

The logo for the European Banking Authority (EBA) is located in the top left corner. It consists of the letters 'EBA' in a bold, white, sans-serif font, set against a dark blue background with a subtle grid pattern. To the right of the letters, the words 'EUROPEAN BANKING AUTHORITY' are written in a smaller, white, sans-serif font, stacked vertically.

EBA

EUROPEAN
BANKING
AUTHORITY

EBA Report on the application of the Infrastructure Supporting Factor (Art 501a CRR)

GCD Conference, 7-8 November 2022

Marina Cernov/ Impact assessment (European Banking Authority)
Clara Garcia/ Credit Risk (European Banking Authority)

Structure of the presentation



- 1. Introduction (background, mandate)**
- 2. Data analysis**
- 3. Conclusion**

Part 1

INTRODUCTION

Background and mandate

- **Infrastructure supporting factor (ISF) :**
 - Treatment: 25% reduction in own fund requirements for specific exposures in corporate or specialised lending categories
 - Scope: Exposures in corporate or specialised lending categories to “*entities which were created specifically to finance or operate physical structures or facilities, systems and networks that provide or support essential public services*” (~ **Project Finance**) + other criteria to ensure low risk
 - Goal: to encourage private and public investments in infrastructure projects.
- **Mandate**: EBA to provide a report on the lending trends and riskiness of infrastructure lending, as well the consistency of own funds requirements:
 - Does ISF impact lending?
 - Are loans s.t. ISF less risky?
 - Are the capital requirements for loans s.t. ISF adequate?

Article 501a (CRR)

Adjustment to own funds requirements for credit risk for exposures to entities that operate or finance physical structures or facilities, systems and networks that provide or support essential public services

1. Own funds requirements for credit risk calculated in accordance with Title II of Part III shall be multiplied by a factor of 0,75, provided that the exposure complies with all the following criteria:

(a) the exposure is included either in the corporate exposure class or in the specialised lending exposures class, with the exclusion of exposures in default;

(b) the exposure is to an entity which was created specifically to finance or operate physical structures or facilities, systems and networks that provide or support essential public services;

(c)

[...]

4. The Commission shall, by 28 June 2022 report on the impact of the own funds requirements laid down in this Regulation on lending to infrastructure project entities and shall submit that report to the European Parliament and to the Council, together with a legislative proposal, if appropriate.

5. For the purposes of paragraph 4, **EBA shall report on the following to the Commission**:

(a) an analysis of the evolution of the trends and conditions in markets for infrastructure lending and project finance over the period referred to in paragraph 4;

(b) an analysis of the effective riskiness of entities referred to in point (b) of paragraph 1 over a full economic cycle;

(c) the consistency of own funds requirements laid down in this Regulation with the outcomes of the analysis under points (a) and (b) of this paragraph.

Challenges and approach taken



Challenges:

- There is very limited data on infrastructure lending;
 - The ISF was implemented in 2020 (with COREP data available only starting 2021), which does not allow to assess the impact of the ISF on lending trends;
 - Supervisory data starts in 2014 (when COREP was implemented), which does not cover a full economic cycle, which does not allow to assess the consistency of own funds requirements with their riskiness level over the cycle.

EBA Approach:

- To fill the data gap, **voluntary industry survey** launched beginning of April, until end of May:
 - Qualitative part (application of the ISF) → 61 banks, 57% of the TA of the EU banking sector
 - Quantitative parts (lending and riskiness data) on a best effort basis → 11-14 banks, 7-14 % of the TA of the UE banking sector
 - Due to voluntary nature of the survey, it is subject to sample selection bias
- In parallel, review of available **external sources of data** (including **GCD**)
 - Mostly default rate data on project finance available over a long period of time;
 - Loss data available, but comes with a lag, so does not cover the period after the introduction of the ISF;
 - External datasets do not collect sufficiently detailed information to identify or proxy PF loans that would be s.t. to ISF.

Part 2

DATA ANALYSIS

Analysis conducted



1. **Impact of Infrastructure Supporting Factor on RWA impact**
2. **Qualitative survey results:** How was the ISF applied by banks?
3. **Quantitative analysis (voluntary data collection, GCD):**
 - a. Infrastructure lending trends
 - b. Riskiness of infrastructure loans
4. **Prudential considerations**

Impact on RWA and CET1 concentrated in large banks, but overall not material

Adjustments to RWA due to the Infrastructure Supporting Factor

Size	Total number of banks	Number of banks with exposures subject to INF SF	Total Adjustment amount for INF SF (EUR billion)
All	2 389	90	21.84
Large institutions	121	43	20.49
Small institutions	2 268	47	1.35

Change in CET1 as a result of adjustments to RWA

Size	Number of banks with exposures subject to INF SF	Impact of INF SF on CET1 (w avg), pp change
All	90	0.06 pp
Large institutions	43	0.06 pp
Small institutions	47	0.17 pp

Source: COREP, data as of 31/12/2021

Note: The data covers all credit institutions reporting COREP, at highest level of consolidation in the EEA. Large institutions are defined in accordance to the list of largest reporting institutions (March 2022)

How was the ISF applied by banks?



