

## Invest Europe's response to European Commission Consultation on the treatment of equity exposures under legislative programmes under CRR

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### Introduction / Executive Summary

The EIF and national promotional banks are key investors in venture and growth capital. The proposed Communication is welcomed and essential to ensure that banks' investments in legislative programmes are not further discouraged by the recent disproportionate increase in risk weightings from 100% to 400%.

However, the Communication will not on its own mitigate the significant negative impact on private investment of the new CRR proposal. Worse, these changes risk creating market imbalances, as they would make it far more attractive for banks to gain exposure to venture and growth funds via legislative programmes than outside them. This could disadvantage existing private investments in fund-of-funds or direct funds without public co-investors.

Below we set out our comments on the proposed text, as well as how the Communication fits within the overall CRR framework.

### General comments

We recommend clarifying what precisely constitutes equity "incurred under" a legislative programme, to avoid divergent interpretations that could undermine the improved treatment of equity exposures.

It is clear from the text and the Communication that a bank investing **in a EIF's public programme that is aimed at supporting venture capital funds** would be eligible. However, there is no specific clarification that a **credit institution acting as a co-investor in a fund supported by the EIF** is effectively "incurred under" this legislative programme, even though their inclusion appears to have been one of the political objectives of the revision.

Such clarification is important. Credit institutions often co-invest alongside the EIF in VC funds but may not be aware that this entitles them to a lower capital charge. Without clarity on eligibility, they may not request the required prior permission from competent authorities.

### Specific comments on the proposed criteria

- We support the automatic recognition that programmes developed or supported by the EIB or EIF comply with Article 133(5) CRR. EIF programmes such as *InnovFin* have played a crucial role in helping venture capital and growth funds invest in start-ups and scale-ups.
- On “significant subsidies and guarantees,” a public participation of 10% of a fund’s total equity already constitutes a significant commitment. We also support the Commission’s statement that programmes not constituting state aid may still provide a sufficient advantage to investing institutions.
- On “government oversight,” the description in the Communication (*robust and transparent selection criteria, monitoring of performance, etc.*) reflects the existing practices of the EIF and national promotional banks and is therefore appropriate.
- On investment restrictions, we suggest broadening the definition of eligible undertakings beyond “meeting the definition of SME, small mid-cap, start-up or scale-up; **or companies whose growth is perceived to be of a high value to the Union’s objectives**”, as there may be situations where relevant companies no longer meet any of the above definitions (in particular for large infrastructure).
- From a sectorial perspective, the Competitiveness Compass’ focus on innovation risks overlooking the role of infrastructure investments. Explicitly clarifying their relevance would help avoid this omission.

In practice, Article 133(5) criteria will generally be difficult to validate. Investments in diversified portfolios or multilayered fund structures may theoretically be eligible - but it will be practically impossible to assess their eligibility against all criteria. As a result, it may be that only large or strategic direct participations will benefit from the improved risk weight - despite such investments being riskier on average than diversified portfolios.

### Broader comments on the Article’s impact

If it is genuinely helpful in fostering banks’ investment in essential legislative programmes, such as the ones carried out by the EIF, Article 133.5 does create asymmetries between funds linked to legislative programmes – for example funds receiving some of their capital from the EIF programmes - and those that are exclusively private.

It could force banks to systematically prefer investing in funds already backed by public support, potentially undermining private-only funds. The sharp contrast between a 100%

risk weight for supported funds and a default 400% risk weight for others will exacerbate this. While public oversight does reduce risk, it is for example not rational to assume that VC funds without EIF participation require four times the capital charge of VC funds with EIF participation.

This issue lies not in the new 100% capital charge, which is appropriate, but in its gap with the 400% default charge. Currently, this distortion has little impact because banks are almost absent from private equity financing — precisely due to CRR’s punitive treatment. However, if banks return as equity investors thanks to the new rules, the asymmetry will start creating perverse incentives.

As mentioned above, one of the outcomes of the CRR as a whole, but certainly of Article 133.5 as drafted, is to lead to practical situations where single/few asset portfolios of legislative programmes are sharply incentivised compared to strongly diversified “standard” portfolios, despite the largely lower risk of the later. All of this is ultimately the consequence of a banking framework that fails to distinguish between direct and indirect exposures, something the Commission cannot address as part of a narrow Communication but should address rapidly.

We call for a **short-term targeted revision of the CRR framework to better reflect the real risk of investments in long-term equity funds**. We argue that the gap described in the previous paragraphs comes from the confusion in CRR between direct short-term equity investments - for example an investment in a single start-up - and long-term diversified exposures in funds - for example an investment in a VC fund-of-fund investing in hundreds of start-ups. The two are not distinguished and amalgamated in CRR. This is exemplified by the reference to “venture capital firms” in Article 133 of CRR, which does not correspond to any market reality – as banks do not invest in VC firms, but well in VC funds making investments in portfolio companies (which are firms).

## Conclusion

The Draghi Report, the Savings & Investments Union project and this very Communication all call for a better role for banks as investors in innovation. The proposed Communication is a **positive step towards this objective** - as it could make it easier for banks to either invest in private-public fund-of-funds, such as the ones set up by the EIF, or to co-invest alongside the EIF in VC funds.

However, the **Communication does not solve the core CRR issue: the lack of real prudential distinction between fund investments and direct equity investments**. This leads to a disproportionated difference between risk weights of exposures incurred under legislative programmes and those outside it, irrespective of the real risk of both exposures.

The Commission's objective to increase the amount of equity investments by banks through this Communication is laudable - but only a change to CRR rules - in a similar spirit to the long-term equity category for insurers - would really affect existing private investment patterns for the better.

In light of the current lack of equity financing in Europe, leading to a widening competitiveness gap with the US, **a targeted revision of CRR equity risk should therefore be a priority for the European Commission.**