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Summary of the responses to the public consultation on the potential impact of CRR and CRD IV on the financing of the economy

Contents

1. INTRODUCTION

1.1. Background

DG FISMA on 15 July launched a consultation on the potential impact of CRR and CRD IV on the financing of the economy. The consultation aimed to gather views and evidence in the light of the following reporting requirements for the Commission to the European Parliament and the Council set out in the CRR:

- Article 501 requires a report 28 June 2016 on the impact of the CRR own funds requirements on lending to SMEs and natural persons;

- Article 505 requires a report by 31 December 2014 on the appropriateness of the CRR requirements in light of the need to ensure adequate levels of funding for all forms of long-term financing for the economy, including critical infrastructure projects;

- Article 516 requires a report by 31 December 2015 on the impact of the CRR on the encouragement of long-term investments in growth-promoting infrastructure.

The consultation closed on 7 October. 84 responses were submitted to the consultation.

This summary has been prepared to provide a qualitative synthesis of the analyses carried out of the various responses. Although there are some very detailed responses, not all respondents have replied to all the questions. Specifically, views from the financial service providers other than banks were hardly populated on the specific questions raised in the consultation. An overall summary of their responses is provided in the annex to this document.

The consultation asked stakeholders for their views on the impact and role of the CRR/ CRDIV on the recapitalisation process (summarised in section 2 below); lending to corporates in general and SMEs in particular (sections 3 and 4); and, lending to infrastructure (section 5). It also asked questions related to proportionality and simplification (sections 6 and 7) and the single rulebook (section 8).

The variation in the length of the various sections is a reflection of the number of questions posed in the consultation paper as well as the level of interest amongst respondents.

1.2. Stakeholders

More than half of responses came from the financial industry.

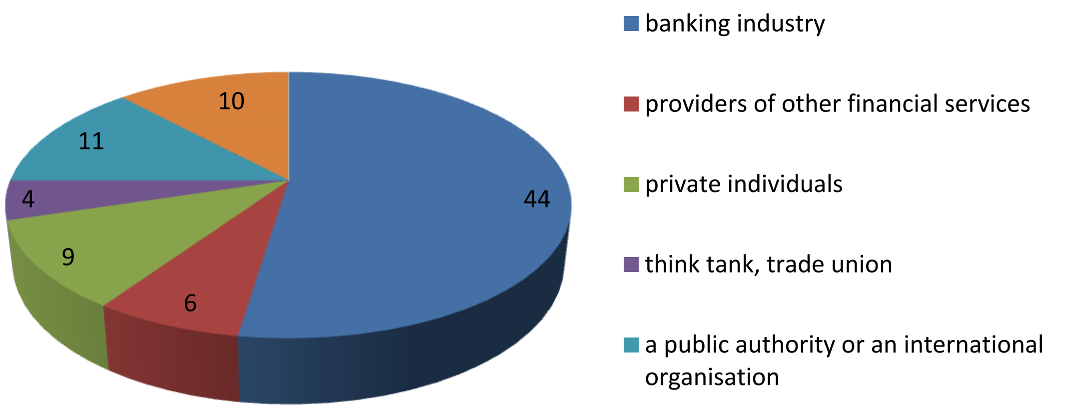

Figure 1. Distribution of respondents according to their interest

Half of the responses came from three Member States: Belgium (a vast majority of European industry associations), the United Kingdom and Germany.

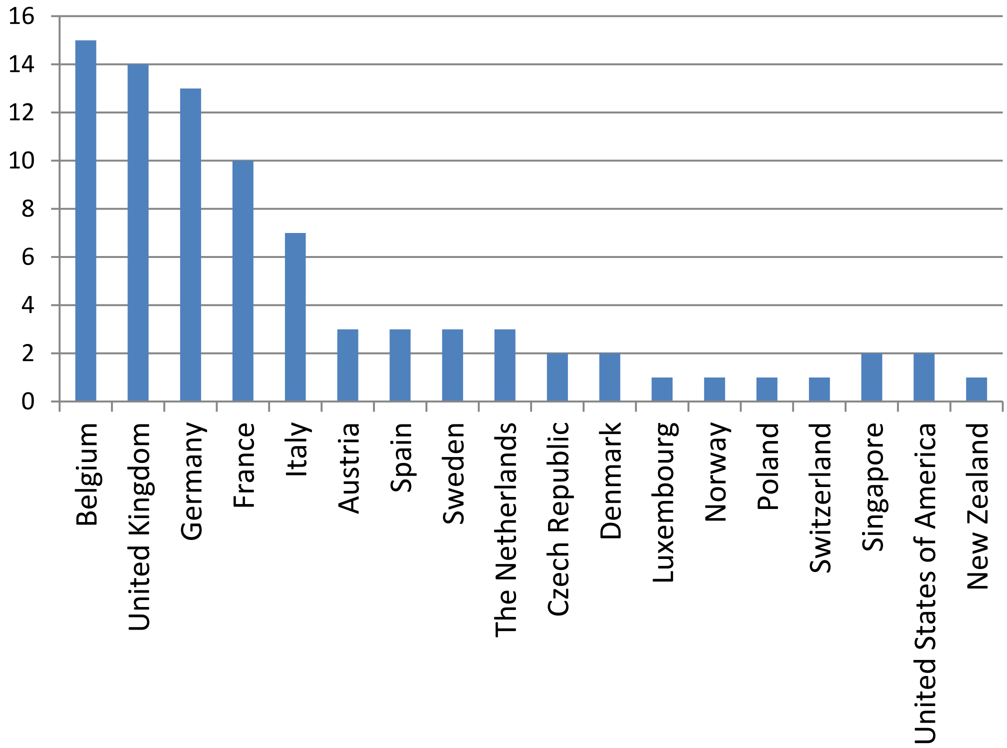

Figure 2. Distribution of respondents according to the country of residence

1.3. General views

For most questions, views diverged between representatives from the industry on the one hand and public authorities (regulators and supervisors) and think tanks and other stakeholders on the other hand. Sometimes views were divergent even within the same stakeholder group, such as between large and small banks regarding to the questions on proportionality.

The consultation specifically asked for quantitative and qualitative evidence from stakeholders to support their view with the view to facilitating the follow-up work on the consultation. Nevertheless, in the vast majority of cases the respondents did not provide evidence to support their views. The issues have been further discussed at the conference organised by the Commission on 14 December 2015 and additional work will have to be performed with a view to more clearly identifying valid concerns about CRR and CRD IV and arriving at effective solutions to address them where relevant.

Stakeholders generally agreed that CRR and CRD IV improved the resilience of the European banking sector by making banks better capitalised and thus better prepared for future crises, while supervisory demands (such as stress tests) and investor / market demands have also substantially contributed to increasing in the capital ratios of European banks, which on average go far beyond the regulatory minima required by CRR and CRD IV.

Representatives from the banking industry thought that CRR and CRD IV requirements negatively affected lending to the economy, but the economic slowdown (demand side) also played a role. Supervisors, think tanks, and a few respondents representing banks, however, noted that those banks which remained well capitalised during the crisis were better able to provide financing to the economy. Moreover, the difficulty of disentangling the impact of regulatory, supervisory and market drivers on lending was often highlighted.

There was generally a lack of evidence as regards the effectiveness of the supporting factor for SME loans (hereafter, SME SF). Representatives from the industry, including banks, claimed that the SME SF was effective but not to the extent expected. More critical comments on the effectiveness of the factor in facilitating lending to SMEs came from other stakeholders, such as regulators, although some of them added that more time was required to assess its effectiveness.

