



Virtual meeting with Meeting with BusinessEurope -

17 February 2021 16:00

Participants Cabinet:

Participants DG FISMA:

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Virtual meeting with [REDACTED] [REDACTED] BusinessEurope	17 February 2021 16:00
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Summary

Confederation of European Business (a.k.a. BusinessEurope) called for a meeting with you to discuss their priorities in the area of financial services. You will speak with the organization's [REDACTED].

For the forthcoming EU political cycle, BusinessEurope has indicated three overarching priorities in the field of financial affairs: i) maintain an efficient and competitive banking system, able to support European companies of all sizes; ii) develop a unified, deep and liquid capital market, and iii) ensure actions to support sustainable finance are proportionate, practicable and accommodate the needs of both the financial markets as well as the real economy.

KEY MESSAGES

Basel III: Based on EBA's and ECB's input we are currently preparing the impact assessment that will accompany our legislative proposal to be tabled in June this year.

Calibration of standardised approach for counterparty credit risk (SA-CCR): In light of the current conservative calibration, DG FISMA is assessing how to best respond to the review of the calibration, mandated by the co-legislators under the Capital Markets Recovery Package.

Non-performing loans: The NPL Communication features well-targeted and politically feasible measures in order to prepare for COVID-induced credit risks.

Solvency II: The Commission has already expressed support for making it easier for insurers to benefit from lower capital requirements when making for long-term equity investments and we are now assessing whether EIOPA's advice on this issue achieves the policy aim.

Capital Markets Union: We will need support from the industry on all CMU actions, in particular the ones that are more difficult and sensitive politically, to deliver the CMU.

Coordinator: [REDACTED] FISMA A1
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Scene setter: Basel III

- On 15 December 2020, the EBA published its updated Basel III impact study in response to our renewed call for advice. It confirms that implementing the final Basel III reforms without further adjustments (i.e. full alignment with Basel) could significantly increase the overall capital requirements for EU banks (+18.5%) over the long-term (i.e. 2028 or later). This would likely be seen as undermining the “no significant increase” objective stated by co-legislators. [REDACTED]

- The ECB has recently submitted its updated macroeconomic assessment of the reforms, looking at the impacts on GDP growth. The estimates indicate that the long-term benefits of the Basel III reforms clearly outweigh the short-term costs.

- Based on EBA’s and ECB’s input we are currently preparing the impact assessment that will accompany our legislative proposal to be tabled in June this year.

Main issues from the perspective of BusinessEurope

BusinessEurope stresses the importance of reflecting European specificities in the EU implementation of Basel III. This would include:

- maintaining risk sensitivity and an adequate prudential treatment of unrated companies;
- maintaining the supporting factors for SMEs and infrastructure;
- maintaining the exemptions from capital requirements for Credit Value Adjustment (CVA) risk and re-calibrating the Standardised Approach for Counterparty Credit Risk (SA-CCR) – see topic 2 below;
- creating a low risk category for specialised lending;
- providing appropriate risk weights for the building sector, for leasing exposures and certain equity exposures (investments in non-speculative start-ups);
- avoiding increased risk weight for unconditionally cancellable commitments.

Those issues are well known and most of them will be addressed by specific adjustments in our forthcoming legislative proposal.

Line to Take: Basel III

- Given the initial shock caused by COVID, we postponed the implementation of the final elements of Basel III in the EU, in line with the one-year delay agreed by the Basel Committee.
- It was only logical to free up the operational capacity of banks, regulators and supervisors to address the immediate threat in times of crisis.
- That said, the deficiencies that led the Basel Committee to reform the global prudential framework after the global financial crisis are, in part, still present. Our commitment to implement these reforms faithfully in the medium to long term has not changed.
- Nor has our commitment changed to take into account certain EU specificities, in particular related to the current challenges, while preserving the integrity of the overall framework.
- Such EU specificities include the important contribution of SMEs to our economy, most of which are currently not rated. In the long run we need to find a way to have more corporates externally rated, not only because of the Basel standards but also to foster the CMU.
- We too are paying attention to distinguish between EU banks' long-term and strategic equity holdings and truly speculative investments.
- Also the ability of EU banks to finance strategic industries, such as aircraft manufacturing, and infrastructure must be preserved.
- These are important examples. Generally speaking, I would consider as European specificities areas where sound evidence suggests that the reforms might have disproportionate negative consequences for some specific sectors, business models or activities.
- By contrast, lowering the prudential standards – via, say, a completely diluted implementation of Basel III – would not address

the sector's enduring profitability problem, nor would it foster the recovery.

