Council of the
European Union

Brussels, 1 April 2022
(OR. en)

7780/22

Interinstitutional File:
2021/0342 (COD)

EF 102
ECOFIN 295
CCG 25
CODEC 413

COVER NOTE

From:	European Economic and Social Committee
date of receipt:	30 March 2022
To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
Subject:	Opinion of the EESC on the Capital Requirements Regulation (CRR3) Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor

Delegations will find attached the opinion mentioned above.

Other language versions, if needed, are available on the following website:

https://dmsearch.eesc.europa.eu/search/opinion

Encl.

OPINION

European Economic and Social Committee

Banking Package 2021

____

Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor
[COM(2021) 664 final – 2021/0342 (COD)]

ECO/571

Rapporteur: **Bogdan PREDA**

Referrals	European Parliament, 17/01/2022 Council of the European Union, 20/01/2022
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	03/03/2022
Adopted at plenary	23/03/2022
Plenary session No	568
Outcome of vote (for/against/abstentions)	154/0/1

1. Conclusions and recommendations

1.1 The EESC advocates a sound, balanced and forward-looking capital policy with risk weightings based on actual stability risks, while also considering the need to boost the competitiveness of EU banks and to increase the financing of sustainable growth. Thus, the EESC calls on the Commission to further evaluate the extent to which the proposals respond to the abovementioned challenges.

1.2 The EESC welcomes the implementation of the remaining elements of the international standards agreed by the Basel Committee for Banking Supervision ("Basel III standards")[1], from the perspective of both timing and substance, as they are meant to enhance the stability of the financial market in the EU, and thus not to expose European citizens to increased financial market risks.

1.3 The EESC stresses that financial market stability is a crucial prerequisite for overall economic stability, whereas the sound regulation and surveillance of the banking sector is essential in order to prevent the threat of turbulences and crisis. The prudential capital requirements are instrumental in reaching the abovementioned prerequisites, whereas the EESC calls on legislators to make sure that the proposals envisage a proper balance between two complementary objectives, namely (i) ensuring that EU banks become more resilient and (ii) the need to ensure financial soundness and competitiveness in the sector, including from the perspective of a balanced capital requirements framework, to support the role of banks in financing the real economy.

1.4 The EESC calls on the Commission to perform periodical assessments of the actual impact of the proposals, in order to evaluate whether their implementation contributes to more financial market stability and resilience in the banking sector, while also taking into account the competitiveness of EU banks. The EESC also acknowledges that sound and balanced capital ratios contribute to competitiveness.

1.5. The EESC highly appreciates the endeavours of the Commission to transform the EU's economy into a greener and more resilient one, including through the revision and permanent evaluation of the current tools envisaged to increase the sustainable finance uptake. The financial sector could become instrumental in building a net-zero carbon economy. Therefore, the EESC welcomes the Commission's approach of strengthening the focus on Environmental, Social and Governance (ESG) risks in the prudential framework (in-line with international workstreams, namely in Basel III), including by better accounting for financial market risks related to climate changes.

---

[1] https://www.bis.org/bcbs/basel3.htm
Basel III is an internationally agreed set of measures developed by the Basel Committee on Banking Supervision in response to the financial crisis of 2007-09. The measures aim to strengthen the regulation, supervision and risk management of banks. Like all Basel Committee standards, Basel III standards are minimum requirements that apply to internationally active banks. Members are committed to implementing and applying standards in their jurisdictions within the timeframe established by the Committee.

1.6. The EESC also welcomes the ESG[2] disclosure work from the European Banking Authority (EBA) aimed at properly assessing banks' environmental risks and their finance strategy for the transition to a net-zero carbon economy. The EESC also calls on the EBA to speed up its scrutinising work on the pillar one framework to determine whether it sufficiently captures the unique features of climate risks. Macro-prudential policies regulation, including capital-based ones, can play an important role to better account for financial market risks related to climate change. In addition, the EESC calls on the EBA to strengthen its endeavours to address the shortcomings in the current ESG disclosures at EU level, including on fossil fuels-related assets and assets subject to chronic and acute climate change events, so as to encourage a substantial increase in the sustainable finance strategies of banks.

