

# European CFO Network

To: European Commission – Financial services, financial stability and Capital Markets Union

Dear Commissioner McGuinness,

I am reaching out to you [REDACTED] of the European CFO Network (CFON), comprising CFOs from the largest 22 banks headquartered in Europe, representing approx. 70% of Europe's banking assets. It is the CFO Network's objective to share common views on key issues faced by the banking industry amongst members and with policymakers, regulators and other similar authorities, notably on the topic of banking regulation.

That said, avoiding undue negative repercussions from final Basel III implementation in Europe has been a priority for the CFON for a long time. The publication of the European Commission's CRR3 legislative proposal on October, 27<sup>th</sup> provided a further trigger point for us, specifically the EU 27 members of the CFO Network directly concerned with this legislation, whose views are articulated in this letter, to continue our open and constructive dialogue with you.

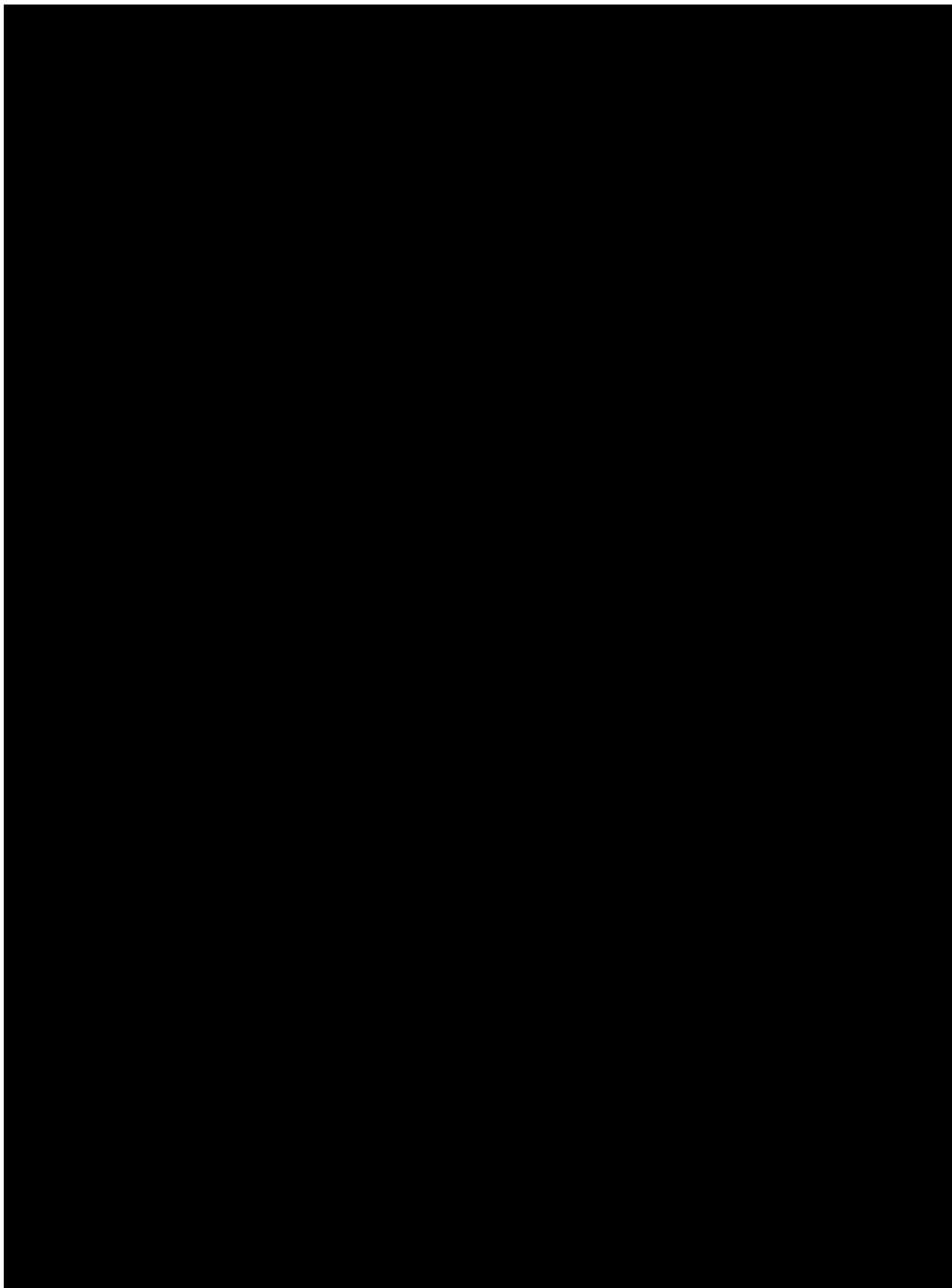
Having reviewed the Commission's CRR3 proposal as well as the European Commission's impact assessment, and benchmarking it against the latest CFON impact study, we continue to anticipate a significant RWA inflation for the major European banks (in particular when transitional arrangements provided for in Art. 465 expire) with negative consequences for availability of bank lending in support of the European economy.

