

Basel II and revision of the Capital Requirements Directive (CRD 4)

European Parliament resolution of 7 October 2010 on Basel II and revision of the Capital Requirements Directives (CRD 4) (2010/2074(INI))

The European Parliament,

- having regard to the Capital Requirements Directives¹ 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 management²,
- 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 agreement³,
- having regard to the Basel Committee on Banking Supervision's consultative documents on strengthening the resilience of the banking sector⁴ and on an international framework for liquidity risk measurement, standards and monitoring⁵,
- 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 resolution of 15 June 2010 on OTC derivatives⁶,
- having regard to the announcement on higher global minimum capital standards made by the Group of Governors and Heads of Supervision on 12 September 2010,
- having regard to the communication from the Commission to the European Parliament, the

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 Basel Committee's consultative proposals on an international framework for liquidity risk measurement, standards and monitoring from 16.12.2009, <http://www.biz.org/publ/bcbs165.htm>,

⁶ Texts adopted, P7_TA(2010)0206.

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)0561) and the accompanying staff working document (SEC(2009)1407,

- having regard to the communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank on bank resolution funds (COM(2010)0254),
 - 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 ¹,
 - having regard to Rule 48 of its Rules of Procedure,
 - having regard to the report of the Committee on Economic and Monetary Affairs (A7-0251/2010),
- 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, innovation and the competitiveness of the European economy; whereas the financing function is especially important for economic recovery; whereas regulatory reform in the financial sector should aim for financial stability and sustainable growth,
- B. whereas the revised, more stringent, capital requirements should be adopted with due regard to the economic cycle and ongoing economic recovery,
- C. whereas the Basel Committee does not make it possible to take account of all stakeholders or the principle of reciprocity,
- D. whereas all financial markets, actors and instruments must be supervised and regulated, as must all systemically important financial infrastructures such as payment, clearing and settlement systems, mechanisms and platforms and the associated provision of custodial services, in order to preserve financial stability, which is a crucial public good; whereas the crisis has highlighted the fact that bank capital has been clearly insufficient regarding solvability and solvency,
- E. whereas prudential standards must be strengthened and properly enforced and shortcomings concerning the quality and amount of capital, liquidity management, the weaknesses of internal models and the pro-cyclical nature of Basel II and the CRD that have been revealed by the crisis must be addressed,
- F. whereas it is necessary to expand the crisis management minimum intervention toolbox available to supervisors,
- G. whereas a clear separation or firewalling between retail and investment banking must be strived for in order to make sure that insured deposits are not used as collateral for trading activities,

¹ OJ L 320, 29.11.2008, p. 1.

- H. whereas the new standards should take into account a bank's size and risk profile and its business model,
- I. 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,
- J. whereas unprecedented market and regulatory failures prompted the G20 to decide at its meetings in London, Pittsburgh and Toronto to increase the quality of capital, strengthen risk coverage, mitigate pro-cyclicality, introduce forward-looking provisioning for credit losses, discourage excessive leverage and introduce a leverage ratio supplementary to the Basel II risk-based framework with a view to migrating to Pillar 1 treatment, and to strengthen liquidity standards,
- K. whereas Europe applies the CRD to all credit institutions and investment firms operating under a variety of business models; whereas other countries restrict the application of the Basel II rules to a certain number of banks having a specific business model; whereas such differences in scope of application raises concerns as regards compatibility, a level playing field and the risk of potential regulatory arbitrage,
- L. 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; whereas it would be desirable for bank lending to be more targeted at specialised fields such as SME lending and for larger companies to be encouraged to issue bonds directly to investors,
- M. whereas a 'one size fits all' approach that does not take into account banks' specific risk profiles and the diversity of the European banking sector is detrimental to the European banking industry and consequently may harm economic growth and economic recovery,
- N. 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,
- O. whereas convergence towards a single set of high-quality global accounting standards is essential in order to maintain 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,
- P. whereas the need for strict obedience to the 'substance-over-form' principle shall be taken into account by all relevant authorities in order to avoid inappropriate results,
- Q. whereas international convergence between reporting for accounting purposes and reporting for regulatory and tax purposes is essential in order to ensure that supervisors and investors are provided with the same transparent and clear information, and whereas dual reporting should be minimised; whereas this does not preclude prudential filters, providing they are presented in all accounts,
- R. whereas banks should focus more on core businesses serving the real economy; whereas the Basel Committee and the Commission should encourage this,

- S. whereas reforms included in the Basel II revision must go hand-in-hand with structural reforms to bank supervision, as advocated by the European Parliament, and, eventually, a route for the drawing up and consistent implementation of Pillar 2-type measures,

