

**DG FISMA consultation paper**  
**on the possible impact of the CRR and CRD IV on bank financing of the economy**

**Introduction**

The Capital Requirements Regulation<sup>1</sup> (CRR) and Capital Requirements Directive IV<sup>2</sup> (CRD IV) together form the cornerstone of the EU's response to the financial crisis. A stable and trustworthy banking system is essential for maintaining a steady flow of financing to the economy. Savers put money into banks they trust and banks facilitate financial flows from savers to investors. This is particularly important in the EU, as banks are the main actor in this area. As a result, if the banking system comes under stress, adequate financing of the EU economy may be at risk. In the most extreme scenario, this situation can lead to a shortage of loan supply, as was seen in many EU economies during the financial crisis. The main objective of the CRR and CRD IV is to prevent similar situations from occurring in the future.<sup>3</sup> They underpin the confidence of savers in the European banking system. The CRR and CRD IV improve banks' capacity to absorb losses and reduce the need for the use of taxpayers' money in case of failure. They are expected to both significantly reduce the probability of individual bank failure and mitigate the consequences in case of such failure. Therefore, the CRR and CRD IV should contribute not only to enhancing financial stability in the banking industry, but also to the resilience of the flow of savings and investment to the wider economy. CRR and CRD IV were proposed based on a full assessment of their likely impacts, to the extent they could be assessed in advance.

However, the adoption of CRR and CRD IV and the international prudential standards underlying them has triggered public debate as to whether these new rules, particularly tougher capital requirements, could at the same time extenuate banks' capacity to provide lending to the wider economy. In response to this debate, the European Parliament and the Council introduced review clauses<sup>4</sup> into the text of the CRR, which mandate the Commission to perform an analysis of how the provisions contained in the CRR may affect banks' ability to finance the economy. The consultation aims to address the following three reporting obligations all of which concern the potential impact of CRR on bank financing of the economy:

- Article 505 requires a report on the appropriateness of the CRR requirements in light of the need to ensure adequate levels of funding for all forms of long-term financing for the economy, including critical infrastructure projects;

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<sup>1</sup> Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 321, 26.6.2013, p. 6).

<sup>2</sup> Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

<sup>3</sup> It should be noted that the CRR and CRD IV apply to institutions, the definition of which also includes investment firms and other types of entities. This consultation paper will focus on banks (credit institutions) as they are the main intermediary operating between savers and borrowers.

<sup>4</sup> Articles 501, 505 and 516 of the CRR.

- Article 516 requires a report on the impact of CRR on the encouragement of long-term investments in growth-promoting infrastructure;
- Article 501 requires a report on the impact of CRR own funds requirements on lending to SMEs and natural persons.

Examination of the potential issues on the banking financing of the economy in the light of the changes in the banking regulatory framework should go hand in hand with creating a Capital Markets Union, currently a top priority for the European Commission. Both banks and capital markets share the same function of ensuring that savings in the economy are efficiently channelled into productive investments. In this regard, it is important that as many borrowers as possible have access to both kinds of financing and can diversify their financing structure. However, for many borrowers bank financing will remain the essential and most convenient source of financing. Furthermore, banks play an essential role in ensuring an adequate functioning of financial markets by rendering essential services, such as underwriting or market making, to other players in the financial markets. This role enhances the liquidity of the markets and provides corporates with better access to them. Additionally, many European banks are themselves also important players in the markets, either as issuers of or investors in traded securities. Therefore, any prudential framework applicable to banks will inevitably have an impact on financial markets as well and the other way round. In particular, some of the key areas of the CMU project, such as covered bonds and securitizations, are particularly closely linked to banks. Not only are banks among the biggest issuers of these products, but also among the biggest investors in these markets.

Additionally, banks, together with other private and public investors, also play an important role in mobilizing the private financing foreseen by European Fund for Strategic Investments (EFSI). The financial guarantees to be granted by the EFSI are expected to trigger additional financing from a variety of sources, including banks. This financing is addressed to investment projects in key areas, such as infrastructure, education, research and innovation, as well as risk finance for small businesses. Therefore, it is essential to ensure that banks are in a position to adequately contribute to the financing of these projects. CRR and CRD IV requirements should create the confidence in the banking sector conducive to the flow of bank savings into these investment projects, but should not constitute an unnecessary hurdle in this respect.

