



European Banking Industry Committee

European Banking Federation (EBF) • European Savings Banks Group (ESBG) • European Association of Cooperative Banks (EACB) European Mortgage Federation (EMF) • European Federation of Building Societies (EFBS)
European Federation of Finance House Associations (Eurofinas)/European Federation of Leasing Company Associations (Leaseurope)
European Association of Public Banks (EAPB)

Brussels, 14 October 2011

Re: The transposition of the Basel III framework into the European Union through the review of the Capital Requirements Directive ('CRD IV')

Dear Member of the Economic and Monetary Affairs Committee,

The European Banking Industry Committee (EBIC) would like to take this opportunity to express its continued support towards the European Parliament's Economic and Monetary Affairs Committee (ECON). In particular, we support the challenging task of the transposition of Basel III into the EU by reviewing the Capital Requirements Directive ('CRD IV')¹. EBIC remains confident that the ECON Committee will ensure that the important specificities of the European banking landscape are upheld when transposing this global framework. For example, the treatment of minority interests is a major issue in this respect and it will be important that all of a subsidiary's capital requirements and surcharges are reflected in the calculation.

Furthermore, EBIC calls on ECON Members to pay due attention to the developments taking place in other jurisdictions in relation to Basel III. This is necessary in order to avoid any unintended consequences for the European banking sector, which could upset the goal of achieving a global regulatory level playing field. EBIC would, therefore, like to draw your attention to some selected issues, which we would like to present in common. The EBIC member organisations will address other issues on an individual basis.

1. Liquidity:

Concerning the liquidity provisions, EBIC strongly advocates to fully respect the observation periods to enable the authorities and industry to monitor the appropriateness and the impact of the new metrics. This will help to ensure that the final specifications of the LCR and NSFR take the different types of business models in Europe into account and also promote financial stability and economic growth.

In this context, EBIC calls for covered bonds to be given a greater level of recognition in the liquidity provisions of CRD IV that fully reflects their excellent track record of safety, liquidity and resilience in times of stress, as witnessed during the recent crisis.

EBIC supports earlier announcements made by the European Commission that the definition of highly liquid assets in the liquidity coverage requirement (LCR) will be broader and based on a wider set of criteria when implementing the Basel III rules into the EU. For instance we believe that there is merit in considering the extent to which good quality retail mortgage

¹ Referring to the Commission's proposals for: 'A Regulation on prudential requirements for credit institutions and investment firms' and 'A Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms [...]'

backed securities could be included in the liquidity buffer. However, EBIC is concerned that the Commission's proposals go beyond Basel III in the context of asset eligibility – stating that it **requires** LCR eligible assets to be central bank eligible, whereas the Basel III text stated that assets should 'ideally' be central bank eligible.

Ultimately, the regulation should not restrict the definition of liquid assets in the LCR in advance. EBIC calls upon the Parliament to ensure that a more flexible approach is pursued.

What is more, EBIC supports the European Parliament's view as expressed in the October 2010 'Karas report', which calls "*for the proper recognition of stable sources of funding specific to Europe (i.e. real estate financing)*".

Finally, it should be noted that the new liquidity provisions, which were designed for deposit-taking institutions, may also be applied by Member States on a legal entity basis to non-deposit taking institutions such as leasing, factoring and consumer credit companies. By definition, the Basel III proposals do not cater for institutions that are not authorised to accept deposits. EBIC would like to reiterate that the application of these rules to this class of institution would not be appropriate. It is vital that the European Parliament ensures that these institutions are excluded from the new liquidity requirements on a legal entity basis.

In this context, EBIC is concerned that the European Commission is empowered to implement the final LCR (exercise of delegation) – i.e., binding standards for the determination of liquidity and cash flows – based on technical guidelines and criteria prepared by the European Banking Authority², following review. This means that review of the final LCR rules is not subject to the ordinary political decision-making process of the Council and the Parliament. EBIC is of the view that the "final" LCR must be subject to political review in the same way as the NSFR, as its implications are too far-reaching for it to be implemented solely through the delegated powers of the European Commission.

