

AFME/ISDA Initial Comments regarding the EP Draft Report on CRR 3

AFME and ISDA (the “industry”) would like to take the opportunity to provide initial comments on the European Parliament’s (EP) Draft Report on the CRR 3 proposal ahead of the 13 June discussion the Economic and Monetary Affairs (ECON) Committee.

European banks have raised hundreds of billions in equity capital since the financial crisis, and their resilience has been proven during recent economic shocks. The co-legislators should therefore uphold their commitment to avoid any significant further increases in capital requirements, which could have unintended consequences for provision of funding to the real economy and the broader economic recovery after the pandemic. Nonetheless, the draft report, which constrains the transitional arrangements introduced in the Commission’s proposal and removes the EU specific treatment for equity exposures, puts at risk a smooth adaptation in Europe to the Basel III standards and could result in material capital increases. Furthermore, some aspects of the draft report could have a broader impact in terms of EU competitiveness and result in consistency and implementation timing issues at EU and international levels. To this end, international alignment will be imperative for internationally active banks to ensure regulatory consistency and a level playing field across jurisdictions, particularly for market risk.

We would also take this opportunity to note the very short deadline for amending this substantive package of banking reforms (11 July) and would recommend that legislators take their time to carefully consider the changes they put forward. An overview of our CRR3 priorities is included as an Annex to this note – all our positions can be viewed in full [here](#).

Transitional arrangements for the Output Floor

Industry supports in principle the introduction of transitional arrangements for unrated corporates, low risk mortgages and the SA CCR framework, as well as the need to review these at the end of the transition period. These arrangements are intended to mitigate the impact of the introduction of the Output floor, with a view to alignment with the Basel framework by 2032, though we note these arrangements could go further in some respects. The Output floor is the most impactful measure of Basel III, and these arrangements are needed to reduce the impact on financing important sectors of the EU economy as banks implement this requirement. We welcome that the rapporteur maintains the application of the floor at the highest level of consolidation, however, the draft report significantly limits the scope and nature of the transitional arrangements as follows:

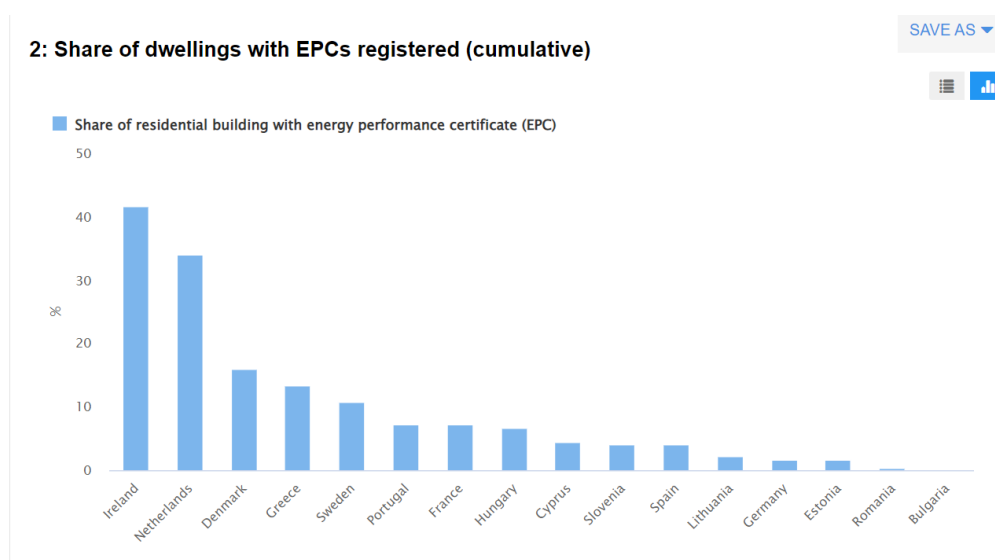
Unrated corporates: The report removes the possibility to extend the transitional treatment for unrated corporates beyond 2032 and limits the scope of this arrangement to unrated corporates which fall below €500mn annual sales.

