NSFR) rules should be decided by the EP and Council(Articles 441 & 481).</td><td>Issue: Entity level reporting (Article 7).</td><td>Issue: Treatment of covered bonds (Articles 404, 405, 413 & 481)</td><td>Issue: Stable Funding Requirements (Articles 414 & 415).</td></tr>
<tr><td>Reason: Given the importance of the LCR and NSFR, the final form of these measures should be subject to the scrutiny of the EP and Council.</td><td>Reason: The Commission's Proposal enables some group structures to report the LCR at group rather than entity level. The derogation does not cover covered bond issuers in certain countries for whom entity level liquidity rules would not make sense.</td><td>Reason: To ensure that excellent track record of safety, liquidity and resilience in times of stress are taken into account, it is proposed that the EBA Review of the LCR takes into account the ECBC Label Initiative designed to further enhance the covered bond asset class.
In addition, technical adjustments are proposed to help ensure that the eventual calibration of the LCR can better achieve its goals.</td><td>Reason: The eventual specification and calibration of the NSFR should take into account the specificities of European mortgage credit and covered bonds.</td></tr>
<tr><td>Solution: Legislative proposals for the LCR and NSFR should be subject to co-decision.</td><td>Solution: Technical adjustment to Article 7 to include covered bond entities within group structures.</td><td>Solution: Covered Bond specificities should be taken into account in the formulation of the final LCR.</td><td>Solution: The EBA Review of the NSFR should assess European mortgage credit and covered bonds.</td></tr>
<tr><td colspan="4">The Covered Bond asset class has an excellent record of safety, liquidity and resilience that can help the LCR and NSFR to achieve their goals of improved liquidity and longer-term funding structures.</td></tr>
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Article 96 (3a) Reporting on losses stemming from mortgage lending
Amendment 1

Commission's Proposal	EMF Amendment
96 (3) a. Reporting Mortgage Losses 3. EBA shall develop draft implementing technical standards to specify the following: (a) uniform formats, frequencies and dates of reporting of the items referred to in paragraph 1;	96 (3) a. Reporting Mortgage Losses 3. EBA shall develop draft implementing technical standards to specify the following: (a) uniform **definition,** formats, frequencies and dates of reporting of the items referred to in paragraph 1 **to ensure a uniform and comparable definition of losses**;

There is a need for a comparable, uniform and consistent definition of losses stemming from mortgage lending. This is particularly important as this data will eventually be used to revise mortgage risk weights (upwards) in the standardised approach (Articles 119 and 120) – a measure which has the potential to introduce a significant degree of procyclicality to the mortgage credit industry.

Given that there is no existing harmonised definition of such losses, it will be very challenging to define and implement a uniform standard for mortgage collateral losses that provides a comparable approach across all Member States, considering differences in mortgage markets, legislation, levels of personal responsibility in mortgage contracts and time frames for loss recovery, etc. The specification of the dates and frequency of reporting should be driven by the definition of losses established by the EBA. For example, the use of quarterly data would not be the most appropriate to capture economic losses stemming from mortgage lending.

The EMF would like to offer its co-operation and support towards finding a practical and uniform definition of mortgage losses to ensure that the information collected provides relevant, comparable and useful information to national competent authorities and the EBA. Based on a preliminary review of mortgage collateral losses, it is necessary to take into account:

- A clarification and more precise definition of the type of loss to be recorded;
- Losses across the business cycle to avoid introducing procyclicality;
- Credit protection;
- The availability of historical data;
- The reliability of the data (i.e. in some jurisdictions, the data sample may be so small as to be unrepresentative).

Article 120 (2) Exposures fully and completely secured by residential property
Amendment 2

Commission's Proposal	EMF Amendment
2. Institutions shall consider an exposure or any part of an exposure as fully and completely secured for the purposes of paragraph 1 only if the following conditions are met: (b) the risk of the borrower does not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence, the repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral. For those other sources, institutions shall determine maximum loan-to-income ratio as part of their lending policy and obtain suitable evidence of the relevant income when granting the loan.	2. Institutions shall consider an exposure or any part of an exposure as fully and completely secured for the purposes of paragraph 1 only if the following conditions are met: ~~**(b) the risk of the borrower does not materially depend upon the performance of the underlying property or project, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence, the repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral. For those other sources, institutions shall determine maximum loan-to-income ratio as part of their lending policy and obtain suitable evidence of the relevant income when granting the loan.**~~

The measure proposed in Article 120 (2b) would be costly to implement but provides no added value. Further, the measure is unnecessary as competent authorities already have the flexibility to impose different risk weights or stricter criteria than those set out in Article 120 (2) for owner-occupied and buy-to-let properties.

Article 120 sets out the conditions to be eligible for the residential mortgage risk weight, including that the capacity of a residential borrower to repay the debt is independent from the cash flow derived from the property. Credit institutions will be required to provide 'suitable evidence' of a borrower's income and have a maximum loan-to-income ratio as part of their lending policy. Problems created by this hard test include the following:

- The hard test would not add any value, and would introduce an additional layer of cost, for owner occupied properties, which represent 70% of all houses;
- The independence criteria discriminates against mortgages secured on rental properties. This could lead to a reduction in the supply of rental properties, which would have a significant social and economic impact; and
- The EMF does not support the formalisation of a loan-to-income metric in the CRD. Mortgage lenders undertake a sophisticated analysis of each loan application, with loan to income being just one of many evaluation metrics. It is not clear what the benefit would be from the formalisation of one particular metric which will also be difficult to define on a comparable EU-wide basis.

