Briefing Note
CRD IV – Overview

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Introduction
The European Commission’s proposal for a Directive and Regulation (collectively known as CRD IV and published on 20 July 2011) will, once completing its path through the legislative process, replace the existing Capital Requirements Directive and implement the Basel III accord in Europe.

Basel III – and, as a result, the CRD IV – is based on five building blocks with the following aims:
1) **Strengthening capital**: change the definition of capital to improve the quality, consistency and transparency of banks’ capital base;
2) **Enhancing risk coverage**: strengthen the risk coverage of the framework with new standards for counterparty credit risk exposures arising from derivatives, repos and securities financing activities;
3) **Leverage**: introduce a leverage ratio that serves as a backstop to risk-based capital measures and is intended to constrain the build up of excessive leverage in the banking system and provide an extra layer of protection against model risk and measurement error;
4) **Limiting procyclicality**: improve measures to address procyclicality (i.e. the cyclical effects of risk based capital requirements) – in particular, the introduction of countercyclical buffers in addition to capital requirements that vary with the economic cycle;
5) **Improving liquidity management**: introduce a new liquidity framework, which includes two minimum liquidity risk ratios – a 30-day LCR and a one-year NSFR – and a set of common monitoring metrics and application standards.

This Briefing Note sets out AFME’s high level positions relating to CRD IV. More information on AFME’s positions relating to particular aspects of CRD IV is contained in further briefing notes, referred to in the ‘Further Information’ section below.

AFME’s Positions

Support for CRD IV
AFME believes that the industry and the regulatory community share the common objective of ensuring that the regulatory capital and liquidity frameworks produce an appropriate amount of capital and liquidity to address risk, whilst enabling continuing support to be given to economic recovery. AFME is supportive of a common set of rules aiming to strengthen regulatory and supervisory convergence at an EU level. Additionally, AFME recognises the importance of properly justified national specificities, but nonetheless wishes to ensure these will not compromise the ability of cross-border institutions to provide much-needed credit facilities to the real economy of Europe.
**Holistic Approach**

As a very general point, AFME believes that there needs to be better understanding of the way different parts of the regulatory reform package interact with each other. Interactions exist between CRD IV and crisis management, EMIR, MiFID, Solvency II, G-SIBs, tax, and accounting rules, for example. Understanding these interactions will better ensure that the right balance is being struck between financial stability and economic growth.

**Consistency**

AFME is a strong supporter of international consistency and global coordination. We believe that this is the foundation of open and integrated global markets which provide strong support to global, regional and local economies. Accordingly we believe that divergences from Basel III should be kept to a minimum. Differences should be transparent and properly justified. They should not occur unless it is clearly shown that such differences are necessary to achieve effective consistency and to take account of important European specificities. The European legislation should be able to be shown to be a strongly consistent implementation of the international Accord.

**The European Banking Authority (EBA)**

The EBA will take a central role in the development of over 150 of the detailed requirements relating to CRD IV. In some cases, such as standards on model quality, the EBA may be required to deliver in advance of the introduction of regulation. It is essential that the EBA works within a strict prioritisation framework. It is not clear what will happen if the EBA is not able to complete all the work it is tasked with within the specified timeframe. Where possible, it would be advisable to allow the EBA more time to develop standards and guidance and more time for both institutions and supervisors to implement EBA measures. Also, we would advocate that a centralised question and answer process be put in place by the EBA so that EBA decisions can be fully documented in a transparent manner. AFME will seek to work closely with the EBA to ensure that binding technical standards and guidance material are developed in a clear and consultative manner and that we assist the EBA with its key priorities.

**Observation Periods**

CRD IV includes a number of observation periods, particularly in relation to the Liquidity and Leverage Ratios. It is important that these observation periods are not shortened because of lack of resources at the EBA and are used appropriately to fully investigate the range of options available, the impact of each and the need for recalibration of proposed measures. Steps need to be taken now to ensure that the data being collected over the period will be provided on a consistent basis in order for meaningful conclusions to be drawn. These conclusions should result from a transparent process including all stakeholders. AFME has concerns about requirements for institutions to disclose these ratios before their design and calibration are finalised. Such disclosure could be based upon a flawed design or calibration and could be misleading to the market. Before the final design and calibration are implemented, institutions will need time to adapt their systems and controls – the scope of this task should not be underestimated.

**Pillar 2**

The interaction between major elements of the Regulation and the Pillar 2 framework is not yet clear. It will be important in light of increased Pillar 1 capital requirements and the new liquidity regime to ensure that there are no areas of overlap and double-counting and also that competent authorities do not use Pillar 2 as a way of gold-plating the provisions at a national level. As well as having consistent rules, it is equally important that these rules are implemented consistently by national authorities. Differences in interpretation in how Pillar 2 requirements are applied can lead to meaningful differences in approach and can create the potential for regulatory arbitrage and unlevel playing
fields. Currently, it also not entirely certain who, i.e., the national supervisors, the EBA, etc., will provide clarity regarding approach.

**Further information**

AFME has broken down positions on the key CRD IV issues in more specific briefing notes:

- Capital and Capital Buffers
- Leverage
- Counterparty Credit Risk
- Liquidity

See also AFME’s materials covering Basel III:

- Overview of Capital Requirements Reform
- General Briefing Note

All of these documents are available on the AFME website

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