EBA advises the European Commission on the implementation of the final Basel III framework

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The European Banking Authority (EBA) published today its advice on the implementation of Basel III in the EU, which includes a quantitative analysis of the estimated impact based on data from 189 banks, and a set of policy recommendations. This work responds to a Commission's call for advice. The impact assessment shows that the full implementation of Basel III, under conservative assumptions, will increase the minimum capital requirement (MRC) by 24.4% on average. This increase in capital requirements will imply an aggregate shortfall in total capital of about EUR 135.1 billion (EUR 91.1 billion in terms of common equity tier 1, CET1). The majority of the capital impact occurs in large globally active banks, while the impact on medium-sized banks is limited to 11.3% in terms of MRC, leading to a shortfall of EUR 0.9 billion, and on small banks to 5.5% MRC with a EUR 0.1 billion shortfall. The EBA supports the full implementation of the final Basel III standards, which will contribute to the credibility of the EU banking sector and ensure a well-functioning global banking market.

The EBA welcomes the improvements introduced in the final Basel III package. These include the introduction of a higher degree of risk sensitivity in the standardised approaches to measure credit and operational risks, and constraints to internal modelling by banks where undue variability of model outcomes was observed in the past. Overall, these reforms will increase financial stability, while at the same time allowing the continued use of risk-sensitive approaches.

The results of the quantitative analysis show that the impact of the full implementation of Basel III, including the discontinuation of EU-specific current policies such as the small and medium-sized enterprises (SME) supporting factor and credit valuation adjustment (CVA) exemptions, is diverse across banks. The weighted average increase in MRC is 24.4% for the entire sample, under conservative assumptions (table 1). However, the impact differs significantly across the sample. For half of the banks in the sample, the impact is less than 10.6%, and it is negative for a quarter of the sample. The MRC increase for small banks is limited to 5.5%. The estimated total capital shortfall is about EUR 135.1 billion (EUR 91.1 billion in terms of CET1), and it is observed almost entirely among large banks (table 2). This estimated shortfall would reduce to EUR 58.7 billion if banks were to retain profits (based on 2014-18 data) throughout the transition period.

Related documents:
Basel III reforms: impact study and key recommendations [PDF, 5790KB]
Policy Advice on Basel III reforms - SFTs [PDF, 1425KB]
Policy advice on the Basel III reforms: Operational risk [PDF, 1641KB]
Policy advice on the Basel III reforms: Output floor [PDF, 1433KB]
Policy advice on the Basel III reforms: Credit risk [PDF, 3807KB]
Letter from Olivier Guersent, DG FISMA, regarding the Call for advice on the final elements of the Basel III framework [PDF, 265KB]

Related links:
Finalised Basel III standards (Dec 2017) – Call for Advice
Correspondence with EU institutions

Table 1 Percentage change in T1 MRC (relative to current T1 MRC), by size

	∆ SA	∆ IRB	∆ CCP	∆ SEC	∆ MKT	∆ OP	∆ CVA	∆ LR	∆ OF	∆ Total
All banks	**2.7**	**2.7**	**0.1**	**0.6**	**2.5**	**3.3**	**3.9**	**-0.5**	**9.1**	**24.4**
Large	2.3	2.8	0.1	0.7	2.6	3.4	4.1	-0.5	9.5	25.0
of which: G-SIIs	1.7	3.5	-0.1	1.2	4.2	5.5	5.1	0.0	7.6	28.6
of which: O-SIIs	2.3	1.7	0.2	0.3	1.6	2.1	3.7	-0.5	12.1	23.6
Medium	9.7	0.1	0.0	0.0	0.9	0.3	0.5	-1.1	0.9	11.3
Small	10.7	0.0	0.2	-1.9	0.0	-3.7	0.3	-0.1	0.0	5.5

Sources: EBA 2018-Q2 quantitative impact study (QIS) data and EBA calculations.

Notes: Based on a sample of 189 banks: Large (104), of which G-SIIs (8), of which O-SIIs (67); Medium (61); Small (24). G-SIIs, global systemically important institutions; O-SIIs: other systemically important institutions; SA, standardised approach to credit risk;

IRB, internal ratings-based approach to credit risk; CCP, counterparty credit risk; SEC, securitisation; MKT, market risk; OP, operational risk; CVA, credit valuation adjustment; LR, leverage ratio; OF, output floor.