According to the banking sector, CRR requirements for infrastructure projects, especially capital and liquidity ones, did have an impact on the capacity of banks to provide loans to this sector while public authorities, by contrast, did not generally share this view. At the same time, a majority of respondents had sympathy for creating a separate asset class for infrastructure, which were more reflective of the particular features of infrastructure investment, except for some public authorities and supervisors, who did not share this view.

Within the banking sector, there was a divide between large and small banks on the issue of proportionality. The former generally argued against more proportionality, claiming that there are already additional requirements for big banks and systemic institutions. The latter favoured increased proportionality, arguing that compliance and reporting costs for small- and medium-sized banks can be disproportionate.

The banking industry generally indicated that greater simplicity of the rules would be desirable. Small banks and supervisors found a connection between simplicity and proportionality, indicating that simpler, smaller banks could be subject to simplified requirements.

On how the framework affects the single market, the vast majority of respondents from the banking sector indicated that greater harmonization both in the prudential framework and in supervisory practices would be desirable. There was however some recognition of the need to maintain certain national flexibility regarding the macroprudential toolkit. As concerns the merits of discretions to increase requirements with a potential to adversely affect lending, views diverged.

Despite the focus of the consultation on the impact of CRR and CRD IV, respondents from the industry and from regulatory bodies also raised concerns on the upcoming legislation, such as the leverage ratio (hereafter, LR) and the net stable funding ration (hereafter, NSFR), as well as other ongoing initiatives at the Basel Committee. Although views on Basel work were not originally sought by this consultation, they have also been considered useful and included in the analysis of responses.

2. THE ROLE PLAYED BY THE CRR AND CRD IV REQUIREMENTS IN THE RECAPITALISATION PROCESS (QUESTIONS 1 TO 3)

The banking industry and its affiliates

Many respondents stated that financial reforms (Basel 3, CRD IV/ CRR) **had significantly contributed to strengthening the European financial sector**. There had been an improvement in both quantity and quality of capital. One respondent argued that this process already started before CRR / CRD IV as a response to the crisis.

Some stressed that it was still too early and at any rate too difficult to assess the impact of the new regulatory environment, as it was not yet fully implemented. They called for a holistic assessment.

A recurrent comment was that international Basel rules, and to some extent CRR / CRD IV were designed for large international banks. Therefore, the size or business model of banks should be better taken into account, in line with the proportionality principle. Some called for specific measures to take better account of particularities in that respect (e.g. need to better recognise physical collateral or lease finance).

Many respondents stressed that the combination of market, supervisory and regulatory pressure on banks to increase capital ratios led to an unprecedented burden with negative effects on lending and bank profitability amplified by the low interest rates level. Some cooperative bank respondents highlighted that they were well-capitalised ahead of the crisis, which enabled them to maintain lending throughout the crisis.

Many respondents stated that market demands have anticipated the CRR / CRD IV adoption timing, putting pressure on banks to reach quickly higher capital ratio levels so as to restore investor confidence, even in the absence of a stable new regulatory framework. As a consequence, banks increased their capital ratios regardless of the transitional period provided for by the CRD IV /CRR. Some mentioned that a perceived “race to the top” by national authorities was damaging in encouraging lending to the economy.

Many respondents argued that the negative impact CRR / CRD IV was further amplified by lingering uncertainty, given that there were more measures in the legislative pipeline (e.g. LR, further Basel work streams amending standardised approaches and capital floors) that would have a significant impact.

According to respondents, different approaches of competent authorities to Pillar 2 were also a concern. In particular, various supervisory actions (comprehensive assessment, asset quality review, stress tests) further increased the need for quickly reaching higher levels of capital ratios, as well as better quality of capital. In particular the Asset Quality Review drove banks to make value adjustment to their portfolios, affecting banks' profitability and capital ratios.

Many respondents considered that market pressure and supervisory pressure were more important drivers for banks recapitalisation than regulatory measures. However the majority of these responses ranked regulatory measures as the most important factor behind bank recapitalisations.

As regards the level of capital requirements, areas of concern mentioned varied depending on the type of the respondent bank. One respondent argued that as a whole, CRR / CRD IV was not sensitive and responsive enough to risks in specific areas of banking.

Specific areas where capital requirements were deemed excessive by a few respondents were securitisation and the CVA framework. Other areas mentioned in individual responses were: certain segments of retail exposures (low loan-to-value mortgages with low default rates, etc.), loans to “social enterprises” that would merit lower requirements or stronger support (similar to SME Support Factor), leasing and factoring, asset based lending, property development, mortgages, corporate lending, SME lending, derivatives, trade finance and infrastructure finance.

Many respondents welcomed the existence of the SME SF and argued that uncertainty whether the SME SF would remain in the CRR limited its effectiveness. It was also mentioned that the reduction in capital charges for exposures to SMEs was subject to overly restrictive conditions, such as the maximum limit of EUR 1,5 million of exposure. Moreover, too much focus was placed on the probability of default and not enough attention is paid to the loss given default. Risks on lending to SMEs could be mitigated in ways currently not sufficiently recognised in CRR by lending on a secured basis.

A certain number of respondents criticised that the supervisory requirements by supervisors on the additional Pillar 2 capital are unclear, unpredictable and difficult to understand and that supervisors focused too much on size but not sufficiently on other elements of risk (e.g. complexity, interconnectedness) and differences in business models.

As regards macroprudential buffers, some respondents acknowledged their necessity. They also underlined that markets expected banks to comply with these buffers. However, some respondents noted that due to the "unpredictable" nature of these buffers, they had a negative impact on lending decisions. The proliferation of different buffers started to be confusing, amplified by transitional arrangements, actions by national competent authorities (hereafter, NCAs), ECB comprehensive assessment, stress-testing, US comprehensive capital analyses. Also, as authorities used other measures to address macroprudential risks, such as loan to value (hereafter, LTV) limits, this caused regulatory overlaps and duplication of requirements.

Many respondents also argued that *national* macroprudential measures made the framework more complex and distorted a level playing field. In that respect, many highlighted the systemic risk buffer and the counter-cyclical buffer as being particularly difficult to predict and giving too much scope for national discretion. Similar comments are made on the Other Systemically Important Institution (hereafter O-SII) framework, which is also regarded as too complex by some respondents. Also, interaction between O-SIIs and global systemically important institutions (G-SIIs) should not lead to the double-counting of capital buffers. On a separate note, cooperative banks called for further national discretion when it comes to calculating the counter-cyclical buffer, also in order to take account of the particular nature of cooperative banks.

Specific comments from individuals and think tanks

A vast majority of individuals and think tanks suggested that the current level of capital ratios, including macro-prudential capital buffers did not go beyond what was necessary. Furthermore, these respondents made the following suggestions to the Commission:

- Perceived flaws of the Internal Ratings Based approach should be addressed

- Systemic risks such as procyclicality of leverage and interconnectedness should be better addressed. These buffers had not addressed comprehensively systemic risk factors and additional macro-prudential measures are needed to reduce the risk of joint bank default. One possibility among others could be to use metrics such as CoVaR (Value-at-Risk of institutions conditional of distress of other financial institutions). In addition, a future LR should also include a countercyclical element, which would be both consistent with the countercyclical buffer and reduce the risk of fire sales caused by a hard threshold.

