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The 2021 Banking Package

EAPB Position Paper

In brief:

1. To promote a more equal treatment of exposures to regional governments, local authorities, and public sector entities (RGLA-PSE) across member states and at the same time a more level playing field between promotional banks using internal models or standardized approaches:
   a) Exposures to RGLA-PSE should be treated uniformly across Members States and thus benefit from a 0% RW in the Standardized Approach, where this is risk sensitive. At least, Member States should be given increased flexibility compared to the existing regulation to establish a risk weight below 20 % by adding the possibility of a risk weight of 10 %.
   b) Exposures to regional governments, local authorities, and public sector entities (RGLA-PSE) should not be treated as corporates in the IRBA from a prudential perspective. Specific input floors for the PD and LGD parameters should be defined for this new RGLA-PSE category. In particular, the LGD input floor should reflect historically observed LGD. To reduce the impact of the output floor for promotional banks, promotional loans should be exempted from the output floor.

   The proposed solutions should not be implemented individually to promote a more equal treatment of exposures to RGLA across Member States and at the same time a more level playing field between promotional banks using internal models or standardized approaches.
2. In countries where exposures to RGLA-PSE are treated as exposures to central governments in the Standardised Approach, banks should be permitted to treat these exposures as exposures to central governments in the IRBA as well.
3. The possibility to permanently exempt certain exposures to central governments and central banks and RGLA-PSEs as well as exposures to institutions within the same institutional protection scheme from the IRBA must be maintained.
4. Physical collateral and assigned receivables should be recognised as collateral under the standardised approach to credit risk.
5. The proposal to treat guarantees for prudential purposes in a uniform manner, regardless of whether the protection provider makes one lump sum payment or assumes the future payment obligations of the obligor should also apply in the framework of the NPL backstop.
6. The possibility to apply a risk weight of 65 percent for exposures to unrated corporates should be extended to certain corporate exposures secured by real estate.
7. Maintaining a proportionate approach to the implementation of the new "unlisted speculative equity" exposure class avoiding a broad definition including private equity.
8. For institutions bound by the output floor, the O-SII buffer and the P2G should not increase.
9. The reporting requirement for the calculation of capital requirements for CVA risks of the exempted transactions would undermine the effectiveness of the CVA exemptions. Also, the Basic CVA approach should be made more granular
10. The α-factor=1 in the SA-CCR formula should be applied not only for calculation of the output floor, but also for institutions using the Standardized approach.
11. Commission income and expenses within a financial network for which an IPS exists should be able to be netted for the calculation of the service component.
12. When determining the own funds requirements for operational risk institutions should be given the option to multiply the business indicator component by the ILM, which depends on the institution's historical OpRisk losses (ILM ≠ 1).
13. Institutions that have practically no influence on the composition of the management body in its supervisory function due to legal requirements should at least be excluded from the ex-ante assessment procedure for these members.
14. The regulations extending the fit and proper regime to key function holders should be deleted.

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15. The regulations considering ESG risks should be adjusted in particular ESG risks should be treated as risk drivers of existing risk categories such as credit risk, but not as a separate risk category.
16. The existing method for calculating own funds requirements for market risks should be preserved for banks with exposures falling below the current threshold for the market risk reporting requirement.
17. The disclosure burden for banks (remuneration, ESG risks, frequency, means and extent of disclosure) should be reduced.

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Our views on the 2021 Banking package (CRR III/ CRD VI)

Introduction and general comments:

The European Association of Public Banks (EAPB) is the voice of the European public banking sector. EAPB represents directly and indirectly over 90 financial institutions with overall total assets of over 3.500 bn € and 15% market share of the European financial sector. EAPB members are national and regional promotional banks, municipality funding agencies and public commercial banks across Europe.

Promotional banks are public banks that provide financial services and funding for projects that support sustainable economic and social development with, amongst others, activities ranging from the funding of companies/SMEs, and the promotion of a greener economy to the financing of social housing, health care, education and public infrastructure at national, regional and local level. Promotional banks are state-owned at local, regional or national level and act in the public interest. They address financing needs underserved by the market and desirable from a public policy perspective, they promote social and economic development, help the real economy and bring concrete benefits for citizens.

The implementation of the finalization of Basel III in the EU would place considerable burden to the business of European public banks, and in particular promotional banks if the specific low-risk business model of promotional banks that fund primarily the public sector and SMEs were not taken into account. This paper attempts to show solutions so that promotional banks and public banks are not disproportionately affected by the implementation of Basel III and can fulfil their role as transformation financiers and countercyclical investors in times of crisis.

On 27 October 2021, the EU Commission presented its proposal for the implementation of Basel III in the EU. It is recognisably characterised by the intention to limit the negative effects of the regulations on the capital requirements of banks - and thus on the real economy. In particular, the negative effects of the proposed implementation of the output floor (so-called “single stack approach”) are to be reduced by allowing model banks to make use of certain relief measures in the calculation of capital requirements according to the Standardised Approaches. Existing specific features of the implementation of earlier Basel standards in the EU are to remain in place. Finally, institutions are to be granted longer implementation periods for burdensome regulations. We welcome this emphatically.

To avoid burdens for the real economy and the banks, it is now important in the upcoming legislative process not to water down the proposed relief – where it is risk-sensitive. However, where it is appropriate or justifiable for reasons of risk sensitivity or consistency of the regulatory framework, the -proposed regulations should also be extended. In many places, the proposed transitional arrangements will merely postpone the negative effects associated with the implementation of Basel III into the future. Therefore, particularly important transitional arrangements should be granted permanently.

Exposures to regional governments and local authorities (RGLA) or public sector entities (PSE) with a 20% risk weight in the standardized approach

Exposures to RGLAs and PSEs that may not be treated as exposures to central governments are classified as exposures to institutions (Article 115 and 116, CRR) leading to a discrepancy of the treatment of entities of the same nature. When exposures to RGLAs (and PSEs) are not considered to be treated as exposures to central government, a risk weight of 0 % is not applicable under the standardized approach. Those exposures are then classified as exposures to institutions, with the lowest possible risk
weight of 20 % under the standardized approach. As we see it there is a need to expand the scope of possible
risk weights under the standard method in those jurisdictions, to address the low risk of exposures to RGLAs (and PSEs) and take into consideration differences in the relation between central government and RGLAs (and PSEs) across countries. EAPB recommends broadening the scope and flexibility of risk weighting exposures to RGLAs (and PSEs). Financing costs for RGLAs and PSEs should not be higher than necessary, consistent with their extremely high creditworthiness. In EAPBs view exposures to RGLAs (and PSEs) in Europe carry an extremely low risk, and it would therefore seem that they should qualify for a risk weight of 0 % and a harmonized treatment across member states due to the low risk of those exposures. If a Member State considers that a risk weight of 0 % would not be appropriate, however, such Member State should be given increased flexibility compared to the existing regulation to establish a risk weight below 20 % consistent with the specific risk assessment in that jurisdiction, for example by adding the possibility of a risk weight of 10 %. However, this should only be a second-best solution. Ideally, all loans to RGLAs in the EU should be treated equally and, due to the low risk profile, be treated as loans to central governments, thus benefiting from the 0% risk weight.

In the past, many banks in the affected countries started modelling loans to RGLAs to better reflect the risk profile and not to have to use the 20% risk weight in the standardised approach. We welcome that banks in member states (MS) where exposures to RGLA and PSE must be treated under the IRBA rules for institutions can still apply the Advanced-Internal Ratings Based Approach (A-IRBA) to these exposures. However, we consider the proposed application of an LGD input floor of 25% to the new RGLA-PSE exposure class to be overly conservative. The LGD models yielded by the model are reliable and conservative since they are systemically submitted to internal controls from the 3 lines of defence, reviewed on a yearly basis (so-called “backtesting exercise”) which includes a monitoring of the realised LGD values in comparison with the calibrated LGD values of the model and subject to the permanent supervision of competent authorities. The internal and external controls applicable modelling activities already provide a fair level of mitigation, and the input floor should not become counterproductive. With the 25% value proposed, the resulting average risk weight for an average RGLA portfolio would be above the 20% resulting from the application of the Standardised approach, for which no such requirements apply. Therefore, we would advocate that the LGD input-floor should be calibrated below 5% to reflect historically observed LGD. Finally, it remains to be emphasised that a lower LGD input floor will only relieve promotional banks using internal models
in the implementation of Basel III insofar as this targeted adjustment is not counteracted by the output floor. Due to the output floor, the RWA of an institution must be at least 72.5% of the RWA that would result if the entire portfolio of the institution had been valued exclusively with standardised approaches. The capital saving for institutions that use their own models is thus limited to 27.5% compared to the use of standard procedures. The final risk weight would therefore be 14.5% (72,5% of 20% in the standardized approach), insofar as the risk weight in the standard approach was not lowered. To counteract this effect, an exemption for promotional
loans of the promotional banks could be introduced, just like it was done by the legislator for the leverage ratio (Article 429a CRR).