The aim of this consultation paper is to gain a better understanding of the impact of the new rules on the availability of financing, especially for infrastructure and other investments that support long-term growth, but also for corporate borrowers, including SMEs. The annex to the consultation paper provides facts and trends that could help stakeholders provide more informed replies and further evidence in relation to the questions raised in the consultation paper. The annex however does not aim to provide conclusions or a fully-fledged analysis of the underlying issues and trends, but reflects the information and knowledge available within DG FISMA at the moment.

The Commission invites those concerned to comment and enter into a dialogue on these issues. After this written consultation, the dialogue will be continued at a public hearing later this year.

The Commission will finally prepare a report to the European Parliament and the Council, drawing on the lessons from this dialogue, the findings from the analysis on SME lending currently being undertaken by

the European Banking Authority and an independent research commissioned specifically for this purpose. Based on this report, the need for future EU legislative measures will be assessed.

### **Background and scope**

The CRR implemented the most up-to-date version of international prudential standards into EU law – in the form of a Regulation directly applicable to competent authorities and banks. This is in itself of great importance: in being written as a Regulation, with direct applicability, the CRR constitutes a big leap forward towards harmonising the prudential frameworks across the EU.

The CRR is also attentive to the potential unintended consequences of the CRR and CRD IV on the economy. For example, it introduces an SME supporting factor, the aim of which is to offset the impact of the increased capital requirements on loans to SMEs. In addition, CRR exempts transactions between a bank and a non-financial corporate from the credit valuation adjustment charge, thus avoiding a potential impact on the OTC derivatives market which may deter non-financial corporations from entering into certain hedging transactions.

Greater harmonisation of banks' prudential frameworks will help to create a more level playing field for all European banks, which will, in turn, improve financial integration within the EU banking system. Improved financial integration, when combined with coordinated supervision and crisis management at European level, promotes greater competition and leads to a more efficient allocation of resources. This has practical economic benefits for all concerned, for example: banks are able to better diversify risks; cross-border banking groups benefit from lower financing and operational costs; and companies and households enjoy improved access to financing, in terms of both the cost and availability of credit.

Compared to its immediate predecessors (Capital Requirements Directives I, II and III), the CRR and CRD IV require EU banks to strengthen their levels and quality of capital. The CRR changed capital requirements for certain types of exposures to ensure that capital is allocated appropriately on the basis of the level of risk involved.

In addition to setting prudential requirements at EU level, CRD IV also allows national authorities to apply additional capital requirements or capital buffers to selected institutions or categories of institutions in order to deal with micro- and macroprudential risks. The CRR also imposes reporting requirements on banks, such as to allow competent authorities to enforce the new requirements.

The CRR provides the legal basis for the new regulatory requirements on liquidity (the liquidity coverage ratio and the net stable funding ratio) and leverage. No specific provisions have yet been introduced in these areas, except for the liquidity coverage ratio that banks will have to comply with as from 1 October 2015. The present exercise therefore principally focuses on the provisions establishing and enforcing risk-weighted capital charges.

### **Capitalisation**

It has been widely acknowledged that changes had to be made to the structure of banks' liabilities and assets, in view of the fragility that the sector showed when faced with the crisis and the ensuing sequence of events. The majority of EU banks have undertaken an intensive balance-sheet repair since the onset of the financial crisis — in many cases subsidised by the taxpayer through capital and liquidity injections

from national governments<sup>5</sup>. European institutions and bodies also contributed to restoring trust in the European banks by encouraging them to increase their capital buffers in order to adjust to various risks. In this regard, EBA undertook a capital exercise in 2011-2013<sup>6</sup>, but also coordinated EBA EU-wide stress test in 2014<sup>7</sup>. Moreover, the ECB also undertook a robust and transparent asset quality review of the largest euro area banks in 2014<sup>8</sup>. Central banks have also been major actors in ensuring the stability of the banking system throughout the crisis by making it easier to access their lending facilities.