- Capital requirements for G-SIBs should be strengthened in recognition of their role as 'super spreaders' of financial contagion due to their size and interconnectedness. It is vital that capital requirements are supplemented with other macroprudential measures to address interconnectedness, improve the diversity and 'modularity' of the system. Banks which are O-SIIs and G-SIIs must have higher capital ratios in order to mitigate systemic risk.

- Traditional banking models should be promoted. They had both safer funding profiles and a tighter focus on lending. There was reference to some research[1], which suggested that resilience remains significantly below pre-

[1] Research by New Economics Foundation (NEF) on Financial System Resilience Index: http://www.neweconomics.org/publications/entry/financial-system-resilience-index

crisis levels in many G7 countries including the UK. There was much still to do: it would be a mistake to begin rolling back post-crisis regulation in the name of economic growth.

Specific comments from supervisors and regulators

Most respondents replied that the CRR and CRD IV package generally was balanced and that the net effects of the reform that had been carried out since the onset of the financial crisis had been positive.

Virtually all respondents agreed that while the main driving factor for the strengthening of capital ratios were the regulatory demands of the CRR, also other factors like the macro-economic environment and especially adjustments made by the banks in response to market demands played an important role. The responses indicated it was difficult to disentangle the effects of these individual factors. Some indicated that banks would probably have increased their capital ratio levels even in the absence of regulatory intervention.

Some respondents highlighted that banks in their jurisdictions were well capitalised beyond the minimum levels required by CRR and CRD IV and that high levels of lending to the corporate sector have been maintained.

While most agreed that the regulatory changes brought significant benefits - especially for the long term – they expressed that transition costs should not be underestimated. One respondent mentioned that reporting requirements for credit institutions under CRR and CRD IV should be reviewed as it is questionable whether the burden is justified compared to the value added of the information. In general, respondents emphasized that it should be a priority to analyse how all the various elements of legislation and legislative proposals (also at international level) interact and what the combined impact was and eventually would be. Some highlighted the need for better coordination between national competent authorities and the ECB/SSM to ensure that any potential overlap between minimum capital and Pillar 2 requirements is avoided.

Many respondents did not consider that capital ratio levels in certain areas went significantly beyond what was necessary in light of the risk incurred and posed by banking activities in these areas. Some respondents even expressed that with regard to systemically important banks, there was a need for an additional loss absorbing buffer to make the resolution of those banks possible.

Most respondents emphasized that capital requirements should continue to be risk based. One respondent mentioned that non-risk based capital requirements could only be complementary to risk based capital requirements. Future rules would need to take into account well-functioning national business models. Especially with regard to potential new rules on NSFR and LR, specificities of national mortgage credit systems should be considered.

One respondent mentioned that the level of risks posed by larger banks was proportionately higher and that the existing buffers reflected this higher level of risk. Another respondent highlighted that in the area of securitisation capital requirements some further fine-tuning could be needed, because they were not commensurate to the level of underlying risks.

Corporates, SMEs and other borrowers

As regards the role of regulation in the recapitalisation and the possible interaction with market expectations and supervisory requirements, respondents stressed a number of themes. Some respondents highlighted that while more capital ratios improved safety, it had no positive effect on lending as higher capital requirements could force banks to refuse more borrowing requests. Some respondents argued that it was difficult to disentangle the effects of the CRR and CRD IV from other factors, as rules and the broader environment interacted. Most respondents argued that markets and supervisors had played a key role, pushing for quicker implementation.

Furthermore, some respondents stressed that the impact on bank behaviour and lending varied between different types of banks. It was less pronounced for some (e.g. guarantee banks) banks, while being more pronounced for others, in particular commercial banks. The combination of regulatory capital requirements with low interest rates contributed to serious profitability problems, leading to business realignments. In that respect, some respondents also highlighted that policymakers should not underestimate the importance of future regulatory requirements (e.g. LR, NSRF) on current bank behaviour.

As regards the appropriate level of capital requirements and whether some asset classes had too high requirements, some themes emerged. The vast majority of respondents argued that SME loans had too high capital requirements and that the SME SF helped, but did not fully offset the capital disadvantage. Many respondents argued that it should nevertheless be made permanent, as a reflection of the stabilising effect that the spreading of risks through SME loans has on banks' businesses. Some respondents also argued that the current cap on exposure volume (EUR 1,5 million) should be lifted. Some respondents furthermore stressed the link with a lack of market financing, arguing that SMEs' dependence on bank financing makes it particularly urgent to review capital requirements.

Some respondents also expressed a more general concern that capital requirements no longer reflect underlying risks to the same extent as before (i.e. actual experiences of unexpected losses). This, it was argued, was in particular the case for loans to SMEs.

Some respondents also argued that the LR presented particular problems given its blunt nature, impacting less risky lending too much. For example, some highlighted long-term financing of properties and commercial real estate as particularly suffering in this respect.

As regards the role of additional capital and buffer requirements, some respondents argued that also markets now expect banks to comply with buffers (“new normal”). Some stressed that this was exacerbated by the existence of new capital instruments (Additional Tier 1), where investors pushed banks to issue capital well in excess of buffer limits so as to limit the risk of these hybrid instruments missing coupon payments.

Some respondents argued that some buffers were more problematic and drew attention to the Systemic Risk Buffer and the O-SII framework in that respect, arguing that these buffers drive complexity and reduce transparency for investors. Some argued that macroprudential instruments were similarly problematic in that respect, leading some to call for restricting their use to specific, extraordinary circumstances.

3. REGULATION – A CAUSE OF THE FALL IN CORPORATE LENDING? (QUESTIONS 4 – 7)

3.1. Have increased capital ratios influenced capacity to lend? (question 4)

The banking industry and its affiliates

All respondents argued that capital requirements tended to reduce banks' capacity to lend. Banks claimed that higher capital requirements could have a negative impact on the growth of the economy as equity is more expensive than debt. As a result, banks argued that new regulation made banks review their portfolios and reshape and/or reduce their involvement in certain non-core businesses (e.g. trading) and certain countries or geographical areas.

Some respondents highlighted that banks reacted differently to the crisis, with the negative impact on lending (reducing volumes and increased credit prices) being more pronounced for banks whose capital position was more constrained.

Some respondents noted that effects on bank financing of the economy could have been greater had the capital requirements not been risk sensitive. Specifically, the situation would have been markedly different if a binding LR had already been imposed.

Going forward, some respondents thought it was likely that stricter requirements in the pipeline, such as the LR or the NSFR, would lead banks to review core client-related operations (e.g. mortgage lending, public sector finance, SME lending).

Many respondents acknowledged that there were a variety of factors at play and that it was difficult to disentangle the effects of any individual piece of regulation. Demand factors were important but there were conflicting views about their impact: while on the one hand the low interest rates increased demand for loans, at the same time such demand was reduced by other factors (e.g. large corporates having higher self-financing and access to capital markets, lack of confidence of SMEs to invest). Respondents noted that credit demand is naturally reduced during crisis, especially on the corporate side, as an effect of lower economic activity and lower investment. On the supply side, many respondents stressed a negative influence due to a *reduction in international funding capacity* and expected future performance of the economy. Many respondents also highlighted uncertainty about further regulatory measures and new supervisory approaches as weighing on supply.

