



EUROPEAN COMMISSION

Brussels, 4.5.2012  
C/2012/ 2673 final

Dear President,

The Commission would like to thank the Bundesrat for its Opinion regarding the Proposal for a Directive of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms ("CRD IV") {COM(2011)453 final}. We apologise for the long delay in replying to this Opinion.

On the specific points you have raised, please allow me to reply as follows:

#### **Implementation of Basel III by a regulation/directive**

Today, European banking legislation is based on a Directive which leaves room for significant divergences in national rules. This has created a regulatory patchwork, leading to legal uncertainty, enabling institutions to exploit regulatory loopholes, distorting competition, and making it burdensome for firms to operate across the Single Market.

In June 2009, the European Council called for the establishment of a "European single rule book applicable to all financial institutions in the Single Market." The single rule book aims to provide a single set of harmonised prudential rules which institutions throughout the EU must respect. This will ensure uniform application of Basel III in all Member States. It will close regulatory loopholes and will thus contribute to a more effective functioning of the Single Market. The Commission suggests removing national options and discretions from the CRD, and achieving full harmonisation by allowing Member States to apply stricter requirements only where these are needed on financial stability grounds or because of a bank's specific risk profile.

#### **Parallel implementation of Basel III**

The EU has an interest in increasing the resilience of its banking system. As Basel III aims to achieve that objective, it is in the EU's interest to implement it. It is also a major G20 commitment. The risk of regulatory arbitrage should therefore be limited since all major jurisdictions are putting in place similar rules. Moreover, the Financial Stability Board will be examining the implementation across different jurisdiction this year. The Commission will remain very attentive to the level play field issue.

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### **Definition of capital**

*Under Basel III, CET1 capital instruments for companies that can issue ordinary shares – so-called 'joint stock companies' - may only comprise "ordinary shares" that meet 14 strict criteria. The Commission proposal does not restrict the highest quality form of capital to "ordinary shares" but requires that any investment would have to meet the 14 strict criteria in order to qualify as the highest quality of capital. Appropriate adaptations have been introduced in order to cater for instruments issued by non-joint stock companies such as mutual banks, cooperative banks and savings institutions. This approach focuses more on the substance of a capital instrument than on its legal form. With 27 different company laws in the EU, a reference to a concept of "ordinary shares" would not ensure homogeneity of the instruments.*

### **Silent partnerships**

*It is important to note that the grandfathering provisions of CRD II allow instruments that did not meet the revised Article 57(a) standards to qualify as 'hybrid Tier 1 instruments'. They did not allow them to continue to qualify as 'original own funds' under Article 57(a) – i.e. the element of capital under the current regime often referred to as 'core' capital. As a result, silent partnerships that did not meet the requirements of the new Article 57(a) ceased to qualify as original own funds under Article 57(a) from 31 December 2010, but were deemed to qualify as Tier 1 hybrid original own funds under Article 63a, subject to a 30-year phase out.*

*The revision of the CRD in 2009, the so-called CRD II, anticipated further improvements in the definition of capital. Already in 2009, the G20 Leaders had commissioned further work from the Basel Committee to raise the quality and quantity of capital. This culminated in the G20 Leaders' Summit in Seoul in November 2010, at which the Leaders endorsed the Basel III commitments to strengthen the financial system. Prior to the entry into force of CRD II on 31 December 2010, Basel III, including the new transitional arrangements for capital and the G20 Leaders' commitment to implement it were a matter of public record. CRD IV implements those commitments, including through the introduction of these new transitional arrangements for capital.*

*In finalising the CRD IV proposals, the Commission undertook a detailed analysis of the cumulative impact of the CRD IV proposals on EU financial institutions and the EU real economy. The results provided compelling evidence of the benefits of the CRD IV proposals, and confirmed the appropriateness of the proposed timeframe for the full application of the new rules.*

### **Sanctions**

*In respect to a minimum harmonisation of sanctions, the Commission gives priority to an effective abatement of infringements to capital regulation. In order to achieve effectiveness and to inform both credit institution customers and market participants, the Commission considers the publication of sanctions to be appropriate. However, the Commission remains open for improvements to address the details, including the exceptions from the general rule.*