2. Introduction

2.1 The subject of this opinion is the European Commission's proposal for a (i) regulation amending Regulation (EU) No 575/2013[3] on prudential requirements for credit institutions as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor (CRR Proposal) and (ii) a directive amending Directive 2013/36/EU[4] as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks, and amending Directive 2014/59/EU (CRD Proposal).

2.2 As set out in the Explanatory Memorandum, the two normative acts are justified by the need to implement Basel III standards, while also addressing several matters of importance for the financial stability and steady financing of the economy in the context of the recovery after the COVID-19 crisis. These include strengthening the risk-based capital framework, enhancing the focus on ESG risks in the prudential framework and further harmonising the supervisory powers and tools.

3. General comments

3.1 The EESC stresses that financial market stability is a crucial prerequisite for overall economic stability and is, therefore, in the common public interest. Sound regulation and surveillance of the banking sector to prevent the threat of turbulence and crisis is essential, while prudential capital requirements are instrumental in avoiding the use of public funds for rescuing banks in distress.

3.2 A faithful but fair implementation of the Basel III standards is important for European companies and jobs, but equally to foster access to residential ownership and to fuel the EU's export-oriented economies, which so many businesses rely on for their growth, and so many citizens for their employment. Also, these international standards are implemented in an EU banking model that is inherently more averse to risk and less dependent on capital markets than in other jurisdictions.

---

2 https://www.eba.europa.eu/regulation-and-policy/transparency-and-pillar-3

3 Known as the Capital Requirements Regulation.

4 Known as the Capital Requirements Directive.

The EESC welcomes the Commission's proposals to introduce the remaining elements of the Basel III standards, which are intended to limit the risk of regulatory arbitrage and to create confidence and predictability for investors and regulators. The EESC acknowledges that the EU needs rules to cater for the challenges (i.e. recovery, climate and digital challenges), specific characteristics (bank credit is by far the main financing channel for the EU economy) and the ambitions (Capital Markets Union and Green Deal) of the European Union. On the other hand, it is imperative that European citizens and taxpayers are not exposed to increased risks of a financial market crisis; a proper balance between the abovementioned challenges and the substance and discretions of the Basel III standards thus needs to be achieved. Therefore, the ESSC calls on the Commission to further evaluate the specific features of European banks and the related impact on them and on the EU economy, to ensure that the legislative proposals strike the proper balance between the faithful implementation of the Basel III standards, the exercise of the national discretions provided by the Basel III standards and the need to put forward adjustments to reflect the specificities of both the EU economy and the EU banks.

3.3 The EESC notes that the implementation of these proposals should safeguard financial market stability, but should not lead to an unjustifiable increase in capital requirements for EU banks, beyond what is envisaged in the Commission's assessment. Thus, the EESC calls on the Commission to ensure that the impact on capital requirements, including on small cooperative banks and small banks, should not be too burdensome and thus should not impact their competitiveness, while also taking care to ensure financial market stability.

3.4 The EESC is also fully aware of the fact that the existing capital requirements contributed decisively to make the banking system more resilient during crises, as was also shown in the pandemic context, where the current level of capitalisation has allowed European banks to get through the pandemic in good condition and to continue financing and supporting the European economy to withstand the major economic shock of the COVID-19 pandemic. The EESC also points to the crucial role of the European Central Bank, which has put in place a highly supportive policy, thus having contributed to the resilience of banks in the COVID-19 crisis.