- It might indeed offer some short-term relief, but it would put at risk the resilience, stability and credibility of the sector – and it could prevent banks from being part of the solution when the next crisis strikes.
 - The issues that the final Basel III rules address remain as relevant as ever, notably doubts about the reliability of internal models.
 - My services are currently assessing the various impacts of the final Basel III reforms. We intend to adopt a proposal in June this year.
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Scene setter: SA-CCR calibration

- As of June 2021, the standardised approach for counterparty credit risk (SA-CCR) will become the new standardised methodology to calculate capital requirements for exposures due to derivative transactions.
- It is acknowledged that the calibration of SA-CCR may be somehow conservative, compared to other standardised approaches of the Basel framework. With the forthcoming implementation of the output floor this might impact more banks with a significant derivative business which normally use internal models.
- Last year, US authorities have agreed some adjustments to the US implementation of SA-CCR, notably by removing the so-called alpha factor for transactions with commercial end-users. These adjustments would lower the impact of the application of SA-CCR for US banks.
- Consequently, EU banks have been calling to do the same in the EU to prevent a distortion of the international playing field.
- In this context, it is important to recall that, as compared with their US peers, EU banks already benefit from lower capital requirements for derivative transactions with a number of counterparties, including corporates, due to the EU-specific exemptions from the own fund requirement for credit valuation adjustment (CVA) risk. Based on our own estimates, those CVA exemptions likely outweigh the impact of the aforementioned adjustments proposed by US authorities; there should thus be no level playing field issue.
- The co-legislators have recently mandated the Commission, as part of the political compromise agreed for the Capital Markets Recovery Package (CMRP), to review by end-June 2021 the application of SA-CCR in the Union.

Main issues from the perspective of BusinessEurope

BusinessEurope stresses the importance of the CVA exemptions. No additional capital requirements should be introduced in the context of the CVA, according to BusinessEurope. On SA-CCR, it is outlined that an **overly conservative calibration of SA-CCR together with a very strict output floor** would make hedging activities for non-financial companies much more expensive.

Line to Take: SA-CCR calibration

- Let me recall that the rules for counterparty credit risk under the standardised approach were adopted in Union law as part of CRR2 in line with international standards. At the time, they **did not raise particular concerns by the banking sector**.
- Furthermore, compared with their US peers, **EU banks already benefit from lower capital requirements** for derivative transactions with a number of counterparties, including corporates. This is because, unlike in other jurisdictions, those transactions are exempted from the capital requirement for credit valuation adjustment risk.
- That said, it cannot be ignored that the SA-CRR **calibration appears to be somehow conservative**, especially combined with the introduction of the output floor.
- My services are hence **assessing how to best respond to the mandate** given by the co-legislators under the Capital Markets Recovery Package (CMRP) – taking into consideration the international level playing field and the future introduction of the output floor in the next banking package.

Background:

Recital from CRR amendment under the Capital Markets Recovery Package that mandates a review of the calibration of SA-CCR:

- (10) *In the context of the economic recovery from the COVID-19 crisis, it is essential that end-users can effectively hedge their risks so as to protect the robustness of their balance sheets. The Final report of the High Level Forum on the Capital Markets Union noted that an overly conservative Standardised Approach for Counterparty Credit Risk (SA-CCR) might have a detrimental impact on the availability and cost of financial hedges to end-users. In that regard, the Commission should review the calibration of the SA-CCR by 30 June 2021 while taking due account of the specificities of the European banking sector and economy, the international level playing field and any developments in international standards and fora.*