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. Welcomes the efforts made by the Basel Committee and the Commission; stresses however that new capital requirement rules should be drafted and implemented with care and their impacts should also be analysed in the wider regulatory overhaul framework;
3. Has concerns about structural deficits and imbalances in the current proposal, as well as the risk of harming economic recovery and economic growth; takes the view that, considering the current economic situation, it will be necessary to monitor that banks are not passing on the cost of the forthcoming proposal to end-users of financial services;
4. Stresses the need to strengthen the interaction between the supervisory review process (Pillar2) and disclosure (Pillar 3) by making the results of stress tests and capital add-ons available to the public;
5. 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 European corporate sector is predominantly financed through bank lending, and calls therefore for a comprehensive examination of the micro- and macro-economic consequences of the proposed new rules;
6. Urges the Basel Committee as well as the Commission to take proper account of such specificities and of the different types of risk affecting the banking sector; stresses the need to clearly differentiate between investment and traditional retail banking services, as well as transaction services, in the revised Basel II rules;
7. Calls on the Commission to be more pro-active in the process of reforming the Basel II rules, to actively 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 the status of ongoing negotiations and actively involve it in the negotiating processes;
8. Acknowledges the importance of international cooperation and coordination with the aim of achieving an international level playing field and avoiding regulatory arbitrage; points out, however, that that aim should not place the European economy and European banking sector at a competitive disadvantage, and believes that the diversity of the banking sector should be preserved;
9. Underlines that a recovery of the European economy requires dynamic financial markets able to finance investment and innovation; warns against rules and requirements that would create a new credit crunch, destabilising economic development and European labour markets;

10. Stresses that the full commitment of all parties engaged in the Basel and G20 processes to a clear and coherent implementation calendar is a precondition for successful reform, ensuring an international level playing field and avoiding regulatory arbitrage; urges the Commission and the Basel Committee to ensure that the standards agreed are implemented in a synchronised manner;
11. Recalls that the Basel II Agreement, and its upcoming revision, is meant to be a global standard; is therefore very much concerned that limitations laid down in various national laws adopted in response to the crisis (in particular in the US Wall Street Reform and Consumer Protection Act, limiting recognition of external ratings) would result in a serious fragmentation of the application of this global standard; urges, therefore, the Basel Committee as well as the Commission to thoroughly assess and draw consequences of such legislation for the implementation of Basel II and the negotiations on the revision of Basel II, and urges the Commission to report to Parliament on the results;
12. Urges the Commission to clarify the role of external ratings for liquidity buffer and to make sure that any alternative criteria which may be considered do not restrict the range of buffer-eligible assets; urges, furthermore, that any alternative criteria that may be agreed should replace external ratings rather than being used in addition to them, so as to ensure an international level playing field;
13. Urges the Commission to intensify its transatlantic financial regulatory dialogue with the US;
14. Underlines that the implementation timetable must reflect the overall impact of the revised standards on the industry, on its capacity for lending to the real economy and on the recovery process in Europe; notes the calendar revision announced by the Basel Committee in order better to ensure a smooth transition to the new standards;
15. 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;
16. Recalls its concern about the limitations of assumptions concerning correlations made by banks that underlie aspects of the methodology for calculating regulatory capital; stresses, in this context, the importance of proper supervisory oversight and monitoring of internalised assessment by banks, using the IRB approach; notes, furthermore, that care must be taken not to introduce perverse incentives;
17. Calls on the Commission to continue to further integrate EU supervision of the banking sector by establishing the new European Financial Supervisory System and European Systemic Risk Board;
18. Calls on the Commission, for a proper assessment to be made, prior to their implementation, of the revised Basel II rules' likely impact on the real economy, with a special focus on SME financing and on banking sector resilience in stress situations;
19. Deems it necessary to expand the crisis management minimum intervention toolbox available to supervisor beyond the provisions of Article 136 of Directive 2006/48/EC to include at least the power to: require that adjustments be made to capital, liquidity, the business mix and internal processes; recommend or impose changes of management; limit

the terms of banking licenses; impose living wills; impose a total or partial sale; create a bridge bank or a good bank/bad bank split; require swaps of debt for equity with appropriate haircuts; impose profit and dividend retention requirements and restrictions in order to consolidate capital requirements and ensure that shareholders pay before taxpayers; restructure and transfer assets and liabilities to other institutions with the objective of ensuring the continuity of systemically important operations; lay down criteria for valuing impaired assets; take temporary public control; wind up failed banks;

20. 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 an active and ongoing interest in loans on their own books, without undue reliance on securitisation or off-balance sheet structures, and to fully consolidate off-balance sheet entities like SPVs;
21. Notes that long term investments, such as energy distribution infrastructure, rely on securitisation;
22. Proposes that the Basel Committee, the International Organisation of Securities Commissions (IOSCO), the International Accounting Standards Board (IASB), etc. should be incorporated into a global structure – possibly the IMF – in order to establish proper organisation of the world of finance and to ensure that all stakeholders are involved in drawing up the rules and that there is sufficient capacity for checking that they are implemented;
23. Is of the view that the issue of 'too-big-to-fail' financial institutions must be addressed, and therefore that capital requirements and counter-cyclical buffers should be proportionate to the size, level of risk and business model of a financial institution;

