BUSINESSEUROPE

EBF European Banking Federation

Ms Irene TINAGLI, MEP
Chair of Committee on Economic and Monetary Affairs (ECON)
Mr Jonas FERNANDEZ, MEP
Coordinator and Rapporteur Committee on Economic and Monetary Affairs (ECON)
Mr Cristian-Silviu BUSOI, MEP
Chair of Committee on Industry, Research and Energy (ITRE)

30 November 2022

Dear Member of the European Parliament,

A banking package for strong European corporates and banks

We are writing to you in view of the ongoing negotiations in the EU institutions regarding the implementation of the finalisation of Basel III as the main part of the legislative dossier known as the *Banking Package*.

A strong corporate sector in Europe is essential for economic growth and to meet the ambitious goals of the green and digital transition. Banks are best placed to identify productive corporates and finance their projects and business lines. The European banking sector has recapitalised itself to levels beyond the objectives set at the beginning of the regulatory reform, putting it in a strong footing. Against this background, one of the objectives of the Banking Package should be that banks can continue supporting European businesses, also in view of the expected tightening of the financing market due to the change in monetary policy, which will significantly alter the financing environment of the last decade in the upcoming years.

Therefore, BusinessEurope and the European Banking Federation would like to address the following issues to you[1]:

Transitional arrangements for corporate exposures

When the European Commission presented its legislative proposal for the Banking Package, a number of measures were introduced to adapt the output floor to European specificities. Currently, we see a risk that those may be removed or rendered meaningless through additional limitations. Given the current dependency of corporates to bank lending, we think it is of utmost importance to maintain the solution found for unrated corporates and maintain it until a viable and capital neutral solution has been

[1] This letter represents shared interests between the European Banking Federation and BusinessEurope. The respective positions of the EBF can be found here for the general Banking Package and here for the more specific case of securitisation within the Banking Package. The BusinessEurope paper is available here.

found for corporates that do not have an external rating. Limiting the transitional arrangement to corporates with a turnover of less than 500 million cannot be the solution. It would not be in the interest of Europe to force thousands of European corporates to obtain external ratings. EU legislators should primarily propose EU-based solutions making good use of the existing information about the creditworthiness of European corporates in Europe. Also, it is important to note that the problem of the lack of rating of EU corporates also affects banks using the standardised approach. Therefore, any measure should include the standardised approach.

The standardised approach for counterparty credit risk

European corporates use bank hedging services to mitigate their risks, notably interest rate risk, foreign exchange risk or commodity risk. A key factor in this respect is the Standardised Approach for Counterparty Credit Risk (SA-CCR) whose exposure formula uses an alpha factor of 1.4, which was established in 2005 and does not reflect the current market environment, in particular the current shift towards increased clearing and collateralization. Setting the alpha factor in the SA-CCR to 1 will allow businesses to efficiently manage their risks without an increase in costs that would put European corporates at a competitive disadvantage or discourage them from hedging their financial risks. This adjustment should also be effective for the standardised approach in line with the recommendations of the co-legislators[2] and the High-Level Forum on CMU[3]. Given that the current calibration dates from 2005 with very different market conditions, it should be kept in place until a revision is undertaken by the Basel Committee.

Transitional arrangements for real estate

In the EU, mortgages are largely dual recourse, which means that the bank has access to the collateral, but also the assets of the owner. This is in contrast with the situation in the US, where low risk mortgages are sold to State-backed entities, thus leaving the high-risk mortgages on the balance sheets of banks. This demonstrates a fundamental difference in the risk profile of EU banks. The Basel standard does not account for such a feature, which is a significant risk mitigant and leads to much lower losses. As a consequence, the output floor will hit low risk mortgages with a significant capital impact, which will reduce significantly the availability of bank financing for businesses. EBF and BusinessEurope therefore urge to make permanent the transitional arrangements proposed for real estate exposures until 2032. This would allow banks to continue applying a lower risk weight to the part of their residential mortgage exposures that is largely secured. Such a preferential regime should also be applied to banks using the standardised approach for the calculation of capital requirements, and thus not be subject to the exercise of a national discretion.