Article 160 (4) Floor for Loss Given Default (LGD) Values for Mortgages in the IRB Approach Amendment 3

Commission's Proposal	EMF Amendment
160 (4) The exposure weighted average LGD for all retail exposures secured by residential property and not benefiting from guarantees from central governments shall not be lower than 10% The exposure weighted average LGD for all retail exposures secured by commercial immovable property and not benefiting from guarantees from central governments shall not be lower than 15%	160 (4) ~~**The exposure weighted average LGD for all retail exposures secured by residential property and not benefiting from guarantees from central governments shall not be lower than 10%**~~ ~~**The exposure weighted average LGD for all retail exposures secured by commercial immovable property and not benefiting from guarantees from central governments shall not be lower than 15%**~~

An LGD floor runs against the principle of creating a risk sensitive framework and would discourage bank's investment in IRB models. It could also decrease supervisors' incentive to monitor models.

Article 160 (4) stipulates a permanent LGD floor for retail exposures secured by residential property and retail exposures secured by commercial property. As with all pre-defined parameters under the IRB approach, values should be calibrated in order to ensure that they are accurate and do not introduce either unintended consequences or inconsistency into the model. While it may have been necessary to introduce a floor with the introduction of CRD I due to there being insufficient data availability, this is no longer the case.

The EMF opposes a permanent LGD floor without a thorough review of the available data.

There is also a risk that the Commission's original proposal for Article 160, when combined with the proposal to modify the definition of default (Article 174), could create serious unintended consequences (see next page).

Article 174 Default of an obligor – the number of days past due that defines a default
Amendment 4

Commission's Proposal	EMF Amendment
Article 174 (1b) The obligor is past due more than 90 days on any material credit obligation to the institution, the parent undertaking or any of its subsidiaries.	Article 174 (1b) The obligor is past due more than 90 days on any material credit obligation to the institution, the parent undertaking or any of its subsidiaries. **The competent authorities of each Member State may set the number of days past due up to a figure of 180 for exposures secured by mortgages on immovable property to counterparties situated in their territory, if local conditions make it appropriate.**

Concerning the removal of the existing national discretion to define default for exposures as 180 days past due rather than 90 days (Article 174), the reduced timeframe is neither appropriate nor compatible with some national mortgage models for which its removal will create significant disruption:

- There is a concern that the shift to a 90 day default definition will encourage a move towards earlier enforcement action by lenders towards customers that are overdue. This would be detrimental to consumers;
- In practice, many loans which go past 90 days overdue are brought into good standing before they reach 180 days overdue, including by national welfare measures. Therefore, the proposed change will artificially increase the number of apparent defaults, bearing little relation to the underlying reality and require credit institutions to set aside considerably more capital and hence increase the cost of mortgages for retail customers;
- In the IRB approach, there will be an impact on probability of default (PD) and loss given default (LGD) modelling. PD will rise and LGD would be expected to decline due to some of these defaults not actually having any losses. However, the floor for mortgage LGDs (Article 160) will prevent the modelled LGD from declining, therefore, overall capital requirements will also increase;
- This measure, when viewed in conjunction with the assessment of the suitability of risk weights for residential real estate, will introduce unwanted procyclicality.

It is therefore proposed to maintain the existing national discretion: the case for subsidiarity is clear.

Recital 68 Leverage Ratio – Amendment 5

Commission's Proposal	EMF Amendment
(68) A leverage ratio is a new regulatory and supervisory tool for the Union. In line with international agreements, it should be introduced first as an additional feature that can be applied on individual institutions at the discretion of supervisory authorities. Reporting obligations for institutions would allow appropriate review and calibration, with a view to migrating to a binding measure in 2018.	(68) A leverage ratio is a new regulatory and supervisory tool for the Union. In line with international agreements, it should be introduced first as an additional feature that can be applied on individual institutions at the discretion of supervisory authorities. Reporting obligations for institutions would allow appropriate review and calibration, with a view to migrating to a binding measure in 2018 **based on a legislative proposal by the Commission, and subject to the Union's full co-decision procedure**.

Article 481(1) of the draft CRR sets out that further legislation would be required to implement the leverage ratio as a binding measure, if appropriate. It is therefore proposed to align the wording of Recital 68 with Article 481(1).

Article 416 Calculation of the Leverage Ratio – Amendment 6

Commission's Proposal	EMF Amendment
2. The leverage ratio shall be calculated as an institution's capital measure divided by that institution's total exposure measure and shall be expressed as a percentage. Institutions shall calculate the leverage ratio as the simple arithmetic mean of the monthly leverage ratios over a quarter.	2. The leverage ratio shall be calculated as an institution's capital measure divided by that institution's total exposure measure and shall be expressed as a percentage. Institutions shall calculate the leverage ratio ~~as the simple arithmetic mean of the monthly leverage ratios over a~~ **every** quarter.