EAPB thinks that the unequal treatment of loans to RGLA in the EU poses problems. While banks in some Member States can use a 0% risk weight, this is not possible in other Member States where a risk weight of 20% must be applied in the standardised approach. Promotional banks often specialise in

these portfolios as municipal financiers, which means that any change in the treatment of RGLA has a significant impact on own funds requirement. As a way out, some promotional banks have started to use internal models to better assess the risk profile and reduce the required equity. This often results in significantly lower risk weights, considerably lower than 20% and thus closer to the 0% risk weight that may be used in other countries. This shows that the risk profile for RGLAs in the different Member States is comparable, despite different risk weights in the standardised approach. However, this also leads to considerable disadvantages for promotional banks that continue to use the standardised approach in these countries vis-à-vis their peers that are using models especially since national supervisors tend to not approve new models for low-risk portfolios.
EAPB therefore proposes an alternative solution package that would at the same time mitigate the impact on those promotional banks that model RGLA loans without generating a possible competitive advantage over promotional banks that use the standardised approach. A lower risk weight in the standardised approach should therefore go hand in hand with the lower LGD floors in the A-IRBA and the exception for promotional loans in the output floor. We believe that these solutions should be seen as a package and not implemented individually to promote a more equal treatment of exposures to RGLA across Member States and at the same time a more level playing field between promotional banks using internal models or standardized approaches.

Exposures to regional governments and local authorities (RGLA) or public sector entities (PSE) with a 0% risk weight in the standardized approach

Currently, exposures to regional governments and local authorities (RGLA) as well as public sector entities (PSE) can be assigned to the exposure class “exposures to central governments or central banks” in the IRBA if they are also treated as exposures to central governments in the Standardised Approach according to Articles 115 and 116 CRR (Art. 147 para. 3 lit. a CRR).

Accordingly, no minimum probability of default of 0.03% needs to be applied for these receivables. This opens the possibility of using the same risk weight for such exposures under the IRBA as under the CRSA (0 percent). The possibility of treating RGLA-PSEs as exposures to central governments is subject to strict conditions under the CRR. In particular, it must be ensured that there is no difference between the credit risks of the positions concerned and the central government due to institutional requirements or appropriate guarantees. The Basel Committee on Banking Supervision proposes to retain this rule (para. 19 Basel III, IRBA).

Deviating from this, the EU Commission proposes to treat RGLA-PSE uniformly in a new exposure class (Art. 147 para2. a1 CRR-E) and to apply the IRBA rules for exposures to corporates to them (Art. 151 para. 11 CRR-E). Accordingly, the increased minimum probability of default of 0.05% would have to be assigned to these exposures (Art. 160 para. 1 CRR-E). A risk weighting as in the Standardised Approach would therefore no longer be possible. For banks using the Foundation IRB approach, the situation would be aggravated by the fact that they would have to use the minimum probability of default applicable to corporate exposures but, as we understand it, could not use the reduced LGD of 40 percent introduced by Basel III. This would result in a risk weight of around 20 percent for an unsecured exposure to RGLA-PSE for these banks.

The lower risk of RGLA-PSEs must also be reflected in the IRBA. This could be achieved by continuing to assign the exposures to the IRBA exposure class central governments. Alternatively, the minimum probability of default of 0.05 percent could be waived for RGLA-PSEs, which are treated as exposures to central governments in the Standardised Approach.

In principle, the exposures in question could also be treated as exposures to central governments in the Standardised Approach. Institutions that currently already use the IRBA for such exposures could in principle make use of the option in Art. 494d CRR-E. However, this presupposes that all exposures to RGLA-PSEs are treated according to the Standardised Approach. Otherwise, partial use would no

longer be possible without further ado (see p. 3 above). In addition, this would have the disadvantage that the banks, for example, would only be allowed to consider guarantees from local authorities that are prudentially recognised when determining risk weights for municipal enterprises. The consideration of other support measures in the estimation of the probability of default would not be possible in the Standardised Approach. This would lead to an unjustified increase in capital requirements for such companies.

Partial Use

The EU Commission proposes to increase the scope of institutions for the permanent partial use of the IRBA. In future, institutions are permitted to apply the IRBA selectively to individual asset classes or subclasses. (Art. 148 para. 1). This regulation is to be welcomed in principle. It will ensure a more level playing field within the EU. The EBA's attempt to standardise the regulations more strongly was dropped at the time with reference to the upcoming Basel regulations. The ECB's TRIM Guide also failed to achieve comprehensive harmonisation on this issue. Although there is no complete transparency on this issue, in our opinion the supervisory authorities in the EU have applied highly divergent regulations in the past regarding permanent partial use. In some Member States institutions had to fulfil a particularly demanding requirement in the EU comparison with a portfolio coverage of 92 percent.

However, it seems problematic to us that at the same time the options for the permanent exclusion of certain categories of exposures from the IRBA according to Art. 150 para. 1 CRR are to be deleted. In future, the general regulations for partial use would have to be applied to these exposures. Accordingly, only either the entire exposure class (Art. 150 para. 1 (b) CRR III-E) or non-material parts thereof (Art. 150 para. 1 2nd subparagraph CRR III-E) could be excluded from the IRBA. In our view, this applies in particular to certain exposures to central governments and central banks and their regional government and local authorities, administrative bodies and public sector entities (Article 150 para. 1 (d) CRR) as well as to exposures between institutions that meet the requirements of Article 113 para. 7 CRR (institutional protection schemes) (Article 150 para. 1 (f) CRR).

Accordingly, institutions could only exclude exposures to one Member State or the central bank from the IRBA if they simultaneously treated all other exposures to central governments and central banks according to the Standardised Approach for credit risk. This could result in the exposures in question being treated under the IRBA in the future.

For regional governments, local authorities and public sector entities (RGLA-PSE), the removal of the possibility to permanently exempt such exposures from the IRBA could also mean that these exposures would (continue to) be treated under the IRBA, where they would receive a risk weight of around 20 percent due to the specified minimum probability of default of 0.05 percent. This would result in a corresponding deterioration of the financing conditions of these entities.

The deletion of the possibility to exclude exposures to other institutions of the same institutional protection scheme (IPS) from the IRBA would largely render the application of Article 113 (7) CRR meaningless. In the respective IPS, those institutions which apply the IRBA, as central institutions, are responsible to a large extent for the allocation of liquidity and external refinancing within the IPS. In this way, they generate a large number of exposures to other affiliated institutions. When Basel II was implemented in the EU (CRD I), the legislator had already recognised that these exposures do not entail any risk and can therefore be counted with a risk weighting of 0 percent. This must not be counteracted by the partial use rules.

Recognising physical collateral and receivables as collateral.

Physical collateral and assigned receivables play a major role especially in the business with small and medium-sized enterprises (SMEs). Furthermore, physical collateral is also relevant in the area of retail financing (e.g., auto loans). Assigned receivables, in turn, play a major role as collateral in the granting of promotional loans by promotional banks. In certain member states, promotional loans are usually not granted by the promotional bank itself but are passed through by the borrower's "house bank". In this way, theses promotional banks have a large number of exposures to banks – most of which are unrated. These exposures are often secured by the exposures assigned by the house bank to the promotional bank.

Under certain conditions, this collateral can be taken into account under the internal ratings-based approach (IRBA) in order to reduce capital requirements. Institutions using the advanced IRBA can estimate their own LGD for appropriately collateralised loans. Under the foundation IRB approach, they can apply a supervisory LGD for the collateralised part.

Under the standardised approach, on the other hand, the risk-reducing effect cannot currently be taken into account. On the one hand, this leads to the fact that in the standardised approach there are no capital-related incentives to collateralise a loan with physical collateral or assigned receivables. In addition, the standardised approach does not reflect the actual risk of the loan granted in this way. The refinancing conditions for SMEs may thus be worse than they could be if these two types of collateral were recognised. Promotional banks can grant fewer loans – this especially holds as capital requirements for loans to unrated banks are to increase substantially for some member states (50%-100%). Last but not least, the lack of recognition of these types of collateral via the output floor also affects the capital requirements of institutions applying the IRBA.

For this reason, we propose that physical collateral and assigned receivables should also be recognised under the standardised approach. They should be eligible under the same conditions as under the foundation IRB approach. This will ensure that all banks that recognise physical collateral or assigned receivables as risk mitigants meet appropriate minimum requirements.