This process of repairing their balance sheets has led to most of the banks involved holding higher levels of capital. Banks mainly made these changes before the CRR entered into force, in response to market demands or bank-specific supervisory measures. Moreover, banks have, for the most part, not made use of the transitional periods provided for in the CRR: by 2014, most banks were already at or above the capital requirements that will apply when all the transitional periods provided for by the CRR have elapsed. Nevertheless, the expectation that more stringent capital requirements would be introduced by the CRR may have encouraged banks to take action.

The events of the crisis demonstrated the importance of monitoring and regulating systemic risks to the financial system, rather than focusing only on individual financial institutions. CRR and CRD IV therefore introduced a set of macroprudential measures designed to address systemic risks in the financial system. Most of these are capital related measures that are gradually phased-in in order to allow banks to adapt smoothly to the new requirements. All banks will have to hold an additional capital conservation buffer and countercyclical buffers, whereas systemically important banks will also be required to maintain additional capital buffers in order to be able to absorb adverse economic shocks. Furthermore, CRR and CRD IV introduced other macroprudential instruments at the disposal of micro- or macroprudential supervisors, such as systemic risk buffer. The European Systemic Risk Board that is in charge of monitoring systemic risk has recently documented the use of some of these instruments<sup>9</sup>.

- 1. What role has been played by the CRR and CRD IV requirements in the recapitalisation process, in terms of the timing and overall effect on the levels and quality of capital held by banks? How have market, supervisory and regulatory capitalisation demands interacted to make banks adjust the level of capital they hold to the current level? Whilst these three factors may be interlinked, is it possible to identify which has/have played the most important role?*
- 2. If you consider that capital levels go significantly beyond what is necessary in light of the level of risk incurred and posed by banking activities in certain areas, please specify those areas and back up your view with specific evidence.*

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<sup>5</sup> A practice that is now allowed when much more stringent conditions are met following the adoption of the Bank Recovery and Resolution Directive: Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council (OJ L 173, 12.6.2014, p. 190).

<sup>6</sup> <http://www.eba.europa.eu/risk-analysis-and-data/eu-capital-exercise>

<sup>7</sup> <http://www.eba.europa.eu/risk-analysis-and-data/eu-wide-stress-testing/2014>

<sup>8</sup>

<sup>9</sup> <https://www.esrb.europa.eu/mppa/html/index.en.html>

3. *What role have the additional capital requirements and buffers exceeding the harmonised requirements set out in the CRR played in the capitalisation process? Are such additional micro- and macroprudential capital requirements and buffers commensurate to the level of risk incurred and posed by banks? Please back up your view with specific evidence.*

### **Regulation — a cause of the fall in corporate lending?**

The financial crisis saw corporate lending in Europe remain at low levels over an extended period. Over 2008 – 2014, the total amount of outstanding bank loans to non-financial corporates in the euro-area banks decreased by more than 10%, whereas new lending flows to financial corporates decreased almost by half<sup>10</sup>. Although it is widely acknowledged that banks were excessively leveraged before the crisis, there is still uncertainty as to the main causes of the reduction in financing of the private non-financial sector of the economy.

There are a number of demand- and supply-side factors that may have contributed to a reduction in the levels of bank credit provided to non-financial companies. Generally, the reduced demand for credit for investment purposes is a common feature of economic downturn. As less attractive investment opportunities arise, entrepreneurs will ask for less bank financing. Another factor may have been efforts by non-financial companies to reduce their leverage, in response to the uncertain economic environment and the low prospects for growth in the economy. Demand for corporate loans may also have fallen as a result of increased availability of internal financing and higher reliance on market financing for largest corporates.

Some observers argue that increased capital requirements may have been one of the supply-side factors affecting corporate lending. These requirements may have led banks to reduce their loan portfolios and/or their holdings of debt securities of corporates well in advance of 1 January 2014, when strengthened capital requirements began to be introduced. The comprehensive assessment carried out under the European Central Bank single supervisory mechanism and the stress tests conducted across the EU in 2014, under the coordination of the European Banking Authority, both of which took place within a year of the entry into force of the CRR, may also have contributed to the fall in the supply of loans. Moreover, looking further backwards, 2011-2013 EBA capital exercise<sup>11</sup> may have worked in the same direction.

