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DRAFT REPORT

on Basel II and revision of the Capital Requirements Directives (CRD 4) (2010/2074(INI))

Committee on Economic and Monetary Affairs

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on Basel II and revision of the Capital Requirements Directives (CRD 4) (2010/2074(INI))

The European Parliament,

– having regard to the Capital Requirements Directives[1] and to Directive 2009/111/EC of the European Parliament and of the Council of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management[2],

– having regard to the Commission proposal for a directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (COM(2009)0362),

– having regard to the Commission staff working document of 26 April 2010 on Possible Further Changes to the Capital Requirements Directive,

– having regard to the Basel II agreement[3],

– having regard to the Basel Committee on Banking Supervision's consultative document on strengthening the resilience of the banking sector[4],

– having regard to the Financial Stability Board's papers,

– having regard to the communiqués issued by the G20 at its Washington, London and Pittsburgh summits,

– having regard to its report on OTC derivatives,

– having regard to the communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the European Court of Justice and the European Central Bank on an EU Framework for Cross-border Crisis Management in the Banking Sector (COM(2009)1561) and the accompanying staff working document (SEC(2009)1407,

– having regard to Commission Regulation (EC) No 1126/2008 of 3 November 2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council [5],

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[1] Directive 2006/48/EC (OJ L 177, 30.6.2006, p. 1) and Directive 2006/49/EC (OJ L 177, 30.6.2006, p. 201).
[2] OJ L 302, 17.11.2009, p. 97.
3 Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version of June 2006, http://www.bis.org/publ/bcbs128.htm.
4 Basel Committee's consultative proposals to strengthen the resilience of the banking sector, 17 December 2009, http://www.bis.org/press/p091217.htm.
5 OJ L 320, 29.11.2008 p. 1..

– having regard to Rule 48 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs and the opinion of the Committee on Legal Affairs (A7-0000/2010),

A. whereas strong, stable and efficient financial markets and institutions are crucial to meeting the financing needs of the EU's various economic actors and to boosting growth and employment,

B. whereas prudential standards must be strengthened and shortcomings concerning the quality and amount of capital, liquidity management and the pro-cyclical nature of Basel II and the CRD that have been revealed by the crisis must be addressed,

C. whereas, however, due account must be taken of the cumulative impact of the relevant elements of the revised Basel II framework and of other regulatory initiatives on the real economy and on economic growth,

D. whereas at the G20 meeting in Pittsburgh it was decided to increase the quality of capital, introduce a leverage ratio and define liquidity standards,

E. whereas there are important European specificities, such as the fact that the corporate sector in Europe is predominantly financed through bank lending; whereas the revised Basel rules must take due account of such specificities,

F. whereas a 'one size fits all' approach is detrimental to the European banking industry and consequently may harm economic growth and economic recovery,

G. whereas, as the EU is currently undergoing an extensive financial regulation reform, there must be consistency between reforms and, moreover, implementation calendars should take into account the cumulative impact of the measures on the real economy and should not hamper economic recovery,

H. whereas convergence towards a single set of high-quality global accounting standards is essential in order to preserve a level playing field and ensure comparability of data globally; whereas such standards must be appropriately upgraded to take account of the lessons learned from the crisis,

I. whereas convergence between reporting for accounting purposes and reporting for regulatory purposes is essential in order to ensure that supervisors and investors are provided with the same transparent and clear information, and whereas dual reporting must be avoided,

J. whereas banks should focus more on the core business of banking, namely lending to the real economy; whereas the Basel Committee and the Commission have to find ways to promote this core business,

General issues

1. Welcomes the G20 commitment to increase the quality and quantity of capital, introduce liquidity management standards, address pro-cyclicality and upgrade the overall prudential standards in response to the financial crisis;

2. Has concerns about structural deficits and imbalances in the current proposal, as well as the risk of harming economic recovery and economic growth;

3. Recalls the important specificities of the European banking sector, such as the variety of business models operating under different legal forms and the fact that the corporate sector is predominantly financed through bank lending;

4. Urges the Basel Committee to take proper account of such specificities, as well as differences between investment and traditional retail banking services, in the revised Basel II rules;