It is proposed to maintain a quarterly calculation of the leverage ratio, however, imposing a calculation based on monthly consolidated data will create an unnecessary burden on credit institutions, to no benefit. So credit institutions can instead calculate the leverage ratio from quarterly data (for example, using end of quarter data).

Article 487 Leverage Ratio Public Disclosure Requirements – Amendment 7[1]

Commission's Proposal	EMF Amendment
2. Article 436 (1) shall apply from 1 January 2015.	2. Article 436 (1) shall apply from 1 January ~~2015~~ **2018**~~.~~

Public disclosure requirements should be delayed until after the leverage ratio review has been completed. Public disclosure requirements for the leverage ratio during the observation phase could lead to market pressure for deleveraging prior to the review of the leverage ratio (Article 482), with mortgage lenders having to anticipate the outcome of the review prior to its completion, particularly given the considerable time necessary for deleveraging.

[1] Note: this Article concerns the public disclosure requirements for the leverage ratio.

Article 482 Leverage Ratio
Amendment 8

Commission's Proposal	EMF Amendment
1. The Commission shall submit by 31 December 2016 a report on the impact and effectiveness of the leverage ratio to the European Parliament and the Council. Where appropriate, the report shall be accompanied by a legislative proposal on the introduction of one or more levels for the leverage ratio that institutions would be required to meet, suggesting an adequate calibration for those levels and any appropriate adjustments to the capital measure and the total exposure measure as defined in Article 416.	1. The Commission shall submit by 31 December 2016 a report on the impact and effectiveness of the leverage ratio to the European Parliament and the Council. Where appropriate, the report shall be accompanied by a legislative proposal on the introduction of one or more levels for the leverage ratio that institutions would be required to meet **as a Pillar I tool or a continuation of a Pillar II approach**, suggesting an adequate calibration for those levels and any appropriate adjustments to the capital measure and the total exposure measure as defined in Article 416. **Any legislative proposal for one or more levels of leverage ratio shall be expressly subject to the full European legislative process involving the Parliament and Council.**

The EMF has serious concerns about the severe consequences of a hard - Pillar I - leverage ratio, which would constrain the availability of credit and increase the cost of mortgage lending.

The concept behind the leverage ratio - to limit unhealthy balance sheet growth - is appealing. However, we fear that in practice it could quickly become not only a hindrance, but a major threat to long-established business models and to entire sectors of the EU banking system. A leverage ratio as proposed in the Basel III Framework would discriminate against low-risk, high-volume business models which are typical of EU markets, such as mortgage lenders

Therefore, the EMF call for the leverage ratio to be implemented not as a hard limit, but as a part of Pillar II. The relevant supervisor is best placed to ensure the most appropriate application of the leverage ratio concept.

Recital 85 Powers Delegated to the Commission
Amendment 9

Commission's Proposal	EMF Amendment
The power to adopt acts in accordance with Article 290 of the TFEU should also be delegated to the Commission in respect of prescribing a temporary reduction in the level of own funds or risk weights specified under that Regulation in order to take account of specific circumstances; to clarify the exemption of certain exposures from the application of provisions of that Regulation on large exposures; to specify amounts relevant to the calculation of capital requirements for the trading book to take account of developments in the economic and monetary field; to adjust the categories of investment firms eligible for certain derogations to required levels of own funds to take account of developments on financial markets; to clarify the requirement that investment firms hold own funds equivalent to one quarter of their fixed overheads of the preceding year to ensure uniform application of this Regulation; to determine the elements of own funds from which deductions of an institution's holdings of the instruments of relevant entities should be made; to introduce additional transitional provisions relating to the treatment of actuarial gains and losses in measuring defined benefit pension liabilities of institutions; to temporarily increase in the level of own funds; and to specify liquidity requirements.	The power to adopt acts in accordance with Article 290 of the TFEU should also be delegated to the Commission in respect of prescribing a temporary reduction in the level of own funds or risk weights specified under that Regulation in order to take account of specific circumstances; to clarify the exemption of certain exposures from the application of provisions of that Regulation on large exposures; to specify amounts relevant to the calculation of capital requirements for the trading book to take account of developments in the economic and monetary field; to adjust the categories of investment firms eligible for certain derogations to required levels of own funds to take account of developments on financial markets; to clarify the requirement that investment firms hold own funds equivalent to one quarter of their fixed overheads of the preceding year to ensure uniform application of this Regulation; to determine the elements of own funds from which deductions of an institution's holdings of the instruments of relevant entities should be made; to introduce additional transitional provisions relating to the treatment of actuarial gains and losses in measuring defined benefit pension liabilities of institutions; **and** to temporarily increase in the level of own funds ~~**and to specify liquidity requirements**~~.

See Amendment 15 (Article 444).