Quality of capital

24. Supports the initiative to increase the quality and level of capital in response to the crisis, and notes the Basel Committee's decision of 12 September 2010 to raise minimum capital requirements, introduce a conservation buffer and substantially increase the proportion of common equity; recalls that this issue is intimately linked to accounting rules, thus implying a consistent approach, having in mind as well global convergence;
25. Notes the decision of the Basel Committee from (end) July 2010 to allow some prudent recognition of minority interests, deferred tax assets and investments in other financial institutions; is of the view that further adjustments might be appropriate;
26. Underlines that, in order to guarantee a level playing field and not to disadvantage any business models of non-joint stock companies, in particular cooperatives, mutuals and savings banks, capital must, irrespective of the legal form taken, be defined in a balanced manner on the basis of the quality of capital instruments (i.e. permanence, loss absorbance, flexibility of payment);
27. 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, mutuals and savings banks), which account for a large portion of the European banking industry;
28. Urges the Commission to review the proposed eligibility criteria for core tier 1 capital and

to restrict the catalogue to those criteria which are necessary to ensure the quality of capital (i.e. permanence, loss absorbance, flexibility of payment);

29. 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 and prudent manner, that, in particular, capital received from minorities that has been directly contributed to credit institutions within the same banking group should be appropriately recognised (i.e. minority interest), and that holdings of regional cooperative and savings banks in their central institutions are not hampered (i.e. no deduction from own funds);
30. Emphasises the important role contingent capital played during the crisis; calls on the Commission and the Basel Committee to recognise the role of flexible contingent capital in crisis situations and to monitor market acceptance of convertible instruments;
31. Calls on the Commission to take proper account of existing differences between tax and accounting balance sheets, in order to avoid any possible competitive disadvantages;
32. Asks the Basel Committee and the Commission to clarify the treatment of reciprocal financial cross-holding agreements;
33. Asks the Commission to consider a balanced treatment between unrealised gains and losses, in order to contain volatility and pro-cyclicality;
34. Calls on the Commission to conduct a comprehensive survey of capital instruments before and after the crisis, in order to assess the importance of specific capital instruments and their relevance in a crisis situation;

Liquidity standards

35. Considers developing high-quality liquidity standards to be a key part of the crisis response; is of the view that liquidity standards should be sufficiently differentiated to take account of the particularities of a bank's business model and risk profile; takes the view that there should be recognition of the fact that the risk of a given asset may vary over time and mechanisms through which this is addressed;
36. Notes that maturity transformation inherently exposes banks to long/short liquidity risk;
37. Is of the view that, in order not to disadvantage banks recognised as financial conglomerates which have a holding in insurance companies, the double counting of own funds between banks and insurance companies must be addressed under the current regime of the Financial Conglomerates Directive;
38. Urges the Basel Committee and the Commission to reconsider the calibration of the liquidity and funding ratios;
39. 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, and should encourage diversification and discourage excessive concentration into one particular asset class, including government debt; considers that liquidity buffers should be made up, as far as possible, of assets that remain highly liquid in periods of high stress and that such a ratio, when properly designed, will improve institutions' resilience to liquidity risk;

40. Calls on the Commission to make sure that, in its forthcoming proposal on the CRD 4 revision, off-balance sheet liabilities are covered by liquidity standards;
41. Calls, in the event of any structural liquidity standard being set (i.e. net stable funding ratio), for proper recognition of stable sources of funding specific to Europe (i.e. Pfandbriefe); is of the view that the national authorities of the host Member States should have access to information on the liquidity situation of the branch in any case;
42. Asks the Commission to define the criteria for high-quality liquid assets taking into account the definition of European Central Bank eligible assets for monetary policy operations (repo facility);
43. Urges the Commission to include all eurozone sovereign debt as high-quality liquid assets, regardless of its specific rating, thus reducing the disproportional impact of rating agency actions;
44. Draws attention, however, to the likelihood that high-quality liquid assets will quickly become illiquid in times of high stress, and therefore calls for credit institutions to conduct stress tests going beyond the liquidity coverage ratio and net stable funding ratio;
45. Calls on the Commission and the Basel Committee to take proper account of legal entities within a group or network of banks in connection with liquidity requirements; calls for transactions and commitments within such groups or networks to be treated in a risk-sensitive manner and, where appropriate, differently from transactions and commitments between third parties;

