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››› Banking regulation in Europe: further steps on a long road

One Pager

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At the end of November 2016, the European Commission presented a new set of proposals for amendments to several pieces of banking regulation already in place in Europe. The proposals represent the implementation of international standards in EU law.[1] We present selected key items of the proposed measures below.

Quantification of the leverage ratio and net stable funding ratio

The proposals quantify two key figures: The first is a binding **leverage ratio** (LR) requirement of 3 %. The LR is an additional key figure for improving financial stability that describes the ratio of equity to non-risk-weighted total assets. The LR requirement of 3 % is in line with international practice. According to the European Banking Authority (EBA), all major and internationally operating banks as well as 95 % of the remaining institutions complied with the LR in December 2015.[2] The EU Commission would like that rate to reach 99 % by the year 2019.

The second proposal quantifies the level of the **net stable funding ratio** (NSFR). Compliance with this requirement is designed to prevent banks from being forced into engaging in fire sales of long-term assets at heavily reduced prices to obtain liquidity in the event of a crisis. This key figure is defined as the amount of available stable funding relative to the amount of required stable funding, with the latter calculated by multiplying relevant balance sheet items with predefined factors. The draft law provides for the NSFR to be at least 100 % in order to ensure that a credit institution has sufficient funds to remain liquid over a period of one year – even under stress. According to the EBA, 65 % of the large banks and 89 % of the remaining banks met the quota at the end of 2015. Here too, the EU Commission is aiming for 99 % by 2019.

Expanding support for SME business and infrastructure projects

One proposal that should have a positive impact on banks as well as economic development in the EU is that of expanding support to **bank financing of small and medium-sized enterprises** (SMEs)[3], which are one of the pillars of the European economy. Currently, SME exposures of up to EUR 1.5 million are subject to a reduction of 23.81 % on the amount of capital banks are required to hold usually when granting loans. In future, all SME exposures are to be given preferential treatment by applying also a capital reduction of 15 % to the part of the exposure above the threshold of EUR 1.5 million. This will increase banks' general lending capacity. In addition, for the **financing of selected infrastructure projects** the proposal recommends applying a 25 % reduction to the capital requirements compared with the normal calculation. This, too, is a mechanism aimed at promoting growth.

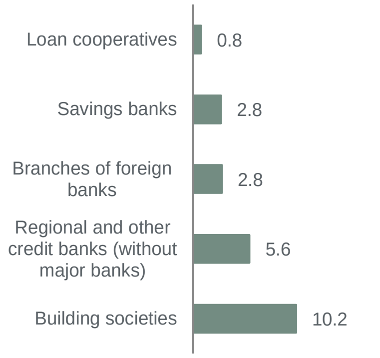
Less red tape for small banks

Finally, a key aim of the proposals presented is to enhance the proportionality of the regulations. This means reducing the bureaucratic burdens for small credit institutions (with total assets of up to EUR 1.5 billion). Thus, the EU Commission proposes easing requirements related to the scope and complexity of reporting, disclosure and remuneration.

In Germany, these amended regulations would primarily benefit loan cooperatives. At the end of 2015, 88 % of them had total assets of up to EUR 1.5 billion, as did 42 % of savings banks (see figure).

Figure: Total assets of selected groups of banks in Germany

Averages as per end of 2015 in billions of EUR



Source: Deutsche Bundesbank

A long way to go

The proposals described above are now being discussed by the national parliaments. Relevant laws are not expected to come into force until 2019. The adjustments point to the right direction and show that the EU Commission is aware of the conflicting goals of regulation and smooth functioning of the credit channel, which is so important for Europe's economies. What is particularly pleasing in this context is the support given to SME and infrastructure loans. At the same time, the plethora of amendments – only a fraction of which are presented here – once again illustrates that it is a long way to go on the path towards greater financial stability through regulation. ■

[1] The standards to be implemented are the rules of the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB). They affect the Capital Requirements Regulation (CRR) and Directive (CRD), the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR).

[2] For these and the NSFR figures, cf. European Banking Authority: CRD IV – CRR / Basel III Monitoring Exercise – Results Based on Data as of 31 December 2015, 13-09-16, p. 21 f. & 41.

[3] The EU defines SMEs as having a staff headcount of up to 250 and either a maximum annual turnover of EUR 50 million or a maximum balance sheet total of EUR 43 million.