Liquidity Coverage Requirement

Recital 89 Powers delegated to the Commission
Amendment 10

Commission's Proposal	EMF Amendment
Recital 89 The Commission should adopt the draft regulatory technical standards developed by EBA in the areas of cooperative societies or similar institutions, certain own funds instruments, prudential adjustments, deductions from own funds, additional own funds instruments, minority interests, services ancillary to banking, the treatment of credit risk adjustment, probability of default, loss given default, corporate Governance, approaches to risk-weighting of assets, convergence of supervisory practices, liquidity, and transitional arrangements for own funds, by means of delegated acts pursuant to Article 290 TFEU and in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level.	Recital 89 The Commission should adopt the draft regulatory technical standards developed by EBA in the areas of cooperative societies or similar institutions, certain own funds instruments, prudential adjustments, deductions from own funds, additional own funds instruments, minority interests, services ancillary to banking, the treatment of credit risk adjustment, probability of default, loss given default, corporate Governance, approaches to risk-weighting of assets, convergence of supervisory practices, ~~**liquidity,**~~ and transitional arrangements for own funds, by means of delegated acts pursuant to Article 290 TFEU and in accordance with Articles 10 to 14 of Regulation (EU) No 1093/2010. It is of particular importance that the Commission carry out appropriate consultations during its preparatory work, including at expert level.

See Amendment 15 (Article 444).

Article 7 Derogation to the application of liquidity requirements on an individual basis
Amendment 11

Commission's Proposal	EMF Amendment
2. Where all institutions of the single liquidity sub-group are authorised in the same Member State, paragraph 1 shall be applied by the competent authorities of that Member State.	2. ~~**Where all institutions of the single liquidity sub-group are authorised in the same Member State, paragraph 1 shall be applied by the competent authorities of that Member State.**~~ **The competent authorities shall waive in full or in part the application of Article 401 to a parent institution and to all of its subsidiaries where all institutions of the single liquidity sub-group are authorised in the same Member State and supervise them as a single liquidity sub group.**

The exemption from entity level reporting of the LCR should be extended to covered bond issuers. Where a covered bond issuer is a separate entity, it typically already has to respect liquidity constraints under national covered bond legislation (such as a 180 day liquidity buffer) or has structural enhancements (such as a prematurity test) to satisfy the market that liquidity risk has been addressed to a very high standard. Applying the LCR for these entities would be a double counting and is less targeted a measure than the specific regulation applying to those entities. Where all the subsidiaries are within the same Member State, the competent authorities have a complete view of the group.

Amendment 12: i) & ii) - Conditions for assets to be reported as liquid
Article 404 Reporting on liquid assets

Commission's Proposal	EMF Amendment
3. Institutions shall only report as liquid assets that fulfil each of the following conditions: (a) they are not issued by the institution itself or its parent or subsidiary institutions or another subsidiary of its parent institutions or parent financial holding company; (c) their price can be determined by a formula that is easy to calculate based on publicly available inputs and does not depend on strong assumptions as is typically the case for structured or exotic products;	Amendment 12 i) – Article 404 (3a): (a) they are not issued by the institution itself or its parent or subsidiary institutions or another subsidiary of its parent institutions or parent financial holding company **This does not apply to assets referred to in (i) and (ii) in paragraph 2, point (a), which are traded on an ongoing basis in the secondary market;** Amendment 12 ii) (c) **their price is generally agreed upon by market participants and can easily be observed in the market, or** their price can be determined by a formula that is easy to calculate based on publicly available inputs and does not depend on strong assumptions as is typically the case for structured or exotic products;

Amendment 12 i) – Article 404 (3)a
Self-issued bonds are not eligible for inclusion in the stock of liquid assets. We would like the provision to be amended to exempt self-issued covered bonds from the rule. Covered bonds are particularly secure. It should be possible to include such particularly secure securities where it can be proved that they are traded in the secondary market on a current basis and therefore are not used as a cash generator.

Amendment 12 ii) – Article 404 (3)c
Conditions for determining liquid assets should be observable in the markets and should be interpreted differently for each market to take European specificities into account. Price conditions should not rule out assets such as callable covered bonds, where mortgage borrowers have the right to repay their principle at par. It is required that prices should be easy to calculate. A strict interpretation of the current requirement could mean that asset prices that are not easy to calculate, however regularly traded with easily observable prices agreed upon by market participants are not included.

Amendment 13

Article 405 Operational requirements for holdings of liquid assets

Commission's Proposal	EMF Amendment
(b) not less than 60% of the liquid assets that the institution reports are assets referred to under points (a) to (c) of Article 404(1). Such assets owed and due or callable within 30 calendar days shall not count towards the 60% unless the assets have been obtained against collateral that also qualifies under points (a) to (c) of Article 404(1);	(b) not less than 60% of the liquid assets that the institution reports are assets referred to under points (a) to (c) of Article 404(1). Such assets owed and due or callable within 30 calendar days shall not count towards the 60% unless the assets have been obtained against collateral that also qualifies under points (a) to (c) of Article 404(1) **Secured lending and capital market driven transactions, as defined in Article 188, that are collateralised by assets not qualifying as liquid assets according to Article 404, is not to have any impact on the eligible amount of liquid assets.**
(g) the denomination of the liquid assets is consistent with the distribution by currency of liquidity outflows after the deduction of capped inflows.	(g) the **consistency of** the denomination of the liquid assets ~~**is consistent**~~ with the distribution by **significant** currency of liquidity outflows after the deduction of capped inflows **is monitored and reported, including the institution's ability to swap currencies and access the relevant foreign exchange markets. A currency is considered significant if the aggregate liabilities denominated in that currency amount to 5% or more of the institution's total liabilities**.