Altogether **61 banks** that provide infrastructure lending responded to the qualitative part of the survey, located in 16 EU countries with TA of 18.5 trillion EUR (57% of the TAs of the EU banking sector):

Application of the ISF

- **Two thirds (39) declared that they use the ISF:**
 - **of which a third have changed their lending policies** to consider the supporting factor (from direct introduction of the ISF criteria in the project finance lending policy to indirect consideration of the lower capital requirements as a factor affecting the cost of capital and profitability).
- **A third of the banks (22) reported not having conducted any assessment** to check if infrastructure loans qualify for the ISF due to the overall **complexity of application** of the article and the likely **limited materiality for the bank**.

Individual criteria

The individual criteria for the application of the ISF were mostly assessed as acceptable or somewhat clear and easy to verify by the banks applying the ISF.

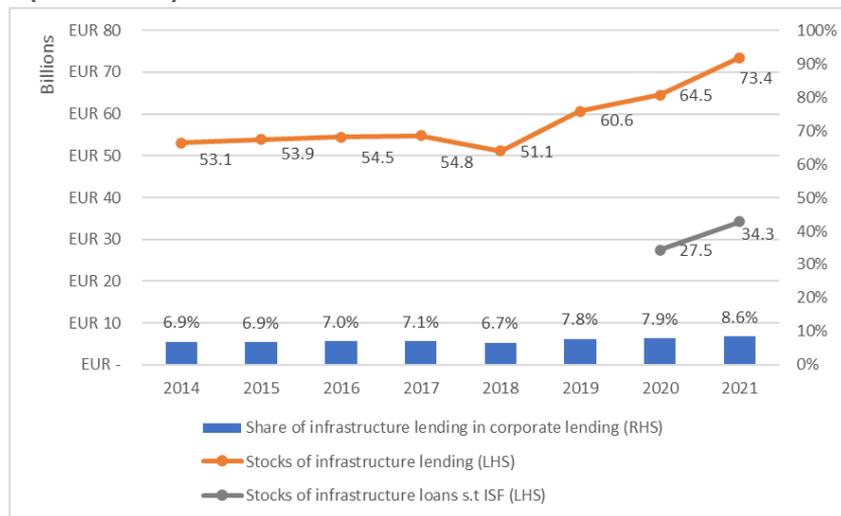
Criteria referring to the ESG assessments, predictability of cashflows and refinancing risk were more often poorly rated by banks, as were seen lacking clear definitions and guidelines.

Note: Due to the voluntary nature of the survey, the sample selection bias should be considered when interpreting the results

Infrastructure lending increased in 2020 and 2021

The survey analysed the trends of volumes of infrastructure loans over time, with a particular focus on the latest years when the supporting factor has been applied

Lending stocks based on a sample of 13 banks over 2015-2021 (EUR billion)

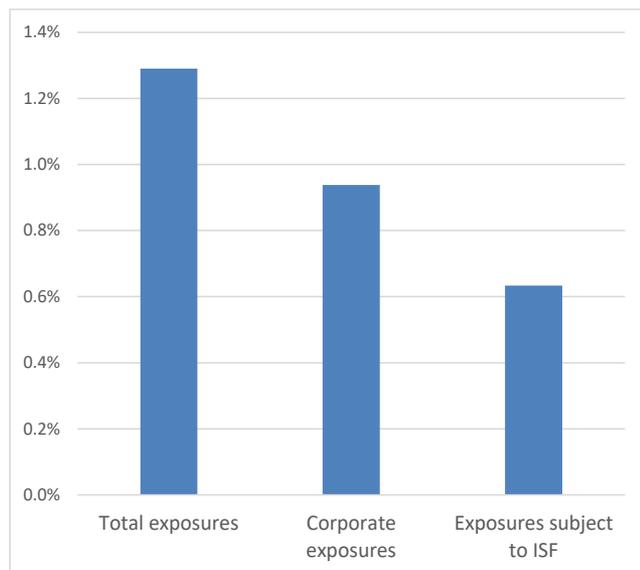


Source: EBA survey on the application of ISF, 2022

- In 2021 infrastructure lending experienced an increase in stocks compared to 2020, while infrastructure lending subject to ISF also increased, but at a lower rate (lower inflows).
- Due to the simultaneous movement, **many potential factors could have impacted the increase**: ISF, government support in specific infrastructure areas following the COVID-19 pandemic
- **Very few datapoints after the introduction of the ISF** to see permanent change in volumes of infrastructure lending, and to conclude about the impact of the ISF.