Scene setter: Non-performing loans

- The impact of the COVID-19 pandemic on the economy is massive, but this is not yet reflected in the NPL ratios.
- Nevertheless, warnings by supervisors and analysts on deteriorating credit quality in the banking sector persist.
- The Communication on NPLs, published on 16 December 2020, lays out four key areas: secondary markets, insolvency frameworks, AMCs, precautionary support.
- To guide the implementation process, the Commission is currently preparing the setting up of an NPL advisory panel and is preparing consultations for the measures proposed in the Action Plan.
- A few Member States favour a European asset management company (AMC). However, a European network of national AMCs, as envisioned in the NPL Communication, would achieve similar benefits, while avoiding the political resistance of a mutualised AMC scheme.
- The phase out of the EBA Guidelines on moratoria was postponed and the Guidelines were extended until 31 March 2021 for the moment, but the measures will be expected to run out in 2021.

FISMA E1

Line to Take: NPL

Rationale and objective of NPL Action Plan:

- The Communication to tackle NPLs recommend policy actions in a few key areas:
 - (1) Improving liquidity, transparency and trading on secondary NPL markets.
 - (2) Improving the efficiency of insolvency frameworks across the EU. This is to increase the efficiency of insolvency and loan enforcement frameworks.
 - (3) Providing guidance for setting up national asset management companies.

- (4) Clarify the BRRD and State aid frameworks and allowing, under strict conditions, public support measures to support the economic recovery.

EBA Guidelines on moratoria:

- Payment moratoria have been important relief measures and have been largely used by banks to address in the short term the liquidity needs and payment difficulties of businesses, in particular SMEs.
- As of June 2020, around 6% of banks' total loans was granted payment moratoria (i.e. up to EUR 871 billion, according to the EBA).
- However, these extraordinary measures cannot last forever.
- At the current juncture, it is crucial to keep credit flowing, in order to support a sustainable recovery of European economies. It is nevertheless essential that businesses anticipate the end of the application of the payment moratoria and engage with their banks as soon as possible in order to prepare, as the case may be, the end of these extraordinary measures.
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Defensive Points: NPL

Does the Commission consider setting up a European “Bad bank” or an EU AMC to solve the problem of NPLs?

- Several factors would make it difficult to set up a single, European AMC. These include the diversity of NPL portfolios across Member States, and different national rules on restructuring, insolvency and collateral enforcement.
- Hence, a European AMC could only provide a common structure, but would have to leave the practical workout to national compartments.
- Lastly, the costs of a European AMC could be very high. Issues on financing and distributing losses of the AMC could lead to political resistance by several Member States.

What are the advantages of a European network of national AMCs?

- An EU network would facilitate the cross-border cooperation of national AMCs established in accordance with the AMC Blueprint, and create valuable synergies.
- We would seek to enable enhanced cooperation among AMCs and unlock the synergies as we outlined in our Action Plan. Such enhanced cooperation could include, but would not be limited to:
 - joint purchases and sales of NPLs;
 - exchange of information via the data hub at European level, where AMCs could contribute to a common database; and
 - the establishment of a joint transaction platform for sales by AMCs at European level.

What would be the next steps of the NPL advisory panel?

- The next steps of the panel are:
 - to work with the EBA to review the NPL templates;
 - to review Pillar 3 disclosure rules, also in consultation with the EBA;
 - to work on the governance and scope of the data hub at European level;
 - work on the guidelines for a best execution sale process for inexperienced sellers of NPLs;
 - lastly, the panel would also be involved, together with EBA, in addressing regulatory impediments and inconsistencies in NPL purchases.
 - As regards other measures in the Action Plan, like AMCs and precautionary support measures, while the Communication provides guidance thereon, any decisions would have to be taken at Member State level.
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Scene setter: SOLVENCY II REVIEW

BusinessEurope is requesting to review prudential rules for insurance companies to invest in companies.

FISMA D4

Line to Take: SOLVENCY II REVIEW

- The EU needs significant private investments to achieve its ambitious goals. To this end, the insurance sector plays a key role in our considerations and I intend to make good use of the Solvency II review.
- This was already expressed in last year's CMU action plan. The plan underlined insurers' role in the economic recovery and in the re-capitalisation of European businesses.
- During an earlier review of Solvency II, the Commission already supported significant lower capital requirements for equity investments of a long-term nature. That treatment is subject to a set of criteria, which are probably too stringent to allow for a meaningful impact on insurers' investments in the economy.
- We asked EIOPA to review those criteria. We are now assessing whether EIOPA's advice in this respect achieves the aim of making the criteria work better in practice.