Before the comprehensive assessment referred to above was completed, the banks subject to this assessment had raised EUR 57 billion since January 2014. Possible increases in banks' financing costs, resulting from the higher levels of capital being held, are seen by some as having made bank loans more costly and thus, in turn, affected demand for loans. On the other hand, the bank lending surveys conducted by the European Central Bank suggest that the liquidity and capital position of banks have been a secondary factor affecting the levels of bank credit, while expectations of overall economic activity and industry- or firm-specific outlooks have played a more major role.

4. *Have increased capital requirements influenced the overall capacity of banks to lend? Which factors, including demand-side factors, regulatory changes and other supply-side factors (such as the volatility of interbank and capital markets), contributed most significantly to the change in the*

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<sup>10</sup> Own calculations on the basis of ECB data.

<sup>11</sup> <http://www.eba.europa.eu/risk-analysis-and-data/eu-capital-exercise>

*volume of loans? How do you think bank lending would have developed had regulatory changes to capital requirements not been introduced?*

5. *Are the effects of increased capital requirements, such as they are, generally temporary and transitional or have structural changes been seen? Has the requirement to hold higher levels of capital increased the cost of funding banks? Has the per-unit cost of bank capital decreased as banks have become less risky?*
6. *Have increased capital requirements affected the market for some categories of assets more than others? If so, which ones and how? Which of the provisions contained in the CRR, apart from those establishing capital ratios, are likely to have created the effects experienced by specific markets and/or exposures?*
7. *Do you think the phase-out of the transitional provisions under CRR could have an incremental impact on future lending decisions? If so, please explain how.*

### **Lending to SMEs**

SMEs are an important source of employment and growth for the EU economy. Ensuring that they have adequate access to finance is therefore a main consideration when setting policies. SMEs are particularly exposed to credit constraints, due to factors intrinsic to their size and structure. They are generally more dependent on bank lending than are larger non-financial companies. Moreover, the asymmetry of information that exists between SMEs, as borrowers, and potential lenders is particularly acute, and limits their ability to switch sources of funding quickly.

Article 501(1) CRR includes a provision that reduces the capital requirements for credit risk on exposures to SMEs. This provision was introduced to ensure that the level of capital required in respect of SME loans did not increase as a result of the higher overall level of capital required under the CRR. Consequently, capital requirements for loans to SMEs have been reduced relative to the requirements for other categories of loan.

8. *To what extent has this provision been effective in supporting lending to SMEs? Could you provide any evidence, preferably quantitative, of the change in lending to SMEs due to the introduction of the supporting factor as from 2014?*
9. *What specific difficulties do banks face when lending to SMEs, compared to when lending to larger corporates? Are these related to the CRR? How could the CRR and other prudential regulations contribute to addressing some of these difficulties in other ways than by adjusting rules for SMEs, or do they need to be resolved by some other means? If so, what other means would be adequate?*

### **Lending to infrastructure**

Loans for infrastructure are generally treated, for the purposes of the CRR, as loans to corporate borrowers. They are therefore not subject to any particular — advantageous or disadvantageous — treatment. Nevertheless, infrastructure loans have certain typical common features that differentiate them from other corporate loans and that may mean that regulation affects them differently, even when the

same treatment as for other corporate loans is applied. These typical features may relate to ownership by special purpose entities, long loan maturities, particular risks associated with projected costs and revenues.

*10. Has the CRR influenced the capacity of banks to provide loans to infrastructure projects? Which provisions are most relevant?*

*11. What are the specific difficulties that banks face when lending to infrastructure projects? Are they related to the CRR? How could the CRR and other prudential regulations contribute to addressing some of these difficulties or do they need to be resolved by some other means? If so, what other means would be adequate?*

*12. Should infrastructure projects continue to be treated as loans to corporate borrowers? If not, why? What common features of infrastructure projects or their subsets would justify a separate treatment from loans to corporate borrowers?*

### **Proportionality**

The CRR and CRD IV apply to 8 000 banks in the EU (the vast majority of which, with only a small number of exceptions, are deposit-taking institutions), in general irrespective of their size and denomination (as commercial, savings or cooperative banks)<sup>12</sup>.