Riskiness – supervisory data shows that loans s.t. to ISF have lower risk (as of end 2021)

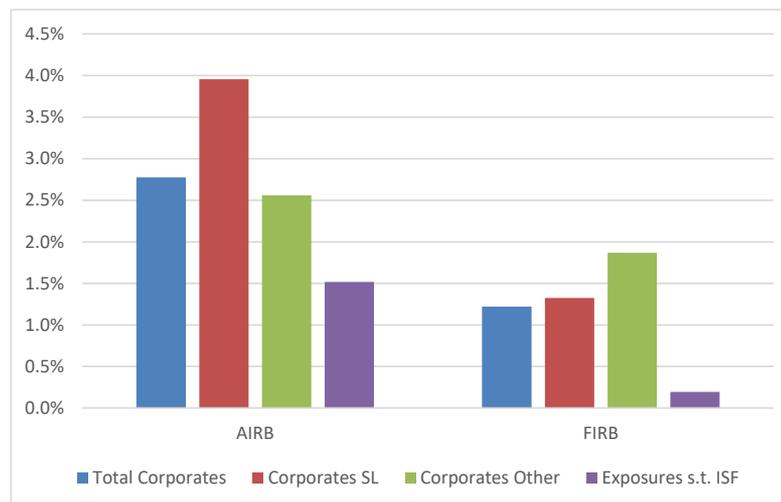
Expected losses by type of exposures, standardised approach



Source: COREP, data as of 31/12/2021

Note: Weighted average, based on 71 banks that reported SA exposures subject to ISF, of which 27 large and 44 small institutions

Average PD by exposure class (AIRB and FIRB)

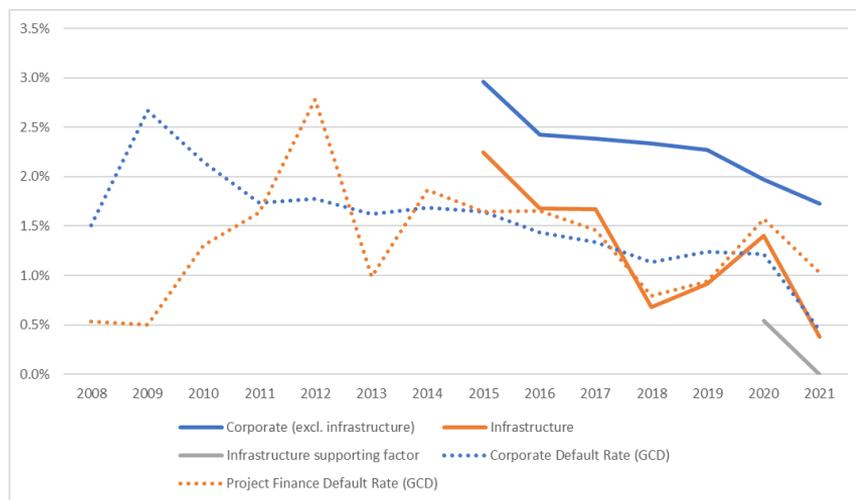


Source: COREP, data as of 31/12/2021

Note: Weighted average, based on 19 banks that reported AIRB exposures subject to ISF, and 14 banks that reported FIRB exposures subject to ISF.

Riskiness – lower default rates and defaulted exposures for loans s.t. to ISF

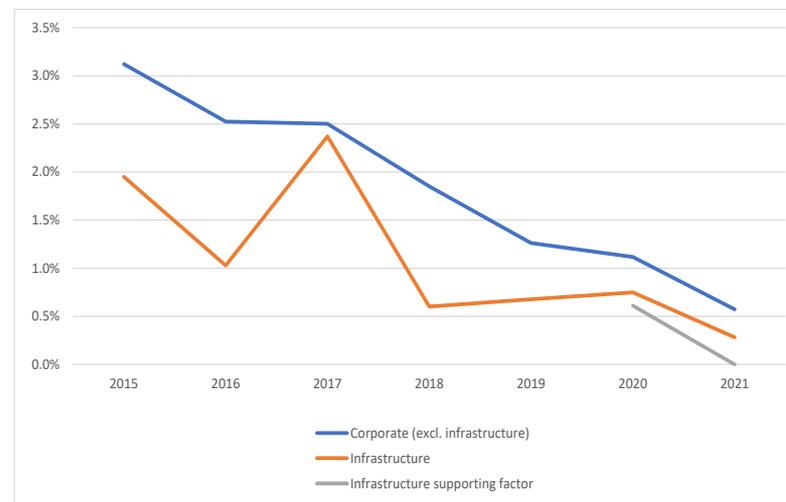
Default rates



Source: EBA survey on the application of INF SF, 2022, data as of end 2021, The Global Credit Data Consortium (GCD) PD&Rating Database H2/2022

Note: The default rate was calculated as the average of each individual bank's default rate, weighed by the number of obligors reported in the same exercise.

