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Capital Requirements Directive IV: Implications for EU mortgage lenders

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Athens, 10 June 2011

CRD IV impact on mortgage lending

- **Mortgages on real estate**
  - No fundamental changes, but SA risk weights will be subject to annual reviews and industry will have to report losses stemming from mortgage lending
- **Minimum level of own funds**
  - CET-I capital strengthened (from 2% to 4,5%)
  - Introduction of capital buffers (conservation 2,5% & anti-cyclical 2,5%)
  - Additional capital charge for SIFIs ?
- **Liquidity regime**
  - Introduction of a Liquidity Coverage Requirement (LCR): recognition of (extremely) high liquid and high quality assets
  - Introduction of a Net Stable Funding Requirement NSFR (at present, only reporting requirements of items providing & requiring stable funding) ?
- **Leverage Ratio**
  - Introduction of a pillar I leverage ratio of 3% penalising low risk businesses and setting wrong incentives ?
  - Legal uncertainty produced by a 2017 observation period is detrimental to long term lending

Further regulatory impact on mortgage lending

- **Deposit Guarantee Schemes**
  - substantial contributions of credit institutions to DGS (1% of covered deposits as target level ?)
- **Crisis Management**
  - contribution of financial institutions to resolution funds
- **Bank levy**
  - Financial Activities Tax (FAT of 5% on total profit and wages)

- **Overall cost impact ?**
  - All regulatory costs have to be financed through low margin mortgage (or public sector lending) business, i.e. margin squeeze puts mortgage lenders' profitability under pressure
  - Emerging evidence that regulatory costs deriving from only CRD IV rules account for 15 to 25 basis points within the mortgage margin
  - No reliable impact assessment of the cumulative effect of the overall new regulatory framework in terms of cost and consequences for the real economy

Regulatory impact on mortgage funding (capital market based)

- **CRD IV:**
  - New rules for exposures to financial institutions
    - deletion of ‚option 1‘ for exposures to rated institutions
    - ‚de facto‘ increase of the risk weight for senior unsecured bank exposures form 20% to 50% (step 2, A+ and lower ratings)
  - ‚De facto‘ increase of the Covered Bond risk weight from 10% to 20%
    - proposal to replace issuer rating by an issue rating based approach

- **Solvency II requirements for insurance companies:**
  - Senior unsecured bank exposures will receive considerable capital charges
  - More expensive unsecured bank exposures and imminent bail-in rules (bank crisis management) will probably lead to a substantial reduction of bank exposures by insurance companies
  - AAA and AA Covered Bonds are expected to receive a preferential market risk treatment (lower spread risk factor), but 6% equity allocation for a 10 y-AAA rated Covered Bond is still 8 x CRD requirements for banks

- Erosion of wholesale funding (Covered Bonds & senior unsecured bonds) and related investor base to the detriment of the underlying conservative business models ?