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Bundesverband deutscher Banken e. V.
Bundesverband Öffentlicher Banken Deutschlands e. V.
Deutscher Sparkassen- und Giroverband e. V.
Verband deutscher Pfandbriefbanken e. V.

Die Deutsche Kreditwirtschaft

Comments

EC Guidance concerning the treatment of equity exposures incurred under legislative programmes according to Article 133(5) CRR

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent approximately 1,700 banks.

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Preliminary remarks

We expressly welcome the EU Commission's intention to foster the provision of equity to innovative and fast-growing companies through a standardised interpretation of Article 133(5) CRR. This can make a significant contribution to promoting innovation and competitiveness in Europe.

Furthermore, we welcome the political goal to support investments in infrastructures and sustainable economy, especially the energy and network infrastructure sector. These objectives, albeit, can only be achieved with a regulatory framework that does not unduly hinder from contributing to the EU's strategic priorities and the growth of the EU economy. The transition to a sustainable economy and society is expected to require very high levels of investment in the coming years, much of which will have to come from the private sector. The political goal must be to promote and strengthen investments in the transition. Financing can take the form of either debt financing or equity investments (as mentioned in Article 133(5) CRR.)

Article 133(5) CRR lays down the regulatory treatment of equity investments by institutions at the interface between state support and the banking sector. The Basel III standards originally conceived such a provision for programmes in the United States in which banks invest in tax-privileged companies for the common good that are subject to restrictions on the use of profits. The aim of these programmes is primarily the local development and revitalisation of disadvantaged areas.

In our view, there is an urgent need to adapt the requirements of the Basel III standards as laid down in Article 133(5) CRR to the specific circumstances of the European promotional landscape - particularly regarding the role of promotional banks as anchor investors to onboard other banks such as other public and regional banks.

The German banking sector makes a significant contribution to the transformation of the economy and society through their equity financing.

Furthermore, as anchor investors in equity funds, German promotional banks mobilise private capital that would often not be available without their involvement. In this way, promotional banks - together with their private or public co-investors - provide young, technology-orientated companies with urgently needed equity. They support innovative companies in areas such as green tech – including energy and net infrastructure -, biotech and artificial intelligence. What is more, by investing in small and medium-sized enterprises, particularly in structurally weak regions, they make a significant contribution to regional development and job security. Finally, they also help to tackle key social challenges such as affordable housing, climate protection and digital infrastructure by investing in housing construction, energy and digitalisation projects. Thus, all equity programmes of promotional banks serve to promote specific sectors of the economy and thus support the objective of Article 133(5) CRR referred to in recital 10 of CRR III.

For your information: The national and regional promotional banks in Germany enumerated in Article 2(5) of the EU Banking Directive (CRD) do not have to apply the provisions of the CRR directly. However, to ensure uniform supervision, the German legislator has largely subjected them back to the regulations of the CRR with the effect of the German promotional banks also falling within the scope of its prudential rules.

If promotional and public and regional banks had to apply a risk weight of 250% for equity investments in corporates such as described above, this would significantly restrict their financial room to manoeuvre. Particularly in the cases described above it may no longer be possible to make the necessary investments.

For this reason, the requirements of Article 133(5) CRR should be specified in the Communication in such a way that equity exposures that stimulate specified sectors of the economy (compare Draft Communication paragraph 1) can be recognised as "legislative programmes" as comprehensively as possible.

General comments:

We support the goal that the EU banking sector should not be unduly hindered from contributing to the EU's strategic priorities and the growth of the EU economy, acknowledging that equity investments contribute to this goal.

To achieve this goal, the interpretation of Article 133(5) CRR in the Communication should not be too narrow and explicitly support investments, inter alia, in SMEs and infrastructure such as the energy and network infrastructure sector. This is necessary to achieve the political goal of EU competitiveness and the transformation to a green economy.

Moreover, the Guidance should include a review clause. This ensures the necessary flexibility to adjust the guidance as new legislative programmes emerge.

Also, the Guidance should explicitly grant a grandfathering for existing arrangements that already benefit from the preferential risk weight to ensure legal certainty and avoid unnecessary additional burden.

Detailed comments:

Section 1. Scope

Paragraph 1

In its accurate interpretation of the term “guarantees” in paragraph 8, the Commission assumes that a legislative programme does not necessarily have to provide “public financial resources”, since “unfunded public measures” can also meet the definition of a “guarantee”. Correctly, in accordance with paragraph 5, it is important that the legislative programme contains, inter alia, measures that effectively mitigate credit risk, for instance by enabling companies in the specific economic sector—particularly the energy sector or network infrastructure—to achieve certain revenues, e. g. revenues that are subject to a rate-of-return regulation. We would therefore welcome if paragraph 1 could interpret the term “legislative programme” in such a way that it does not refer to “public financial resources”.

