THE DIRECTOR GENERAL

**Mr Valdis Dombrovskis**
Vice-President
Responsible for Financial Stability,
Financial Services and
Capital Markets Union
European Commission
Rue de la Loi 200
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Dear Vice-President,

**Banking Regulation**

I write to you regarding current work on international prudential standards for the banking sector. BusinessEurope has supported reinforced prudential rules and strengthened 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.

Additional tightening of prudential rules will further increase financing problems. In this context, we refer in particular to regulatory initiatives initiated by the Basel Committee regarding the revision of the standardised approach for credit risk, the use of internal model approaches, the standardised measurement approach for operational risk, and also the Net Stable Funding Ratio (NSFR). We are concerned that new requirements would significantly affect the cost and availability of lending capacity in the EU and also of risk management products for non-financial companies. This should be duly considered when validating and finalising the new rules.

For example, current proposals regarding the NSFR are likely to have a negative impact on derivatives used by non-financial companies to hedge risks and will make long-term financing of companies more costly and difficult to obtain due to constraints of maturity transformation. We are concerned about quantitative analyses carried out by AFME and Oliver Wyman that suggest that the proposed changes could lead to an additional €15 billion of annual costs for providers of these derivatives as the proposed NSFR would require banks to fund short-term inventory held to hedge exposure on derivatives facilitation with long-term funding which increases the costs of trade provision. These increased costs are likely to be passed on to end users, discouraging the use of hedging instruments and reducing their availability. This would neutralise the relief provided by the European Market Infrastructure Regulation (EMIR). Additionally, in the area of trade finance, with mostly short-term, uncommitted and trade-related finance, current proposals risk to reduce the availability of funding.

This should be further analysed before implementation of any new requirements. Specifically, further analysis is needed of the impact on European companies of

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proposals regarding the recognition of margin received by banks for high quality liquidity assets, and the 20% required stable funding for derivatives liabilities. Such analysis should be made in conjunction with other jurisdictions to ensure that the rules are applied coherently between the US and EU.

We are also concerned that reforms about the standardised approach, internal rating models and Capital Floors (the BCBS 2016 reforms) could lead to significant capital requirement increases for European banks. Such increases would come on top of the original Basel III new solvency requirements that EU banks have already almost completed as well as other capital increasing measures such as higher levels of equity or bail-inable securities for an orderly resolution process (TLAC/MREL). One of the most significant areas of change with important impacts are linked to proposals to make less use of the risk sensitive internal models for credit risk through the extensive recourse to the standardised approach and the introduction of input floors (and even a potential output floor). Because of this, the prudential framework could in fact become less risk sensitive, back to the Basel I framework. This would negatively impact the lending capabilities for the best-performing companies with the most solid and conservative risk profiles. The pricing and availability of lending products should be related to the creditworthiness of companies and the use of effective structures to mitigate risk, such as the pledging of collateral, should be reflected in the pricing and in the prudential framework. We are worried about the combined impact of these proposals, especially on the large mid-cap segment, as well as specialised lending activities such as asset financing and project finance. Additionally, we are concerned that proposals to apply a higher credit conversion factor for unconditionally cancellable commitments to firms (from the current 0% to 50-75%) could be detrimental for business facilitation. The removal of the 0% conversion factor would mean that there is little to no difference in capital requirements between the cancellable and non-cancellable commitments in spite of the fact that the use of the former would put the bank in a better position to manage its risk.

In order to create growth and jobs, businesses need stability and regulatory certainty. The EU and its Member States should carefully assess the need for, and impact of new legislation, especially as some of the Basel Committee proposals mentioned above are still to be validated at the level of the governors in September. It is important to focus on cumulative effects and the bedding-in of the reforms of recent years. A higher degree of consistency between regulatory measures is essential to ensure investment and a proper functioning Capital Markets Union.

We hope that you share these concerns and that future work on banking regulation will ensure that the rules 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