Nevertheless, we are pleased to acknowledge the continuation of certain items already previously agreed by the EU legislator, specifically the supporting factors for SMEs and infrastructure finance, as well as certain CVA exemptions. We also welcome certain other elements featured in the legislative proposal which make use of flexibility provided within the Basel III final framework and/or address European specificities and support European strategic autonomy, notably

- For **Operational Risk**, the Internal Loss Multiplier (ILM) is set to 1, a choice provided within the Basel III final framework
- For **unrated corporates** with no external rating, *when calculating the output floor*, a 65% risk weight (RW) is provided for internally rated investment grade corporates (IRB PD≤0.5%), instead of 100%, until YE 2032
- For **residential mortgages** executed in markets that have a low loss-history and dual recourse, *when calculating the output floor*, Member States can opt for a reduced Standardized Approach (SA) RW for exposures up to 80% of the property value, until YE 2032
- For **derivative exposures**, *when calculating the output floor*, the **SACCR** alpha multiplier is set at 1, until YE 2029, with a possible permanent modification of the alpha multiplier value through delegated act based upon an EBA report on this setting (*for pre and post output floor calculations*)
- For unrated high quality object finance lending (**specialised lending**) under SA a reduced 80% risk weight is proposed; and under IRB a 3-year transitional arrangement is introduced for LGD input floors
- For the output floor, the P2R and the Systemic Risk Buffer (SyRB) requirements implemented in Europe are "**frozen**" (in absolute Euro terms) to avoid an automatic (also referred to as "arithmetic") increase in the amount of regulatory capital required. In addition, the output floor is implemented at consolidated level
- For **FRTB** we welcome the mechanism embedded in Article 461a empowering the European Commission to monitor the implementation of FRTB standards internationally, and to adopt a Delegated Act to address any significant deviations from a level-playing field perspective, notably i) to postpone by 2 years the go-live date for the own fund requirements and/or ii) to apply, where necessary, a multiplier to the institutions' own funds requirement for market risk (set between 0 and 1)