Article 405 (b): Holdings of liquid assets financed by secured transactions

The purpose of this amendment is to ensure that a maturing repo within the 30-day horizon, backed by a non-liquid asset does not have any impact on the liquidity buffer, in order to provide the same treatment as an unsecured deposit and to prevent market makers from being discouraged from holding trading inventories of non-liquid assets which would decrease liquidity in those markets.

Article 405 (g): Denomination of liquid assets vs. net cash outflows

The provision states that the currency denomination of the liquid assets must be consistent with the distribution by currency of liquidity outflows. The proposed EMF amendment would ensure that Article 405 (g) is fully compliant with the relevant Basel III recommendations[2].

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[2] Points 32, 172 and 174 in "Basel III: International framework for liquidity risk measurement, standards and monitoring", December 2010. Point 172 in "Basel III: International framework for liquidity risk measurement, standards and monitoring", December 2010. Point 174 in "Basel III: International framework for liquidity risk measurement, standards and monitoring", December 2010.

Article 413 Inflows
Amendment 14

Commission's Proposal	EMF Amendment
1. Institutions shall report their capped liquidity inflows. Capped liquidity inflows shall be the liquidity inflows limited to 75% of liquidity outflows. Institutions may exempt liquidity inflows from deposits placed with other institutions and qualifying for the treatments set out in Article 108(6) or Article 108(7) from this limit.	1. Institutions shall report their capped liquidity inflows. Capped liquidity inflows shall be the liquidity inflows limited to 75% of liquidity outflows. Institutions may exempt liquidity inflows from deposits placed with other institutions and qualifying for the treatments set out in Article 108(6) or Article 108(7) from this limit. **Institutions may exempt liquidity inflows from monies due from borrowers and bond investors related to mortgage lending funded by bonds eligible for the treatment set out in Article 124(3), (4) or (5) or as defined in Article 52(4) of Directive 2009/65/EC from this limit.**
2. (a) monies due from customers that are not financial customers shall be reduced by 50% of their value or by the contractual commitments to those customers to extend funding, whichever is higher. This does not apply to monies due from secured lending and capital market driven transactions as defined in Article 188 that are collateralised by liquid assets according to Article 404;	2. (a) monies due from customers that are not financial customers **for the purposes of principal repayment** shall be reduced by 50% of their value or by the contractual commitments to those customers to extend funding, whichever is higher. This does not apply to monies due from secured lending and capital market driven transactions as defined in Article 188 that are collateralised by liquid assets according to Article 404 **and monies due from mortgage lending funded by bonds eligible for the treatment set out in Article 124(3), (4) or (5) or as defined in Article 52(4) of Directive 2009/65/EC**;

Paragraph 1 – Capped inflows (75%)

Some European mortgage banks comply with a business model where all mortgage lending is fully funded by covered bonds issuance based on a pass-through principle where new lending is granted simultaneously with selling tap-issued covered bonds in the market and cash inflows from borrowers (ordinary payments and prepayments) are passed on directly to the bond investors.

This model is often referred to as a "pass-through model" and it holds the benefit of such mortgage banks not having to rely on access to market liquidity facilities to process payments except for delinquencies. In periods of market stress such as in 2008 the pass through model proved highly valuable to financial stability.

We find the cash inflow cap equal to 75% of cash outflows very inappropriate for pass-through systems. Within the scope of the pass-through model the equivalent of the 75% cap on inflows is to assume a borrower delinquency rate of 25%. This exceeds maximum observed delinquency for such mortgage banks by a factor of four and is therefore excessively punitive. Another paradox of the 75% cap on inflows within the scope of the pass-through model is the assumption of a delinquency rate of 75% of all prepayments. In periods of significant changes in market interest rates and thus increasing borrower prepayment calls in order to re-mortgage, the mortgage bank risks temporary to run out of liquidity. All in all, for this type of business models, 100% of cash outflows to bond investors are included under the LCR, which should therefore also include 100% of cash inflows from borrowers (except expected delinquencies).

In general, the cap penalises systems which minimise liquidity risk using other tools. The Basel Committee has introduced the 75% cap to make sure that institutions have a certain liquidity buffer. If outflows are higher than inflows, an institution automatically needs a liquidity buffer, and the cap therefore seems irrational. The rule favours systems with large liquidity deficits, while penalizing systems which minimize liquidity risk through e.g. the pass-through principle. This is anti-competitive.

Since cash inflows from particularly secure deposits placed with other banks may be exempt from the 75% cap, it should also be possible to exempt cash inflows from other equally secure assets, for example loans secured by mortgage on properties and funded by covered bonds. Also, borrowers who are personally liable have a strong incentive to meet mortgage payment and prepayment obligations.