Defensive Points: SOLVENCY II REVIEW

The Solvency II review should free up capital for investments in businesses.

- We agree that insurers should have a pivotal role to play in financing businesses, especially in the aftermath of the crisis.
- Even before the crisis, we have invited EIOPA to work on long-term investments.
- This objective has been reiterated in the CMU action plan.
- We are analysing EIOPA's advice, in particular on the treatment of equity, with this objective in mind.

Scene setter: CMU

On CMU, they will likely want to understand the Commission's policy agenda and priorities for the coming years with a focus on how to develop alternative sources of finance to bank lending.

FISMA B1

Line to Take: CMU

- The COVID crisis we have been experiencing for almost a year now reinforces the need for a Capital Markets Union that supports financial stability, and reduces companies' overreliance on bank lending.
 - **CMU is more urgent than ever** to mobilise private capital for our political objectives: recovery, green and digital transitions, resilient economy, competitiveness of European firms and open strategic autonomy.
 - **Facilitating access to finance for SMEs and high-growth innovative companies** has been from the very beginning a key goal of the Capital Markets Union.
 - Since the launch of the Capital Markets Union Action Plan, the Commission has made considerable progress in addressing barriers to SMEs' access to finance and diversifying the range of financing options available to them.
 - A fragile investor base is one of the main barriers to tackle. This is why President-elect von der Leyen already called for the **creation of a private-public fund to help finance initial public offerings of SMEs**, in order to complement the range of existing public support measures at early funding stages. As we now have an agreement on the InvestEU, this has enabled us to start the negotiations with the potential implementing partner on the more concrete set up of the fund that would help SMEs access public markets.
 - There are other measures put forward by the CMU Action Plan which aim to further facilitate the use of market funding and to

help companies employ all possible funding sources, tailoring to their business models and individual needs. As you know, one of the measures – **the creation of the European Single Access Point** - will seek to make companies more visible to cross-border investors and better integrate markets by setting up an EU-wide platform that provides investors with seamless access to comparable company information. It will seek to support the re-capitalisation of the corporate sector by incentivising institutional investors to hold more equity.

- This being said, **the CMU remains a long-term project** that needs to be built brick by brick, and step by step. **We will need support from all, including from you in the industry** when reaching out to your political leaders, if we want to make decisive progress on these issues if we are serious about CMU.

Defensive Points: CMU

What are the measures foreseen in the CMU Action Plan, and how could businesses benefit from these?

- The CMU Action Plan commits us to 16 legislative and non-legislative actions, with a clear timeline for delivery
- The Commission will set out to create a single access point for investors to company data. Providing investors with seamless access to financial and sustainability-related company information will reduce information search costs, widen the investor base for companies, help to integrate smaller local capital markets and support recovery.
- We will support insurers and banks to invest more in EU businesses, and invest long-term. This will contribute to the re-equitisation of companies, which is essential in particular after COVID.
- We will aim to reduce informational overload for retail investors and increase the quality of advice. Retail investors must receive simple and comparable information on financial products and sound advice, so they can take the right decisions for themselves.
- We will seek to support increased pension adequacy across Europe. This would help people invest long-term so they get higher sustainable returns and a suitable complementary income for their retirement.
- We will simplify withholding tax procedures. This will make it less costly for investors to invest across borders and prevent tax fraud.

- We will seek to harmonise or make convergent certain insolvency rules. Making the outcomes of insolvency proceedings more predictable will support cross-border investment.
 - We will aim to facilitate shareholder engagement and make it easier for Europeans to have a say in how companies are being run, notably as regards sustainability issues.
 - We will strengthen the rules protecting cross-border investments. This is key to encourage investors to invest in other Member States and will contribute to financing recovery, in particular in countries that have been most hit by the crisis and where the investment needs are the largest.
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