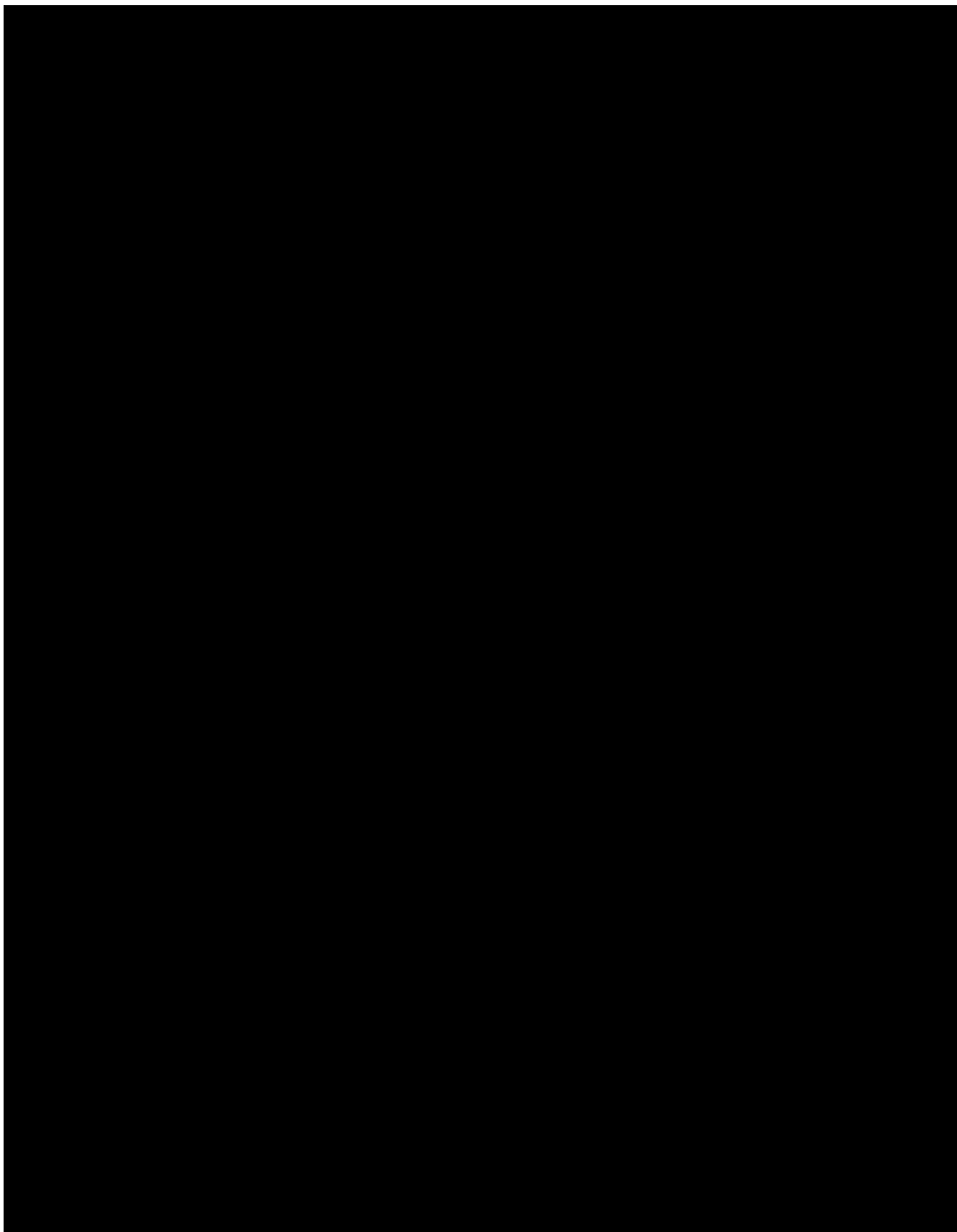
# European CFO Network

---



# European CFO Network

---





# European CFO Network

That said, we recommend that **further targeted amendments** should be considered to ease the strain on banks' lending capacity and competitiveness. Here, we would again like to reiterate some of our targeted suggestions<sup>11</sup> which we already outlined in our earlier engagements with European authorities and legislators, namely,