Paragraph 2, point (a) – Inflows from non-financial customers

Business models under which new lending is fully funded by bond issuance should be exempt from the requirement that relending of at least 50% of cash inflows from non-financial lending should be assumed. Under business models fully based on the pass-through principle, cash inflows from borrowers are passed on directly to bond investors, and new lending is fully funded by new bond issues. For this type of business models, 100% of cash outflows to bond investors are included under the LCR, which should therefore also include 100% of cash inflows from borrowers. New loans are issued only against the issuance of new bonds and consequently should not affect cash inflows.

The requirement that relending of at least 50% of cash inflows from non-financial lending should be assumed has presumably been included because some short term bank loans funded by deposits are rolled over, which in practice extends the loan terms. The cash inflows from such loans are therefore not considered genuine. The 50% requirement has been introduced to solve that problem. If that is the case, the requirement should be rephrased so that the 50% is calculated on the basis of principal repayment since interest payments are not rolled over.

Article 444 Delegated Acts and Liquidity
Amendment 15

Commission's Proposal	EMF Amendment
1. The Commission shall be empowered to adopt a delegated act in accordance with Article 445 to specify in detail the general requirement set out in Article 401. Such specification shall be based on the items to be reported according to Part Six, Title II. The delegated act shall also specify under which circumstances competent authorities have to impose specific in- and outflow levels on credit institutions in order to capture specific risks to which they are exposed. 2. The Commission shall be empowered to modify the items referred to in paragraph 1 or add additional items only if one of the following conditions is met: (a) a liquidity coverage requirement based on those criteria, considered either individually or cumulatively, would have a material detrimental impact on the business and risk profile of European institutions or on financial markets or the economy; or (b) modification is appropriate to align them with internationally agreed standards for liquidity supervision. For the purposes of point (a), in assessing the impact of a liquidity coverage requirement based on those criteria, the Commission shall take into account the reports referred to in paragraphs 1 and 2 of Article 481. 3. The Commission shall adopt the first delegated act referred to in paragraph 1 at the latest by 31 December 2015. A delegated act adopted in accordance with this Article shall, however, not apply before 1 January 2015.	***Article Deleted***

This Article gives power to the Commission to adopt a delegated act to specify the Liquidity Coverage Requirement (LCR). Given the importance of this issue and its potential impact on business, consumers and financial markets, the EMF proposes that the eventual specification of the LCR should be subject to co-decision in the Council and the European Parliament (see also Amendment 16 to Article 481), rather than by delegated act.

Article 481 Report and Reviews of the Liquidity Requirements
Amendment 16

Commission's Proposal	EMF Amendment
2. EBA shall, by 31 December 2013, report to the Commission on appropriate uniform definitions of high and of extremely high liquidity and credit quality of transferable assets for purposes of Article 404. EBA shall in particular test the adequacy of the following criteria and the appropriate levels for such definitions: (a) minimum trade volume of the assets (b) minimum outstanding volume of the assets (c) transparent pricing and post-trade information (d) credit quality steps referred to in Sub-section 2 of Annex VI (e) proven record of price stability (f) average volume traded and average trade size (g) maximum bid/ask spread (h) remaining time to maturity (i) minimum turnover ratio 3. By 31 December 2015, EBA shall report to the Commission on whether and how it would be appropriate to ensure that institutions use stable sources of funding, including an assessment of the impact on the business and risk profile of Union institutions or on financial markets or the economy and bank lending, with a particular focus on lending to small and medium enterprises and on trade financing, including lending under official export credit insurance schemes. By 31 December 2016, the Commission shall, on the basis of these reports, submit a report, and if appropriate a legislative proposal to the European Parliament and Council.	2. EBA shall, by 31 December 2013, report to the Commission on appropriate uniform definitions of high and of extremely high liquidity and credit quality of transferable assets for purposes of Article 404**, taking into account all relevant factors such as the applicable legal framework, incentive structures, available market initiatives and tools designed to enhance transparency and liquidity of assets**. EBA shall in particular test the adequacy of the following criteria and the appropriate levels for such definitions: (a) ~~**minimum**~~ trade volume of the assets (b) ~~**minimum**~~ outstanding volume of the assets (c) transparent pricing and post-trade information (d) credit quality steps ~~**referred to in Sub-section 2 of Annex VI**~~ (e) proven record of price stability (f) average volume traded and average trade size (g) ~~**maximum**~~ bid/ask spread (h) remaining time to maturity (i) ~~**minimum**~~ turnover ratio **3. The Commission shall submit a legislative proposal to the European Parliament and Council to specify in detail the general requirement set out in Article 401. Such legislative proposal shall be based on the items to be reported according to Part Six, Title II. The legislative proposal shall also specify under which circumstances competent authorities have to impose specific in- and outflow levels on credit institutions in order to capture specific risks to which they are exposed.** **4. For the purposes of paragraph 3 the Commission shall either individually or cumulatively assess whether a liquidity coverage requirement would have a detrimental impact on the business and risk profile of European institutions or on**

	financial markets or the economy and shall take into account the reports referred to in paragraphs 1 and 2. **5. The Commission shall submit the proposal referred to in paragraph 3 at the latest by 31 December 2014.** ~~**3**~~**6**. By 31 December 2015, EBA shall report to the Commission on whether and how it would be appropriate to ensure that institutions use stable sources of funding, including an assessment of the impact on the business and risk profile of Union institutions~~**, including non-deposit taking institutions**~~ or on financial markets or the economy and bank lending, with a particular focus on lending to small and medium enterprises and on trade financing, including lending under official export credit insurance schemes**, and match funded mortgage lending**. By 31 December 2016, the Commission shall, on the basis of these reports, submit a report, and if appropriate a legislative proposal to the European Parliament and Council. **7. The reports referred to in paragraph 1, 2 and 6 shall be open for public consultation in all Member States before submitted to the Commission.**