The amount of capital relief should also correspond to that of the IRB foundation approach. In our opinion, there is no justification for a more conservative capital charge under the standardised approach as long as standardised banks fulfil the same requirements as IRB institutions. Specifically, we propose to adjust the exposure value of exposures secured by physical collateral or assigned exposures by means of a scaling factor that depends on the ratio of the supervisory LGD of an unsecured and a secured exposure.

Prudential provisioning and public guarantees

Based on the current article 47a of the CRR the calendar for provisioning for exposures benefitting from a public guarantee seems to be applicable when a debtor is classified as non-performing even when the guarantor is paying in a timely manner according to the original scheduled payment dates as the original debtor is classified as non-performing and the guarantor is classified as guarantor. It does not make sense to have a provision against the debtor as long as payments are being made according to the original schedule by the guarantor. It also contradicts the eligibility of a guarantee where the guarantor may assume the future payment obligations of the obligor for credit mitigation purposes (Article 213 proposed amendment CRR). Moreover, it results in a different treatment for provisioning compared to a guarantee where the guarantor makes a lump sum payment of all monies due under the claim, while for credit risk mitigation the guarantees are treated equally.

Under the CRR Quick Fix the minimum coverage requirements for non-performing loans benefiting from public guarantees have been aligned with those guaranteed by official export credit agencies, since the two guarantees are deemed to have similar risk-mitigating effects. Therefore, there are no coverage expectations during the first 7 years and the coverage expectation of 100% is applicable to publicly guaranteed exposures only after more than 7 years of NPE status. The rationale being that provisioning for publicly guaranteed exposures should take place after 7 years in case the guarantor is not acting on its guarantee. We welcome the amendments brought forward with the CRR Quick Fix, which is why we consider it important that the intention of the co-legislator is also implemented in practice.

A guarantor can either compensate a lender by directly paying the covered amount (lump sum) or compensate the lender according to the original repayment schedule of the loan. The latter is a common feature of government guarantees. While in such a case the payments are received according to the schedule, technically the exposure is to be classified as NPE, according to Art. 47a of the CRR, since the classification refers to the borrower and not to the guarantor. As such, provisioning rules apply even if the cover is an unfunded credit protection, and the issuer of the cover continues to pay according to schedule. EAPB recommends equal treatment of both guarantee-structures for the provisioning rules. This treatment seems appropriate since in the new Article 213, the Commission proposes to treat guarantees for prudential purposes in a uniform manner, regardless of whether the protection provider makes one lump sum payment or assumes the future payment obligations of the obligor. Hence, the treatment of such guarantees for the formation of reserves is not in line with the treatment of such guarantees for credit risk. After all, for credit risk, the risk reduction provided by such guarantees is recognized while for the formation of reserves these are not fully recognized. We would advocate to acknowledge the described guarantee-structures and amend the provisioning requirements accordingly. We propose to exempt from prudential provisioning the covered part of a non-performing exposure if the borrower is paying on schedule, or the cover is valid unfunded credit protection granted by the guarantor who is performing as scheduled.

Transitional arrangements for exposures to unrated corporates

To limit the negative effects of the output floor, banks are to be permitted until the end of 2032, when calculating the floor, to count exposures to unrated corporates in the Standardised Approach, which have been assigned a probability of default of up to 0.5 percent under the IRBA, with a risk weight of 65 percent (Art. 465 para. 3 CRR III). This regulation goes back to point 42, Basel III: Finalising post-crisis reforms, according to which banks in countries in which external ratings may not be used for banking supervisory purposes may apply a risk weight of 65 percent for general corporates if the company meets certain criteria for an “investment grade”. The EU Commission wants to grant this possibility also to banks in the EU, although external ratings can be used here (so-called “hybrid approach”). Furthermore, it should not be necessary for the companies treated in this way to have securities outstanding on a recognised securities exchange – as required by the Basel Committee. Last but not least, the possibility is to be opened up for all exposures to corporates – i.e. also for specialised lending exposures and purchased corporate receivables.

We strongly support this proposal. Above all, it will lead to a less significant increase in the capital requirements of IRBA institutions for exposures to non-externally rated companies with a good credit rating than would be the case if a flat risk weight of 100 percent were applied. In this way, the regulation makes an important contribution to cushioning the negative effects of Basel III on the financing of corporates in the EU.

We particularly welcome the fact that this provision can also be used for exposures to corporates that do not have securities outstanding on a recognised securities exchange. In the EU, most externally unrated companies are unlikely to be public companies that have issued shares or exchange-traded debt securities.

Furthermore, we find it appropriate that the regulation can also be applied to specialised lending exposures. Also, in the area of specialised lending – despite the proposed implementation of a preferential risk weight of 80 percent for high-quality project and object finance – the capital requirements would increase significantly due to the output floor. The inclusion of specialised lending is also justified from a risk perspective. In the Standardised Approach, the same risk weights are to be applied to externally rated exposures to corporates (Art. 122 para. 1 CRR III) and specialised lending exposures (Art. 122a para. 2 CRR). Accordingly, the legislator has recognised that these exposures bear a comparable risk with the same external rating. In our opinion, specialised lending should even have a lower risk than unsecured corporate exposures with the same probability of default. This is because in the case of specialised lending, the banks regularly have a comprehensive collateral package at their disposal, which not only allows them to realise the financed assets in the event of default, but – especially in the case of project financing – often even grants them extensive rights of influence regarding the management of the company.

To comprehensively counter possible negative effects of the output floor on exposures to corporates, we believe that certain exposures to corporates that must be allocated to the exposure class “exposures secured by mortgages on immovable property” in the Standardised Approach should also be covered by this rule.

In this context, we particularly advocate the inclusion of corresponding exposures that must be treated as exposures to corporates for the purpose of determining risk weights. Accordingly, parts of loans secured by commercial real estate that exceed 55 percent of the property value should fall under the regulation. According to the proposal of the EU Commission, such exposures would have to be assigned to the exposure class “exposures secured by mortgages on immovable property” (Art. 112 lit. i CRR), although they must be treated like unsecured loans to corporates for banking supervisory purposes (Art. 126 para. 1 lit. b CRR III). To be able to include the aforementioned exposure parts in the regulation of Art. 465 para. 3 CRR, they should be explicitly included there.

Finally, we would like to advocate that “IPRE Exposures” secured by commercial real estate also fall under the regulation of Art. 465 para. 3 CRR, unless they are allowed to be treated according to Art. 126 para. 2 2nd subparagraph CRR III-E due to a passed “hard test” according to Art. 126 para. 1 CRR-E (loan splitting). “IPRE exposures” must be treated as “exposures secured by mortgages on immovable property“ under Basel III in the Standardised Approach, although they basically meet the requirements for specialised lending exposures in Art. 122a CRR-E and are also comparable to those exposures in terms of risk. IPRE exposures are object or project financings that serve the construction of real estate and are collateralised by it. They are therefore also treated as specialised lending exposures in the IRBA (Art. 147 para. 8 CRR III). In its consultation paper on the revision of the Standardised Approach of December 2014, the Basel Committee on Banking Supervision had proposed to also consider IPRE as specialised lending (para. 27). In the final regulations of the Basel Standardised Approach, however, they were assigned to the exposure class “exposures secured by mortgages on immovable property”, to implement a more risk-sensitive risk weighting geared to the loan-to-value ratios. The treatment in the exposure class “exposures secured by mortgages on immovable property” has the consequence that these exposures must first be separately “defined out” of the definition of the exposure class specialised lending (Art. 122 a (1) (b) CRR). These exposures should also be explicitly included in the transitional regulation according to Art. 465 CRR III-E.

In our opinion, the temporary nature of the regulation merely shifts the problem of increasing capital requirements for corporates without an external rating into the future. Moreover, the time limit may even lead to the fact that the relief associated with the measure does not even unfold its effect during the entire transitional phase. In our estimation, lenders and rating agencies will demand that banks meet the capital requirements that will arise after the end of the transitional phase already well before the end of the transitional phase. The relief would thus already run into empty space during the transitional phase. We would therefore strongly advocate abandoning the time restriction and making the regulation available until there is sufficient coverage of companies in the EU with external ratings.

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During the transitional period, the EU Commission wants to find ways to improve the coverage of companies in the EU with external ratings. This is to be welcomed in principle. To this end, the ESAs are first to prepare a report on the obstacles to this by one year after the new rules come into force (Art. 135 para. 3 CRR III-E). Subsequently, the EBA is to report on the actual rating coverage by the end of 2028 (Art. 465 para. 3 2nd subparagraph CRR III-E). We fear that the mandated supervisory authorities will consider this issue primarily (or even entirely) from a regulatory point of view and that the economic implications are likely to play a rather subordinate role. For this reason, we would like to suggest that not the supervisory authorities, but the EU Commission itself should be commissioned with the preparation of these reports.