5. Asks the Commission to play an active part in the process of reforming the Basel II rules, to promote and safeguard European interests, to coordinate the approaches of the Member States in order to achieve the best outcome for the European economy and to provide Parliament with regular reports on ongoing negotiations;

6. Acknowledges the importance of an international level playing field; points out, however, that that aim should not place the European economy and European industry at a competitive disadvantage;

7. Stresses that the full commitment of all parties engaged in the Basel process to a clear and coherent implementation calendar is a precondition for successful reform, ensuring an international level playing field and avoiding regulatory arbitrage;

8. Underlines that the implementation timetable must reflect the overall impact of the revised standards on the industry and its capacity for lending to the real economy without excluding the possibility of grandfathering, phasing in or, if necessary, calendar revision;

9. Recalls the need to involve Parliament, as the democratically elected European body, in the negotiations, and urges the Commission and the Basel Committee to take the necessary steps to involve it on a permanent base;

10. Recalls its concern about the limitations of assumptions concerning correlations made by banks that underlie aspects of the methodology for calculating regulatory capital;

11. Calls on the Commission to continue to further integrate EU supervision of the banking sector;

12. Calls for a proper assessment to be made of the impact on the real economy, with a special focus on SME financing;

13. Calls on the Commission to create incentives for the banking sector to manage risk and profit with a view to long-term outcomes and to encourage banks to keep loans on their own books without excessive securitisation and to fully consolidate some off-balance

sheets items like SPVs;

Quality of capital

14. Supports the initiative to increase the quality and level of capital in response to the crisis;

15. Is of the view that, in order not to disadvantage certain business models of non-joint stock companies, in particular cooperatives and savings banks, capital must be defined in a balanced manner on the basis of the quality of capital instruments (i.e. permanence, loss absorbance, flexibility of payment) rather than their particular legal form;

16. Urges the Basel Committee and the Commission, when defining eligible capital instruments, to take proper account of the needs and particularities of non-joint stock companies (i.e. cooperatives and savings banks), which account for a large portion of the European banking industry;

17. Urges the Basel Committee and the Commission to ensure that, in consolidated capital calculations, both risk and capital are taken into account in a balanced manner (i.e. minority interest);

18. Calls on the Commission to take proper account of existing differences between tax and accounting balance sheets to avoid any possible competitive disadvantages;

Liquidity standards

19. Considers developing high quality liquidity standards to be a key part of the crisis response;

20. Is of the view that a 'liquidity coverage ratio' should take greater account of the risk of concentration of eligible assets in any liquidity buffer, encourage diversification and discourage excessive concentration into one particular asset class;

21. Calls, in the event of any structural liquidity standard being set, for proper recognition of stable sources of funding specific to Europe (i.e. real-estate financing);

Counter-cyclical measures

22. Welcomes the effort to limit excessive credit growth and the risk of credit bubbles;

23. Is concerned about the pro-cyclical nature of a fixed bank-specific capital conservation buffer;

24. Welcomes the attempt to identify a set of macro-economic variables in order to build efficient counter-cyclical buffers;

25. Recognises the benefits of through-the-cycle provisioning (expected loss approach) as a possible measure to reduce pro-cyclicality and encourage recognition of expected credit losses with regard to the business cycle;

26. Calls for convergence between reporting for accounting and reporting for regulatory

purposes, in particular as regards an expected loss approach in disclosed profit, to take account of the lessons learned from the crisis and ensure that the same set of clear and transparent rules are used when generating information for supervisors and investors; cautions about the negative impact of dual reporting;

Leverage ratio (LR)

27. Notes the concept of a 'crude' LR as a possible backstop against building excessive leverage, but has strong concerns about its added value;

28. Is of the view that such a ratio, in order to be effective, must comprise off-balance sheet items and derivatives, must be clearly defined, simple and comparable internationally and should take into account the different leverage ratios existing internationally;

29. Is, however, concerned that a crude LR may penalise entities providing traditional low-risk banking services (such as corporate and real-estate financing) or economies where the corporate sector is financed predominantly through lending;