Topics	CFO Network recommendations on EC CRR3 legislative proposal
Aggregate output floor of 72.5%	<ul style="list-style-type: none"> <li>■ We welcome that the Output Floor is implemented at consolidated level</li> </ul>
	<ul style="list-style-type: none"> <li>■ We regret that the "parallel stack approach", which had been confirmed as Basel compliant by various law firms, has not been included in the legislative proposal. As a result, the impact of the OF remains significant and we recommend implementing it as a <b>true backstop</b>, e.g. by applying a cap of 10% of IRB RWA</li> </ul>
Unrated corporates	<ul style="list-style-type: none"> <li>■ We welcome the transitional measure of allowing unrated corporates to receive 65% risk weight if determined as investment grade based on well governed internal ratings. We continue to support the establishment of external corporate ratings provided by central banks based on information received by them from banks in their respective jurisdiction monthly, facilitated by the data from the Harmonised European Accounts Database (BACH) and AnaCredit information. We recommend <b>extending the transitional measure</b> until sufficient ratings coverage is achieved in the EU</li> </ul>
	<ul style="list-style-type: none"> <li>■ We believe that this capacity should also be allowed for SA banks</li> </ul>
Real estate financing	<ul style="list-style-type: none"> <li>■ We welcome the embracement of the dual recourse concept and the inclusion of a beneficial treatment for low-risk residential mortgages. We, however, recommend that this beneficial treatment should not be temporary but <b>permanent</b>. In addition, we recommend that this beneficial treatment applies to RRE with LTV &gt; 80% in case criteria (of dual recourse and a hard test) are met. Furthermore, we recommend to not make Art. 465 (5) subject to <b>national discretion</b> of Member States to ensure that a reduced RW for the part of exposures up to 80% of the property value equally applies in EU, avoiding cross-border implications and an un-level playing field within EU.</li> </ul>
	<ul style="list-style-type: none"> <li>■ We believe that this capacity should also be allowed for SA banks</li> </ul>
	<ul style="list-style-type: none"> <li>■ We recommend letting banks <b>choose the approach</b>: "splitting" approach or "whole loan" approach</li> </ul>
	<ul style="list-style-type: none"> <li>■ RRE under construction: we ask to eliminate the <b>threshold of one-to-four</b> family residential housing units</li> </ul>
CVA	<ul style="list-style-type: none"> <li>■ We welcome that the CVA exemption has been maintained. However, the gap has not been narrowed between <b>regulatory CVA and accounting CVA</b>: we propose for regulatory CVA a reduction of MPoR and, when justified, the use of a different expected LGD than the market LGD</li> </ul>
	<ul style="list-style-type: none"> <li>■ We also ask to restore granularity of risk weights by rating grade and adding distinction between riskier and less-risky types of <b>financial counterparties</b></li> </ul>
	<ul style="list-style-type: none"> <li>■ We recommend improving recognition of <b>index and proxy hedge</b> effectiveness</li> </ul>
SFT	<ul style="list-style-type: none"> <li>■ We welcome the EC proposal not to introduce minimum haircut floors for SFTs. We recommend this topic should be <b>re-opened at Basel level</b> in order to align local implementation</li> </ul>
	<ul style="list-style-type: none"> <li>■ SA: we recommend allowing <b>maturity adjustments</b>, i.e. to recognize that SFT transactions are usually very short dated</li> </ul>

<sup>11</sup> Certain targeted amendments, e.g. in the important area of securitization (e.g. securitization SA in the output floor), even though not listed in the table, are nevertheless equally relevant for further review and discussion with authorities in the run up to the CRR3 finalization.