### **Delegated Acts (Art 443)**

*Within the Regulation, it is essential that macro-prudential flexibility is provided so that actions can be taken effectively and efficiently when required, as demonstrated by the current*

crisis. Article 443 is one of the key tools in the CRD IV package which allows this macro-prudential flexibility. In addition, it also provides legal certainty, as actions taken are legally binding. Member States can turn to the Commission with any macro-prudential concern and the Commission will be able to react quickly and flexibly. Both the effectiveness of the instrument and the correct functioning of the single market are thus ensured.

The legal basis for delegated acts is set out in Article 290 TFEU. Delegated acts are suitable in this context as the objective is to react quickly to a crisis situation and a delegated act can, in principle, be adopted within a week. The European Parliament and Council may, of course, object to any delegated act and/or revoke the delegation.

### **Binding Technical Standards**

Technical standards are needed to provide the details and clarity to make the Regulation operational. EBA is a body set up with the skills and technical expertise needed to develop the detailed technical standards. The text developed by the EBA will be adopted by the Commission by either an implementing or a delegated act. Given the timeframe to adopt the CRD IV package, it is not possible to provide in the Level 1 text the degree of detail and clarity needed. The Commission has been careful in considering what should be tasked to the EBA to develop implementing and regulatory standards. Negotiations with the Council and the European Parliament have now started and they will also be considering the technical standards that have been set out in the package.

### **Liquidity**

The Commission agrees with the Bundesrat that a monitoring period should apply before setting binding liquidity standards and, therefore, has proposed that a detailed LCR should not be defined before 2015. Furthermore, the Commission agrees that the market liquidity of assets should be monitored by the EBA before final decisions are taken on the definition of liquid assets. Bonds issued by Förderbanken will be part of that analysis.

### **Leverage Ratio**

The Commission takes note of the Bundesrat's concern on the potential negative impacts of the introduction of the leverage ratio on institutions deemed to have a low-risk business model. However, it is important to gather information in the coming years in order to be able to precisely assess such impacts and, if need be, modify the design and calibration of the leverage ratio in order to mitigate them. This is why the Commission intends to undertake a comprehensive review in the second half of 2016.

The Commission review will start earlier than the one foreseen by the Basel Committee for two reasons. First, the Commission wants to have at hand information concerning the impact of the leverage ratio in the EU before the start of the process in Basel in order to be able to influence that process. Second, given that a decision on the adoption of the leverage ratio as a Pillar 1 measure needs to be taken prior to 2018 and the decision will be subject to a co-decision procedure, in the Commission's view an early start of the review is necessary.

The Commission understands the Bundesrat's concerns regarding the publication of the leverage ratio starting from 2015. However, the Commission does not consider that postponing or even abandoning a publication requirement would address the concerns.

*Indeed, even in the absence of a publication requirement, the market would still try to estimate the leverage ratio of individual institutions. Since such estimates would inevitably be based on incomplete information, the consequences of not requiring publication may end up being detrimental compared to those of a mandatory publication. In the Commission's view it is more prudent to ensure that the information available in the market is accurate and to provide institutions with the possibility to justify the changes in their leverage.*

### ***SME financing***

*The Commission shares the analysis that ensuring a continued flow of credit to SMEs is essential. The Commission's impact assessment shows that the impact of Basel III should not lead to a reduction of lending to SMEs.*

*It should also be noted that the current CRD and the Basel II framework already allow institutions to use a lower risk weighting than the standardised 75%. If institutions can prove that their SME lending policies have a lower loss history, they can use the Internal Ratings Based approach which would then allow such institutions to apply a lower risk weighting.*

*Moreover, the European Banking Authority has already been asked to look into the issue of the risk-weighting for SMEs loans and will report to the Commission during 2012.*

*The Commission hopes that these explanations serve to clarify the concerns raised in the Opinion and looks forward to continuing the political dialogue on this very important issue.*

*Yours faithfully,*

*Maroš Šefčovič  
Vice-President*