Output Floor

The EU Commission would like to implement the output floor at the consolidated level in the form of a so-called “single stack approach”. This means that the currently applicable Total Risk Exposure Amount (TREA) at the consolidated level is to be replaced by a “floored” TREA (Art. 92 para. 3 CRR III-E). The “floored” TREA is to be the maximum of the “unfloored” TREA, i. e. calculated using internal models (U-TREA) and a certain percentage (x) of the TREA calculated according to the Standardised Approaches (S-TREA):

$$TREA = max\ (U - TREA;\ x \times S - TREA)$$

In this context, the percentage x is to be gradually increased from initially 50 percent to 72.5 percent during an introductory phase, which is to last from 1 January 2025 to 1 January 2030 (Art. 465 para. 1 CRR).

The relevant capital ratios are calculated in the CRR by dividing the respective existing own funds by the total risk exposure amount (Art. 92 para. 2 CRR).

$$capital\ ratio = \frac{own\ funds}{TREA}$$

These capital ratios may not fall below certain minimum values (minimum capital ratios) (Art. 92 para. 1 CRR).

$$\frac{own\ funds}{TREA} > mimimum\ capital\ ratio$$

Accordingly, the minimum own funds to be held by the institutions are calculated as the product of the minimum capital ratio and the TREA.

$$own\ funds > minimum\ capital\ ratio \times TREA$$

In particular, the institutions must hold so-called “Common Equity Tier 1 capital (CET 1)” (Art. 50 CRR) in the amount of 4.5 percent of the TREA (Art. 92 para. 1 lit. a CRR).

However, the TREA is not only used to calculate the CET 1 capital requirements according to Art. 92 para. 1 lit. a CRR, but also to determine a variety of other CET 1 capital requirements of the so-called “Pillar 1”:

- “Capital conservation buffer” (Art. 129 CRD) amounting to 2.5 percent of TREA;
- “Institution-specific countercyclical capital buffer” (Art. 130 CRD) of up to 2.5 percent of TREA;

- Capital buffer for “global systemically important institutions” (G-SII; Art. 131 para. 4 CRD) of up to 3.5 percent of TREA;
- Capital buffer for “other systemically important institutions” (O-SII; Art. 131 para. 5 CRD) of up to 3 percent of TREA;
- “Systemic risk buffer” (Art. 133 CRD) of up to 3 percent of TREA.

Finally, CET 1 capital requirements are also imposed on institutions under the so-called “Pillar 2”, which are expressed as a percentage of TREA:

- “Additional own funds requirements” (so-called “P2R”; Art. 104a CRD).
- “Guidance on additional own funds” (so-called “P2G”; Art. 104b CRD)

However, according to the requirements of the Basel Committee on Banking Supervision, the floored TREA must only be applied to the capital conservation buffer, the institution-specific countercyclical capital buffer as well as the capital buffer for G-SII (so-called “Basel capital buffer”) (cf. Output Floor, para. 2, p. 137 Basel IV).

In our opinion, these requirements can be implemented most easily within the framework of a so-called “parallel stacks approach”. In this approach, the minimum capital requirements from Article 92 (1) CRR and all additional capital requirements and buffers listed above are first calculated based on the unfloored TREA (U-TREA) (first stack). In parallel, the requirements of the output floor – in the form of a separate capital requirement – must then be calculated and complied with based on the floored TREA in a second “stack”. However, in the second “stack”, the TREA is only applied to the minimum capital requirements according to Art. 92 para. 1 CRR and the “Basel capital buffers”. In this way, a “gold plating” of the Basel requirements in the EU would be avoided.

However, if one wants to implement the output floor – as proposed by the EU Commission – in the form of a single-stack approach, the problem arises that not only the capital requirements according to Art. 92 (1) CRR and the Basel capital buffers, but also the “EU buffers”, automatically increase if the TREA increases due to the output floor since the EU buffers are determined as a percentage of the TREA (so-called “arithmetic effect”). This would lead to the Basel requirements being overfulfilled in the EU (“gold-plating”).

The EU Commission proposes to solve this problem by initially freezing the amount of the P2R and the systemic risk buffer (SRB) at their value before the introduction of the floor (Art. 104a para. 6 lit. a CRD (P2R); Art. 133 para. 2a lit. a CRD (SRB)). This is expressly to be welcomed.

In addition, the appropriateness of the amount of the capital buffer for otherwise systemically important institutions (O-SIIs) is to be reviewed for institutions that are bound by the output floor (Art. 131 para. 5 CRD VI-E). In our opinion, this provision goes in the right direction. However, it should also be made clear here that there must be no increase in the O-SII buffer due to an increase in the TREA through the output floor. In this respect, the calibration of the O-SII buffer should be adjusted so that the amount of the buffer in terms of value remains the same.

With this in mind, we would also like to advocate that P2G does not increase because of the output floor.

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CVA risk framework

For many of our institutions, the current standardized approach is replaced by the basic approach. While being conceptually the same, the capital requirement will increase greatly. The increase is caused by a less granular approach (IG/non-IG versus credit rating steps), impacting especially derivative exposures from financial counterparties (non-clearable derivatives such as currency swaps). We would be in favor of a more granular approach, such as the current framework as the proposed less granular approach introduces two undesired issues. There is a significant cliff effect once a counterparty deteriorates from investment grade to high yield, while the incremental risk can be marginal. On the other hand, a significant deterioration but still within the range of investment grade will not lead to additional capital.

We suggest applying a more granular scale of credit ratings including lower risk weights for highly rated counterparties, like the one currently used in the standardised method for CVA (article 384 CRR). If the risk weights are not re-calibrated hedging will become much more expensive and will hinder banks' risk management.

In Art. 384, a risk weight of 3 percent is applied in the basic approach (with and without consideration of eligible hedging transactions) for central government, central banks, and multilateral development banks of low credit quality or without a rating (see Table 1). The corresponding reduction of the risk weight to 2 percent in the framework revised by the Basel Committee in July 2020 was not adopted. An implementation that is not conform with the Basel framework should not be pursued, especially against the background of the associated disadvantage compared with third countries.

The formula for calculating the capital requirements for the basic approach without considering eligible hedges does not include the discount factor of 0.65. According to the revised Basel framework of July 2020, the value corresponding in the Commission draft (see Art. 384 para. 2) should be multiplied by the discount factor 0.65 to determine the capital requirements. We recommend a Basel-compliant implementation (see 50.14 in the revised Basel framework).

Lastly, EAPB would welcome a clarification on how to treat transactions with RGLAs with a 20% RW. It seems like an inconsistency in the exemptions in Article 382.4, as transactions with NFCs with RW 20% are exempted, while transactions with RGLAs with the same RW seems not to be exempted (except if those are meant to be recognized as NFC). We find it difficult to see the rationale for treating these exposures differently.

Application of alpha factor of 1 to SA-CCR

According to the transitional regulation in Art. 465 para. 4 CRR III-E, an alpha factor of 1 should be applied to derivative transactions from Annex II (interest rate, foreign currency and gold derivatives) in the Standardised Approach for counterparty credit risk (SA-CCR) during the introduction phase of the output floor. This rule, which only applies to users of the internal model for counterparty credit risks, should be implemented consistently such that users of the SA-CCR can also apply an alpha factor of 1 for derivative transactions from Annex II.

Furthermore, this should be permanent for the output floor and the calculation of the SA-CCR. The alpha factor should be neutralised for the calculation of the SA-CCR in accordance with Art. 274(2), as this factor does not adequately reflect current market practices and the regulatory environment, especially in the current environment of long-term low interest rates. As a result, the impact on the EAD of the SA-CCR and thus on the capital requirements is excessive. Finally, alpha risk is intended to capture such risks that are already covered by other regulatory factors (e.g., to reflect the volatility of individual asset classes in stressed markets).