2. Own Funds and transitional periods:

In principle, EBIC welcomes the *definition of Common Equity Tier 1* as regards an institution's legal form and governance. It is essential to retain the Commission's proposal.

a) Grandfathering, phasing-out:

Regarding *deferred tax assets (DTA)*, it must be ensured that regardless of the permission of the tax authority for offsetting, DTAs may be netted with deferred tax liabilities (DTLs) if the DTAs and associated DTLs both arise from the tax law of one Member State or third country. Otherwise, substantial competition distortions in relation to tax law could occur when calculating own funds since there is no harmonised European tax law.

Regarding the diverging grandfathering and phasing-out provisions in CRD II and Basel III, EBIC would welcome a compromise between the two provisions. CRD II created legitimate expectations and ultimately, in order to protect these, capital instruments that were grandfathered under CRD II should remain fully grandfathered until December 2022. Furthermore, the condition under para.95 of Basel III should apply for certain instruments that are grandfathered under CRD II. This permits the grandfathering of instruments as Common Equity Tier 1 as long as they received unlimited recognition as Tier 1 capital under national banking law when the final Basel recommendations were issued.

² EBIC's comments regarding the role of the European Banking Authority (EBA) are outlined in greater detail below.

b) Phasing-in arrangements:

EBIC takes note of the fact that several Articles of the proposed Regulation (see Articles 448 to 450, 458 to 461) allow national supervisors to disregard the phasing-in arrangements proposed by the Basel III accord. The lack of common implementation dates across the EU will create an unlevel playing field and moreover, contribute to confusion in the markets.

c) Prolongation of Basel I floors:

EBIC is highly concerned regarding the prolongation of the Basel I floor due to several aspects:

Firstly, the current legislation foresees 31 December 2011 as the end date for the Basel I floor. The Basel I floor was introduced as a "safeguard clause" when migrating from Basel I to Basel II, by requiring that 80% of own funds under Basel I be met. In the meantime, however, the outcomes of Basel II have been tested sufficiently whereas the standards have been upgraded through Basel '2.5' and Basel III. As a consequence, the Basel I floor provision has become obsolete as a benchmark. Furthermore, the planned further extension of the Basel I floor and other delegated acts will create considerable uncertainty among the institutions. It is feared that it will invalidate the investments institutions have made in the past few years to improve their risk management and to implement Basel II. In addition, other delegated acts may make it necessary to introduce additional, expensive changes in internal processes.

Secondly, as CRD IV proposes to amend the way in which the Basel I floor needs to be calculated, it obliges banks to continue to review and update their IT systems merely with a view to examining if an outdated benchmark – i.e., the Basel I floor - has been met. In order to limit the administrative burden, CRD IV should allow for the Basel I floor to be calculated on the basis of the CRD provisions as they stood before 1 January 2007, although we would prefer to do away with the floor requirement completely.

Last but not least, a legal basis to maintain the Basel I floor in the year 2012 is missing.

3. Lending to small and medium sized enterprises (SMEs):

Several empirical studies point out that capital requirements in respect to SME-loans are far too high in comparison with the unexpected losses actually incurred - even at the peak of the crisis in 2009. EBIC, therefore, welcomes the provision contained in Part III (Article 485, p. 151) of the Commission's proposal for a Regulation relating to 'Retail Exposures' which states that the "*Commission shall within 24 months after entry into force of this Regulation, report on the impact of the own funds requirements laid down in this Regulation on lending to small and medium sized enterprises*".