30. Asks the Basel Committee and the Commission to explore alternatives to a crude LR, such as setting backstop limits for business lines and portfolios;

31. Urges the Commission to ensure that a leverage ratio does not lead to excessive securitisation and less credit (these being likely ways for banks to reduce their leverage ratio);

Counterparty credit risk (CCR)

32. Calls for enhanced standards as regards stress-tests, back-tests and addressing wrong-way risk;

33. Call for different capital treatment for an OTC transaction and a transaction through a central counterparty (CCP), provided that the CCP meets high-level requirements to be defined in European legislation while taking into account standards agreed at international level, with due regard for the potential costs for the corporate sector of using derivatives to hedge its commercial activities;

34. Underlines that the crisis has shown that interconnectedness between financial institutions is greater than interconnectedness between financial institutions and corporates, and takes the view that capital requirements for CCR should reflect that fact;

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35. Instructs its President to forward this resolution to the Council, the Commission, the governments and parliaments of the Member States, the Euro Group and the European Central Bank.

EXPLANATORY STATEMENT

Based on strong commitment of the G20 and conclusions reached at Washington, London and Pittsburgh G 20 summits, the Basel Committee (later referred to as 'Committee') launched works to reform the Basel II framework in order to strengthen the resilience of the banking system.
The Committee's proposal aims to improve the quality of the capital base, extend and strengthen the coverage of the capital framework (such as counterparty credit risk arising from derivatives, repos, etc.). The Committee also intends to introduce a leverage ratio to help containing excessive build up of leverage in the system and other supplementary countercyclical measures such as capital buffers to be build in good times. Last but not least global standards on liquidity management are proposed.

The rapporteur is convinced, that the crisis has set a clear case for an in depth revision of the current regulatory framework. And therefore welcomes the efforts of the Basel Committee to upgrade the framework in general.

Despite his general support to reform the framework, the rapporteur is strongly concerned about visible shortcomings of the negotiation process on the revised framework, and that the framework, as currently presented, clearly puts the European economy at competitive disadvantage.

The main reason for this report is therefore a call of the European Parliament on the Basel Committee to be included in the appropriate way in the ongoing negotiations and a call to make necessary adjustments to the framework so that the European industry and economy are not disadvantaged.

The European Parliament must play an active role and strongly influence the revision of the rules already in the process of negotiations in the Basel Committee. The rapporteur believes that, as the European Parliament is the democratically elected European body who will later on co-legislate on the Commission proposal of the Capital Requirements Directive (CRD 4 Directive), should be involved in the negotiations process at an early stage, and asks the Basel Committee and the Commission to take necessary steps in this respect.

Although there is a strong international commitment to revise the Basel framework, it is important that such revision strikes the right balance between various business models, investment and traditional retail banking, different legal forms and predominant financing of corporate sector through bank lending in Europe. While the American economy is mainly financed through the capital market, the European corporate sector relies on the lending capacity of the banking sector. 80% of investment and lending in Europe is based on bank credits. The revised rules should take into account such differences without penalising certain markets or business models. Otherwise, there is a risk of harming the European economy and industry.

The rapporteur agrees with the importance of international level playing field as regards Basel II revised framework under condition that such framework does not put the European Economy at competitive disadvantage.

Within the Basel Committee there needs to be a strong commitment of all engaged parties to a clear and coherent implementation calendar. The rapporteur is of the view that this is a pre-condition for successful reform and for preventing regulatory arbitrage. The rapporteur calls on the Commission and on Member States to better coordinate in the interest of the European Union.

The implementation calendar must take into account the impact of all the elements of the Basel II revised framework and of all ongoing reforms on the real economy. Especially, SMEs and corporate sector financing has to be ensured, given that the SMEs are one of the driving forces for growth and employment in Europe.

Furthermore, the upcoming proposal of the CRD4 has to be inline with a strong supervisory authority.

The rapporteur is concerned about the interlink between the different components of the upcoming proposal - strengthening the quality of capital at the same time while raising the level of capital has to be done in a cautious way.

The rapporteur is of the view, that as underlining goal of the reform, banks should focus more on managing risk and profit towards long term outcomes. The upcoming proposal should find a way to create incentives for banks to keep credits on their books without excessive use of securitisation and off-balance sheet items.