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Operational Risk - Consideration of commission income and expenses in the service component

In the Commission proposal, the capital requirements for operational risk consist of the business indicator (BI), which must be multiplied by predefined factors depending on the size of the BI. The BI in turn consists of an interest component, a service component, and a financial component. While in the interest component the interest income and expenses and in the financial component the profits and losses from the trading and banking book are netted, the service component is determined by the larger value of commission income and expenses. The associated risk overstatement of the commission business may be justified based on data up to the financial crisis of 2008/2009, but it does not reflect the current situation (see following table):

Comparison of the interest component and the services component divided by the net OpRisk losses of the corresponding business areas of six large EAPB member institutions, 2017 to 2020[1]

	2017	2018	2019	2020	Avg. (2017 - 2020)
interest component / net OpRisk loss interest	32,1%	171,1%	58,3%	45,1%	76,7%
services component (**max**) / net OpRisk loss fee and commission	179,9%	242,1%	747,7%	111,9%	320,4%
services component (**net**) / net OpRisk loss fee and commission	100,1%	132,8%	398,0%	58,7%	172,4%

The first row shows the interest component, which is the interest income minus the interest expenses, divided by the net operational risk losses stemming from the interest business. The second row shows the services component, which is the maximum of fee and commission income and expenses, divided by the net operational risk losses stemming from the fee and commission business. The values of the interest component in the first row and the services component in the second row are in line with the Commission proposal. The third row shows the services component, calculated as the fee and commission income minus the expenses, divided by the net operational risk losses stemming from the fee and commission business. This value for the services component deviates from the Commission proposal, as it allows for netting of income and expenses. All values are aggregated values of the six large EAPB member institutions.

If the interest and the services component would reflect the actual net losses in the corresponding business areas perfectly, the values should be identical (= 100 %). It is obvious that each component of the business indicator does not claim to perfectly reflect the actual net losses. Large deviations between the interest and the services component and the net losses in the corresponding business areas are expected to appear, especially on a yearly basis. Despite that do the values above demonstrate that the extent of the deviations in the fee and commission business are not justified for EAPB members on a yearly basis and on average. The average values of the services component are more than three times higher than the actual net operational losses in the fee and commission business if the services component is calculated as the maximum of fee and commission income and expenses. Even if netting between fee and commission income and expenses would be allowed, there would be an overstatement of more than 70 % for VÖB members. While the interest component underestimates the actual net operational losses in the interest business, the deviation is not as immense as it is for the services component.

[1] Data provided by DakOR, the OpRisk data consortium of VÖB-Service GmbH; data are exclusively from large central institutions that exchange their loss data in the DakOR data consortium; net loss equals gross loss minus the sum of indirect/direct loss reductions.

In addition, many institutions have changed their business models from an interest-dominated business to a fee- and commission-based business in view of the persistent low interest rate environment (see following table).

Furthermore, the service component in financial networks (cooperative banks and savings banks) leads to significantly higher capital requirements for operational risk than in financial groups, which can largely eliminate intercompany transactions. Transactions within financial networks with legally independent regulated institutions lead to a consideration of commission income and expenses for each booking. Due to the gross consideration (or the maximum of expenses and income), these cannot be netted such that the risk is overstated (as a counterexample, the calculation of value-added tax or turnover tax, where input tax is offset). Such financial networks are organised under private law and offer a private-law protection of claims. Group consolidation cannot be carried out due to the structure. An example of such a value chain is, for example, a transaction between a central institution, a fund company and a large retail bank within a financial network. If the central institution is the custodian of the fund company and the retail bank brokers a fund of the fund company, the income and expenses in the individual institutions must be considered each time. Similar examples could be constructed with regulated securities brokers or payment service providers within a financial network.

If an institution in the example is not subject to the capital requirements, the total capital requirements across the value chain would be lower. The same applies to groups of institutions with a network of branches. Thus, according to the Commission proposal, unregulated institutions or groups with a branch structure would be favoured, and financial networks, such as the cooperative banking sector and the public savings bank sector with several regulated institutions, would be disadvantaged.

14 Financial networks for which an institutional protection scheme exists should be eligible for netting the fee and commission income and expenses within the network for the calculation of the service component.

Calculation of capital requirements under the new standardised approach for OpRisk

The European Commission proposes to not consider historical OpRisk losses or to set the internal loss multiplier (ILM) to 1 in the new standardised approach for determining capital requirements for operational risks. This does not comply with the idea of the new standardised approach to introduce a risk-sensitive model. The option to set the ILM to 1 exists under the Basel framework. In view of some large banks in the EU that have ILM values significantly higher than 1, the Commission proposal is understandable to a certain extent: a risk-sensitive model would lead to a sharp increase in capital requirements for such banks, which have suffered high OpRisk losses in the past.

However, numerous public banks in the EU are worse off, as they achieve ILM values below 1 due to successful management of operational risks:

ILM values of selected EAPB members from 2017 to Q3 2021

	2017	2018	2019	2020	Q3 2021
Balance sheet total weighted average of the ILM	0.92	0.91	0.88	0.83	0.85
Aggregated balance sheet total (EUR billion)	1,235	1,259	1,342	1,437	1,344

By equating the risk of all banks in the EU across the board, despite existing differences, banks that successfully manage their operational risks are penalised and those that show weaknesses in their OpRisk management are rewarded.

A historical analysis by the EBA[2] shows that the approaches currently used and the new standardised approach with an ILM = 1 are significantly less effective in reflecting actual operational risks. According to the study do outliers, where the actual OpRisk losses would be greater than the capital charge in OpRisk, occur more than three times more frequently with an ILM = 1 than with the risk-sensitive approach; the size of the outliers is three to four times higher. Furthermore, according to the study, there is a statistically significant correlation between the loss history and the current losses of an institution. This additionally supports the superior modelling quality of operational risk through a risk-sensitive standard approach with ILM ≠ 1.

We are in favour of introducing an option for institutions to multiply the business indicator component by the ILM, which depends on the institution's historical OpRisk losses, when determining capital requirements for operational risk. This would have a stabilising effect on the operational risks of the entire banking industry in the EU: banks with an ILM < 1 that want to make use of an option to use the risk-sensitive model would have an incentive to keep their risk profile constant or improve it through active risk management. Banks that currently still have ILM values far above 1 would have an incentive to improve their operational risk management to make use of the option in the long term and thus benefit from ILM values below 1.

Exposures to rated banks

In the proposed Article 120 par. 2 the residual maturity is replaced by the original maturity. This would exclude items with 3-months residual maturity from short-term qualification when the risk profile is the same than for an item with an original maturity of 3 months. This already constituted an EU deviation in CRRII which should thus be maintained.

Management of ESG risks

The introduction of the requirements for the management of ESG risks is associated with various adjustments in Article 73 et seq. CRD VI, which affect both the bank's internal processes for ensuring adequate capital and liquidity (ICAAP and ILAAP) and the supervisory review and evaluation process (SREP). In particular, the previously short- and medium-term consideration horizon of the economic and normative perspective is extended to include a long-term consideration horizon, which actually relates specifically to dealing with climate and environmental risks. In principle, this is understandable. However, there are several problems associated with the proposed formulation:

- Thus, the relevant strategies and processes now refer to risks to which the institutions are or could be exposed in the short, medium and long term. While the long-term time horizon is appropriate for climate and environmental risks, its introduction would not provide any additional insight for various other risks. The long-term time horizon should therefore be limited to climate and environmental risks only.
- Intervention by the supervisory authorities, as envisaged in Article 104 Para. 1 part m, would only be necessary if there were an unacceptable risk. We take a critical view of interventions in the business model.
- ESG risks should not be treated as a separate risk category, but as a driver of existing risks, as already stated by all supervisory authorities (including EBA, ECB and national authorities).

[2] [2] See EBA analysis on the impact of the Basel framework on EU institutions, 2 August 2019: ref. 26

According to the current wording of the CRR III (Article 4, para. 1), this insight does not seem to be anchored clearly enough.

Finally, the requirement to report banks' exposure to ESG risk should be deleted. Supervisory reporting requirements are usually based on corresponding Pillar I requirements. The envisioned ESG-risk reporting requirements however lack such a basis. It is consensus that ESG-risks are not a separate risk category, but only a driver of risks. Consequently, separate reporting thereon would not be meaningful.

Fit & Proper – Members of the management body

We see no need for harmonisation of the suitability assessment procedure and consider the requirements for harmonisation of the suitability criteria to be sufficient (Art. 91). At least it should be taken into account that an ex-ante assessment procedure of the members of the management board in its supervisory function (supervisory board), which is carried out by the institutions themselves (Art. 91a) or by the competent supervisory authorities (Art. 91b), would not be feasible to comply with for institutions which, due to legal requirements, have practically no influence on the composition of the supervisory board as this is only determined after the election or appointment by public bodies or shareholders or by ex-officio members. This would also be problematic for institutions subject to corporate co-determination in the case of supervisory body members to be elected by the employees. The envisaged exception that urgently needed appointments can be reviewed retrospectively is not sufficient. We therefore demand an exemption for these cases, regardless of the size of the institution. Irrespective of this, we consider it sufficient to limit the scope of application of the regulations to business managers. In addition, the supervisory assessment period of up 80 to 120 working days should be shortened to 20 to 40 days to avoid problems in the recruitment process and long vacancies:

Fit & Proper: Key function holder

Furthermore, we consider the extension of the fit and proper rules to key function holders and the application of suitability criteria comparable to those for managing directors to be disproportionate and advocate the deletion of Articles 91c and 91d. The responsibility for the members of the institution should remain with the board of the institution, not with the supervisor.