Paragraph 2 provides EBA to make uniform definitions of extremely high or high liquidity and credit quality transferable assets based on a number of criteria. The EMF and European Covered Bond Council[3] (ECBC) would like to propose that the Covered Bond Label Initiative is taken into account in the EBA review of assets that are of extremely high liquidity and credit quality.

The ECBC presented its **Covered Bond Label Initiative** in October 2011[4], highlighting to investors the value and quality of covered bonds and further enhancing the recognition of, and trust in the covered bond asset class. The label will also improve access to relevant and transparent information

[3] The European Covered Bond Council represents the covered bond industry, bringing together covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. The ECBC was created by the European Mortgage Federation (EMF) in 2004 to represent and promote the interests of covered bond market participants at the international level. As of February 2012, the ECBC has over 100 members from more than 25 active covered bonds jurisdictions. ECBC members represent over 95% of the €2.4 trillion covered bonds outstanding.

[4] For more information on the ECBC Label Initiative, see the ECBC Press Release of 7 October 2011.

for investors, regulators and other market participants. The long-term objective of the initiative is to promote liquidity and strengthen covered bonds' secondary market activity.

With over €2.5 trillion outstanding at the end of 2010 and €600 billion issuance during 2010 at a global level, covered bonds have confirmed their central role in bank funding strategies, providing essential access to capital markets. Their consistently strong performance, quality features and stable investor base have stimulated the interest of regulators and market participants in the asset class around the world.

The key to the success of covered bonds lies in their simplicity as a clear plain vanilla instrument, typically guaranteed by mortgages and public sector assets. The strong supervision and the underlying regulatory and legislative framework of covered bonds are all designed to properly assign collateral in case of resolution.

Paragraphs 3 – 5 are inserted following the proposed deletion of Article 444.

The new paragraph 6 (former paragraph 3) provides EBA and the Commission to make an assessment whether or not the NSFR is appropriate. It must be ensured that the effects of being a non-deposit taking bank or having match-funding systems are explicitly reviewed.

Non-deposit taking banks do not have a current run off liquidity risk and will seek to have a range of capital market funding instruments with different time to maturity in order to minimize point in time liquidity risk. Under business models of mortgage lending based on match funding (the pass-through principle), liquidity risk is extremely limited and the correlation between cash inflows and outflows is unique.

Stable Funding (NSFR)

Recital 76 Net Stable Funding Requirement
Amendment 17

Commission's Proposal	EMF Amendment
Recital 76 Apart from short-term liquidity needs, credit institutions and investment firms should also adopt funding structures that are stable at a longer term horizon. In December 2010, the BCBS agreed that the NSFR will move to a minimum standard by 1 January 2018 and that the BCBS will put in place rigorous reporting processes to monitor the ratio during a transition period and will continue to review the implications of these standards for financial markets, credit extension and economic growth, addressing unintended consequences as necessary. The BCBS thus agreed that the NSFR will be subject to an observation period and will include a review clause. In this context, EBA should, based on reporting required by this Regulation, evaluate how a stable funding requirement should be designed. Based on this evaluation, the Commission should report to Council and European Parliament together with any appropriate proposals in order to introduce such a requirement by 2018.	Recital 76 Apart from short-term liquidity needs, credit institutions and investment firms should also adopt funding structures that are stable at a longer term horizon. In December 2010, the BCBS agreed that the NSFR will move to a minimum standard by 1 January 2018 and that the BCBS will put in place rigorous reporting processes to monitor the ratio during a transition period and will continue to review the implications of these standards for financial markets, credit extension and economic growth, addressing unintended consequences as necessary. The BCBS thus agreed that the NSFR will be subject to an observation period and will include a review clause. In this context, EBA should, based on reporting required by this Regulation, evaluate how a stable funding requirement should be designed. Based on this evaluation, the Commission should report to Council and European Parliament together with any appropriate proposals in order to ~~**introduce**~~ **decide whether** such a requirement **should be introduced** by 2018.

The recital is stricter than Article 481 which do not require the introduction of a stable funding requirement. Article 481 says that by 31 December 2016 the Commission shall, submit a report, and if appropriate a legislative proposal to the European Parliament and Council on whether and how it would be appropriate to ensure that institutions use stable sources of funding.