4. Leverage ratio:

EBIC strongly opposes the introduction of a leverage ratio which would be designed as a Pillar I measure and therefore, lack sufficient flexibility. Such a leverage ratio could discriminate against low-risk, high-volume business models, such as mortgage lenders and lenders to public authorities. This is likely to have major repercussions in mortgage markets, constraining the availability of credit and increasing the costs of mortgage lending and for public sector lending. Therefore, EBIC stresses that it is essential that the observation phase is used to address the unsuitability of a hard leverage ratio for many long-standing business models and to avoid encouraging high-volume low-risk models from shifting to riskier

models. EBIC would welcome careful reflection towards implementing the leverage ratio as part of Pillar II given that the relevant supervisor is best placed to ensure the most appropriate response to any breach of the eventual leverage ratio requirements. Additionally, the requirements for public disclosure of the leverage ratio from 2015 should be delayed until after the completion of the EBA's review of the leverage ratio in 2016. This would avoid market pressures forcing credit institutions to anticipate the outcome of the review prior to its completion. The EBA review should also address how to avoid introducing competitive distortions due to differences in accounting standards.

The European Commission regulation proposal considers the introduction of 'leverage risk' as an additional risk category under Pillar II which is not mentioned in the Basel III framework. This would have a discriminatory effect on the European banking industry. Apart from definition problems and difficulties in practical implementation, it is likely to interfere with current methods of managing liquidity risk and market price risk and allocating economic capital. Above all, the proposal deviates from the initial idea of having the leverage ratio as a back-stop-regime counteracting the risk based provisions. With this concept, it would become part of the risk based regime of ICAAP. EBIC, therefore, opposes an introduction of this new risk category and urges for further analysis before altering the risk management framework by introducing a new risk category.

5. Large Exposures:

EBIC urges to keep the large exposure limit unchanged. The limit should continue to be calculated on the basis of all Tier 1 and Tier 2 capital. The proposed change in Article 4 para 23 CRR would significantly restrict an institution's ability to lend to the corporate sector. An adjustment is not required under the Basel framework, nor is it necessary from a prudential perspective.

6. Loss Given Default:

In Article 160 paragraph 4 of the Regulation, a lower limit of 10% is introduced indefinitely for own average estimates of loss given defaults (LGDs) for all retail exposures secured by residential property and not benefiting from guarantees of central governments. For institutions which implement the IRB Approach, this prolongation means that they will have to provide higher own funds to cover the credit risks in the retail business above and beyond the current transitional period. Extremely low credit risk institutions, such as 'Bausparkassen', will now have to continue to adjust their own estimates of LGDs to this set LGD floor. The planned establishment of a permanent LGD floor will also practically cancel the effect of precisely measuring the risks, which is the purpose of the IRB Approach. This effect will be amplified by the removal of the existing national discretions allowing banks to use a 180 day definition of default.

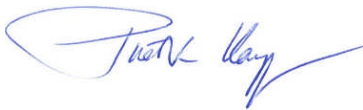
7. The role of the European Banking Authority (EBA):

Regarding the role of the EBA, EBIC notes that the proposed mandates for this Authority to develop technical standards are demanding (according to the Commission's CRD IV proposals, there are at least 170 mandates for the EBA, which often stipulate extremely short deadlines) and therefore offers its support to the EBA in this regard. Consequently the European banking industry would be willing to optimise the cooperation with the EBA in order to ensure that these technical standards will be developed in an accurate way. For example, regarding the criteria for recognising physical collateral for credit risk mitigation purposes, it has to be ensured that

future technical standards, which are to be developed, do not significantly impact basic practices, such as mortgage lending and leasing and do not negatively affect Europe's citizens and small businesses.

In conclusion, EBIC remains confident that the members of the ECON Committee in the European Parliament will take note of these important concerns in the upcoming legislative process surrounding CRD IV and is also aware of the magnitude of this task. EBIC stands ready to offer its support through the provision of data and the further development of cooperation and constructive dialogue. This will ensure that the transposition of this global banking framework within Europe is carried out in a manner which is beneficial to all.

Yours sincerely,



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