It should at least be taken into account that the additional supervisory ex-ante suitability assessment of key function holders planned for large institutions would mean a high administrative burden. In particular, binding contractual commitments could only be made after supervisory approval, as otherwise employment relationships would be exposed to the risk of having to be terminated, wound up or changed. To avoid recruitment problems and long vacancies, at least the supervisory assessment period should be shortened from up to 80 working days to a maximum of 20 to 40 days.

Simplified procedure for return from IRBA to CR-SA

Institutions that have already received IRBA approval are to be allowed to return to the Standardised Approach for Credit Risks (CR-SA) within a period of three years within the framework of a simplified procedure – compared to the normal procedure according to Article 149 CRR (Article 494d CRR III-E). Since institutions must only notify the competent authority of their intention to revert to the Standardised Approach and the authority must object within a period of three months, this is likely to speed up the process of reverting to the Standardised Approach considerably. Apart from this, however, the scope of application of the simplified procedure is much narrower than that of the previous procedure according to Article 149 CRR.

On the one hand, it seems problematic to us that the proposed regulations only allow the return to the Standardised Approach for entire asset classes or subclasses and not for “types of exposures”. Accordingly, institutions would have to exclude, for example, all exposures in the exposure classes “general corporates” or “specialised lending” from the IRBA. However, within these exposure classes, banks often apply different rating systems to different types of exposures. As already explained, strict supervisory requirements have forced institutions in Germany to apply the IRBA to asset types for which the development and operation of rating procedures is not economical or for which only limited data is available. The introduction of the output floor may once again significantly change the assessment of economic efficiency. Especially for such types of receivables, institutions should be given the opportunity to return to the CR-SA. We therefore propose to allow the return to the credit risk Standardised Approach also along exposure types (Article 142 para. 1 No. 2 CRR) and thus rating systems (Article 142 para. 1 No. 1 CRR).

On the other hand, according to Article 494d CRR III-E, only a return to the Standardised Approach for credit risk shall be possible for IRBA institutions. Already today, however, institutions have the option under Article 149 para. 2 CRR to return from the advanced IRBA to the IRB foundation approach. According to para. 48 Basel III: Finalising post-crisis reforms, IRBA institutions may, under “exceptional circumstances”, switch not only to the Standardised Approach for credit risk, but generally to less sophisticated IRB approaches. According to the EBA's August 2019 recommendations on the implementation of Basel III in the EU (CR-IR 3), the implementation of the Basel III rules constitutes such an “exceptional circumstance”. Accordingly, the simplified procedure in Article 494d CRR III-E should also be opened for the transition from the advanced IRBA to the foundation IRB approach.

Supervisory stress tests

The prohibition proposed in Article 100 para. 3 CRD VI for institutions, advisors and third parties to refrain from benchmarking, information exchange, etc. in the context of supervisory stress tests is clearly too far-reaching and should therefore be dropped. It is understandable that the supervisory authorities expect realistic information and, in this respect, wish to counter possible influence by third parties. However, the exchange between the banks and via the associations promotes high quality and enables conceptual further developments.

Means of disclosure

To reduce the disclosure burden of institutions, the EBA should use supervisory reporting to compile the corresponding disclosure for all institutions, rather than just for small and non-complex institutions (SNCIs). There is no need to develop a separate process for larger institutions in Article 434, as it would lead to double processing of data points and it may create inconsistencies.

Disclosure of information on remuneration

By adapting Article 434, there should be an option to publish information according to Article 450 CRR (remuneration) separately (from other contents of the disclosure report). In some cases, this information is only available at a later point in time for procedural reasons – for example if the approval in the shareholders' meeting is needed. Such an option would foster more timely disclosure of other information according to Part 8 CRR.

Extent of disclosure and first implementation of new disclosure rules

The principle that Pillar III disclosures should not exceed reporting should be reinforced, as current exceptions applied for ESG and interest rate risks in the banking book (IRRBB) disclosures may lead to unnecessary and burdensome ad hoc reporting requests.

The first application date of new disclosure rules should be linked to the publication of the specifying ITS. In order to avoid the risk of having to start the disclosure without finalised technical solutions there should be an implementation period of at least 24 months.

Disclosure of ESG risks

The lastminute changes in CRR 2 concerning the semi-annual disclosure of ESG-risks are unsubstantiated. ESG risk drivers are of a medium and long-term nature, which is also reflected, for example, by the assumed time horizons in scenario analyses. Furthermore, the sustainability disclosures are based on the counterparty information which is only published annually in accordance with the CSRD and the Taxonomy Regulation. We do not expect any material changes in risk analysis and disclosure in the course of the year to justify the semi-annual frequency of disclosure.

Treatment of the IAA in the calculation of the output floor

We advocate that institutions be allowed to use the Internal Assessment Approach (IAA) to calculate S-TREA in relation to securitisations. The IAA – despite its name – is in our view comparable to the external assessment-based approach for securitisations (SEC-ERBA), which may be used to calculate S-TREA. On the one hand, the banks' internal assessments are based on the methodologies of external rating agencies and are adjusted once a year to reflect changes in these methodologies. This is reviewed by the supervisory authority. On the other hand, the risk weights for the securitisation exposures assessed under the IAA are determined according to the SEC-ERBA. In our opinion, there is therefore not fundamental difference between the IAA and the SEC-ERBA.

Equity exposures

We welcome the proposal of the EU Commission to implement the option granted by the Basel Committee for the privileged recognition of equity exposures in the context of so-called “legislative Programmes” with a risk weight of 100 percent in the EU. This option is primarily aimed at supporting publicly funded equity programmes of banks in the United States. In the EU, equity financing is provided by state owned promotional banks, e.g. to promote business start-ups, which in our opinion can be used to implement government objectives in the banking sector in a targeted and efficient manner. We therefore advocate that equity programmes of promotional banks should also be covered by the regulation. The preferential risk-weighting of equity within the framework of such programmes could be used to invest in a larger volume of participations with the intention of promotion and thus enable greater eligibility for promotion. Furthermore, additional programmes could be devised to mobilise private capital for equity investments and this privilege could be passed on to the financial sector in the form of the preferential risk weight. Unfortunately, the criteria created for US banks for the inclusion of participations in “legislative programmes” only fit the European funding landscape to a limited extent. To make the regulation also accessible to promotional banks, we propose a corresponding amendment to Article 133 (5) CRR.

We appreciate the proportionate and conciliatory approach of the Commission's proposal in the implementation of the new exposure class "unlisted speculative equity" and in particular the introduction of a holding criterion to characterise a long-term investment (article 133.4 CRR). This criterion, limited to unlisted shares in the current proposal, could also give rise to an ad hoc "all long-term equity exposure class" (inspired, for example, by the approach of the Solvency II Directive).which could benefit from a preferential treatment (<250%).

Moreover, the European Commission new 400% weighted "unlisted speculative equity" exposure category should be limited to speculative trading. It is particularly important to avoid a broad definition that would include private equity. Private equity is a long-term investment activity that supports the economy and has proven its resilience during the last economic crisis for its countercyclical role. It offers an alternative source of financing for companies not able to obtain financing from the stock market and thereby helps them to mobilize debt capital. Public financing institutions' equity investments aim to be long term-oriented, not falling below a holding period of typically 3 years at least. The intention is clearly not to generate short-term profits, but rather to foster growth and welfare in the long run.
Lastly, we consider it important that current requirements continue to apply to certain equity positions that have already been held by the institution for six years. In this regard, the current wording of the grandfathering clause in Article 495a par. 3 should be maintained without further changes

Unconditionally cancellable commitments

The credit conversion factor (CCF) for commitments that can be cancelled at any time are to be raised from 0 to 10 percent (Art. 111 para. 2 lit. e CRR III-E). However, the EU Commission would like to make use of the Basel option, after which certain credit commitments to small and medium-sized enterprises (SMEs) will continue to remain capitalisation-free (Art. 5 No. 9 CRR III-E). We welcome the exercise of the Basel option.