Industry view: We do not support a merely time limited transition for unrated corporates. It will take time to find a workable solution to address unratedness. **Legislators should reinstate the possibility for the Commission to extend this arrangement via legislation or – as industry propose – via a delegated act beyond 2032.** We would note that “unratedness” in Europe is a structural feature of the economic and financial system, consistent with the European set-up. Enforcing external ratings on corporates which are traditionally reliant on bank funding introduces unnecessary strain and, in our view, does not automatically improve risk assessments despite additional costs to the corporate. In addition, **this treatment should apply to both SA and IRB as all banks are able to identify investment grade unrated corporates irrespective of the Output Floor.** The specific limitation to unrated corporates below €500mn will impact corporates which rely on bank funding and do not have

a rating. Furthermore, external ratings can only be used for the entity the rating agency issued it for, so this is a challenge particularly for subsidiaries of larger groups which do not assume the rating of the parent holding company but would need a separate rating. The issue of unrated corporates also needs to be revisited internationally to ensure global consistency of application.

Low risk mortgages: The report removes the possibility to extend the transitional treatment for low risk mortgages beyond 2032 and limits the scope of this arrangement to only the highest energy efficient properties (rated grade A/ A+). The report also replaces the member State discretion to apply low-risk mortgage treatment with a discretion for the competent authorities.

Industry view: Given the specific nature of the European mortgage market and important societal role EU banks play in providing mortgages which are long term exposures, **we believe this exposure type warrants a permanent treatment in the standardised approach (i.e. to cover all banks) instead of a transitional arrangement which is only relevant for IRB banks.** Furthermore, while we appreciate the intention of the rapporteur to incentivise energy efficient mortgages, **we do not believe the limitation of this transitional arrangement to only the most energy efficient properties is workable.** In our view there is insufficient data and harmonisation across the EU of the Energy Performance Certificate (EPC) label for it to play such an important role in banking regulation. As demonstrated by the EC fact sheet data below, relatively few buildings even have a registered EPC¹ recognised at European level:



We therefore consider the existing amendment of the Commission to account for improvements to energy performance to be taken into account in the valuation process as sufficient. Finally, we do not support the application of this treatment as a discretion for the competent authority, and instead consider an automatic application across the EU27 would be most appropriate and in line with the single market.

SA CCR: The draft report deletes the empowerment for a delegated act that can permanently modify the value of the Alpha factor for the purpose of the Output Floor.

Industry view: The delegated act is an important tool to address the shortcomings of the alpha factor, which was calibrated before the output floor was conceived. The alpha factor, which increases exposures by 40%, significantly increases the costs of hedging for end-users (e.g. corporates

¹Source: [EU Buildings Factsheets | Energy \(europa.eu\)](#) – see “certification” tab

– including SMEs, pension funds, etc.). This amendment runs counter to concerns previously raised by the EP in the Capital Markets Recovery Package (2021)² which called for a review of it. **We strongly support a review of the calibration of the Alpha factor** as anticipated by the EC proposal, and further strongly encourages this review to take place **at international level to ensure consistency. In the interim, industry would recommend that legislators temporarily apply the re-calibration of alpha factor to 1 for all uses of the standardised approach**, which should not be limited to the output floor. Alongside this permanent application should be further considered as part of the future EBA's report and addressed via maintaining this delegated act.

Other measures intended for a smooth implementation of Basel 3

The draft report also seeks to limit or remove the scope of the other Commission proposals to smooth the implementation of Basel III in Europe.

In respect of equity investments, **we oppose the deletion of the specific treatment for intragroup equity exposures and the grandfathering of all strategic equity exposures** which have been held for more than six years. **It is important to reflect the diversity of business models in the EU by making the treatment of all strategic holdings of equity - whatever the approach (IRB or SA) - held for more than six years subject to the same 100% RW calculation.** In addition, we do not support the rapporteur's inclusion of all venture capital in the speculative equity category. As recognised by the Commission, long term investments in venture capital can be a useful vehicle for banks to invest in innovation.