Counter-cyclical measures

46. Welcomes the effort to limit excessive credit growth and the risk of credit bubbles;
47. Is concerned about the possible pro-cyclical nature of a fixed bank-specific capital conservation buffer as currently proposed; is of the view that both capital conservation buffers and counter-cyclical buffers should be able to absorb losses during a period of stress; is of the view that, in order to make the buffers effective, they should be designed and developed in parallel;
48. Welcomes the attempt to identify a set of harmonised macro-economic variables in order to build efficient counter-cyclical buffers;
49. Recognises the benefits of forward-looking provisioning (expected-loss approach) as a possible additional measure to reduce pro-cyclicality and encourage recognition of expected credit losses with regard to the business cycle;
50. Deems that the forthcoming European Banking Authority should play a leading role in the drawing up and implementation of measures relating to capital requirements and counter-cyclical capital buffer standards at EU level;
51. Calls for international convergence between reporting for accounting and reporting for regulatory purposes, in particular as regards an expected-loss approach in disclosed profit, so as to take account of the lessons learned from the crisis and ensure that the same set of clear and transparent rules is used when generating information for supervisors and

investors; cautions about the need to minimise dual reporting; considers that such efforts should build upon and further investigate innovations such as a regulatory page or prudential filters in accounts;

52. Points out that counter-cyclical regulation requires harmonised criteria in order to ensure comprehensive and careful monitoring of the financial markets and the market environment by supervisory authorities, including, amongst other things, full exchange of information, synchronisation of regulatory actions and real-time monitoring of exposure and risk, including through a requirement for audit trails on all financial-market transactions;

Leverage ratio (LR)

53. Notes , given the complexity of the financial system, the concept of a LR as a useful, simple and hard-to-manipulate backstop against the building of excessive leverage and excessive risk taking; cautions that a single, flat-rate leverage ratio needs, in order to be effective, to be weighted in such a way as to capture the differences in credit institutions' business models and risk profiles;
54. Is of the view that such a ratio, in order to be effective, must include all off-balance sheet items and derivatives, must be clearly defined, simple and comparable internationally and should take into account regulatory netting and the different accounting standards existing internationally;
55. Is concerned, however, that, taken alone, a crude LR would fail to take sufficient account of risk and would penalise entities providing traditional low-risk banking services (such as retail, corporate and real-estate financing and transaction banking services) or economies where the corporate sector is financed predominantly through lending; underlines, therefore, the importance of supervisory authorities monitoring leverage changes as well as overall leverage levels, since significant changes may be indicative of incremental risk; is also concerned that, taken alone, a 'crude' (undifferentiated) LR might create adverse incentives to shift financial assets into more risky exposures;
56. Asks the Basel Committee and the Commission to assess properly the leverage ratio options applicable to Tier 1 and Tier 2, taking due account of the specificities of the EU banking industry;
57. Asks the Basel Committee and the Commission also to explore the possibility of setting backstop limits for business lines, RWAs and portfolios; believes that the measurement of assets as either net or gross amounts should be considered in this context;
58. Asks the Basel Committee and the Commission furthermore to explore proportionality within a crude LR through the use of threshold triggers for regulatory intervention;
59. Notes the Basel Committee's decision to have a monitoring period in Pillar 2 with a view to migrating to a Pillar 1 treatment; urges the Commission to include a review clause in the CRD 4 legislative proposal;
60. Notes that the leverage ratio is a necessary tool to measure banks' total exposure, but urges the Commission to devise regulatory tools aimed at limiting effectively excessive leverage (in particular, excessive reliance on short-term and wholesale funding);

61. Calls for further consideration to be given to alternative forms of leverage ratio in Pillar 2; points out that a leverage ratio could, for example, have a flexible margin and supervisory authorities would have the discretion to act upon the breach of the limit;
62. Urges the Commission to ensure that a leverage ratio does not lead to inappropriate securitisation of the kind highlighted by the financial crisis, or to substitutes and less credit, especially for lending in the real economy (these being likely ways for banks to reduce their leverage ratio);

Counterparty credit risk (CCR)

63. Calls for enhanced standards as regards stress tests, back tests and addressing wrong-way risk, as well as assessments of long-term social and environmental risks arising from companies and projects receiving bank loans;
64. Urges the Basel Committee and the Commission to explore alternatives that will better address the credit value adjustment risk arising from the deterioration of the credit quality of banks' counterparties;
65. Consider that credit default swaps (CDSs) should not be used to bypass capital requirements;
66. Calls for counterparty credit risk treatment to be risk-proportionate and for capital charges to be higher for non-centrally cleared transactions than for transactions through a central counterparty (CCP), provided that such CCPs meet 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; calls for the highest standards to be incentivised in the case of bilateral clearing;
67. Underlines the fact 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 be stricter for exposures of financial institutions to other financial institutions and should also reflect the dynamic nature of this risk over time; stresses that careful monitoring of interconnectedness is necessary in order to detect any concentration of transactions between large players and to take subsequent regulatory measures regarding CCR;

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68. 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.