# European CFO Network

SACCR	<ul style="list-style-type: none"> <li>▪ We welcome that the Commission has introduced an alpha factor of 1 for purposes of the output floor. However, we recommend to further align with international implementation, i.e. to <b>extend this to the whole SACCR framework</b> and make it <b>permanent</b></li> </ul>
	<ul style="list-style-type: none"> <li>▪ We recommend to only require different <b>netting sets</b> if margin frequency of two CSAs is different</li> </ul>
	<ul style="list-style-type: none"> <li>▪ We ask to increase <b>initial margin</b> recognition in the PFE add-on</li> </ul>
	<ul style="list-style-type: none"> <li>▪ We recommend eliminating overstatements in SACCR exposure in case of <b>currency triangulation</b></li> </ul>
	<ul style="list-style-type: none"> <li>▪ We recommend recognizing <b>diversification benefits</b> across hedging sets in IR and FX asset classes</li> </ul>
OR SMA	<ul style="list-style-type: none"> <li>▪ We recommend in addition to allow <b>netting of income and expenses</b> in the Service Component or Financial (TB P&amp;L and BB P&amp;L) Components</li> </ul>
Specialised lending	<ul style="list-style-type: none"> <li>▪ SA/IRB/Slotting: We recommend <b>more granularity</b> in RW and LGD floor</li> </ul>
	<ul style="list-style-type: none"> <li>▪ SA/IRBA/Slotting: We ask for a better <b>collateral recognition</b></li> </ul>
Trade Finance	<ul style="list-style-type: none"> <li>▪ We recommend maintaining the <b>Trade Finance CCF setting as per CRR2</b> (20% CCF for Trade Finance guarantees, 0% Credit Conversion Factor (CCF) for uncommitted facilities). We believe a review of the proposed UCC definition is indicated</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Within the current CRR the actual (or effective) maturity can only be allowed at discretion of the national competent authority. We recommend allowing to opt for the <b>effective maturity</b>. In addition, we ask to apply specific LGDs depended on the instrument and its historic loss rate as e.g. 45% LGD for exposures to banks is significantly above the historically observed LGD for trade finance related bank exposures</li> </ul>
FRTB	<ul style="list-style-type: none"> <li>▪ We welcome the introduction of a <b>Delegated Act</b>, allowing the Commission to adapt timing and substance of FRTB capital requirements as a function of international developments</li> </ul>
	<ul style="list-style-type: none"> <li>▪ We recommend that the <b>3bp PD floor in DRC</b> should not apply in IMA to the issuers eligible for a 0%RW in SA. A more appropriate calibration for Covered Bonds as a separate risk class, reflecting their distinct characteristics and risks should be defined. We also recommend applying a similar treatment to sovereign debt in the IMA as the one in the SA to avoid the disproportionate impact of the DRC in the case of higher risk weighted sovereign debt (BB ratings)</li> </ul>
	<ul style="list-style-type: none"> <li>▪ We recommend that <b>NMRF</b> should be a residual component of market risk capital for IMA banks. Banks require more headroom in developing their own methodologies to better reflect risk management practices. Remove model static parameters used to scale shock sizes, simplify the Risk Factor Eligibility Test (RFET) rules around mapping of Real Price Observations (RPOs) to model risk factors and allow the use of all available data for the calibration of shocks (instead of just looking at the stress period)</li> </ul>
	<ul style="list-style-type: none"> <li>▪ We think that the P&amp;L Attribution Test (<b>PLAT</b>) should not be binding until sufficiently tested on real portfolios to avoid e.g. that less well-hedged portfolios could have a higher probability of passing PLAT than the ones in which risks are fully hedged</li> </ul>
	<ul style="list-style-type: none"> <li>▪ Even if the proposed CIU flexibility to ease the look-through approach is welcome, <b>CIU</b> treatment is still restrictive for both SA and IMA approaches, therefore we recommend: <ul style="list-style-type: none"> <li>○ To not impose constraints on the nature of the third parties, provided that the adequacy of the data they provide to banks has been confirmed by an audit</li> <li>○ That at least for regulated CIUs (e.g.: UCITS), the risk weight of the single equity approach should be recalibrated to provide a more credible fallback to the look-through approach and to account appropriately for the degree of diversification in such CIUs (i.e., <math>RW \leq 15\%</math>)</li> </ul> </li> </ul>



# European CFO Network

	<ul style="list-style-type: none"> <li>○ To not impose a mandatory look-through approach for IMA. Instead, banks should have the flexibility to choose their own risk modelling under internal model, provided this is approved by competent authorities</li> </ul>
	<ul style="list-style-type: none"> <li>■ In addition, with regards to the <b>mandatory standard approach</b>, we recommend that:           <ul style="list-style-type: none"> <li>○ The Correlation Trading (CTP) framework should be closely aligned with that of non-CTP wherever differences are not justified, and CTP exposures should be able to be decomposed to constituents of the product for better recognition of economic hedging</li> <li>○ Banks should be able to decide to include a product in scope for <b>curvature risk</b> for each product per trading desk or asset class separately rather than across all asset classes simultaneously as this would better reflect risk management practice and allow a business area which strategically hedges linear products with options (or vice versa) to function without adversely impacting other businesses</li> <li>○ Products that are in scope for the Residual Risk Add-on (RRAO) should either be considered out of scope or alternatively the RRAO charge needs to be revised to reflect notional at risk</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li>■ Own Credit Spread (OCS) should not be capitalized in market risk</li> </ul>
	<ul style="list-style-type: none"> <li>■ Internal Risk Transfer (IRT): we recommend removing the requirement to “perfectly” offset (Art 106.5.a) the interest rate risk with an external counterparty whenever the IRT desk leverages on other internal trading desks to manage the IR exposures stemming from the BB. The requirement to “perfectly” externalize the risks transferred from the BB to the TB should also be removed for Equity and Credit Risk Transfers (Art 105 3 and .4) not to turn the TB prerogative to manage risks into simplistically passing them on</li> </ul>

We further note that, based on past experience, banks will need to start calculating and disclosing to the market **“fully loaded” CRR3 capital ratios** much ahead of the expiry of any temporary/transitional arrangement initially applied; hence banks will be bound by the **“fully loaded” CRR3 package** much ahead of time. Any signal of capital shortfalls, after **temporary measures expire**, would negatively impact investor confidence early on which would affect banks’ ability and need to raise capital (or bail-in debt) evidently restricting future lending capacity. We therefore recommend that the **transitional (temporary) arrangements for residential real estate, unrated corporates and SACCR** proposed in the CRR3 legislative proposal are turned into **permanent ones** and are **extended to the SA**. Otherwise, these mitigating measures would not bring the intended relaxation to the European banking system and real economy.