We have strong concerns with **the proposed changes in the draft report with regard to specialised lending – namely the deletion of Commission's proposed treatment of high-quality object finance exposures and the review and potential to extend the treatment of input floors and leasing arrangements.** As the Commission notes: *"Promoting viable infrastructure projects and other specialised projects is of vital importance for the economic growth of the Union. Specialised lending by institutions is also a defining characteristic of the Union economy, as compared with other jurisdictions where such projects are predominantly financed by capital markets. Large institutions established in the EU are major providers of funding for specialised projects, objects finance and commodities finance, in the Union and globally; as such, they have developed a high level of expertise in those areas."*³ We therefore strongly support maintaining these provisions to support EU projects. Furthermore, **we do not support linking the infrastructure supporting factor to the EU Taxonomy** which would limit its application and does not provide an indication on the riskiness and associated credit quality of exposures.⁴

Finally, **we oppose the deletion of the potential to review and extend the transitional arrangement for Unconditionally Cancellable Commitments** which are a useful financing tool for the real economy, particularly for trade finance. In respect of trade finance, we also urge legislators to maintain the current CRR2 CCF of 20% (not 50% as proposed by the Commission) for trade finance related items in Annex 1, which has not been addressed by the rapporteur.

Fundamental Review of the Trading Book

We see the deletion of the market risk delegated act which provides the possibility to delay by 2-years the market risk standard as a major concern. The industry strongly supports the objectives

² Recital 10 of Regulation (EU) 2021/558 of 31 March 2021, as regards adjustments to the securitization framework to support the economic recovery in response to the COVID-19 crisis ([Link](#))

³ [CRR3](#) – Commission's preamble page 14

⁴ See the [EBA Discussion Paper](#) on the prudential treatment of environmental risks paragraph 97

underpinning the CRR 3 delegated act under Article 461a, to ensure a globally consistent and aligned implementation of the market risk capital rules. A number of major jurisdictions (including the US and the UK) have not yet published their draft rules, inclusive of the implementation timeline, while others have already set different timing expectations and/or are still consulting on their national rulemaking. **The flexibility provided in the delegated act under Article 461a, is a critical tool in light of the uncertainty resulting from the lack of visibility on timing, content, and impact of the locally adopted FRTB rules in other major jurisdictions.**

We recognize that the EU as a 'first mover' does not yet have visibility on the rules that will be proposed by other jurisdictions, and it is essential that a mechanism to align and address potential inconsistencies is maintained in the final CRR3 text. Given the timeline for finalization of CRR 3 and the impending start date of 1 January 2025, the Industry understands there are timing and process constraints for the implementation of the framework in the EU. The 2-year delay proposed under Article 461a could be accompanied by a mandate to develop, if needed, a fast-tracked legislative proposal to ensure these inconsistencies are properly addressed. In the meanwhile, the mechanism set in Article 461a to adjust the calibration of FRTB (by setting a '0-1' multiplier to market risk capital) – whilst not being the optimal long-term solution – could prove necessary to deliver a level playing field for specific risk classes and specific risk factors in a timely manner.

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About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society. AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is listed on the EU Register of Interest Representatives, registration number 65110063986-76. Information about AFME and its activities is available on the Association's website: www.afme.eu.

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 850 member institutions from 66 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org.

Annex - Overview of AFME/ISDA priorities for CRR3

Below is a summary of AFME and ISDA's priorities to be taken into account in the CRR3 amendments.

