BUSINESSEUROPE

European Banking Federation

Mr Michel Barnier
Commissioner for Internal Market
and Services
European Commission
Rue de la Loi 200
1000 Bruxelles
BELGIQUE

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Dear Commissioner,

BUSINESSEUROPE and the European Banking Federation wish to draw your attention to an aspect of the regulatory reform of the financial sector that has so far not been considered sufficiently, especially given the potential it has to impact in an undesirable way the intermediation of credit to businesses and the wider economy.

Whilst you will have found broad support to put in place measures to overcome the financial crisis and to prevent any repeat in the future, the pace of this regulatory reform is such that unintended consequences cannot be ruled out arising from the piecemeal focus placed on individual components up to now. We believe it may be still opportune to pause and reflect on the totality of measures proposed and understand how they will interact, including on the growth capacity of the real economies of the EU. Carrying out a cumulative impact assessment in this context is therefore highly necessary.

One set of such measures that is currently being considered in the EU are the liquidity standards, which in their objective are to be supported but their methodology and calibration have not reached a point of maturity. G20 Leaders accepted as much when they agreed to the proposed observation periods, which should be fully used and explored before a legally binding solution is arrived at for the EU.

The two liquidity ratios as presently proposed by the Basel Committee on Banking Supervision aim to avoid in future a significant credit contraction in difficult economic times, but have been recognised *ceteris paribus* to lead to substantial liquidity and funding shortfalls. The Committee of European Banking Supervisors (CEBS) has calculated these gaps to be in the order of EUR 1.8 trillion (long-term funding) and EUR 1 trillion (short-term liquidity) for Europe, amounting to approx. 15% and 8% of EU GDP, respectively. Considering the main role played by European banks in credit transformation and the fact that European companies depend highly on bank lending (75% vs. 25% in the US for instance), this will have a significant effect on the European economy.

Strengthening prudential regulation of banks will increase the cost of borrowing for businesses but this is one of the prices of financial stability. However, implementing rules which have not been calibrated correctly may increase this cost and give rise to a range of unintended consequences for businesses and the wider EU economy. In particular, medium and long term financing activities with long maturity or low profitability will be affected. These costs should also be considered in the light of the likely effect of other prudential rules that are being placed on the banking sector and the wider range of new legislation, such as for example Solvency II for insurers.

The activities that may be most heavily impacted include, among others, lending to SMEs, lending to public entities such as municipalities, trade finance, infrastructure investments relying on project and export finance, as well as activities requiring investments, such as commercial paper issuance, which rely on liquidity facilities. In the absence of sufficient funding by long term investors, interest rates will rise increasing costs for European businesses which would be facing a difficult time accessing funds and at higher cost, especially as SMEs in Europe do not easily have access to the securities markets. Favouring government bonds over high quality private debt securities as liquidity buffers would also reduce investment in corporate bonds.

In light of these undesired consequences, we urge you to defer the inclusion of binding minimum liquidity ratios in European prudential legislation at this moment. The forthcoming CRD IV should not specify any details as to compute the liquidity metrics. It should, however, lay down principles and define the reporting process to allow the observation periods to be fully used to design an appropriate liquidity regulation on the basis of a well founded experience of how liquidity and funding conditions respond to other regulatory changes in the economy.

Yours sincerely,

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