Furthermore, we recommend to not make Art. 465 (5) subject to **national discretion** of Member States, to ensure that a reduced RW for the part of exposures up to 80% of the property value equally applies in the EU, avoiding cross-border implications and an un-level playing field within EU.

We further note that any material increase in RWA should be questioned on the backdrop of the now completed ECB Targeted Review of Internal Models which concluded that “the outcomes of the TRIM investigations confirmed that the internal models of [banks under ECB remit] can continue to be used for the calculation of own funds requirements”<sup>12</sup>, subject to improvements; such improvements being already materially implemented by banks at this stage.

In addition, we find it imperative that due consideration is given to the interplay between the expected CRR3 RWA inflation and related regulatory requirements in order to avoid unintended consequences with negative implications for the financing of the real economy in Europe.

Notably, following the publication of CRR3 banking package, the calculation of own funds requirements under the FRTB framework remains a concern for European banks. The FRTB framework imposes significant challenges

<sup>12</sup> [ECB Targeted Review of Internal Models](#)

# European CFO Network

---

for banks to economically justify the implementation of the IMA approach. In fact, IMA capital charges are generally not significantly lower than SA capital charges but implementing and maintaining an IMA model is significantly more expensive. This is further complicated by the addition of new, operationally expensive tests that banks must pass on a regular basis to even make full use of the IMA approach. Furthermore, the IMA approach includes new charge elements which would benefit from a phased go-live approach. There are also examples of material discrepancies between FRTB SA and FRTB IMA (e.g. EUR sovereign exposure requires less capital in SA than IMA). If banks decide to derive more of their own funds' requirements under FRTB SA, they are exposed to the various shortcomings of the SA approach. Some of these shortcomings lead to excessively conservative charges for certain instruments (e.g. vanilla CMS Spread options, callable bonds) that are currently actively traded and used for hedging purposes. The resulting charges are not in line with the economics of associated trades and can lead to detrimental effects on the viability of some products being offered to clients as well as deterioration in hedge effectiveness. To mitigate the existing shortcomings of the FRTB framework, a constant dialogue between the industry and regulators must be maintained with the aim and willingness to further address known deficiencies in the FRTB framework.

Furthermore, in Europe actual or perceived incomplete risk capture under current Pillar 1 RWA is today compensated for by **Pillar 2 requirements** imposed by the ECB and NCAs which are set over and above Basel minimum requirements and buffers post the annual SREP. To the extent these risks will be captured through increasing Pillar 1 RWA under CRR3 (pre and post output floor) going forward, this should lead to commensurate reductions in the Pillar 2 requirement setting for banks. Whilst this is structurally acknowledged by the ECB, visibility on how such "double count" would be measured and eliminated at CRR3 go-live is lagging.

In addition, the expected CRR3 induced RWA inflation would trigger untenable **MREL** increases as long as no compensating relaxation is provided, i.e. a corresponding recalibration of the RWA based MREL regime is required.

Finally, we support the extension of the measures regarding the calculation of the SA for the output floor calculation (unrated corporates, low risk mortgages and SACCR) to the SA calculation in general. Not only the same arguments apply to support the application to all EU banks (low ratings coverage of EU corporates, need to recognize low risk mortgages, need to allow all EU corporates to hedge their business risks at a reasonable cost) but also operational reasons. Having two standardized approaches adds complexity and operational burden costs to all EU banks who will need to make this double calculation even if not affected by the output floor.