ISSUES IN DETAIL:

Quality of capital

The rapporteur strongly supports the idea of strengthening quality and quantity of capital as response to the crisis. He welcomes the approach to revise definition of capital towards quality of capital instruments based on permanence, loss absorbance and flexibility of payment but has doubts about an indirect concentration towards certain legal forms. Furthermore, definition of eligible capital instruments should not disadvantage certain business models of non-joint stock companies, in particular cooperatives and saving banks, which represent a large portion of European banking industry.

All capital requirements have to be in line with the overall Basel goal on risk sensitivity by avoiding imbalances within the capital deduction, which should take into account both risk and capital in a balanced manner (i.e. minority interests).

Liquidity standards

The rapporteur is of the view that strengthening liquidity standards is a key part of the revised Basel requirements as response to the crisis. One of the lessons from the crisis as liquidity crisis is that more liquidity is needed to be able to cope with stress situations both in the short and the long run.

The rapporteur is of the view that the new liquidity standards should not encourage

concentration of eligible assets in liquidity buffer into a particular class, but should instead encourage diversification into high quality liquidity assets. The rapporteur has concerns about the structure of the Stable Funding Ratio. The situation regarding certain government bonds demonstrates that no asset class is per se a stable one.

The rapporteur sees a need for greater flexibility in terms of eligible high quality liquid assets which are available in Europe by taking into account the specificities and properly recognise stable sources of funding specifics in Europe.

Countercyclical measures

The Basel Committee foresees introduction of a set of measures to encourage banks to build capital buffers in good times in order to disburse them in bad times.
The rapporteur welcomes the efforts of the Committee to limit excessive credit growth and building up of credit bubbles, such measures should be conceived in order to dampen pro-cyclical nature of the existing regulatory framework. The rapporteur is however concerned about a persisting pro-cyclical nature of a possible fixed bank specific conservation buffer.

The rapporteur strongly supports the concept of forward looking through-the-cycle provisioning as a possible counter-cyclical measure. In this respect he stresses importance of convergence between reporting standards for accounting and prudential purpose in particular as regards an expected loss approach in disclosed profit, and cautions about negative impact of dual reporting.

It should be added that efforts in achieving global convergence of accounting standards towards a set of high quality international standards (IFRS) is of paramount importance for successful accomplishment of the G 20 agenda, ensuring comparability of investor information and international level playing field.

Leverage ratio

Based on conclusions of G 20, the Basel Committee puts forward the concept of a crude leverage ratio. The aim of the ratio is to be a backstop preventing excessive leverage build-up in the system.

The rapporteur has strong concerns about such ratio. Furthermore, he is of the view that such a ratio, in order to be effective, should cover areas highlighted by the crisis such as off-balance sheet items and derivatives, and be comparable internationally. Once the structure of the LR has been set up, further issues need to be considered, such as inclusion of LR under pillar 1 or pillar 2, impact on low risk banking services such as real estate and corporates financing.

Counterparty credit risk (CCR)

The crisis revealed important shortcomings in the way stress-testing, back-testing is conducted and wrong way risk is addressed. Furthermore, the crisis has shown how devastating impact lack of transparency and clarity on derivatives trades carried through OTC markets could have. The Basel Committee proposes a set of changes to address key problems

where CCR management proved to be deficient.

The rapporteur strongly supports efforts of the Committee to strengthen the standards on stress-testing, back-testing and addressing wrong-way risk.
He welcomes the effort of the Committee to incentivise clearing of OTC trades through a central counterparty (CCP) and is of the view that the capital requirements should differentiate between risks of transaction carried through a CCP and that of an OTC transaction upon condition that such CCP meets high level standards. The standards should be developed by the European Commission while taking into account international developments.

The rapporteur also notes concerns of the corporate sector using derivatives to hedge their commercial risks about the possible costs of capital charges for non-centrally cleared derivatives and asks the Commission to consider the possible impact and related costs for corporates when differentiating between capital charges between OTC transaction and CCP cleared derivatives transaction.