3.5 The EESC therefore calls on the Commission to ensure that the current proposals enhance the current rules, particularly in the context of capital requirements, to continue to prevent excessive risk-taking, high leverage and speculative behaviours. Given the current economic and social context, there are many significant risks that still need to be properly dealt with, such as climate risks or NPLs, for example. Capital requirements should be high enough to prevent the threat of bankruptcy and financial market turbulence and crisis, but it should not be excessive. At the same time, the EESC acknowledges that EU banks play a pivotal role in financing the real economy and supporting the digital and sustainable transitions, with an indirect impact on jobs and living standards. Regulatory provisions related to capital requirements need to take these aspects into account.

3.6 As concerns the ESG, the EESC points out that the financial markets can and should support and enhance the transition to a more sustainable and greener economy, but the banking sector, cannot deliver this long-lasting change alone. According to the latest reviews by the European Court of Auditors (ECA), more than half of EU Member States still subsidise fossil fuels more

than renewables[5], while the "*the EU support for investments needs to be better aligned with the sustainable finance principles*"[6]. In this context, the EESC calls for the industrial policies and the relevant EU and national legal frameworks to become fully consistent towards (i) promoting sustainable investment opportunities to influence the allocation of economic resources in this direction and (ii) removing fossil fuels subsidies and reconciling climate objectives with social needs. Therefore, the EESC welcomes the strengthening of ESG-related provisions in the legislative proposals but calls on the Commission to clarify the applicability of the provisions regarding the powers of supervisors to "reduce risks arising from the institutions' misalignment with relevant policy objectives of the Union and broader transition trends relating to ESG factors" so as to make it clear how such powers should be exercised.

3.7 In addition to disclosure and climate stress testing, macro- prudential policies, including capital based measures, can play a role in properly accounting for banks' ESG-related risks and facilitating a distribution of credit flows across sectors that can support the transition to a net-zero carbon economy. Thus, the EESC recommends that the EBA and ECB accelerate their work:

(i) On the pillar one framework, so as to determine the extent to which the current regulatory framework adequately captures the ESG risks and related measures needed, if the case, and

(ii) On the proper and timely calibration of stress testing for ESG risks.

3.8 The EESC welcomes the mandates granted to the Commission to monitor the implementation of the standards in other jurisdictions to ensure consistency as concerns the timing and significance of the impact on the relevant stakeholders, including in terms of the increase in capital requirements. The EESC also warns, however, against a downward spiral of regulatory standards or a further delay in standards taking effect, pointing to the poorer implementation of particular rules in some jurisdictions. These could trigger severe global stability risks.

4. Specific observations

4.1 The EESC welcomes, in particular, the following proposals in the Commission proposal, but recommends several further technical improvements to be analysed:

(i) **The application of the Output Floor (OF) at the highest level of consolidation with risk-based redistribution mechanism** (to ensure adequate capitalisation of subsidiaries in the EU) for each banking group, as it would not only ensure international consistency, but also avoid the negative effects that application at entity level would have.

(ii) **The specific enhancements regarding the OF in specialised lending** (Article 495b) are appreciated, but it should be further evaluated from the perspective of achieving greater consistency with respect to the input floors, considering the specificities of the sub-classes of specialised lending, whereas the parameter floors under the standardised approach do not match the actual risks or reflect the robustness of these types of financing.

(iii) **Keeping the SME and infrastructure supporting factors (ISF) together with the Credit Valuation Adjustments exemptions** (Article 501/501a) is highly appreciated, as

---

[5] https://www.eca.europa.eu/en/Pages/DocItem.aspx?did=60760

[6] https://www.eca.europa.eu/Lists/ECADocuments/SR21_22/SR_sustainable-finance_EN.pdf

they are significant tools for banks to continue to support important segments of the European economy, especially in the context of the post-COVID-19 recovery. However, the EESC calls on the Commission to evaluate the opportunity to further clarify and simplify the criteria for the ISF to boost the infrastructure financing, while also taking into account the related risks and safeguarding financial stability;

(iv) **Streamlining the look-through approach in the treatment of investment funds (CIUs) is, as a principle, well designed**, but the EESC considers that further correlation of the related governance rules and limitations is needed (e.g. reliance on data provided by third parties within the calculation of the own funds requirement for market risk against CIUs.);

(v) **Maintaining the 100% risk weighting for long-term strategic equity investments of banks is needed**, but the EESC believes that it is appropriate to apply it fairly to all banks, whether they are under a standardised or internal models approach.