As promotional banks provide public funding to promote specific economic sectors based on national statutes, we believe that all equity exposures of German promotional banks fall within the term "legislative programme" as defined in paragraph 1 of the draft Communication (with exception of those mentioned in paragraph 2). This should ensure that every co-investing bank can consider their respective equity exposure as being part of a legislative programme under Article 133(5) CRR.

Paragraph 2

The EU Commission would like to clarify that venture capital funds set up by private banks without state participation do not constitute legislative programmes. In our opinion, it would be helpful in this context to clarify that venture capital investments with state participation can constitute legislative programmes.

Section 2. Eligibility conditions of legislative programmes for the purpose of Article 133(5) CRR

Paragraph 5

Guarantees are not always structured in such a way that they directly benefit the investing institution, but rather, within the overall financing structure, they significantly mitigate the default risks for the institution (to the point of being virtually risk-free in certain circumstances). The wording “for the investment to the institution” could be too narrow for these structures and should be adjusted in line with our comments to paragraphs 9a and 9b, 9c and the wording of paragraph 13, which also takes into account participation structures with intermediaries. Alternatively, a revised wording should be considered which states that “must contain financial and legal arrangements that materially reduce the effective credit risk of the investing institutions”.

Paragraph 6

We expressly welcome the statement in paragraph 6 that, in addition to EIB and EIF equity programmes, corresponding programmes of national promotional banks may also fall under Article 133(5) CRR, provided they meet the criteria set out in the Communication. In our opinion, it should be clarified in this regard that this statement applies to all public development credit institutions as defined in Article 429a(2) CRR.

Paragraph 8

We share the Commission’s view that “guarantees” do not necessarily require the use of public funds. As rightly emphasized in paragraph 5, it is important that the legislative programme effectively mitigates credit risk. This can also be achieved, for example, if the legislative programme ensures that companies in the specific economic sector, particularly in the energy sector or network infrastructure, are entitled to certain revenues, especially to revenues that are subject to a rate-of-return regulation.

Paragraph 9a and 9b

A key criterion for the application of Article 133(5) CRR is the existence of a "significant subsidy or guarantee" for the privileged equity exposure. We welcome that the Commission recognizes in paragraph 9(a) and (b) that such a significant subsidy also exists if a public body invests in a fund or company together with one or more institutions.

The new but not further defined term ‘co-investment’ refers either to ‘investing in equity’ or to ‘the capital of an entity’. This seems to suggest that these two points only concern the equity contribution of ‘subsidies’ and disregard the many other public contributions.
We therefore request additional clarification that ‘co-investment by the public sector’ is not limited to equity contributions from the public sector but includes all types of ‘subsidies and guarantees’.

According to paragraph 12, eligible providers of subsidies and guarantees are the entities listed in Article 133(5)(a) CRR. This includes public development institutions as defined in Article 429a(2) CRR. In our view, the participation of such a development bank means per se that the equity exposure of other participating institutions can also be regarded as “sufficiently subsidised” within the meaning of Article 133(5)(a) CRR.

However, it is not clear from the wording of paragraph 9 whether the equity position of the promotional bank itself, which triggers this subsidy effect for other institutions in the first place, is also deemed to be sufficiently subsidised within the meaning of Article 133(5)(a) CRR.

We are of the opinion that this needs to be clarified. The final Communication should explicitly state that promotional banks themselves can also benefit from the subsidy effect they create through their participation.

Furthermore, not regarding investments by promotional banks would also have a significant knock-on effect on investments by other institutions. As explained above, promotional banks often act as anchor investors. Their investments encourage other institutions to invest in a particular fund or company. According to the draft Communication, investments by promotional banks will also lead to privileged recognition of equity investments at the co-investing institutions. If the capital requirements for promotional banks were to increase and the promotional banks were to withdraw from these investments as a result, this could lead to other institutions also refraining from investing in these funds on a large scale.

We therefore propose to include the following clarification in paragraph 9: "Where the public investment constituting the subsidy is provided by a public development credit institution within the meaning of Article 429a(2) CRR, Article 133(5)(a) CRR shall be deemed to be met for the respective co-investment of the public sector."

We also believe that the specification of fixed minimum participations by promotional banks should also be dispensed with. Promotional banks typically hold less than 10% of the funds in which they invest. This applies in particular to investments in large funds. Large funds in which promotional banks hold less than 10% stake are characterized by a high degree of granularity and diversification.

