BUSINESSEUROPE

THE DIRECTOR GENERAL

Lord Jonathan Hill
Commissioner
Financial Stability, Financial Services
and Capital Markets Union
European Commission
Rue de la Loi 200
B-1049 Brussels
BELGIUM

25 November 2015

Dear Commissioner, Dear Lord Hill,

Capital Requirement Rules: CRR/CRD IV

BUSINESSEUROPE is pleased that you are assessing the possible impact and interaction of financial legislation. As you know, we have repeatedly highlighted the need to consider the cumulative effects of all EU policies on the availability of finance, as well as the broader impact of policies on companies' investment decisions.

We are particularly interested in the outcome of your recent consultation on the possible impact of the capital requirement rules (CRR and CRD IV) and the work of the European Banking Authority regarding the SME Supporting Factor.

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 desired scale.

It is therefore particularly important to develop alternative financing routes for non-financial companies. In this respect, almost everybody, including banks, acknowledge the necessity of a comprehensive and well-designed Capital Markets Union. But the benefits of such a Union should not be overestimated. Financing options which entail recourse to the capital market are not always an alternative for smaller and medium-sized companies. A Capital Markets Union will in particular help growing medium-sized firms to access finance. Other smaller companies will continue to need reliable access to bank loans.

The positive effects of the Capital Markets Union could also be offset by **proposed new regulation that will increase capital demands**. We refer in particular to regulatory initiatives that would affect the risk weight calculations (so-called Basel IV proposals related to the Standardised Approach for Credit Risk and Capital Floors). Considering the strong dependence of smaller and medium-sized companies on bank finance, we are concerned that new rules in this area will have an especially strong negative effect on the EU economy. Apart from this, we refer to increased capital

demands in the context of the supervisory review and evaluation process (SREP), and higher levels of equity or bail-inable securities for an orderly resolution process (TLAC/MREL). All these new requirements would also affect the cost and availability of capital.

Regarding the **SME Supporting Factor**, this is very important for the financing of smaller and medium-sized companies which, as said, will continue to be very dependent on bank lending. In this context, we would like to refer to the response from the European Banking Federation to the EBA Discussion Paper on the SME Supporting Factor (http://www.ebf-fbe.eu/wp-content/uploads/2015/10/EBF_017047F-Response-to-EBA-consultation-on-the-SME-supporting-factor.pdf) which concludes that application of the SME Supporting Factor has had a positive effect on SME lending. The response shows that the SME Supporting Factor has increased loans to smaller and medium-sized firms by 2% since its introduction at a time when lending to larger firm decreased by 7%. Furthermore, after introduction of the SME Supporting Factor, the downward trend in lending to smaller and medium-sized companies changed relatively rapidly while the decline in lending to larger firms continued until the end of 2014, before showing signs of recovery.

CRR/CRD IV also impact on the trading of 'over-the-counter' derivatives (**OTC derivatives**). The exemption from the obligation to match CVA risks of derivatives that are used by non-financial companies in conjunction with risk mitigation of underlying real economic risks, i.e. from their operative businesses (for example related to price changes of commodities, currencies or interest rates) is very important. Without the exemption, hedging costs would significantly increase. High cost and lack of capacity will increase costs for businesses and could lead to less possibilities to hedge risks. This would increase not only the risk for the single corporation concerned but also for the economy as a whole considering that companies would be more vulnerable to financial market risks.

CRR/CRD IV also affect **securitisation**. Reviving securitisation markets would be an important contribution to strengthening financing. This will require changes in prudential regulation that presently clearly discourage issuance and investment in these asset classes through high capital cost. We need a balanced evidence-based approach to securitisation that takes account of the credit and price performance of high quality securitisations. In this context, we are alarmed about proposals to limit recognition of Asset Backed Commercial Paper (ABCP) to underlying assets with maturity lower than one or two years as this appears to exclude a significant part of European programmes with possible repercussions also on the ability of money market funds and insurance companies to play an active role in these markets.

The expiration of the **exemptions for 'commodity dealers'** in the Regulation is also a crucial issue. In our view, an extension of three years to the two key exemptions contained within Articles 493 (large exposures) and 498 (own capital) of CRR, which expire at the end of 2017, is essential. Such an extension would allow sufficient time to consider thoroughly the nature and risk profile of commodity firms in the context of the ongoing review of the capital requirements regime. The application of an unaltered CRR from the end of 2017 to commodity firms has the potential to cause significant damage to the EU commodity markets.

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Lastly, **trade finance** is also affected by the rules. Export finance often involves backing by an export credit agency (ECA). Considering that no important credit losses have been reported by banks that have financed ECA-guaranteed transactions, these loans should be better calibrated to the risks attached and thus be subject to lower – or no capital requirements.

We hope that you share these concerns and that future work on CRR/CRD IV will ensure that the legislation will function effectively, encouraging growth and preventing damage to businesses in the wider economy. We remain at your disposal should you wish to discuss this subject further.

Yours sincerely,

Markus J. Beyrer