Comments from individuals, think tanks and trade unions

Almost all respondents noted that higher capital requirements are aimed at maintaining a sustainable flow of lending to the economy over the financial cycle. By being more solid, banks could lend to a larger number of counterparties, including risky counterparties. It was also noted that to the extent that banks' needed to rebuild their balance sheets resulted in the post-crisis contraction in lending, this was a function of pre-crisis over-leverage and not post-crisis over-regulation.

One respondent postulated that more capital meant more financial resources that a bank has at its disposal and therefore can use for more lending. Other respondents noted that solid bank balance sheets support lending and thus building banks' resilience should not be considered in conflict with supporting the economy. Finally, some respondents highlighted a desire to force banks to raise new equity to cover shortfalls rather than leaving them with incentives to reduce lending.

Many respondents thought that both demand and supply factors affected the volume and prices of loans to be provided, with supply factors playing a bigger role in more crisis-hit countries. It was also underlined that reduced demand for loans is a typical feature in economic downturn. Finally, respondents claimed that evidence suggested that banks which were more exposed to volatility of interbank and capital markets contracted their lending much more. The respondents reported that "stakeholder banks" (i.e. non-shareholder banks) with more traditional business models, including German public savings banks, Swiss cantonal banks and US credit unions, all maintained their lending through the post-crisis years, while shareholder-owned commercial banks were contracting lending.

Specific comments from supervisors and regulators

Virtually all respondents thought that overall credit supply has not been constrained or not to a significant extent. One respondent argued that the high level of competition in his national banking sector had prevented the restrictive impact of regulatory changes and banks' equity endowments from translating into an actual tightening of credit standards for corporate loans. He highlighted even an increase in lending by savings banks and cooperatives to non-financial corporates and households.

One respondent questioned to what extent regulatory discounts regarding capital requirements, such as the SME SF, actually affected banks' provision of credit to SMEs. It was argued that banks' decision to extend lending to a given firm is conducted before such discounts are taken into account and that the primary factor in the decision is the repayment capacity of the firm. The SME SF mainly acted to reduce the pricing of loans which would have been extended regardless of the discount.

Several respondents argued that the purpose of financial regulation was to maintain financial stability, investor and consumer protection and should not be a policy tool to incentivise lending. Although in the short term higher capital requirements might increase costs for banks, a move to a more resilient banking sector is considered beneficial for credit supply in the long run. One respondent argued that the crisis had shown there are limits to self-regulation and market discipline.

Corporates, SMEs and other borrowers

Many respondents stressed that "Basel 3" rules would reduce credit volumes in general and increase credit costs for borrowers. Some corporate respondents underlined that the impact was particularly important in market segments that are high volume, high risk and long-term. They also were concerned that the banks' portfolio reallocation so far focused on non-core activities; going forward, core activities such as corporate and SME lending were more likely to suffer. Also trade financing and export credit was likely to suffer going forward.

Some respondents thought that the main effects of regulation were likely to be observed in the next cyclical downturn, when more difficult economic conditions would decrease ratings and test the sufficiency of banks' capital reserves to ensure a sustainable financing of the economy.

A few respondents acknowledged that it was difficult to disentangle the effects of the CRR and CRD IV from other factors (e.g. monetary policy, economic environment). Still, they argued that most studies showed that the effects of regulation had not been negligible.

Some respondents also stressed that alternative financing means (e.g. factoring) helped cushion the impact for SMEs.

3.2. Are effects of capital requirements temporary, transitional or structural? Impact cost of funding and capital? (question 5)

The banking industry and its affiliates

Most respondents considered the effects of capital requirements to be structural, arguing that they led to a structural increase in refinancing costs for banks. Many respondents thought that the reform modified the structural composition of assets and liabilities of banks, thus reshaping lending portfolios to focus on industries and activities that were less capital intensive.

Some respondents stressed the adverse impact on market liquidity from the cumulative impact of regulation. The increase in capital requirements made banks more prudent in using capital and liquidity; dealer-led markets would suffer the most and market making might be further constrained by the Bank Structural Reform. Furthermore, increased use of central counterparty (hereafter, CCP) clearing would reduce liquidity for over-the-counter (hereafter, OTC) instruments which were not suitable to CCPs and frequently used by corporates. Moreover, liquidity rules and collateral requirements would push banks to hold high quality assets. The lack of high quality assets might have significant impact in stress. Further reforms (the Fundamental Review of the Trading Book, the Markets in Financial Instruments Directive and Regulation, Bank Structural Reform, Financial Transaction Tax) would affect market liquidity further.

Respondents acknowledged that the increase in banks' funding costs was not only due to CRR and CRD IV. The bail-in provisions of the Bank Recovery and Resolution Directive (hereafter, BRRD) were often highlighted as important in this respect. Many respondents also thought that costs increased as banks and market participants anticipated the introduction of a LR and the new liquidity framework. Moreover, many respondents also underlined that costs increased further due to other changes in the environment more broadly (e.g. markets favouring more capitalised banks).

Some respondents argued that the increase in the cost of capital is magnified by the fact that the cost of a large part of banks' debt is not risk-sensitive (deposits protected by DGS). Accordingly, the higher cost of equity had not significantly been compensated by lower cost of debt. Furthermore, the cost of increased equity materialised in the short term, while benefits on the debt side could be observed only in the long run. Furthermore, the respondents also highlighted that the favourable tax treatment of debt compared to equity was an important driver of funding cost. Some respondents acknowledged that the above mentioned effects had to some extent been neutralised by a decrease of the risk-free rate, due *inter alia* to an expansionary monetary policy.

Comments from individuals, think tanks and trade unions

The new prudential requirements were seen by respondents as having both transitional and structural effects with the latter identified more often in the responses. One respondent highlighted the importance of timing and transitory effects of capital strengthening: in a banking crisis, where it was difficult for banks to issue new capital or retain earnings to strengthen their capital base, cutting back lending to the real economy is the easiest way to increase their capital ratios.

Respondents shared the view that the hypothetical absence of CRR and CRD IV would have kept banks vulnerable to future crises and might have caused an abrupt drop in lending in the future. The lending to the economy would in any event have been cut by banks exposed to wholesale funding and capital markets.

Most respondents agreed that higher capital requirements increased the overall cost of bank funding, but that the unit cost of capital decreased due to the lower riskiness of banks. Respondents identified a set of drivers which could make bank overall funding costs decrease and the expected returns from equity and debt to converge:

- the introduction of bail-in-able debt should lead to the expected returns from debt and equity to converge;

- better capitalised banks would be less risky countering the increase in the cost of funding;

Some respondents would favour the removal of the favourable tax treatment of debt over equity, which could also lead to a convergence in the cost of funding for both instruments;

Specific comments from supervisors and regulators

Some respondents explained that data for banks in their respective Member States illustrated that funding costs tended to increase when a bank increased its capital. But this increase was modest and most often compensated by attenuating factors.

There might be a higher short term transitional impact on the cost of funding but the long term impact would be modest. However, it was still early to conclude on the structural impact at this stage.

Corporates, SMEs and other borrowers

Corporate respondents' views differed somewhat on the subject, with many stressing that it was too early to draw conclusions. However, some argued that the impact of the increased cost of funding was likely to be structural. Most acknowledged however that the CRR and CRD IV was not the only reason: BRRD, the anticipation of LR and NSFR as well as the changing environment played important roles. Some respondents stressed that the introduction of bail-in requirements in BRRD was particularly important: the risk of being bailed-in off-set the otherwise positive effect of higher capital requirements on investors' risk perception.