The CRR and CRD IV apply, to some extent, differently to different institutions, while seeking to maintain a level playing field across the sector. Some of the provisions set out in the CRR and CRD IV apply only to institutions that are considered to be systemically important (e.g. the buffers that systemic institutions are required to hold); some apply to banks engaged in certain activities or business lines (e.g. trading book capital requirements); some take account of particular business structures (e.g. in the definition of capital and the level of application of the requirements); and some, notably those contained in Commission Delegated Regulation (EU) 2015/61<sup>13</sup> on liquidity coverage, adapt particular provisions to specific business lines (e.g. leasing and factoring, which are classified as banking services or undertaken by banks in some Member States). The Union legislation also allows institutions to choose which of a number of different approaches to calculating capital requirements they wish to apply according to their size, complexity and preferences.

Nevertheless, the requirements of the CRR and CRD IV, particularly those relating to credit and other prudential risks, are of general application to all financial institutions, without any distinction being made on the basis of size, business model or business line, and are designed to ensure a level playing field. This also applies to certain operational provisions, which are needed to enforce these requirements in a consistent way across the single banking market. This can potentially create varying implementation costs

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<sup>12</sup> if certain conditions specified under article 10 of CRR are met, competent authorities may, in accordance with national law, partially or fully waive the application of the requirements set out in Parts Two to Eight of CRR to one or more credit institutions situated in the same Member State and which are permanently affiliated to a central body which supervises them and which is established in the same Member State.

<sup>13</sup> Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement Regulation (EU) 575/2013 with regard to liquidity coverage requirement for Credit Institutions (OJ L 11, 17.1.2015, p. 1).

for individual banks. Smaller banks, for example, may be less able to spread fixed overheads over a large range of activities. It should also be noted that the standards set by the Basel Committee on Banking Supervision, which the CRR was to a large extent based upon, were designed to apply to internationally active institutions only. A conscious decision was made to make the requirements of the CRR and CDR IV apply more widely.

*13. Should the provisions contained in the CRR allow for more differentiation in how they are applied to banks of different sizes or with different risk-profiles? How can they do this without compromising the objective of achieving financial stability and creating a level playing field within the single banking market? Are there any provisions that could potentially be applied with greater differentiation? If so, what are these provisions? Provided application on a differentiated basis is desirable, what considerations could be relevant to make such a differentiated application? Are any concrete changes desirable in this context? If so, what are these changes and the associated costs and benefits?*

### **Scope for simplification**

Over recent decades, the prudential regulation of banks has undergone a gradual, but significant, evolution. Changes have been made in order to adapt regulation to emerging risks to which banks, including the most complex organisations, are exposed or which banks may generate for the wider economy. In many cases, changes in the regulatory framework have occurred in parallel to the evolution of banking itself, which has been becoming increasingly sophisticated. Moreover, detailed rules provide more legal certainty and level playing field. However, regulation has therefore become more detailed and sometimes more complex, as a result of which the burden placed on some banks has increased.

*14. Which areas of the CRR could be simplified without compromising the Regulation's objective of ensuring prudence, legal certainty and a level playing field? Are there areas that could be simplified, but only for specific types of bank or business models? Would it be useful to consider an approach where banks that are capitalised well above minimum requirements or that are less exposed to certain risks could be subject to simplified obligations? What would be the risks with such an approach?*

### **Single rulebook**

Unlike earlier EU legislation in this area, the CRR takes the form of a Regulation and is directly applicable to all EU banks and competent authorities. This means that the provisions set out in the Regulation and in the related implementing and delegated acts are directly binding on banks and supervisors. This is an important step towards creating a more level playing field and achieving closer integration in the EU banking sector, developments which will bring benefits for all involved. The CRR still, however, contains provisions offering a number of alternatives and allowing Member States and competent authorities a certain amount of discretion, although many of these provisions are time-limited or subject to review clauses.

*15. What additional measures could be taken in the area of prudential regulation to further promote integration and enhance a level playing field? Can you indicate specific examples and evidence of discretions that affect the cost and availability of bank lending?*