Article 414 Items providing stable funding
Amendment 18

Commission's Proposal	EMF Amendment
1. The following items shall be reported to competent authorities separately in order to allow an assessment of the availability of stable funding: (a) own funds; (b) the following liabilities not included in point (a): (ix) liabilities resulting from securities issued qualifying for the treatment in Article 124;	1. The following items shall be reported to competent authorities separately in order to allow an assessment of the availability of stable funding: (a) own funds; (b) the following liabilities not included in point (a): (ix) liabilities resulting from securities issued qualifying for the treatment in Article 124 **or as defined in Article 52(4) of Directive 2009/65/**;

The EBA needs the data collection to determine the NSFR. It is important that the EBA is given the information necessary for it to make a qualified analysis of the NSFR. It is important explicitly to report on all types of covered bonds to complete the assessment performed by EBA.

Covered bonds are a commonly used funding instrument in the EU and are becoming more prevalent. It is important that the EBA in their future analysis of the NSFR takes this instrument separately into consideration and that all types of European covered bonds are included in the analysis - including only-UCITS-compliant covered bonds.

Article 415 Items Requiring Stable Funding
Amendment 19

Commission's Proposal	EMF Amendment
1. The following items shall be reported to competent authorities separately in order to allow an assessment of the needs for stable funding: (g) non-renewable loans and receivables, separately those the borrowers of which are: (i) natural persons other than commercial sole proprietor and partnerships and deposits placed by small and medium sized enterprises where the aggregate deposit placed by that client or group of connected clients is less than 1 million EUR; (ii) sovereigns, central banks and PSEs; (iii) clients not referred to in (i) and (ii) other than financial customers; (iv) any other borrowers;	1. The following items shall be reported to competent authorities separately in order to allow an assessment of the needs for stable funding: (g) non-renewable loans and receivables, separately those the borrowers of which are: (i) natural persons other than commercial sole proprietor and partnerships and deposits placed by small and medium sized enterprises where the aggregate deposit placed by that client or group of connected clients is less than 1 million EUR; (ii) sovereigns, central banks and PSEs; (iii) clients not referred to in (i) and (ii) other than financial customers; (iv) any other borrowers; **and separately those:** **(v) collateralised by commercial real estate (CRE);** **(vi) collateralised by residential real estate (RRE);** **(vii) match funded (pass-through) via bond eligible for the treatment set out in Article 124 or as defined in Article 52(4) of Directive 2009/65/EC;**

The EBA needs the data collection to determine the NSFR. It is important that the EBA is given the information necessary for it to make a qualified analysis of the NSFR. It is important explicitly to report on all types of mortgage lending models to complete the assessment performed by EBA.

For instance it is important that the information should allow assessment of all mortgage funding models, including match-funded models. Also, it must make visible the differences between loans secured by mortgage on residential and commercial properties, respectively.

Other Issues

Article 476 Transitional Basel I Floor
Amendment 20

Commission's Proposal	EMF Amendment
1. Until 31 December 2015, institutions calculating risk-weighted exposure amounts in accordance with Part Three, Title II, Chapter 3 and institutions using the Advanced Measurement Approaches as specified in Part Three, Title III, Chapter 4 for the calculation of their own funds requirements for operational risk shall meet both of the following requirements:	~~**1. Until 31 December 2015, institutions calculating risk-weighted exposure amounts in accordance with Part Three, Title II, Chapter 3 and institutions using the Advanced Measurement Approaches as specified in Part Three, Title III, Chapter 4 for the calculation of their own funds requirements for operational risk shall meet both of the following requirements:**~~

The so called Basel I floor should be removed - it will have no real impact but divert resources and focus away from adjustment to the CRD IV rules. Credit institutions are already holding capital levels higher than those required by Basel I, the fears that they would release too much capital is unfounded. This would only be a limiting factor for banks with low risk profile due to the lack of risk sensitivity of the former Basel I Accord.

The Basel I floor was introduced as a "safeguard clause" when migrating from Basel I to Basel II. In the meantime, however, the outcomes of Basel II have been tested sufficiently. As a consequence, the Basel I floor provision has become obsolete as a benchmark. Moreover, there is currently no decision of the Basel Committee which calls for such an extension. Last but not least - as the EU regulation will enter into force only on 1 January 2013 - there is no legal basis for an extension of the floor for the year 2012.

Should the floor be retained, it is very important that the current CRD III method for assessing its fulfilment will still be available. . If the current CRD method is not available it will create an unnecessary administrative burden for institutions.

Article 478 Review of covered bond criteria and own funds requirements
Amendment 21

Commission's Proposal	EMF Amendment
The Commission shall, by 31 December 2015 and after consulting the EBA, report to the Parliament and the Council, together with any appropriate proposals, whether the risk weights laid down in Article 124 and the own funds requirements for specific risk in Article 325(5) are adequate for all the instruments that qualify for these treatments and whether the criteria in Article 124 should be made stricter.	The Commission shall, by 31 December 2015 and after consulting the EBA, report to the Parliament and the Council, together with any appropriate proposals, whether the risk weights laid down in Article 124 and the own funds requirements for specific risk in Article 325(5) are adequate for all the instruments that qualify for these treatments and whether the criteria in Article 124 **are appropriate** ~~should be made stricter~~.

The mandate for EBA should be to report on the appropriateness of criteria and own funds requirements for covered bonds on an objective basis and without being restrained on its conclusions by the mandate.