(vi) **The stimuli for banks to shift resources towards a net-zero carbon economy** and engagement with customers are key in financing the green transition. In this regard, in order to speed up and enhance such a necessary switch, the EESC believes that it is essential that the EU and the Member States implement a major change in the incentives and disincentives to the underlying economy, as transposed in industrial policies and in the relevant frameworks. The EESC asks the Commission to further evaluate the ESG-related provisions in the CRR and CRD proposal in the light of the above.

4.2 Meanwhile, the EESC suggests a number of issues that would need to be reconsidered within the proposals. The EESC stresses in that context that the common public interest to safeguard financial market stability is a top priority and, in this regard, a proper balance with other policy goals needs to be achieved, whereas putting financial stability at risk has to be absolutely avoided. The adoption of Basel III standards in the EU must not undermine the goal of increasing financial market stability in order to be better prepared for economic turbulences and crises in the future. Moreover, the proposed measures should, in any case, ensure that the capitalization of the banks is further strengthened, while also ensuring their competitiveness:

(i) **To eliminate the conditionality based on uptake of ratings for the transitional solution to reduce the impact of the Output Floor (OF) on unrated corporates** (Article 465(3)). This is due to the low coverage of external ratings for the EU market and to avoid over-reliance on external ratings, in line with the Credit Rating Agencies Directive.

(ii) As concerns **the transitional arrangement for residential mortgages for the output floor**, the EESC calls on the Commission to evaluate the opportunity to revise it from several perspectives (Loan–to-value, asymmetry between risk methodologies, risk sensitivity) to avoid unintended consequences on access to residential mortgages. However, any revision in this respect should also consider the need to avoid any risks of real estate bubbles.

(iii) **Further revision of the provisions regarding the Internal Rating-based approach (IRB)** allowing the use of real maturities, instead of fixed maturities in order to reflect the real risk embedded.

(iv) **To maintain the credit conversion factors (CCF) at 20%** for transaction-related contingent items (e.g. performance bonds, bid bonds, warranties) due to its key role in the EU economy, so as to be consistent with the real default data of the relevant market.

(v) **The capital-market-related provisions should be further evaluated** to avoid the risks of a disproportionate impact on hedging, liquidity and funding costs for sovereigns and corporates, and, therefore, to help boost the ability of EU Corporate Investment Banks to compete on EU and international markets.

(vi) **To amend the calculation of the real contributions of minority interests to the consolidated capital,** which currently goes against the goals of the Capital Market Union, impairing the appetite for listing companies.

4.3 The EESC stresses that climate change results in risks that are already affecting banks and that might have profound financial stability implications for banks, if not properly tackled at both the regulatory and banking levels. In this respect, the EESC appreciates the Basel Committee's and the European authorities' work on climate-related financial risks, in identifying potential gaps in the current framework and considering possible measures to address such gaps. In addition, the EESC calls on the Commission to ensure that the double materiality principle is fully observed when further developing the relevant framework for financing the transition to a greener economy.

4.4 The EESC calls on the Commission to evaluate the applicability of the proportionality principle as concerns banks which, in terms of size, role and exposure to systemic risks, are small (as per the definition of a small and non-complex entity in the Capital Requirement Regulation), but which still have to comply with more onerous requirements, including disclosure and capital requirements, because they are part of a "significant" banking group. However, any evaluation of the proportionality principle has to take into account that smaller banks, which are part of a significant banking group, have more resources available to master disclosure and capital requirements.

Brussels, 23 March 2022.

Christa Schweng
The president of the European Economic and Social Committee

____