Finalisation of Basel III in the European Union

Recommendations from ESBG, SME United and UNI Europa Finance

ESBG, UNI Europa Finance and SME United believe that the implementation of Basel III standards in the EU regulatory framework should reflect the proportionality principle, taking into consideration the nature, scale, riskiness and complexity of the activities of European credit institutions. The indiscriminate application of the Basel standards, which are designed for internationally active banks, would in fact endanger the diversity of the European banking market, its ability to provide finance to the real economy, local businesses and customers and, as a consequence, local employment markets. We therefore call for a proportionate and careful implementation of the last elements of Basel III in the EU, which should take well into account the specificities of the European economy.

For this purpose, ESBG, UNI Europa Finance and SME United would like to encourage the European decision-makers to take the following considerations duly into account:

1. Proportionate implementation of Basel III in the EU

ESBG, UNI Europa Finance and SME United and their members have long called for proportionality as a way to achieve better regulation and supervision, which allows financial institutions to carry out their daily activities, such as lending to SMEs, under a non-detrimental regulatory framework which increases the strength of the European banking sector. We argue that proportionate banking rules should account for factors such as an institution's size, business model, risk profile and interconnectedness. Proportionality is needed because smaller and less complex banks have had to adapt to administrative burdens that were originally designed to regulate large global players with a completely different risk profile. The regulatory weight negatively affects also the banks' employees, who would be overcharged by huge amounts of compliance requirements, leading to them spending less time providing service to customers and in many cases adding to the stress and risk of burnout, faced by many bank employees these days.

Different regulatory regimes for different banking models would help them to compete on an equal footing while ensuring compliance with standards being set at international level. This would allow for a level playing field, promote local communities and growth – and therefore increase jobs – and in turn contribute at EU level to the further development of the Single Market as well as to financial stability. The big beneficiary of more proportionate regulation will be, inter alia, SMEs, consumers and local communities, who will have easier access to finance but also the local employment market.

The upcoming implementation of the final Basel III framework will be a great opportunity to insert more elements of proportionality in the EU's (prudential) banking regulation.

2. Adaption to European specificities and prudential treatment of SMEs in Basel III

Against the background of the framework conditions of the European banking market, the EU special features already anchored in the CRR/CRR II, such as the treatment of financial equity holdings and supporting factors for SMEs and infrastructure exposures, should be retained.

Both smaller European banks, which use the Standardized Approach (SA) to measure risk, and larger European banks that use Internal Ratings Based (IRB), will be severely affected by the latest Basel reform. The new calculation of risk weighted assets for credit risk will considerably reshape the risk framework for banks in general, and the prudential treatment of SME lending in particular. The new risk weights introduced by Basel III for SME lending exposure, combined with other requirements (capital floor) are likely to increase banks' cost of capital, in particular for low-risk banks, including i.e. mortgage credit banks. The additional costs and lost risk sensitivity for banks are likely to be passed on to the wider economy through higher prices for low-risk credit and reduced lending to SMEs.

In this context, we believe that the EU decision-makers should do their utmost to further stimulate growth of the real economy through an appropriate prudential framework at both international and European level. We are therefore supportive of the so-called SME Supporting Factor as introduced in the European legislative framework (CRR II). This factor grants SME exposures of up to EUR 2.5 million a factor of 76% while any exceeding amount receives a factor of 85%. This could take the average risk weight for SMEs down and help mitigate some of the negative price effects on banks SME clients. We are also convinced that this treatment is justified from a risk perspective.

To ensure that savings and retail banks are in the position to continue providing SMEs with loans, ESBG, UNI Europa, and SME United believe that the higher SME Supporting Factor introduced in the EU through CRR II should be maintained when transposing the last elements of Basel III in the EU.

This is especially important considering that the upcoming legislation will not only be about resilience but about credit supply to the economy. The focus should be on the overall impact of the reforms, as the Basel III package is effectively a collection of various changes to existing standards; all these changes – and their interrelations – should thus be considered as a whole.

Moreover, regarding the granularity criteria, already in Basel II, retail portfolios with loans up to 1 million (consumer and SME loans) got a risk weight of 75%, if the loan portfolio consists of many small exposures which reduces the risk of the overall portfolio (granularity). As indication was given that a single loan should not be bigger than 0.2% of the whole portfolio. Currently, the European legislation allows other options to ensure sufficient granularity, which may not be possible anymore under the new Basel agreement.

Insisting on the 0.2% definition would create problems for smaller banks with smaller retail portfolios, because a retail loan of 1 million could only be provided, if the overall retail portfolio has at least the size of 500 million Euro. This is not the case for many local savings or cooperative banks, which would face restrictions in providing loans to households and SMEs. We would therefore underline that the current definition as regards the granularity of retail portfolios (Art 123 CRR) is sufficient to fulfil the needed requirements and should be kept.

3. <u>Diversity in the banking sector to enrich local employment markets</u>

The European Commission itself has acknowledged that the diversity of banking business models across the EU is beneficial to competition, enhances the overall banking system's efficiency, and helps the system overcome shocks. The heterogeneous structure of the European banking sector provides diversity to the system, which is beneficial as it encourages banks to compete, improving their processes and structures in order to survive and better adapt to evolutions.

Diversity also ensures that the full range of services can be offered to the customers, in particular in banks which focus on SMEs and households, as they build up centres of expertise with a long record of experience and vast knowledge regarding their needs, problems and business structures.

A varied banking landscape is also crucial with regards to local communities as proximity is the cornerstone of savings and retail banks. Thus, through their network of 50,000 branches, savings and retail banks serve 150 million customers and employ 650,000 people in Europe, in particular in rural areas. These stable and highly qualified jobs contribute to the flourishing economy throughout the EU countries. We therefore fully agree with Commissioner Dombrovskis when he says that "We need to consider proportionality to cater for the diversity of the EU banking sector, as well as differences in bank size, complexity, business model and risk profile when applying the single rulebook" and hope to see these words reflected in action when a proposal for implementation is put forward.

About ESBG (European Savings and Retail Banking Group)

ESBG represents the locally focused European banking sector, helping savings and retail banks in 21 European countries strengthen their unique approach that focuses on providing service to local communities and boosting SMEs. An advocate for a proportionate approach to banking rules, ESBG unites at EU level some 900 banks, which together employ more than 650,000 people driven to innovate at roughly 50,000 outlets. ESBG members have total assets of €5.3 trillion, provide €1 trillion in corporate loans (including to SMEs), and serve 150 million Europeans seeking retail banking services. ESBG members are committed to further unleash the promise of sustainable, responsible 21st century banking. Our transparency ID is 8765978796-80.

About SME United

SMEunited (formerly UEAPME) is the association of Crafts and SMEs in Europe with around 70 member organisations from over 30 European countries. SMEunited reassembles national cross-sectoral Craft and SME federations, European SME branch organisations and other associate members, which support the SME family. Combined, SMEunited represents more than 12 million enterprises with around 55 million employees across Europe. SMEunited is also a recognised employers' organisation and European Social Partner. SMEuntied is a not-for-profit and non-partisan organisation and its transparency ID is 55820581197-35

About UNI Europa Finance

UNI Europa Finance is the European-level trade union body for the finance sector. It represents 100 unions with 1.5 million workers in the banking and insurance industries. UNI Europa Finance is part of UNI Europa, representing 7 million workers in the services and communication sectors. UNI Europa is member of the ETUC and registered in the European Commission's Transparency Register. It is part of UNI Global Union and recognised by the European Union as a social partner.