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[2] REGULATION (EU) 2021/558 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 31 March 2021 amending Regulation (EU) No 575/2013 as regards adjustments to the securitisation framework to support the economic recovery in response to the COVID-19 crisis

[3] Final report of the High Level Forum on the capital Markets Union, link

Trade finance and unconditionally cancellable commitments

European businesses rely on exports to remain competitive in the global markets. For that purpose, it is important that the so-called credit conversion factors (CCFs) for trade finance exposures remain at their current level of 20%. An updated study[4] of the International Chamber of Commerce and Global Credit Data has demonstrated that such a calibration would remain sufficiently conservative. The contemplated 50% CCF, on the other hand, would significantly increase the costs for EU businesses, thus undermining their competitiveness. We welcome the Council's General Approach in that sense. Regarding unconditionally cancellable commitments (UCCs), the European Commission's legislative proposal had included a transitional arrangement for a more beneficial treatment of UCCs (article 495d) with a 0% CCF. This arrangement also included a mandate for the EBA to assess if an extension was needed. UCCs are a useful financing tool for the real economy, as acknowledged by the Commission. Therefore, we support maintaining the EBA's mandate in the transitional arrangement.

Supporting factors for SMEs and infrastructure projects, and CVA exemptions

Maintaining the SME and infrastructure supporting factors will be important for the support of SMEs, which are largely dependent on bank lending, and for the financing of infrastructure projects, which Europe will need to meet its objectives linked to the green and digital transitions. Therefore, we caution against limiting the application of the infrastructure supporting factor by introducing additional environmental criteria that would request either an EU taxonomy alignment or linking eligibility for the SME supporting factor to environmental performance of SMEs. Such limitations to the existing infrastructure or SME supporting factors would make it more difficult for SMEs to manage their own green transition and would crowd out EU banks and corporates from important non-EU infrastructure projects. Moreover, we strongly encourage to maintain the CVA exemptions in the current legislation as this also helps to limit corporate hedging costs.

Specialised lending

Specialised lending comprises of 3 different categories of finance which play a key role in the EU economy: project finance (e.g., sustainable infrastructure investment, financing of export business), object finance (e.g., a ship or an airplane) and commodity finance (e.g., finance for the import and export of agricultural goods). It is important that the Banking Package remains risk sensitive with respect to those low risk exposures, for example through a better recognition of collateral. This will help to make sure that corporates can continue to easily access financing for those exposures. Similarly, the slotting approach should be reviewed taking into account the adjustments introduced to this asset class to ensure that there is consistency between the 3 approaches: standardised, slotting and IRB.

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[4] ICC/GCD 2022 Performance Guarantees study, link

Brown penalising factors

We note with concern that some policy makers are considering a Pillar 1 capital charge for so called “brown exposures”. We do not think that this is the right way to deal with the climate crisis at this given point in time. A Pillar 1 charge will raise the costs for businesses who are in the process of improving their environmental performance, thus making it even more difficult to meet the public policy objectives for carbon neutrality. It is an effect that we consider to be unintended and of a significant impact. The current NGO proposals for a brown penalising factor estimate additional capital of 34 billion euros[5] for the 22 banks in the sample. Such impact would withdraw more than 800 billion euros of lending to the European economy. To put this into perspective, this is more than the entire size of the NextGenerationEU programme. In conclusion, the Pillar 1 brown penalties proposed by NGOs will simply limit the capacity of companies to finance their green transition and detract funds from the European economy at large.

We are confident that these recommendations will be taken on board in the articulation of the banking package legislation contributing to a strong corporate sector in Europe financed by a strong banking system.

We remain at your disposal for further discussion.

Yours sincerely,

Markus J. Beyrer
BusinessEurope Director General

Wim Mijs
EBF Chief Executive Officer

[5] Finance Watch report: A safer transition for fossil banking, link