INVEST EUROPE

Targeted consultation on the competitiveness of the EU banking sector

Invest Europe Response

Executive Summary

- In the context of the Savings and Investment Union, EU credit institutions can - and should - play a **stronger role as indirect investors in start-ups and scale-ups**.
- Currently, banks account for less than 6% of total venture capital fundraising and allocate less than 0.1% of their capital to long-term equity.
- By limiting banks' ability to act as indirect investors in start-ups and scale-ups, the EU framework not only **weakens competitiveness** but also **forces innovative companies to rely more heavily on foreign capital** due to the insufficient depth of EU capital markets.
- Even from a prudential perspective the current rules are also problematic. The CRR framework indeed makes it **comparatively more attractive for EU banks to invest in riskier direct assets** rather than in diversified long-term equity fund portfolios.
- To address these issues, EU policymakers should **use the forthcoming revision of the banking framework**, as suggested by the European Council, to **introduce targeted and proportionate changes to the credit risk treatment of diversified long-term equity exposures** under Article 133 CRR.

Context

In its March 2026 conclusions, the European Council called for "*targeted amendments to the prudential framework to enhance the banking sector's capacity to finance the European economy, while safeguarding financial stability*." It also invited the European Commission to present a report on banking sector competitiveness by summer 2026.

Long-term equity investments are widely recognized as essential to strengthening Europe's competitiveness. They support innovation, digitalisation, strategic technologies, and industrial transformation. Venture capital and private

equity are key pillars of this ecosystem, providing patient capital, operational expertise, and scale-up financing that debt alone cannot deliver.

While Mario Draghi has argued that banks are not well equipped to finance innovation, recent ECB comments suggests this view is incomplete. Banks can support innovation indirectly by allocating a small portion of their balance sheets to diversified portfolios of equity funds. This approach enables them to finance start-ups and scale-ups while maintaining a controlled risk profile.

However, the CRD/CRR framework has largely discour**aged banks from playing this role**, to the detriment of both financial stability and long-term returns. This paper argues that it is possible to encourage bank participation in equity investment while remaining fully aligned with Basel objectives.

Appropriately assessing the risk of bank equity exposures

....to reflect the real risk of investments

Under the current CRR "look-through" approach, risk is calculated as if banks invest directly in portfolio companies, regardless of whether the investment is made through a diversified fund structure. This approach **ignores a substantial body of academic research demonstrating that diversification significantly reduces risk**.

Many studies[1] show that **increasing the number of underlying funds reduces return dispersion and the probability of capital loss**. For example, diversification across multiple funds dramatically narrows the range of outcomes and lowers downside risk. In some cases, portfolios of 20–50 funds reduce the probability of capital loss to near zero. Similarly, research on fund-of-funds structures shows that their risk—measured by the standard deviation of returns—is significantly lower than that of individual funds.

By failing to account for diversification, the **current framework can make it cheaper for banks to hold riskier direct exposures** rather than safer, diversified fund investments. This is counterproductive from a prudential standpoint. Fund-based

[1] **Size Matters – Small is Beautiful: The Impact of Portfolio Diversification and Selection on Risk and Return in Private Equity**, Gottschalg, Gleisberg und Derungs (2015): **Risk in Private Equity. New insights into the risk of a portfolio of private equity funds**, Diller und Jäckel (2015); **Private Equity: Risk Calibration, Europe Economics, July 2018:** ; **The Risk Profile of Private Equity Fund-of-Funds,** Weidig, Kemmerer and Bonn (2004):

exposures can be **up to four times less risky** than direct investments. The regulatory framework should therefore reward, not penalise, risk-mitigating structures.

…to reflect the role banks must play in the Savings & Investment Union

Moreover, reducing the capacity of European banks to indirectly support **innovation, scale-ups, and long-term industrial transformation** – despite banks making up for most of the available EU assets – is a choice with potentially dire consequences. It clearly puts the EU at a competitive disadvantage vis-à-vis **global peers**, which can rely on broader capital markets for historical reasons.

It also puts most of the brunt of the financing of innovation to **public** institutions, such as national promotional banks – absurdly requiring taxpayers' capital to finance investments private institutions could have made in the first place and making it harder for these public institutions to leverage private capital, one of their key missions.

Where the CRR can be improved without increasing risk

In practice, the current CRR creates confusion between two fundamentally different types of exposures:

- Direct equity investments in private companies, which are often short-term and higher risk;
- Investments in diversified fund portfolios, which are long-term and risk-mitigated.

This confusion partly stems from outdated Basel definitions that equate "venture capital" with direct exposures, which does not reflect how the term is used in modern financial markets.

As a result, the CRR framework is both **inconsistent with the objectives of the Savings and Investment Union** and **misaligned with its own prudential goals**, as it may incentivise riskier investments.

A more appropriate approach would explicitly recognise diversification and assign capital charges that reflect the true risk profile of diversified portfolios. This would not be unprecedented: a similar logic was previously applied under internal models (Article 155 CRR).

We propose targeted amendments to Article 133 CRR with two main objectives:

- Encourage investment in diversified equity portfolios, which are inherently less risky;
- Clarify the definition of “high-risk” exposures and remove ambiguity around venture capital.

<u>Proposed Amendment</u>

3. Equity exposures, other than those referred to in paragraphs 4 to 7, shall be assigned a risk weight of 250%, unless those exposures are required to be deducted or risk-weighted in accordance with Part Two.

3a. Private equity and venture capital exposures—defined as exposures to diversified portfolios of long-term equity investments—shall be assigned a risk weight of 150%, provided they meet appropriate diversification criteria, unless those exposures are required to be deducted or risk-weighted in accordance with Part Two.

4. The following equity exposures to unlisted companies shall be assigned a risk weight of 400%, unless those exposures are required to be deducted or risk-weighted in accordance with Part Two:

(a) investments held for short-term resale;

(b) ***direct exposures to the equity of private undertakings****,* ~~*venture capital firms,*~~ *or similar investments acquired with the expectation of significant short-term capital gains.*

By way of derogation, long-term equity investments—including investments in corporate clients with which the institution has, or intends to establish, a long-term relationship, as well as debt-equity swaps for restructuring purposes—shall be assigned a risk weight in accordance with paragraphs 3, ***3a,*** *or 5, as applicable.*

For the purposes of this Article, a long-term equity investment is defined as an equity investment held for at least three years, or intended to be held for at least three years, as approved by the institution’s senior management.