POSITION PAPER

24 April 2018

THE CAPITAL REQUIREMENTS DIRECTIVE AND REGULATION
Commission Proposal

Introduction

BusinessEurope supported reinforcing prudential rules and strengthening supervision as financial market stability is fundamental for the economy and European companies. The new rules have restored confidence in financial institutions and made them more resilient. At the same time, bank lending came under pressure and there is a significant risk that as economic growth picks up banks will be unable to meet companies' funding requirements on the necessary scale. Future work on the capital requirement rules should therefore ensure that the legislation functions effectively, encouraging growth and preventing damage to businesses in the wider economy.

For this reason, we have expressed concerns that additional tightening of prudential rules should not further increase financing problems. We also emphasised the importance of the SME Supporting Factor for the financing of smaller and medium-sized companies. New capital requirements should also not discourage the use of hedging instruments and reduce their availability, neutralising the relief provided by the European Market Infrastructure Regulation (EMIR). And, in the area of trade finance, given the short term and low risk profile of this type of financing, new rules should not reduce the availability or increase the cost of trade finance products.

Given the need for risk capital across Europe and the crucial role of banks in EU finance, any new rules should retain the EU's current approach to banks making sensible, well-diversified equity investments in European companies through collective investment undertakings

The Credit Valuation Risk Exemption

In 2013, when the current rules were negotiated, the legislator recognized the specifics of the use of derivatives by non-financial companies in order to avoid negative side effects on business operations by exempting uncollateralised exposures from derivatives with non-financial counterparties used for hedging purposes from the own funds requirements for credit valuation risks (CVA risks). The CVA risk exemption could however be undermined by the European Banking Authority and/or national competent authorities due to amendments to Article 104ff CRD that would change the nature of the supervisory review and evaluation process increasing the powers of these authorities. It should thus be clearly stated that this is not intended by the legislator. We therefore support amendments that are recognising the importance of the exemption and remove the possibility of the European Banking Authority and national supervisors to impose additional capital requirements in this context.

The Net Stable Funding Ratio

Current proposals regarding the Net Stable Funding Ratio (NSFR) and gross derivative liabilities could still have a negative impact on derivatives used by non-financial

AV. DE CORTENBERGH 168
BE-1000 BRUSSELS
BELGIUM
VAT BE 863 418 279

BUSINESSEUROPE a.i.s.b.l.

WWW.BUSINESSEUROPE.EU

TEL +32(0)2 237 65 11
FAX +32(0)2 231 14 45
E-MAIL: MAIN@BUSINESSEUROPE.EU
EU Transparency register 3978240953-79

companies to hedge risks as they will make long-term financing of companies more costly and difficult to obtain due to constraints of maturity transformation. Increased costs are likely to be passed on to end users, discouraging the use of hedging instruments and reducing their availability. This should be carefully analysed before finalising new requirements. We specifically do not understand the rationale behind the proposed 10% stable funding requirement on uncollateralised derivatives payable with non-financials, as these typically relate to corporate hedging transactions (please see our comments on the CVA risks above). We therefore support amendments which seek to align the rules with the recent Basel publication on the gross derivatives liabilities add-on. Aligning the add-on to the Basel 5% will reduce the costs of derivative transactions used for corporate hedging.

In addition, we also support a further reduction of the impact on (reverse) repos. Repos and reverse repos are important for the smooth functioning of short term money markets. Banks typically conduct reverse repo with regulated financial counterparties (insurers and pension funds). These institutions are highly unlikely to be in need of cash on a short-term basis. If so, they would typically borrow unsecured for an appropriate term and not utilize the short-term repo market. These counterparties enter into short-term repo with banks because they are seeking an efficient redeployment of their excess assets, rather than to borrow cash. Inversely, also corporate treasuries are using that market for secure short-term liquidity deposits. This activity contributes to the vital market liquidity for high quality liquid assets (HQLA). We support the 0% stable funding requirement for reverse repos backed by HQLA to reflect the highly liquid nature of the collateral.

Furthermore, to facilitate client positions, banks purchase equities on their behalf. In doing so, they are facilitating financing of the real-economy. Deep and liquid equity markets are vital for supporting growth in the EU. The original proposal could lead to banks no longer performing the role of facilitating investment in equity markets due to the increased cost of the NSFR, and consequently, no longer being able to support the European equities market. We support amendments that recognise that the equity securities held by banks for hedging purposes deserves a lower level of required stable funding. This will support maintaining a liquid market for corporate equities.

Risk Weights

Salary and pension secured loans should have a favourable prudential treatment in the context of Article 123 CRR. Similarly, in the context of Article 125 CRR, exposures fully and completely secured by mortgages on residential property should have a more risk-sensitive treatment since the current flat rate of 35% RW does not capture the appropriate risk-sensitivity of these exposures. In the context of Article 181 CRR, the effect of the sales of non-performing loans on the loss given default (LGD) should be sterilised, or at least mitigated, in order to avoid any possible disincentive for banks to sell these loans.

As the EU develops its Capital Markets Union, special attention should be paid to the new risk-weighted treatments proposed for equity investments, particularly venture capital, and subordinated debt. European companies need risk capital to grow and innovate and banks have a crucial role to play given their strong relationships with these firms and position as the principal providers of finance across the EU. Any new rules should retain the EU's current approach to banks making sensible, well-

diversified equity investments in European companies through collective investment undertakings.

SME Supporting Factor

As mentioned, it is vital to preserve the SME Supporting Factor (Article 501 CRR). In fact, BusinessEurope believes that the threshold to which the 0.7612 factor applies should be increased to Euro 5 million given the improvements in enterprise capitalisation and the growth in credit demand for fixed investment.

Trade Finance

Regarding trade finance, businesses are very concerned about the increase of Trade Finance related capital requirements as these would have a significant impact on the competitiveness of EU businesses. Like all short-term trade receivables and payables financing techniques (such as factoring, forfaiting or reverse factoring), trade finance plays a key role in the real economy as it enables the financing of commercial transactions of exporting and importing firms via lending and the issuing of letters of credit or guarantees. The proposed level of Required Stable Funding (RSF) would put European companies at a competitive disadvantage vis-à-vis their competitors outside the EU. We would therefore favour a maximum RSF level of 3% for all off-balance sheet trade products, regardless of their maturity. We are worried that the original policy recommendations from the relevant supervisory authorities were unsubstantiated due to lack of market data. We therefore urge the legislator to engage with both the Commission and the European Banking Authority to ensure a policy outcome that does not penalise European businesses trading in and out of the EU.

In addition, export finance activities, export credits in currencies other than Euro should not be subjected to different prudential treatments. The currency criteria for EU Export Credit Agencies are not relevant as the majority of international trade conducted by EU banks is in USD and such a restriction would be detrimental to EU companies.

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