According to the proposal it shall be possible to continue to apply the 0 percent CCF until 31 December 2029. Subsequently, the CCF is to be gradually increased in a transitional phase ending on 31 December 2032 by multiplying the applicable factor by certain percentages (25, 50, 75 percent) (Art. 495d para. 1 CRR III-E).
The long transition periods are to be welcomed in principle, but in our opinion, they will merely postpone the problem into the future. It can even be assumed that lenders and rating agencies will require banks to hold those capital requirements that will apply after the end of the transitional period well before the end of the transitional period. Therefore, it can be assumed that the relief will effectively not even be available during the transition period. We are therefore strongly in favour of removing the time limit. This is also justified from a risk point of view, since with a credit line that can be terminated at any time, a bank does not run the risk of taking on an undesirable credit risk.

Determination of the property value

The European Commission proposes to introduce a real estate value to be determined according to sustainable criteria (Art. 4 para. 1 No. 74a CRR III-E). The real estate value is to be distinguished from a mortgage lending value according to Art. 4 para. 1 No. 74 CRR III-E and a market value according to Art. 4 Para. 1 No. 76 CRR III-E. The newly introduced real estate value is to be used as the basis for determining the loan-to-value ratio, which is decisive for the allocation of a privileged risk weight.

The property value shall be determined independently of the loan acquisition, loan decision and loan processing process according to conservative valuation criteria. Speculative elements shall be excluded. If the market price of the property to be valued is significantly higher than the value that can be considered sustainable during the term of the loan, adjustments to the property value shall be permitted. The property value shall not be higher than the market value.

The methodology for valuing real estate according to the newly introduced real estate value is unclear. In our view, the valuation principles proposed by the EU Commission do not exclude the valuation of real estate collateral at market value. We are therefore in favour of retaining the CRR's institutional choice between valuing real estate collateral at or below the mortgage lending value or at or below the market value. We believe that the principle of prudence in the valuation of real estate collateral contained in the proposals of the EU Commission is already sufficiently covered by the provisions on regular value monitoring and review (Art. para208. 3 lit. B CRR III-E).

Market risk framework

General remarks on the start of application

In the event of a possible postponement of the first application of the new market risk framework, there should be a solution for the value with which the market risk is included in the output floor calculation in the years 2025 and 2026. It should be ensured that the currently applied approaches can be used in the event of a further shift. An implementation of, for example, the old, standardised approach for a transitional period of only a few years would be disproportionate.

Inclusion in the trading book

The initial application of the FRTB alternative standardised approach for capital requirements by CRR III-E was postponed to at least 1 January 2025; according to 461a (b) CRR III-E, it is possible to postpone capital requirements for market risk by two additional years. The revised regulations on trading book allocation (Art. 104 CRR III-E) must be applied from 1 January 2025 at the earliest, while internal hedging transactions (Art. 105 CRR II) and reclassifications of positions between trading and banking book (Art. 104a CRR II) must be applied from 28 June 2023, as they were already included in CRR II. Furthermore, Art. 104a contains a mandate for the EBA to develop additional guidelines to define - exceptional circumstances under which a position can be reclassified. However, these exceptional circumstances will be defined by the EBA by 28 June 2024.

Due to the different points in time, only parts of the FRTB regulations would be implemented as an isolated solution, whereby there are dependencies between the regulations. For example, the “old” trading book allocation to the intention to trade would still exist as of 28 June 2023, while reclassifications (according to the new regulation) would only be permitted in exceptional cases as of this date; these exceptional cases will be determined by the EBA until 28 June 2024.
The temporally different initial application for trading/banking book allocation, internal hedging transactions and reclassification of positions is not expedient. It should be possible to implement these regulations as a complete package. Therefore, we propose a uniform date of initial application for all regulations, which corresponds to the trading book allocation according to 104 CRR-E.

According to paragraph 2 (g), listed equities should generally be allocated to the trading book. If such holdings are held on a long-term basis for strategic or business policy reasons, the intention to trade can be excluded. We request for clarification that such positions can be allocated to the banking book without permission. The same should apply to investments in companies that would have to be allocated to the trading book due to a change in the legal form to a listed corporation. Likewise, the intention to trade can be excluded at the time of the investment.

According to para. 3 (h), own liabilities should not be allocated to the trading book unless the positions fulfil the criteria from para. 2 (e) (market making activities). This deviation from the Basel framework contradicts the widespread practice of issuing certain instruments from the trading book, such as share certificates. In principle, own liabilities can be issued with or without trading intent, regardless of the

exclusive condition that they arise from market-making activities. Flexibility in the allocation to the trading or banking book should be maintained.

Conditions for using the simplified standardised approach

The thresholds for the simplified standardised approach according to Art. 325a (1) (size of its on-balance sheet and off-balance sheet business below 10 percent of total assets and €500 million) are an EU-specific deviation from the Basel framework. Under CRR II, these are thresholds that exempt institutions from special reporting requirements. Under the Basel framework, supervisors may approve the use of the simplified standardised approach based on certain criteria. These can be, for example, that the institution is not a globally systemically important institution, that it does not use an internal model for the trading desks or that the institution does not operate an alternative correlation trading portfolio. We are in favour of following the Basel requirements for institutions who's on-balance sheet and off-balance sheet transactions are above the thresholds according to Art. 325a para. 1.

Own funds requirements for delta and vega risks

For the treatment of foreign currency positions in the banking book, we ask for clarification that only the foreign currency risks in the standardised and simplified standardised approaches are considered. The effects from sensitivities of other risk types (e.g. interest rate or credit spread) for the treatment of banking book positions should not be considered. Art. 325f para. 3 CRR III-E should be specified accordingly.

Treatment of collective investment undertakings

According to Art. 325j (1a) CRR III-E, there is the option for CIU positions to not decompose them for the default risk if they are considered undecomposed in the sensitivity-based part. We welcome this possibility.

However, for consideration as an individual position, the credit quality step "not rated" should be assigned. Consequently, according to Art. 325y (1), Table 2, a default risk weight of 15 percent applies. We do not consider this to be appropriate. If the CIU has a better rating or if it can be proven via the mandate that all components have a better rating, it should be possible to choose a lower credit quality step (e.g. 1-3).

The same applies to the blanket allocation to the bucket "other sector" according to Art. 325j 1 (b)(i) CRR III-E with a risk weight of 70 percent for undecomposed CIUs in the sensitivity-based approach (Art. 325 ap para. 1, Table 8). According to the underlying securities of the index, an allocation to bucket 12 or 13 (high market capitalisation/advanced economy indices or other indices, respectively, corresponding to risk weights of 15 percent and 25 percent) should be possible.
According to the newly introduced Art. 325j (1a) CRR III, the capital requirements for the undecomposed CIUs are also calculated on a "stand-alone" basis or as a separate portfolio. We request clarification as to whether the risk-weighted assets must be reported separately from the other risk-weighted assets for this purpose.

Intra-bucket correlations for commodity risk

We welcome the reduction of the risk weight for commodity risk for the bucket CO2 business (energy - carbon trading) according to Art. 325as of CRR III-E from 60 percent to 40 percent. In addition to the recommendation to reduce the risk weight for CO2 certificates, ISDA's 'ESG Risk and Capital' working

group argued for an increase in the tenor correlation from 0.99 to 0.996. In its argumentation, ISDA refers to market data that an increased tenor correlation reflects the risk of the CO2 business more adequately. Therefore, the tenor correlation for the CO2 business should also be increased accordingly from 0.99 to 0.996.

Prudential consolidation rules (definition)

In Art. 4 para. 1 no. 26 CRR III-E, the definition of a financial institution is to be amended. In future, all payment service providers within the meaning of Directive (EU) 2015/2366 shall be included (Art. 4 para. 1 no. 26 lit. b (ii) CRR III-E). However, the current definition only covers payment institutions. According to Art. 1 para. 1 lit. a Directive (EU) 2015/2366, credit institutions are also considered payment service providers according to Art. 4 para. 1 no. 1 CRR. It should therefore be specified which payment service providers mentioned in Art. 1 (1) Directive (EU) 2015/2366 fall under the term financial institution.

Art. 4 para. 1 no. 26a CRR III is intended to introduce a definition of a pure industrial holding company. Insurance holding companies within the meaning of Art. 212 para. 1 lit. f of Directive 2009/138/EC are excluded in Art. 4 para. 1 No. 26a lit. b CRR III-E (financial sector entities according to Art. 4 para. 1 No. 27 lit. h CRR), but not mixed insurance holding companies within the meaning of Art. 212 para. 1 lit. g of Directive 2009/138/EC. Since mixed insurance holding companies are also considered financial sector entities according to Art. 4 para. 1 no. 27 lit. j CRR, they should be supplemented accordingly.

Furthermore, it is not comprehensible why Art. 4 para. 1 no. 26a lit. c CRR III-E, when referring to Annex I sections A or B of Directive 2014/65/EC, only mentions activities, but not services. For reasons of legal certainty, the term "services" should be added.

