European Commission

Finalising post-crisis reforms: **Basel III implementation and further improvements**

Review of Capital Requirements Regulation and Directive (CRR/D)

EESC Conference
8 February 2022

Banking and finance

Background

- The 2008/09 **global financial crisis** revealed a number of weaknesses and vulnerabilities in the banking system.
- Transmission to the rest of the financial system and the real economy resulted in **massive contraction of credit and liquidity.**
- In response, between December 2010 and December 2017 the Basel Committee on Banking Supervision (BCBS) agreed **substantial reforms of the prudential framework** for banks to enhance banks' resilience, increase financial stability and provide the basis for stable funding of the economy ("**Basel III framework**").
- The EU adopted **banking legislation** (CRR/CRR II & CRD IV/CRD V) to implement most of these reforms.
- However, a number of the **final elements** of the Basel III framework **still need to be implemented**.

European Commission

Context

- **G20 agreed to "full, timely and consistent implementation"** of all elements of the reform package (some third countries already published draft legislation).
- **Co-legislators** expressed support for implementation of final Basel III reforms, while stressing that reforms **should not to result in a significant increase in overall capital requirements** for the banking sector.
- Due to COVID-19, the BCBS agreed to **postpone implementation deadlines by 1 year** to 1 January 2023.
- **Preparatory work** for Basel III implementation started already in spring 2018:
  - Calls for technical Advice to EBA (2018, 2020);
  - Public consultations (2018, 2019);
  - Stakeholder conference (2019);
  - Exchanges with MS and MEPs (since 2018 ongoing).
- **EBA reports** on third country branches, supervisory independence.

Rationale

- **Objectives of outstanding Basel III reforms:**
  - improve **overall balance** between simplicity, comparability and risk sensitivity of the framework (i.e. denominator of capital ratios);
  - restore **confidence** in risk-based capital requirements and improve **solidity** of banks, in particular by:
    - **addressing deficiencies of internal models**, mainly used by large banks, some of which were undercapitalised and vulnerable after the financial crisis;
    - **enhancing the risk sensitivity and robustness of standardised approaches** to provide credible alternatives and backstops to internal models.
- **EU implementation** particularly important given:
  - EU banks' high reliance on internal models;
  - need to support international regulatory cooperation and multilateralism.

Rationale (c'td)

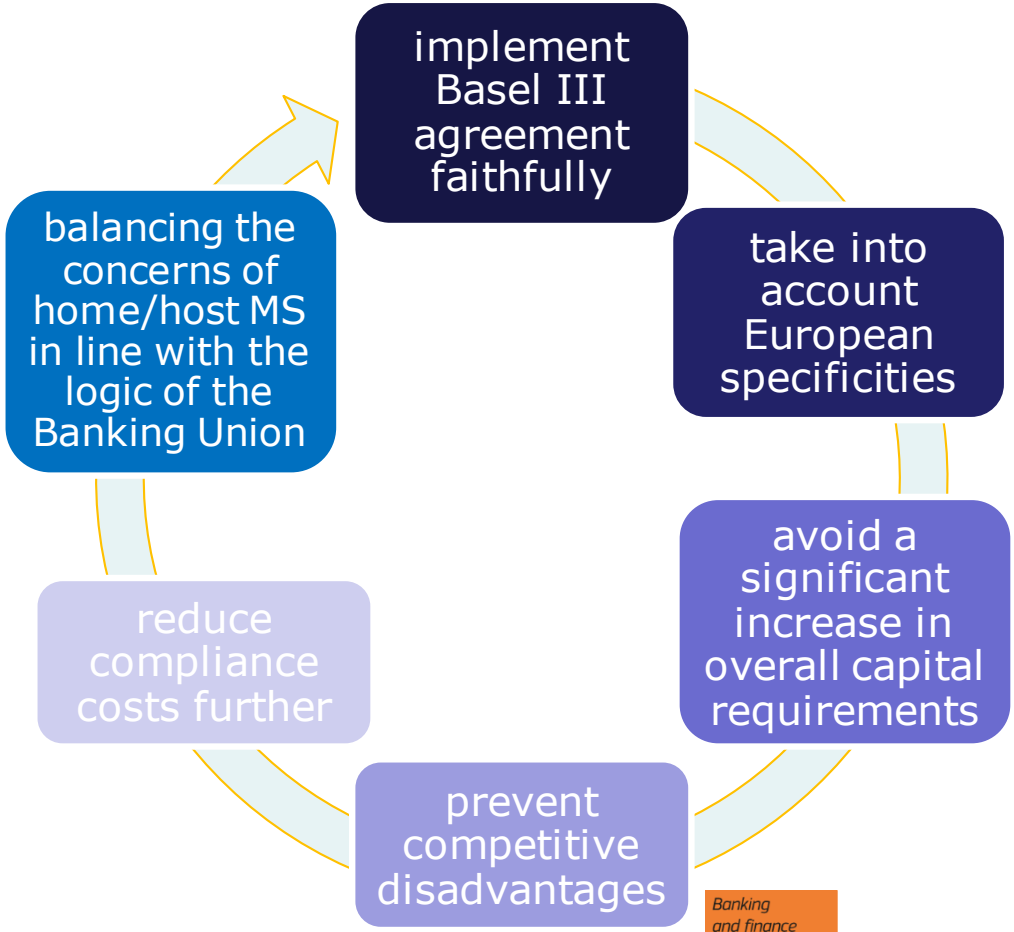
- **Further (non-Basel) objectives pursued by CRR3/CRD6:**
  - **incorporate sustainability risks in the prudential framework** (risk management, supervision, stress testing, reporting and disclosure);
  - **harmonise the supervisory toolkit and its application** (supervisory approval of certain structural changes, common list of sanctionable breaches, convergent and risk-based fit & proper assessments);
  - **implement lessons learnt from Wirecard case** (prudential consolidation of fintechs, minimum requirements for supervisory independence);
  - **establish minimum standards for third country branches** (authoritisation and prudential requirements, supervisory cooperation and powers on systemic branches);
  - **reduce banks' administrative costs while improving access to banks' disclosures** (dual-use of supervisory data, centralised data-hub at EBA);
  - **address the inconsistencies identified between the prudential and the resolution frameworks** (daisy chains, MPE).

Rationale (c'td)

- Targeted improvements to address the various issues outlined on the previous slide are important to ensure that the **EU prudential framework remains fit for purpose**, i.e. that's it:
  - provides the regulatory foundation for **EU banks to act as a sustainable source of finance;**
  - contributes to a **level playing field** in the Single Market and vis-à-vis international banking groups;
  - enables a proper functioning of the **Banking Union.**

Trade-offs for Basel III implementation

- COM proposal **aims to balance several political objectives**



No significant increase in capital requirements

- Overall capital requirements of EU banks expected to increase by less than 9% on average in 2030 under conservative and static assumptions (no adjustments)
- Impact varies across banks and average results dominated by largest banks

	Short-term impact (2025)			**Long-term impact (2030)**	
	% change in capital requirements	TC shortfall (in EUR bn)		% change in MRC	TC shortfall (in EUR bn)
		moderate recovery scenario	*adverse recovery scenario*		
Full alignment with Basel	+11.8%	27.6	NA	+18.5%	52.2
Basel III implementation with EU-specific adjustments (Commission proposal)	Between +0.7% and +2.7%	Below 7.6	Below 30.4	Between +6.4% and +8.4%	Below 26.3

NB: **Estimates do not take into account the mitigating effects of the specific treatment for low risk residential mortgage lending and unconditionally cancellable commitments**.