EUROPEAN CENTRAL BANK

BANKING SUPERVISION

DIRECTORATE GENERAL MICROPRUDENTIAL SUPERVISION I
DIVISION 3/c

ECB-CONFIDENTIAL

Mr. Morelli
Chief Executive Officer
Banca Monte dei Paschi
Piazza Salimbeni, 3
53100 Siena
Italy

15 October 2018
Reference: 238045495

Calculation of risk-weighted exposures for speculative immovable property financing

Dear Sir,

This letter is sent to Banca Monte dei Paschi di Siena and to all significant institutions supervised by the European Central Bank (ECB) with the purpose of reinforcing the adequate **treatment of speculative immovable property financing** exposures according to the Capital Requirements Regulation (hereafter "CRR") [1].

According to Article 128 of the CRR, institutions applying the standardised approach for credit risk have to assign a 150% risk weight to exposures that are associated with particularly high risks, including.

- investments in venture capital firms;
- investments in Alternative Investment Funds;
- investments in private equity; and
- **speculative immovable property financing**;

Article 4(1)(79) of the CRR defines speculative immovable property financing as "loans for the purposes of the acquisition of or development or construction on land in relation to immovable property, or of and in relation to such property, with the intention of reselling for profit".

This definition triggered several questions from the industry to the European Banking Authority (hereafter "EBA"), especially about the possibility that institutions use additional criteria that would allow them to apply a risk weight lower than 150%. In this regard Q&A 3131 and Q&A 3173 published by the EBA in June 2017 and September 2018 respectively, mention that, when a loan fulfils the definition of "speculative immovable property financing", there is no qualitative criterion that allows institutions to apply a different risk weight than 150%, especially where future contract agreements with future prospective

[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

European Central Bank
60640 Frankfurt am Main
Germany

Tel.: +49 69 1344 0
Fax: +49 69 1344 6000
E-mail: info@ecb.europa.eu
Website: www.bankingsupervision.europa.eu

owners of the properties under development have been signed, but where these agreements are not irrevocable.

Considering all the above, institutions are expected to:

1. for exposures to which the institution applies the standardised approach for the calculation of capital requirements:

    a) **properly identify all exposures that meet the definition** of speculative immovable property financing in Article 4(1)(79) of the CRR, considering also EBA Q&A on this topic;

    b) **assign a risk weight of 150%** to all exposures that meet the definition of speculative immovable property financing as required by Article of the 128 CRR;

    c) **properly report** such exposures under the supervisory reporting framework and specifically COREP to reflect their inclusion in the exposure class "Items associated with a particular high risk"; and

    d) **perform an independent review** (e.g. internal audit) **and send the conclusions and the related remediation plan (where the case) to the Joint Supervisory Team by 30 June 2019** covering the institution's compliance with the points above.

2. for exposures to which the institution applies the internal ratings based approach for the calculation of capital requirements:

    a) have in place **models with a good predictive power** and without material biases in a way that capital requirements are not distorted as a result of its use (Article 174(a) of the CRR);

    b) have **estimates that are plausible and intuitive** and based on the material drivers of the respective risk parameters (Article 179(1)(a) of the CRR);

    c) add to its estimates a **margin of conservatism that is related to the expected range of estimation errors**. Where methods and data are considered to be less satisfactory, the expected range of errors is larger, the margin of conservatism should be larger (Article 179(1)(f) CRR); and

    d) **perform an independent review** (e.g. internal audit) **and send the conclusions and the related remediation plan (where the case) to the Joint Supervisory Team by 30 June 2019** covering the institution's compliance with the points above.

Finally, the ECB hereby informs Banca Monte dei Paschi di Siena that additional ad-hoc data reports on speculative immovable property financing are foreseeable in the coming months.

Yours sincerely,

Anne Lécuyer
Head of Division

Winfried Liedtke
JST Coordinator