

28 February 2023

AWG work on updating LGD

Background

1. In 2016, AWG, through its independent technical adviser, prof. Vadim Linetsky, produced a paper on 'regulatory capital treatment of aircraft-backed loans: Basel data exercise'. That paper (in short, the **LGD study**) studied and drew policy conclusions from the historical low LGD for aircraft-backed loans. The LGD study was submitted to the BCBS in connection with its 2015 and 2016 proposals on credit risk assets and constraints on use of internal models, respectively. AWG also released a supplemental ppt setting out the 'unique features and data supporting low LGDs for aircraft-backed loans'. The LGD study and that supplemental ppt are on the AWG website.

2. That AWG work was requested by AWG member banks in connection with efforts with the BCBS and national regulators. Seven banks, which included a few non-AWG banks, were actively involved in the work on the LGD study. More specifically, they replied to a detailed questionnaire sent by professor Linetsky, provided their LGD data, and worked on technical features and data comparability.

3. New EU proposals impacting bank regulatory capital for aircraft-backed loans are now under consideration (proposal to amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (referred to variously as CRR 3, Basel 3.1, Basel 3.5 or Basel 4, but, herein, simply **revised Basel**).

4. Much remains in play on revised Basel, including (a) whether aircraft backed loans should be treated as 'other physical collateral' in connection with LGD floor on internal models or as 'high quality object finance' with an 80% risk-weight, and (b) the effect of that decision on the output. Regulatory Technical Standards will be published by the EBA which may impact on the regulatory classification of aircraft financing.

Potential update of LGD

5. Some AWG banks have asked AWG to update the LGD study for use in connection with revised Basel.

6. This study will only be successful if AWG member banks actively participate and provide data inputs. In addition, as with the LGD study, we would invite non-AWG banks to provide data so as to enhance the statistical integrity of the document.

Next steps

7. AWG banks should again be surveyed as to whether they support AWG work updating the LGD study, and, if so, whether they would actively work with our expert, including by providing LGD data.

8. The result of that bank survey would be taken up by the AWG board, meeting 29 March. If, based on the banks' replies, the board agrees that the work would be undertaken, we would allocate a budget (from internal funds) and contact prof Linetsky to discuss the terms of a potential contact.

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