Table 2 Capital ratios and shortfalls, by size

	CET1 capital			Tier 1 capital			Total capital		
	Current ratio (%)	Revised ratio (%)	Shortfall (EUR billion)	Current ratio (%)	Revised ratio (%)	Shortfall (EUR billion)	Current ratio (%)	Revised ratio (%)	Shortfall (EUR billion)
All banks	**14.4**	**11.5**	**91.1**	**15.3**	**12.3**	**127.5**	**17.9**	**14.3**	**135.1**
Large	14.2	11.4	91.0	15.2	12.2	126.8	17.8	14.2	134.1
of which: G-SIIs	12.7	9.9	53.5	13.8	10.8	69.0	16.2	12.7	82.8
of which: O-SIIs	15.4	12.5	33.6	16.3	13.2	51.5	19.2	15.6	43.8
Medium	17.4	15.2	0.1	17.6	15.4	0.8	19.0	16.6	0.9
Small	17.0	16.0	0.0	17.2	16.1	0.0	18.3	17.1	0.1

Sources: EBA 2018-Q2 QIS data and EBA calculations.

Notes: Based on a sample of 189 banks: Large (104), of which G-SIIs (8), of which O-SIIs (67); Medium (61); Small (24). Tier 1 and total capital shortfalls include the shortfall incurred by institutions constrained by the leverage ratio in the revised framework.

It is important to stress that the estimated impact included in these reports cannot be directly compared to the figures the EBA publishes periodically in the context of regular Basel III monitoring exercises (e.g. latest one in March 2019) which limit the impact analysis to Pillar 1 minimum requirements and specific buffer requirements (capital conservation buffer and G-SII buffer where applicable). The analysis published today includes Pillar 2 requirements and the full set of combined buffer requirements in the calculation of banks' minimum required capital and assumes that these requirements remain at current levels.

These results should also be read in conjunction with a set of conservative assumptions underlying the assessment. Mainly, the lack of any adjustment carried out by banks or authorities in response to the implementation of Basel III. Banks' balance sheets are assumed to be static, meaning that banks will not alter their current exposures and all maturing assets are expected to be replaced by similar instruments. Pillar 2 and macro-prudential requirements (expressed in percentage of risk weighted assets) are also assumed to remain unchanged. This adds a significant degree of conservatism.

Detailed policy recommendations are also provided for a number of areas of the Basel III framework in the four policy advice reports published today. These recommendations include:

- In the area of credit risk: all the newly agreed revisions should be implemented in the EU, maintaining a prudential framework based on external ratings and the loan-splitting approach to exposures secured by real estate. The report also recommends that no EU-specific supporting factors for SME and infrastructure lending exposures are retained.
- In the area of securities financing transactions: all the newly agreed revisions should be implemented in the EU, except for the minimum haircuts floor framework where EBA believes further analysis is needed.
- In the area of operational risk: the new Standardised Approach (SA) should be implemented. The SA should be based on the institution-specific historical loss component for larger institutions to maintain a risk-sensitive approach. For the same reason, smaller institutions may be allowed to also use the historical loss component on a case-by-case basis. The EBA advises the Commission to consider a phase-in period for the SA.
- The output floor should be introduced and, where applicable, should be used to compute all capital requirements, including EU-specific requirements such as the systemic risk buffer. The output floor should be applied at all levels of consolidation.

The Basel Committee has recently made targeted revisions to the fundamental review of the trading book (FRTB), which is not assessed in this report.[1] In line with the request from the Commission, the EBA will publish its advice on the implementation of the finalised FRTB and CVA frameworks, and an analysis of the macroeconomic impact of the final Basel III framework later this year. In this context, the EBA acknowledges receipt of an additional request for technical advice from the Commission on further aspects of the final Basel III framework (Commission letter is available here).

Note to the editors

The report 'Policy advice on the Basel III reforms: credit risk' has not yet undergone final editorial checks but it is published today to provide all stakeholders with timely sight of the EBA's advice. This final editing will solely improve the language of the publication without altering its analytical or policy content. The EBA will update this report when available.

[1] The EBA has previously published its advice on the implementation of the FRTB prior to these latest revisions by the Basel Committee. See: Report on SA CCR and FRTB implementation (EBA-Op-2016-19) .

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