Share of default exposures



Source: EBA survey on the application of ISF, 2022, data as of end 2021

Note: The share of defaulted exposures was calculated as the average of each individual bank's share of defaulted exposures, weighed by the stocks of loans reported in the same exercise. The share of defaulted exposures for infrastructure loans s.t. ISF consists only of those banks that had reported non-zero loans subject to ISF – 8 banks. Out of the 8 banks, only one has reported a non-zero share of defaulted exposures and it is higher than the share of defaulted exposures in infrastructure lending of that banks

.... But no loss rate data

Information on **loss rates, an important aspect of riskiness, is not presented in this report** due to the following reasons:

- **Insufficient sample:** In the industry survey only 6 banks provided the information, of which only one had exposures s.t. ISF
- **Data not available after the introduction of the ISF due to lag in processing of losses (GCD)**

→ No conclusion can be made about the overall riskiness of infrastructure loans without this component

Broader prudential considerations and policy conclusion



Background

Current data analysis does not allow the assessment of the consistency of own funds requirements with the lending and riskiness of infrastructure lending.

Previous policy discussion in the context of the Policy Advice Basel 3 reforms – Credit Risk ([published in 2019](#)).

Policy argumentation

Under **the Standardised approach**,

- In the case of eligible credit rating, the ISF introduces a double counting in the recognition of the (potential) low risk
- In the case of non-eligible credit rating, the final Basel III framework introduced further risk sensitivity (specialised lending exposure class, as well as the so-called “high quality project finance” exposures). → The ISF results in setting out two different treatments in the recognition of the low risk of the qualifying infrastructure exposures, with potentially different outcomes and in a less risk sensitive way

Under the **IRB approach** (including Supervisory Slotting Criteria):

- Risk-sensitive by design, hence as for the credit rating in the SA, the ISF introduces a double counting in the recognition of the (potential) low risk;
- Other impacts from the IRB repair program and the final Basel 3 framework (e.g. input floors) are warranted in order to reduce the observed undue variability, and are unrelated with the ISF purpose.

In addition, a deviation from the Basel rules would negatively impact on the EU’s credibility with regard to implementing international regulatory agreements.

Policy conclusion: no justification for the continued applications of the supporting factor

Part 3

CONCLUSION

Summary conclusions



- Despite some findings based on the quantitative data and the qualitative survey, **the data is not sufficient to conclude** on the impact of ISF on lending or the consistency of the riskiness of the affected loans with the own funds requirements.
- In line with previous EBA recommendations, owing to the latest Basel III changes and the CRR3 proposal, **the continued application of the ISF could be questioned from broader prudential perspective.**
- Lack of sufficient quantitative data is one of the main obstacles to conclude on the impact of the ISF and to provide an evidence-based policy recommendation. A repeated exercise assessing the impact of the ISF may be justified only once more data is available.
- Some ideas for better data:
 - Larger and/ or consistent sample of banks over time
 - Information on the eligibility for the ISF (either ISF flag or details on features required to qualify for ISF, e.g. green assessments)

The logo for the European Banking Authority (EBA). It features the letters 'EBA' in a bold, white, sans-serif font. To the right of the letters is a vertical bar with a blue-to-orange gradient. The background of the slide is a low-angle photograph of modern skyscrapers with glass facades, rendered in a light blue, semi-transparent style.

EBA

EUROPEAN
BANKING
AUTHORITY

Thank you!

The logo for the European Banking Authority (EBA) is located in the top left corner. It consists of the letters 'EBA' in a large, white, sans-serif font. To the right of the letters, the words 'EUROPEAN BANKING AUTHORITY' are written in a smaller, white, sans-serif font, stacked vertically. The logo is set against a dark blue background with a subtle grid pattern.

EBA

EUROPEAN
BANKING
AUTHORITY

EUROPEAN BANKING AUTHORITY

Floor 24-27, Tour Europlaza
20 Avenue André Prothin
92400 Courbevoie, France

Tel: +33 1 86 52 70 00

E-mail: info@eba.europa.eu

<https://eba.europa.eu/>