Paragraph 9c

In our view, the significance of subsidies or guarantees should not only depend on whether the legislative programme provides for co-investments in funds or companies, or for public interventions. Rather, it should also be considered as an effective mitigation of credit risk if the legislative programme is structured in such a way that it ensures companies in the specific economic sector, particularly in the energy sector or network infrastructure, are entitled to certain revenues, especially to revenues that are subject to a rate-of-return regulation.

The objective of "risk mitigation" described in the preamble and paragraph 5 of the Communication, and thus the limitation of default risk (which should be the main justification under paragraph 9c), should be expressed more clearly here. Financing structures that, through embedded guarantee arrangements, effectively reduce the default risk for the investing institution should also be covered here. This does not necessarily mean that the exposure value must be reduced by 30%, but rather that the default risk associated with the investment must be reduced significantly, otherwise the "subsidies and guarantees" would work more like the Credit risk mitigation of Part Three, Title II, Chapter 4 of the CRR which they are explicitly separated from in paragraph 8.

Paragraph 11

The EU Commission intends to clarify that legislative programmes which do not constitute state aid could still provide an advantage to the investing institution. We would like to point out that the term 'advantage' could be interpreted as 'preferential treatment' in the context of state aid law. We thus recommend using terms such as "support" or 'funding' in order to avoid misunderstandings.

Paragraph 12

Eligible providers of subsidies and guarantees shall be the entities listed in Article 133(5)(a) CRR. This includes public development banks within the meaning of Article 429a(2) CRR. Additionally, the EU Commission wants to clarify that 'national public development banks and institutions' should also be recognized. In our opinion, it should be clarified whether and to what extent these differ from public development banks under Article 429a(2) CRR.

Paragraph 13

This paragraph is appreciated as it makes clear that also complex equity structures are within the scope. Such clarification is absolutely necessary in order to do justice to ownership structures in practice. Often, several companies/company hierarchies are involved here.

Paragraph 15

In our opinion, the term 'national public financial institution' is not sufficiently precise. It should be clarified that government oversight can also be exercised by public development banks within the meaning of Article 429a(2) CRR. This would ensure that regional development banks are also permitted to exercise government oversight.

Paragraph 18

We would welcome if the Commission could clarify that the regulation of authorized AIFMs ensures sufficient government oversight within the meaning of point (b). It should also suffice for the purposes of the regulation if—for example in the area of network infrastructure—the investees are subject to supervision by an independent public authority.

Paragraph 20

We share the Commission's view that the list in point (c) is not exhaustive but rather intended as examples. Furthermore, we believe that the restrictions mentioned in the regulation should not obligate the institution to invest via a diversified fund, but should also allow it to select one or more companies that meet the requirements of the legislative programme and to make a single investment, provided that it observes the investment limits applicable at institution level for risk management as well as the limit set out in Article 133(5), sentence 1, CRR.

We, furthermore, assume that the restrictions regarding the size and economic sector of the companies in which the investments are held apply individually and not cumulatively, i.e. that government programmes do not have to include all of these restrictions, but only some of them. We request clarification on this point.

Section 3. Monitoring and enforcement

The whole section 3 (except for paragraph 22) is not required by Level-1-text in CRR. Article 133(5) CRR does not provide for any kind of monitoring and enforcement requirements. Therefore, details regarding monitoring and enforcement could, in principle, be left out for the purpose of a Communication.

Paragraph 21

The draft Guidance requires that (own emphasis): "Institutions should seek the permission of the competent authority <u>every time</u> they intend to apply the 100% risk-weight to the equity exposures incurred under a particular legislative programme". This requirement should be dropped. It is disproportionate and will lead to unnecessarily high bureaucratic burden. Competent authorities sold have the flexibility to combine or waive approvals where appropriate.

Paragraph 22

According to the EU Commission, when calculating the upper limit in relation to own funds, the denominator should include 'all equity exposures incurred under legislative programmes that meet the requirements of Article 133(5) CRR'. In our opinion, it should be clarified that this figure should be determined after the application of credit risk mitigation techniques in accordance with Part Three, Title II, Chapter 4 of the CRR.

Paragraph 23

The requirements for notifying legislative programmes should be as unbureaucratic as possible for Member States. As intended by the EU Commission, it should facilitate the recognition of legislative programmes and not create additional hurdles. Notification should therefore not be a legal prerequisite for the recognition of a legislative programme. If notification requires considerable implementation effort on the part of Member States, appropriate implementation periods should be granted.

Are we correct in assuming that this public list of the EU Commission does not conclusively list all eligible government programmes, but that all government programmes listed are eligible? Accordingly, after individual banks have reviewed the requirements, government programmes that are not yet listed may also be eligible.

Paragraph 24

It should be clarified that the notification is not a notification procedure under Article 108 TFEU.