Some respondents also stressed that higher capital requirements may have potentially contributed to the disintermediation trend, with market financing gaining share.

3.3. Does increased capital particularly affect some asset categories? (question 6)

The banking industry and its affiliates

In general terms, many respondents stressed that large, risky and long-term instruments were more affected. Moreover, the more subordinated an instrument, the more affected it was.

Specifically, the following asset categories and/or activities were highlighted as particularly affected:

- Ordinary lending to households, SMEs and corporates, especially for uncollateralised credits. The SME SF counterbalanced this to some extent, but not enough to compensate for the increase in capital requirements. Many argued that the benefit of the SME SF was limited by the uncertainty surrounding its longer term fate;
- Securitisation, structured finance and other market activities;
- Trade finance;
- Repos and derivatives;
- Real estate, and construction and equity investments;
- Long-term lending to public entities; and
- Transaction banking (due to significant additional risk based and non-risk based capital to be allocated for notional cash pooling).

Many respondents also identified regulatory measures that had led to these effects:

- **The impending LR** and its interaction with risk-based capital requirements. This had a profound impact on the risk profile of banks and structure of the balance sheet. Generally, many respondents highlighted that the LR made business loans with low-risk and low-return less attractive. More specifically, some respondents noted that the non-recognition of risk-reducing benefits of collateral for LR calculations also led to substantially higher capital requirement for securities financing. Similarly, some respondents argued that the future requirements on uncommitted facilities would have a particularly negative impact on trade and commodity finance. Furthermore, some respondents thought that OTC instruments should not have a higher risk profile than Exchange Traded Derivatives (hereafter, ETD). Some respondents argued that revising the LR treatment for cleared derivatives was desirable. The Standardised Approach to Counterparty Credit Risk agreed by the Basel Committee provided a ready-made fix to this problem. Some respondents also highlighted that the LR could also have particular negative effects on custody banks, due to the high proportion of central bank deposits.

- **Liquidity** requirements in the form of the LCR and NSFR. The NSFR was regarded as having a particularly negative effect on capital market activities' of banks (e.g. derivatives, repo) as well as SME assets, which were not liquid. Some also linked the short-term liquidity requirements to the increase in the costs of bond-funded lending (e.g., mortgages funded by covered bonds). Furthermore, the requirements for issuance sizes in some asset classes had contributed to differentiating the costs within the individual asset class.

- Concerns about future increases in **the capital requirements for trading book exposures** were identified as negatively affecting market-making.

- Furthermore, some respondents stressed that a possible **(re)introduction of a prudential filter limited to unrealized gains** (i.e. not filtering out losses) was a major concern and could negatively impact the banks' capital ratio.

Comments from individuals, think tanks and trade unions

In terms of the categories of assets that were differently affected by the CRR, some respondents mentioned that sovereign debt, to the extent it had a zero risk weight, crowded out lending to the real economy in the light of declining interest rates for mortgages and corporate loans. Some respondents proposed extending the application of large exposure limits to sovereign debt, which would not only reduce the home bias in banks‘ balance sheets and the associated concentration risks to the solvency of their home sovereign, but would also provide banks with incentives to lend more to the private sector.

Some respondents argued that small banks were hit disproportionately by higher capital requirements, since the standardised approach they use to calculate their regulatory capital did not enable them to "optimise optimistically" their capital as the IRB approach did for large banks.

Specific comments from supervisors and regulators

While a few respondents noted that there was no evidence that the capital requirements had affected the markets for particular categories of assets, except in the case of SME loans due to the SME SF, others argued that regulatory change had impacted some categories of assets more than others. One mentioned the case of securitisation. Another case mentioned was the use of internal models, which might cause distortions, particularly where the internal model delivered lower risk weights than the standardised approach. The example used was the case of mortgages where smaller banks using the standardised approach might be encouraged to compete for riskier mortgages where the differentials were less severe. One respondent specified that the effects of increased capital requirements for investment banking were felt more by banks with larger exposures to trading positions, derivatives, repos, securities lending and interbank business, though statistics did not seem to suggest an abrupt fall in volume for those business lines. Some respondents believed the LCR set strong incentives to hold sovereign bonds or central bank reserves as highly liquid assets. It was nevertheless considered difficult to examine the effect of the LCR in this respect given the current environment of expansionary monetary policy.

Corporates, SMEs and other borrowers

Similar to banks, some respondents argued that large, risky and long-term assets had been more affected. They also thought that the LR made low-risk and low-return activities less attractive.

Availability of long-term financing was argued to have become particularly problematic. This undermined necessary investments of corporates. Market financing did not compensate for all corporates, particularly for SMEs due to high fixed costs. Particular features of the regulatory framework highlighted as problematic in this respect include: the NSFR (threat, which had already affected bank behaviour); review clauses (e.g. SME SF, undermining its effectiveness); Basel plans (e.g. possible capital charge for interest rate risk in banking book); and, side-effects of the LCR further promoting holding of sovereign bonds, thus crowding out other asset classes.

Given the particular problems of SMEs, many respondents argued that was is necessary to make the SME SF permanent and some also called for removing the EUR 1,5 million threshold.

3.4. Impact of the phase-out of transitional provisions (question 7)

The banking industry and its affiliates

Most respondents argued that the impact would be limited, as the market had anticipated the target level and had accordingly forced banks to comply with end-point requirements in advance. Also Minimum Requirements for Eligible Liabilities (hereafter, MREL) and expected Total Loss-Absorbing Capacity (hereafter, TLAC) requirements led banks to strengthen their capital positions. This is especially true for larger banks, such as G-SIIs and O-SIIs, while smaller and specialised banks had been better able to take advantage of the transitional arrangements.

Nevertheless, some banks considered that the phase out of transitional provisions (e.g., relating to capital buffers and grandfathered capital instruments) could have a negative impact on banks' future lending and strategic decisions.

Making a broader point, a few others argued that the phase-out of transitional provisions should be eliminated to the extent they lead to distortions in the Single Rule book.

Comments from individuals, think tanks and trade unions

In terms of future prudential rules, respondents thought that the liquidity rules might incentivise banks to hold liquid assets rather than increase their stable funding. As a consequence, liquid tradable securities might crowd out loans to companies.

Some respondents noted that the phase-out of the transitional provisions under CRR could still have some incremental impact on future lending decisions, but that it would be sensible to assume that banks acted forward-looking and aimed at anticipating future policy actions which thus determined their current behaviour.

Comments from supervisors and regulators

One respondent explained that its banks had reported no effect of the new capital requirements on their lending standards since 2012. Banks also expected no influence of the tighter capital requirements on their lending standards for the next six months. Respondents argued that overall, the isolated effects of the phasing-out rule on banks' lending decisions would probably be very limited.

It was highlighted that the lack of harmonisation of Member States' use of the transitional provisions might mean that further harmonisation and phasing out of the transitional provisions might have an incremental impact on lending. One respondent mentioned that the lack of certainty over the requirements in the upcoming Level 2 measures could also be detrimental. Finally, the use of regulatory technical standards in order to achieve greater harmonisation might be burdensome without adding significant regulatory value.

Corporates, SMEs and other borrowers

There were not many corporate respondents to this question. Of those who did respond, most saw transitional provisions as irrelevant, as market pressure had forced banks to anticipate the steady state. Instead, some respondents argued that it was more important now to address lingering uncertainty about future initiatives (e.g. SME SF, NSFR).