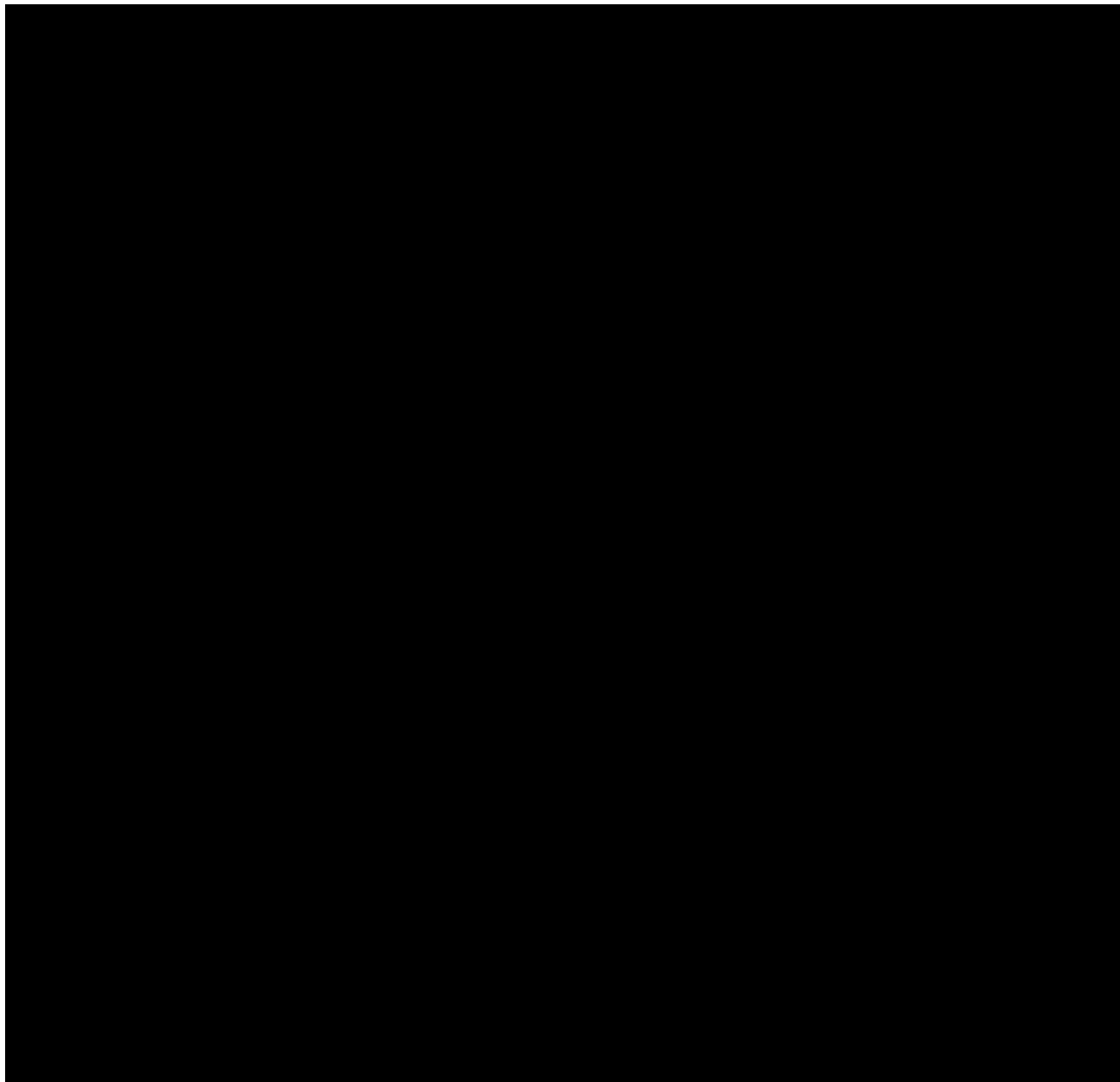
You find our impact study data and conclusions and a deeper discussion on the above items in the appendix to this letter; and we would welcome the opportunity to discuss our observations with you in more detail.