Issue	Position
Output Floor	<ul style="list-style-type: none"> • Apply at the highest level of consolidation, to avoid further fragmenting the European market. • Empower the EC to extend transitional arrangement for unrated corporates if underlying issues of corporate ratings not resolved, taking account of international level playing field issues. Apply to all banks (SA and IRB). • Make treatment of low risk mortgages a permanent feature of the SA (i.e. applicable for SA and IRB banks), to reflect the specific nature of EU mortgage market and long-term nature of this lending. • Re-calibrate the SA-CCR alpha factor to 1 in the standardised approach (and not only in for the purposes of the output floor). • Fundamental review of Pillar 2 (not just freezing) to ensure no model risk is double counted.
Credit Risk	<ul style="list-style-type: none"> • <u>Trade finance</u>: Maintain the CRR2 treatment of trade finance with trade finance items kept in "bucket 4" (20% CCF) instead of being moved to the more penalising "bucket 2" (50% CCF). Improve scope of definition of "commitment" for trade finance exposures. • <u>Taking into account maturity</u>: Given the new limitations to modelling make the application of the FIRB maturity waiver a permanent feature. Reduce the risk weights for SFTs which are short term in nature and support working capital for corporates and liquidity in bond and equity markets. Confirm CRR2 definition of "short term maturity" as exposures with a residual maturity (as opposed to "original maturity"). • Further amendments to improve prudential treatment of strategic equity investments and specialised lending and CRM.
Counterparty Credit Risk	<ul style="list-style-type: none"> • Re-calibrate the SA-CCR alpha factor to 1 in the standardised approach so its applied consistently across the prudential framework (including the large exposure and leverage ratio). • Better calibrate SA-CCR in the following areas: allow internally calculated deltas; recognise diversification benefits between FX hedging sets; recognise initial margin. • In line with credit risk recommendation improve treatment of SFTs (short term and low risk in nature)
Operational Risk	<ul style="list-style-type: none"> • Maintain the Commission's proposal to set Internal Loss Multiplier (ILM) to 1. • Bring forward the EBA mandates to develop the reporting standards and taxonomy for operational loss events. • Ensure that the disclosure standards are aligned with supervisory reporting and that exclusion of losses from the loss history is based on sound principles.
FRTB	<ul style="list-style-type: none"> • Standards need to be implemented simultaneously and harmoniously across jurisdictions. A delegated act with adequate scope can ensure the necessary flexibility for this. • The scope of the delegated act should include the CVA framework to ensure the concurrent implementation of FRTB and CVA, as the risk weights in CVA are largely based upon the market risk standard.

Issue	Position
	<ul style="list-style-type: none"> • Collective Investment Undertakings (CIUs): There is a need to ensure a more proportionate calibration of capital requirements to avoid potential impact on availability of investment solutions and liquidity. • Trading and banking book boundary: It is important to have appropriate grandfathering provisions in place, as well as supervisory flexibility for reallocation without undue penalty charges. • RRAO should address only risks not capitalized elsewhere in the framework and ensure that only real truly exotic underlying risks are subject to the 1% charge. • CTP treatment should ensure a capital outcome that is more aligned with the underlying risk for better recognition of hedging. • Ensure IMA remains viable with particular focus on PLAT, NMRFS and the 3bp floor for sovereigns in IMA DRC. • Carbon trading: While we welcome the lower 40% RW proposed, the framework still penalizes carry positions. We recommend also addressing the tenor correlation parameter to improve bank intermediation capacity.
CVA risk	<ul style="list-style-type: none"> • A recognition of the different risk profiles of different financial institutions through the introduction of distinct risk weights per type of financial institutions, instead of their allocation a single bucket • A better recognition of indices used to hedge CVA risk • A greater alignment of regulatory and accounting CVA
Third Country Branches	<ul style="list-style-type: none"> • We support the objective of a proportionate and less fragmented treatment of third country banks operating in the EU through branches. • Subsidiarisation should be considered only as a last resort, and liquidity requirements are justified only in exceptional circumstances. • Central bank deposits and HQLA should be excluded from the calculation of thresholds and capital requirements owing to their relatively 'risk free/low risk' nature.
21c	<ul style="list-style-type: none"> • The proposed new Art. 21c represent a major change to the existing regimes regulating cross-border business into the EU, rather than a clarification of existing treatment. • It would have a significant adverse impact on the ability of EU financial institutions, corporates, governmental entities, and individuals to access international markets and cross-border services. • It would introduce a cross-border regime significantly more stringent than those of other key jurisdictions.
Other issues	<ul style="list-style-type: none"> • <u>ESG</u>: Support proposals but further improve treatment of carbon certificates. Await outcome of EBA report on green/brown assets (support consistency with traditional principles of risk based prudential regulation). • <u>Governance</u>: ensure consistency with national frameworks, and smooth processes; revert to CRD5 definitions • <u>Crypto</u>: Consultation will be important to ensure the full implications for the EU landscape are understood.