4. LENDING TO SMEs (QUESTIONS 8 – 9)

The banking industry and its affiliates

Banks have claimed that the preferential capital requirement applicable to SME loans resulting from the supporting factor (SF) has had a positive effect on lending to SME, since it allowed setting lower prices for SME loans. One example submitted by a relatively small bank indicated that loans provided by German cooperative banks have increased almost 10% between December 2013 and June 2015.

However, most agreed that the SME SF proved not to be as effective as expected in improving lending to SMEs. Moreover, the SME SF factor tended to address small and micro businesses and only marginally medium-sized enterprises and therefore could even limit the growth of exposure to SMEs overall.

Additionally, a few policy suggestions were made by some respondents:

- The standardised approach should distinguish more than at present between the risks of unsecured and secured lending and allow the lower risk profile of secured lending at prudent LTVs to be reflected in risk weightings.

- Future global capital standards and the introduction of the NSFR into EU law must take into account their effects on maturity transformation, including the relevance for longer-term SME lending. Additionally, the financial knowledge of SMEs should ideally be improved.

- In order to support SMEs, a more efficient credit risk sharing between the public and private sectors should be promoted. This could be done by increasing the available amounts of public guarantees or loosening requirements to access them.

Comments from individuals, think tanks and trade unions

Respondents outside the banking industry were more sceptical on the effectiveness of the SME SF and referred often to the 'slight effectiveness' of the SME SF. Some suggested that excessive and unwise SME lending contributed significantly to the banking crises and the economic downturns and low-growth periods that many countries experienced in the 1990s. According to them, it was not lending per se that is good, but properly assessed and properly priced lending. Moreover, respondents did not believe that CRR should be used as a means to further support SME lending.

They also provided the following suggestions regarding prudential requirements affecting SME lending:

• Removing the inbuilt advantage of the Internal ratings-based approach (hereafter, IRB approach) over the standardised approach (hereafter, SA). This would stop promoting unfairly large banks over small banks, the latter actually granting most of the SME lending.

• Redesigning liquidity ratios to promote stable funding. This would stop incentivising banks to invest in liquid securities over illiquid loans.

They have also expressed that some of the problems linked to lending to SMEs, in particular those related to information asymmetries, could be addressed by a better credit register coverage in the EU.

Corporates, SMEs and other borrowers

The borrowers believed in the effectiveness of the SME SF, but most of them claimed that it was difficult to provide empirical evidence and referred to the ongoing EBA work on this issue. Some quantitative evidence provided by respondents did not indicate that the SME's access to finance improved since the introduction of SME SF.

Generally, respondents shared the view that SMEs were generally by nature riskier businesses than large, well-established firms and one should therefore expect potential investors (in both equity and debt) to require a higher return to compensate them for that risk. SME lending faces difficulties arising from greater information asymmetries between borrower and lender (e.g. in the absence of audited accounts). Therefore, SMEs were, according to respondents, unlikely to ever be able to obtain financing as easily or as cheaply as larger businesses. However, the greater granularity and idiosyncrasy of risk embedded in banks' SME loans portfolios should generally help reduce the risk on a portfolio level.

Supervisors and regulators

Regulators and supervisors provided relatively sceptical views on the effectiveness of the SME SF in increasing bank lending to SMEs. Only one respondent believed in the effectiveness of the SME SF, while others thought it was not effective or remained silent in their responses. At the same time there was a call for more time in order to draw more robust conclusions before changing the current set of rules.

Many respondents tended to emphasize factors outside the scope of CRR as causal for the subdued lending to SME, notably the difficult economic environment, reduced demand for SME loans or competition from alternative sources of finance. Moreover, one respondent noted that banks might choose to ignore the SME SF in bad times, as they preferred to estimate actual credit risks as precisely as possible and subsequently made sure that they held sufficient capital to cover for this risk.

A few respondents also referred to the ongoing analysis on the issue undertaken by the EBA. Moreover, some noted that the SME SF distorted the perception of actual risk and SMEs financing problems should be addressed by more targeted measures than a beneficial capital treatment, such as subsidies, guarantees, expert consultations, investment from public funds, and, in particular, overall political, legal and economic stability in the country.

Overall, respondents were sceptical about the use of prudential regulation to address these difficulties. The prudential regulation should make sure that the risks are adequately covered. Only one response defended that the capital benefit would make banks more competitive against non-bank financing and that ultimately SMEs could benefit from this competition.

5. LENDING TO INFRASTRUCTURE (QUESTIONS 10-12)

The banking industry and its affiliates

The majority of respondents argued that the CRR had had an impact on the capacity of banks to provide loans to infrastructure projects. In addition to the risk-weighted requirements applicable to infrastructure loans, they pointed out the liquidity regulation (LCR, upcoming NSFR) as also affecting the provision of infrastructure loans, but they were mostly silent on the concrete channels through which this influence would take place. Within the risk-weighted requirements, many banks argued that the fact that there was a variety of possible methodologies to be applied to loans to infrastructure projects[2] and that supervisors across the EU had discretion to allow one approach or the other was acting as hurdle to lending to infrastructure projects. Also, respondents were quite consensual on the fact that infrastructure projects should not be treated as loans to borrowers, since their features were significantly different: higher collateralization, higher recovery rate, lower volatility. This was seen to be making the current approach non-risk sensitive.

Among their policy proposals, respondents suggested a beneficial capital treatment for infrastructure loans, comparable to that for SMEs. A differentiated prudential treatment should apply depending on the type of infrastructure borrower, greater harmonization and a greater risk sensitivity of the whole prudential framework applicable to infrastructure. One respondent suggested a specific policy option: implementing a single mandatory approach for all banks, which would consist of a re-calibrated supervisory slotting approach[3]. This would address the issue of disparity of approaches while providing a prudential treatment for these loans different from that of corporate loans.

Individuals, think tanks and trade unions

Some respondents pointed out the fact that these activities are low-yield and low-margin, makes them less attractive to banks. Also, some of them highlighted the need to better take into account government guarantees and the type of interest rate risk (floating/fixed) in the prudential requirements.

Corporates, SMEs and other borrowers

Overall respondents thought that the new regulatory framework had affected the financing of infrastructure loans and that the general treatment of infrastructure projects as corporate loans was too undifferentiated. One respondent mentioned the need to review the prudential treatment of Commercial Real Estate as well, since that type of exposure was intrinsically linked to and hard to differentiate from infrastructure. Another argued in favour of lower capital charges for infrastructure on the grounds of consistency between the banking prudential regulation and the insurance one, in a reference to the Solvency II "qualifying infrastructure investment" treatment announced in the Capital Market Union Action Plan.

Supervisors and regulators

Public authorities had different views on whether the CRR has had an impact on the provision of loans to infrastructure projects. Those who thought it had mainly referred to future NSFR and LR. The NSFR would penalise exposures with longer maturities, which is the case of infrastructure. However, some also recognized that the average maturity of infrastructure loans was decreasing over time.

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[2] Advanced or foundation IRB, standardized approach.

[3] As currently applicable within the context of the IRB approach.

On whether exposures to infrastructure should receive the same regulatory treatment as corporate exposures, views were also split, although a slight majority thought the same regulatory treatment should be kept, since it would ensure simplicity of the framework. Those in favour of not keeping the same treatment argued that infrastructure exposures had different features and lower risk profiles than corporate exposures. They quoted specific research stating that default rates of infrastructure exposures were lower and recovery rates higher in many cases.