Best regards,

CFO Network   
On behalf of the CFO Network

# European CFO Network

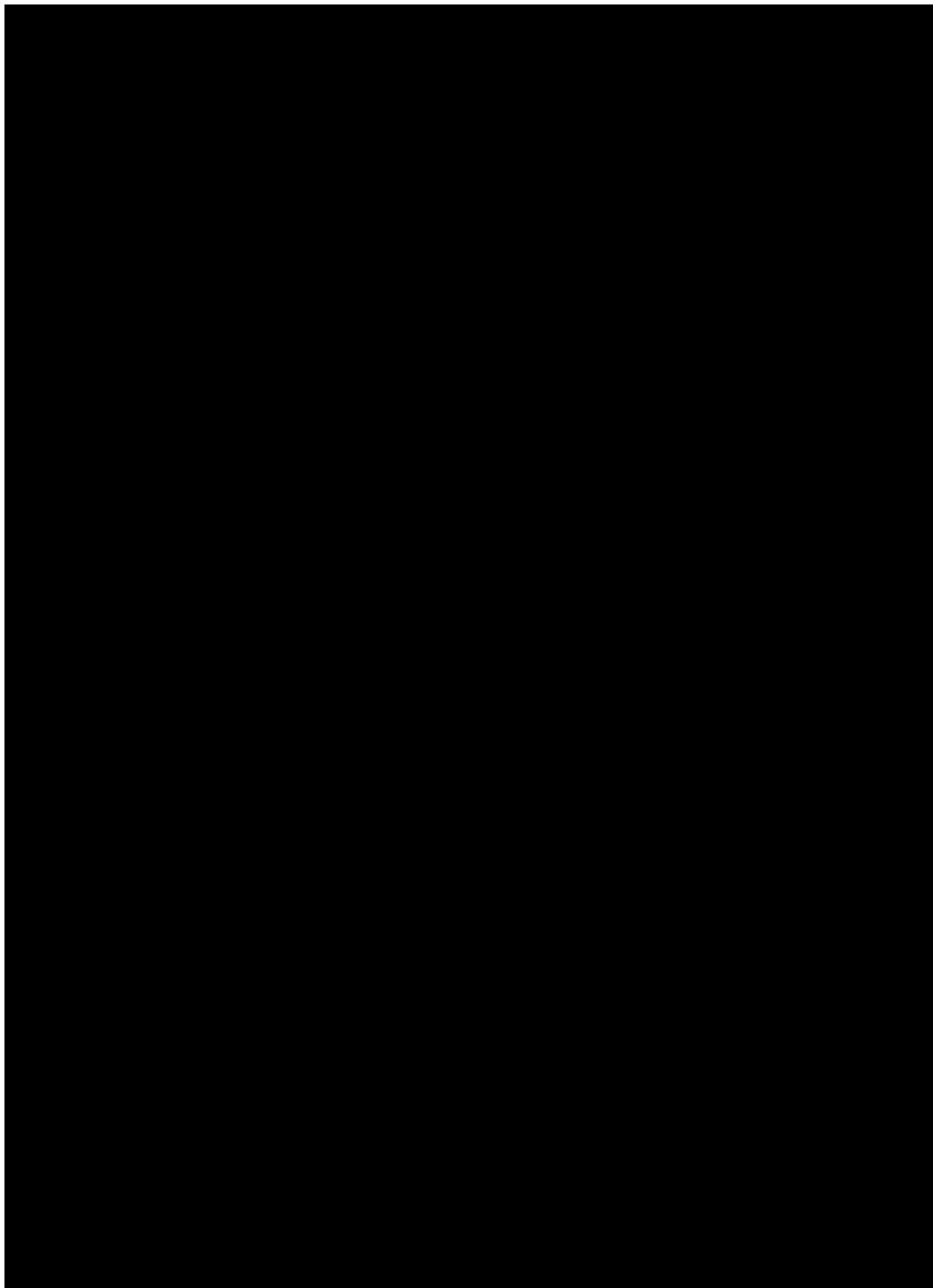
---





# European CFO Network

---



# European CFO Network

---

EBA report explicitly acknowledges that its estimated shortfall should in most cases be an underestimation of the actual shortfall as it does not consider capital elements beyond Pillar 1.

In fact, the EBA is using the CFON proposed Output Floor parallel stacks approach to calculate the capital shortfall they report publicly (using only internationally agreed capital requirements as MRC and considering shortfalls only if the current capital does not allow to respect this MRC). It may be the right approach as this is the only way to have comparable figures and outcomes across jurisdictions as per Basel III monitoring reports' spirit but taking this argument to its logical conclusion it also implies that the Output Floor parallel stacks approach is deemed fully compliant with Basel. Otherwise, the EBA should calculate the impact of what it is calling "fullstack" on EU banks to provide co-legislators with figures consistent with their own recommendations for the Output Floor implementation in Europe.

A detailed outcome of our corresponding analysis is described in the following specific thematic sections.