Definition of the group term for investment firms

On 26 June 2021, the EU Investment Firms Regulation (IFR) and the EU Investment Firms Directive (IFD) came into force. The aim was to create a separate supervisory regime corresponding to the risk of investment firms. The IFR (Article 62) amended the CRR to the effect that now, according to Art. 4 para. 1 no. 1 lit. b (ii) and (iii), small investment firms must be classified as CRR credit institutions if they belong to a group whose total value of the consolidated balance sheet total of all companies in the group is equal to or exceeds EUR 30 billion and engage in proprietary trading and/or issuing business.

The unintended consequence is that these grouped medium-sized and smaller investment firms, which were just supposed to be subject to eased requirements, will be fully subject to banking supervisory requirements and will have to be allocated to the banks' deposit guarantee scheme.

To clarify that group membership is limited exclusively to investment firms and that no CRR credit institutions have to be included, the definition of group in the CRR for the purposes of Art. 4 para. 1 no. 1 lit. b (ii) and (iii) should be amended accordingly.

TLAC deduction rules for G-SRI

According to Art. 72e CRR, global systemically important institutions (G-SII) are obliged to deduct indirect and synthetic holdings in certain eligible instruments. In Art. 4 para. 1 points 114 and 126 CRR III, the terms “indirect holding” and “synthetic holding” are adapted to the effect that they also cover other holdings of relevant liabilities in addition to holdings of capital instruments.
The formulations in Art. 4 para. 1 points 114 and 126 CRR III do not restrict the scope of application to eligible liabilities, but speak generally of “the value of the liabilities issued by an institution” or “to liabilities issued by an institution”. In our opinion, a restriction to “eligible liabilities” should therefore be made.

Mandatory use of the substitution approach within the large exposure regime

According to Article 401 (4) CRR, institutions must use a credit risk mitigation technique for large exposure purposes when it has used it for calculating own funds requirements. This collateral must then be counted as an indirect risk position against the large exposure limits of the collateral provider or issuer. The European Banking Authority has clarified in Q&A 2020_5496 that the mandatory substitution approach should also be applied to collateral in securities financing transactions (SFT) that are subject to a master netting agreement under Articles 220 and 221.

However, this interpretation does not consider the specifics of netting. For example, the application of the substitution approach under Article 403 CRR requires that collateral is provided by a third party. Under conventional credit risk mitigation techniques, the default risk of an exposure to a counterparty is reduced by financial collateral or a guarantee from a third party. Nevertheless, in this case the institution retains a risk position in the original amount vis-à-vis the counterparty. In the case of netting, on the other hand, opposing positions of the institution and a counterparty are set off against one another, so that only a reduced risk position (net position value) remains after netting. The securities received thus leads to a reduction in the risk position. Only this reduced risk position is subject to a default risk (of the counterparty). Thus, the offsetting of positions in netting precisely does not result in the default risk of the netted position being replaced in whole or in part by the default risk of a third party. Therefore, securities in securities financing transactions are not taken into account as a credit risk mitigation technique in the strict sense in the context of a netting set. Rather, their value is used as an offsetting measure for the net position. The value of the securities is taken into account on a daily basis and the net position value is daily adjusted. Shortfalls in coverage must be offset on a daily basis (so-called margining or re-collateralization). In this respect, daily netting adequately hedges the double default risk.

In addition, a mandatory substitution approach for securities financing transactions when applying master netting agreements contradicts the purpose of the large exposure regime to prevent idiosyncratic risks. Whereas unsecured interbank refinancing (e.g., unsecured money market transactions) may indeed give rise to cluster risk, securities financing transactions provide risk diversification through the collateral behind them. If large exposure limits are threatened to be exceeded, institutions could be forced to restrict collateralized business. This could have drastic effects on the liquidity situation of banks, as the repo and securities lending market represents an important short-term source of funding or investment opportunities. Banks could again increasingly switch to the unsecured money market, which would certainly represent a step backward from a risk perspective. In addition, secured transactions could increasingly shift to unregulated market participants. These market participants are not subject to large exposure regulations and thus are not subject to the substitution approach, i.e., they have no corresponding restrictions.

We therefore strongly advocate exempting securities financing transactions that are subject to a master netting agreement from the substitution approach in the large exposure regime.

Third-country branches

According to Art. 21c CRD, Member States shall require undertakings established in a third country as referred to in Article 47(1) and (2) to establish a branch in their territory and apply for authorisation in accordance with Title VI to commence or continue conducting the activities referred to in paragraph (1) of that Article in the relevant Member State.

The requirement to reauthorise already authorised branches is cumbersome and will lead to unnecessary costs and administrative effort. It will be especially disadvantageous in member states that already require third-country branches to apply for authorisation.

Infrastructure supporting factor

The application of the infrastructure supporting factor (Art. 501a CRR) was preponed by the "CRR quick fix" to 27 June 2020. During the implementation of the supporting factor in the banks, it became apparent that the adopted regulations do not allow certain infrastructure financings, which were also intended to be covered by the regulation according to the legislator, to benefit from the envisaged capital relief. In order for the supporting factor to develop its full intended effectiveness, it is urgently necessary to adjust the factor with regard to two groups of infrastructure financing.

Treatment of demand risk

The provision of infrastructure for the future technologies of electric mobility and solar and wind energy is an important prerequisite for the transition to a carbon-free economy. Digital infrastructure (e.g., fibre, 5G mobile, cloud computing) is also an important foundation for the climate-friendly transformation of industry (e.g., automation, energy management, autonomous driving). For this reason, the EU legislator wants to explicitly support such infrastructures according to recital 60 of CRR II by introducing an infrastructure supporting factor (Article 501a CRR).

However, according to the current regulations, the supporting factor shall only be applicable to such projects where the cash flows generated by the debtor are predictable (Article 501a (1) (e) CRR). This is specified in more detail in Article 501a (2) CRR. According to this, there may only be a low demand risk. The problem, in our opinion, is that the revenues from solar and wind energy infrastructure, electric mobility as well as digital infrastructure are to a certain extent, or even completely, subject to certain market risks. In the case of solar and wind energy, there are offtake agreements with a term over the first few years, but not over the complete term of the financing. Therefore, for the further (often larger) part of the financing term, assumptions must be made about follow-up contracts that are subject to certain market risks. In the case of e-mobility infrastructure (charging stations comparable to petrol stations) and digital infrastructure, the market risk is even immanent from the outset.

In order for the infrastructure supporting factor to fully unfold its effect as intended, also in the future topic of decarbonisation, we believe that the criterion of the predictability of cash flows should be considered fulfilled even if certain market risks remain, but these are considered low by the institution on the basis of well-founded forecasts by independent third parties and nevertheless cover all future loan repayments during the term of the loan with a high degree of probability.

Financing of rolling stock

In our opinion, if the criteria of Art. 501a CRR are otherwise fulfilled, the financing of rolling stock should also fall under the infrastructure supporting factor. However, with the current wording in the CRR, it is questionable whether these can be considered as part of “physical structures or facilities, systems and networks that provide or support essential public services".

Looking at the legislative history of the CRR II, the EU Commission made it clear in the explanatory memorandum to its legislative proposal that, when drafting the criteria for the application of the infrastructure supporting factor, it was aiming for consistency with the definition prescribed for the insurance sector under Solvency II (23.11.2016, COM (2016) 850 final 2016/0360 (COD), p. 22). In fact, the definition of "infrastructure asset" in Art. 501a CRR was taken verbatim from Art. 1 No. 55a Commission Delegated Regulation (EU) 2015/35 (as amended by Art. 1 (1) Commission Delegated Regulation (EU) 2016/467).

However, while the legislative proposal for CRR II was being discussed in the Council and the European Parliament, the EU Commission (Art. 1 (1) Commission Delegated Regulation (EU) 2017/1542) added "physical assets" to the definition of "infrastructure assets" in Art. 1 No. 55a Commission Delegated Regulation (EU) 2015/35. In doing so, it has taken up a proposal that the insurance industry had submitted to the European Insurance and Occupational Pensions Authority (EIOPA) as part of a "call for evidence". The aim of this proposal was that "rolling stock companies" could also be included under the term "infrastructure assets". EIOPA considered the proposal to add "physical assets" to the definition as a reasonable clarification (EIOPA CP 16/005, 15.04.2016, p. 51: "reasonable clarification"). In our opinion, this adjustment to Solvency II was simply overlooked in the negotiations on the legislative proposal for CRR II. Accordingly, we would like to advocate for this to be made up for within the framework of the current revision of the CRR.

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