6. PROPORTIONALITY (QUESTION 13)

The banking industry and its affiliates

A majority of respondents from the financial industry argued in favour of the need for more differentiation within the framework of CRR and CRD IV. Yet, views were rather diverse as regards: the justification for this further differentiation, the criteria to be used for differentiating between institutions and the specific areas where differentiation would be mostly needed.

Justifications for more differentiation included:

- the need to avoid disproportionate compliance costs for small or medium sized banks;
- the need to address differences in regulatory capital requirements stemming from different approaches (SA, IRB approach) for banks competing in the same markets;
- the need to avoid that a one-size-fits all approach, which would reduce over time the diversity in the banking sector, squeezing out specific models that are well functioning;
- the need to make sure that the risk-sensitivity of the regulatory framework is designed appropriately so as to ensure that capital is commensurate to risks and allocated in the most effective manner.

Those opposing further differentiation in the CRR and CRD IV, emphasised the already existing additional requirements for big banks (i.e. buffers) as well as the possibility to use Pillar 2 in order to differentiate between banks. They claim that the current architecture of capital requirements already includes different approaches to address the risks incurred by an institution, whereas further differentiation would create an uneven playing field and would give competitive advantages to certain institutions over others.

As for the criteria to be used for further differentiation, part of the banking industry argued in favour of size and complexity criteria, measured either in terms of total balance sheet, cross-border activities, systemic relevance organisational complexity and business profile. Several respondents favoured differentiation on the basis of the existing capital level (risk-based solvency ratio) of institutions as a starting point.

A significant number of respondents, however, claimed that size and complexity were not sufficient criteria for differentiation, pointing out to the advantages of the more diversified portfolios of bigger institutions and the merits of the universal banking model. They argued for the risk profile to be a determining criterion for further differentiation. Several respondents propose a holistic assessment or the use of a qualifying infrastructure investment "balanced scorecard of criteria", including: asset size, sustainability of the business model, extent of cross-border activity, ownership structure, absence of a trading book, use of wholesale funding, engagement with national payment systems, concentration risk, proportion of deposits covered by deposit guarantee schemes, ease of solvability. Some respondents also suggest considering the impact on banks' lending to the real economy as a basis for further differentiation.

In terms of how to differentiate between institutions respondents pointed out to various ways forward:

- create exemptions from operationally burdensome CRR requirements;

- develop simpler, less expensive rules for small/less risky institutions;

- keep the same rules for everyone but request supervisors to apply them proportionately (e.g. credit risk calculation should be done with the same methods, accuracy and detail for all, but supervisors' assessment of the results should take into account proportionality);

- observe/enforce the proportionality principle when drafting/applying binding technical standards;

- observe the proportionality principle when considering further harmonisation (e.g. the ECB exercise on options and discretions);

- "think small first", not as an afterthought when rolling out Basel rules;

- assess "Basel 4" in terms of proportionality before transposing it;

- design options for rules, easy to implement without requiring disproportionate resources;

The areas that could benefit from more differentiation, as indicated by the respondents, were:

- Frequency and complexity of reporting requirements and Pillar 3 (disclosure) requirements, which should be reduced for small banks or well-capitalised banks.

- Leverage ratio: avoid that the effects of the non-risk sensitive backstop LR are amplified by the TLAC requirement; modulate the LR to different business models and risk profiles;

- Liquidity regulation: NSFR should take over the differentiation as developed for the LCR and should be adapted for specific business models, especially short-term financing models such as leasing, factoring, consumer credit activities and for the Danish mortgage model;

- Remuneration: a flexible approach to proportionality should be adopted;

- IRB approach for credit risk: Validation requirements of IRB approaches should be better suited for small institutions that mutualise risk assessment functions;

- Simplification of certain areas of regulation for less complex and less systemic institution, in particular: Pillar 2, internal risk management, governance, annual review of resolution plans, imposition of MREL, intra-day liquidity reporting, modelling expected losses under IFRS 9, definition of default.

Individuals, think tanks and trade unions

One respondent considered there should be a more differentiated approach in function of the size or business models of banks. Some responses favoured more differentiation on the grounds that current regulation favours large banks. They argued in favour of removing the use of internal models by large banks, introducing a binding leverage, redesigning liquidity rules order to promote stable funding rather than holding liquid assets.

Those not favourable to more differentiation highlighted that small banks were not immune from failing and imposing externalities. They argued in favour of regulating activities rather than entities in order to avoid regulatory arbitrage. They also proposed to align disclosure requirements with the US rules (freely accessible, high frequency, standardised, available from a central repository).

Corporates, SMEs and other borrowers

Respondents argued in favour of differentiation, mainly to take account of different business models and risk profiles. One respondent supported differentiation on the basis of the risk-weighted capital ratios. Some respondents claimed that the current rules put small or medium sized banks at a disadvantage because of the higher compliance burden, or neglected specialised institutions. They highlighted that the change from principles-based to rules-based supervision had taken away supervisors' discretion of applying the regulatory framework in a proportionate manner. This requires proportionality to be clearly spelled out in the rules.

Respondents also called for the rules on LR and NSFR to take into account the different risk levels in business models. They require differentiation between the treatment of risky financial products (trading assets, derivatives) and the treatment of financing of the real economy (SMEs and other non-financial corporates) or long-term property financing.

Supervisors and regulators

The majority of respondents in this category pointed to the fact that proportionality was already imbedded in the risk-based rules characterising the framework of CRR and CRD IV and the possibility to choose between standardised approaches and more complex alternatives based on internal models. They highlighted the merits of risk-based rules and that systemically relevant institutions were already subject to additional requirements. They hinted that further differentiation would entail problems of setting suitable limits and would further increase the complexity and opacity of the framework, risking to compromise comparability and to create arbitrage.

Nevertheless, most respondents considered it necessary to properly calibrate future requirements such as NSFR or LR so as to preserve well-functioning business models and to avoid burdensome compliance for small banks or institutions having simpler business models. One respondent referred also to remuneration rules. Others also suggested alleviating disproportionate administrative compliance burdens by simplifying reporting requirements (including through standardisation of data on exposures and risk information, reducing frequency and details).

An overall investigation of proportionality of the CRR and CRD IV for banks, as it is done currently by EBA for investment firms, was also encouraged. Respondents highlighted that it would be important for banking regulation not to create a barrier for new market entrants. The merits of a diversified and less concentrated banking sector were highlighted and in this context respondents thought it was necessary to start discussions on whether and which rules make sense for small banks. However, respondents also highlighted that if simpler rules are envisaged for smaller banks in specific areas, they should not be less strict.

7. SCOPE FOR SIMPLIFICATION (QUESTION 14)

The banking industry and its affiliates

Respondents from the banking industry generally indicated that the multiple prudential regulations increased compliance costs and constituted an increasing burden for banks. Smaller banks pointed out that complexity creates a competitive advantage for large banks, which can achieve more economies of scale in allocating resources to compliance functions. As opposed to this, some banks (and some other providers of financial services) pointed out the difficulty to clearly define types of banks or business models as a criterion for differentiating prudential requirements which, if implemented, would also lead to a lower level of harmonisation within the single market.

Overall, smaller banks favoured a differentiation of prudential rules based on business models. However, some other respondents argued that in a single market context with a level playing field, simplification should not be done for core prudential parameters such as capital, leverage and liquidity and argued that a certain level of prudential requirements is needed also as a seal of quality for investors. Few respondents pointed out that in other continents (e. g. US) smaller banks were subject to a much simpler regulatory and supervisory regime.

