EUROPEAN CENTRAL BANK
BANKING SUPERVISION

Andrea ENRIA
Chair of the Supervisory Board

Mr Billy Kelleher
Member of the European Parliament
European Parliament
60, rue Wiertz
B-1047 Brussels

Frankfurt am Main, 30 March 2022

Re: Your letter (QZ-006/2022)

Honourable Member of the European Parliament, dear Mr Kelleher,

Thank you for your letter on the potential solution to disparate mortgage interest rates across the European Union (EU), which was passed on to me by Ms Irene Tinagli, Chair of the Committee on Economic and Monetary Affairs, accompanied by a cover letter dated 23 February 2022.

In your question, you enquire about the role played by prudential requirements in general, and the implementation of the final Basel III reforms in the EU in particular, in explaining differences in lending rates across Member States. You point, in particular, to the relatively higher average density of risk-weighted assets (RWA), i.e. the amount of risk weighted assets relative to the total assets, exhibited by Irish banks compared to the average of EU banks.

As a starting point, let me recall the President's response[1] to your earlier question on a related issue, in which she noted that bank lending rates are determined by a number of factors, such as the economic situation and outlook, the creditworthiness of borrowers, interest-rate fixation periods, loan maturities and market reference rates, as well as by specific features of the banking system. Structural cost efficiency problems at banks, high

[1] See *Letter from the ECB President to Mr Billy Kelleher, MEP, on monetary policy*, dated 21 April 2021, available at: https://www.ecb.europa.eu/pub/pdf/other/ecb.mepletter200422_Kelleher_5~431b6d9007.en.pdf?932e80e289e0b0e83e85509251242d36.

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levels of non-performing loans and a lack of competition in the banking sector can also lead to higher levels of bank lending rates in certain jurisdictions.

From this perspective, prudential requirements and differences in RWA densities are only one element to consider in explaining differences in mortgage loan interest rates. We should also be mindful of the underlying objective of prudential requirements, which is to ensure the safety and soundness of individual banks as well as of the entire European banking system. Therefore, the prudential framework has been calibrated in such a way that higher risks are reflected in higher RWA densities, which in turn implies that higher capital requirements can be appropriate. And in this respect, it is key that internal models appropriately measure risks.

Since you also refer to the implementation of the Basel III standards, let me emphasise in this regard that there are several measures in the CRR-CRD review that will reduce unwarranted variability of risk-weighted assets across institutions, thereby reinforcing the level playing field and strengthening the prudential framework. Addressing unwarranted, non-risk-based variability in RWA densities has been a key concern for supervisors and regulators since the global financial crisis. Specifically, the Basel III reforms adopted by the Basel Committee on Banking Supervision in December 2017 introduce a new output floor, which will be implemented via the CRR-CRD review, that aims to address this variability in RWA densities. This output floor ensures that banks which use internal models to assess the riskiness of their assets cannot end up with total risk weighted assets that are much lower than what it would be when applying the standardised approach. The ECB's targeted review of internal models, finalised in April 2021[2], complements these regulatory initiatives from a more bottom-up perspective to ensure all model parameters are prudently and correctly calibrated.

We therefore welcome the Commission's proposal, published on 27 October 2021[3], and consider it important to implement the Basel reforms[4] in a timely, complete and faithful manner. In this regard, it is worth noting that the European Banking Authority's impact study suggests that the impact of the Basel III reforms, including the output floor, is expected to lower the minimum capital required from Irish banks[5], while minimum required capital is expected to increase on average for EU banks.

Finally, I remain at your disposal to meet and discuss this further.

Yours sincerely,

[signed]

Andrea Enria

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[2] See *Targeted Review of Internal Models – Project report*, ECB, April 2021, available at: https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.trim_project_report~aa49bb624c.en.pdf.

[3] See the European Commission's webpage detailing the banking package, available at: https://ec.europa.eu/info/publications/211027-banking-package_en.

[4] See ECB opinion of 24 March 2022 on a proposal for amendments to Regulation No 575/2013, available at: https://www.ecb.europa.eu/pub/pdf/other/en_con_2022_11_f_sign~c61d08274d.en.pdf

[5] See Figure 4 in *Basel III reforms – Updated impact study*, EBA, 2020, available at: https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2020/961423/Basel%20III%20reforms%20-%202019Q4%20update%20and%20Covid%20impact.pdf