Some respondents welcomed the Commission's orientation for simplification and assessing the cumulative impact of the post-crisis regulation, arguing for a more integrated approach based on market sectors served by banks and non-banks. Several respondents pleaded for further harmonisation by deleting options in the regulation in order to ensure a level playing field and to create regulatory certainty. A few emphasised also in this context the need to maintain risk sensitive approaches in the light of the current Basel simplification work because simple, standardised approaches do not properly reflect risks. Furthermore, several respondents expressed a concern about the forthcoming “Basel 4” rules, which would add another layer of complexity, and called explicitly for a regulatory pause.

Specific areas mentioned for simplification without compromising the objectives of the regulation are: supervisory reporting (COREP and FINREP), using accounting concepts instead of prudential concepts such as prudent valuation or credit risk adjustments, abolishing prudential filters in general, and adapting requirements on governance and risk management.

Individuals, think tanks and trade unions

Several respondents asserted that the risk sensitivity of the model based risk approaches did not improve financial stability and its complexity created opportunities for regulatory arbitrage. Therefore, the complex internal ratings based approaches should be replaced by a simple LR in combination with the standardised approaches for measuring risks.

Supervisors and regulators

One supervisor pointed at the simplification exercise that the Basel Committee is currently undertaking and warned against front-running “Basel 4” by the Commission. Another supervisor pointed out that the proportionality principle is already implicit in the CRR. Nevertheless, whilst full compliance with Basel standards is important for internationally active banks, a differentiated treatment for smaller institutions only active in local markets may be justified and, if property calibrated, in line with the single market and financial stability concerns.

8. SINGLE RULEBOOK (QUESTION 15)

The banking industry and its affiliates

The vast majority of respondents were supportive of greater harmonization and against national discretions. Harmonization is understood by many respondents not only as harmonizing Pillar I requirements, but also Pillar II ones (supervisory practices) through guidelines and other tools. Furthermore, respondents would like to see greater harmonization not only at EU level, but also at an international one, given the fact that international standards are sometimes implemented differently in different jurisdictions. There is, however, some recognition of the need to maintain certain national flexibility regarding the macroprudential toolkit, given that different EU jurisdiction may not follow the same financial cycles. However, the macroprudential toolkit must be used solely for macroprudential purposes and not as a leeway for more flexibility in Pillar I or Pillar II requirements.

As far as specific options and discretions with a potential to affect the single market are concerned, responses were scarce. Individual respondents listed specific issues, such as:

- The option for competent authorities to exempt specific exposures from the Large Exposure Regime.

- The possibility for member states to change their tax laws to allow deferred tax assets (DTAs) not to be deducted from common equity tier 1 (CET1) capital.

Individuals, think tanks and trade unions

Several respondents stressed the importance of implementing the FSB's binding recommendations on securities financing transactions (SFT) by introducing minimum haircuts and capping the re-use of collateral. In their view, this would address key systemic risks such as reducing the pro-cyclicality of leverage and the excessive elasticity of large banks' balance sheets. It would also help reduce the fragility of large banks' funding structures and internalise the negative externalities of SFTs. As the funding cost of SFTs does not reflect their true cost, implementing the FSB's recommendations would enhance the level playing field between large EU banks, whose main source of funding is SFTs (61% of total liabilities on average), and small banks, which rely more on retail deposits.

As an additional measure to enhance the level playing field, a vast majority of the respondents argued for more stringent regulation for shadow banking, in line with the rules applied to bank lending, since the two perform similar activities and are consequently subject to similar types of risks.

One respondent drew the attention to the importance of certain corporate governance features, such as whistleblowing and competence requirements for employees, considering that these are both elements that can help stabilise the financial sector.

A majority of respondents agreed that there are certain discretions which have an impact on the cost and availability of bank lending. For example, prudential liquidity ratios implicitly favoured liquid tradable securities over loans, thereby reducing the availability of bank lending, as securities could crowd out loans. The same respondents also stressed that the zero risk weight for sovereign debt pushed banks to lend to governments instead of lending to households and businesses. They also claimed that the favourable tax treatment of debt financing compared to equity pushed banks to minimise their regulatory capital, potentially affecting adversely their ability to lend in a sustainable manner.

Corporates, SMEs and other borrowers

One respondent stressed the importance of maintaining the SME SF – introduced by the CRR as well as harmonising the definition of SMEs to ensure a level playing field across all EU Member States. Another respondent called for the inclusion of 'financial services' in the scope of the Transatlantic Trade and Investment Partnership (TTIP) negotiations in order to promote an international level playing field avoiding regulatory arbitrages. Closely related, one respondent argued for the need to ensure that higher priority is given to mutual recognition of different regulatory regimes around the world.

Supervisors and regulators

Although supervisors in general highlighted the benefits of having a single rulebook and the need to further it, there were in their view some cases in which divergent approaches by competent authorities were justified. A few also expressed the need for more stability in the regulation and full implementation of CRR and CRD IV before introducing any additional prudential reform.

Among the discretions which may affect the single market, only a few respondents gave specific answers, such as the variety of regimes in place for cooperative and mutual banks, the lack of harmonization in insolvency procedures and the different approaches used by competent authorities to allow the transfer of capital and liquidity within a banking group.

ANNEX 1. OVERVIEW OF REMARKS PROVIDED BY THE FINANCIAL SERVICE PROVIDERS OTHER THAN BANKS

This stakeholder group thought there was a need to ensure that prudential requirements are appropriate for asset managers as well as for banks. The consideration of the proportionality principle was also relevant for asset managers. When questioning the application of CRR and CRD IV to all banks the application of the CRR and CRD IV to asset managers and to investment firms more generally should also be considered.

One respondent mentioned that the increase in complexity and the more demanding nature of the new regulatory framework would mean loans to the real economy would become more constricted. The cumulative effects of reform should be examined and the resulting capital requirements calibrated to help address the possible gearing up of capital requirements as they interact together.

A risk to the viability of market making activities was highlighted due to the broad application of CRR and CRD IV, which did not contain distinction or proportionality principles between different kinds of firms. In particular, the application of the Markets in Financial Instruments Directive (MiFID II) meant that market makers will become subject to the CRR as investment firms. However, the approaches prescribed under the CRR might not be appropriate as they had been designed for banks. In some cases market makers might be required to hold 100 times the funds they were currently required to hold. This might make market making economically unviable. The short term solution was to confirm the existing 'local firms' exemption for such firms from the CRR regime through 2020. This was necessary to ensure that market makers could comply with the continuous quoting obligations in MiFID II and provide transparent pricing for investors in EU financial instruments. They welcomed the chance to engage with the Commission in any review of the CRR, in order to explore amendments to the methodologies for own funds requirements for market risk.

One respondent highlighted a perceived key problem with the eligibility of collateral under the CRR. There was a weakness in the current credit risk mitigation rules related to the possibility of substituting risk weights where an external credit assessment is not available.

One respondent commented that they had not encountered an increase in bank lending to SMEs and noted that a healthy lending environment for SMEs was necessary for them to contribute to economic growth. SMEs suffered from a credit shortage, due to the banks' ongoing retrenchment from the SME market, which was partly driven by tougher capital requirement regulations and partly by the banks de-skilling with regard to SME lending. There is clear appetite for finance from SMEs and more can and should be done to raise awareness of alternatives to bank finance.