Box 8.1

LAST PHASE OF BASEL III ADOPTION IN THE EUROPEAN UNION

The publication of the European Commission's legislative proposal on 27 October triggered discussions on finalising the incorporation of Basel III in the European Union (EU), which it is proposed will come into force in 2025. The proposal consists of three separate documents:

— Amendment of Regulation (EU) No 575/2013 (CRR-III): constitutes the bulk of the reform, and includes changes to the methods for calculating own funds requirements.

— Amendment of Directive 2013/36 (CRD-VI): while incorporating changes relating to the adoption of Basel III, most of the amendments are not related to Basel III, but seek to improve the supervisory framework for institutions and the harmonisation of the various national regimes.

— Amendment of Regulation (EU) No 575/2013 and Directive 2014/59: both the Regulation and the Directive are amended on issues relating to global systemic institutions with a multiple point of entry (MPE) resolution strategy, and to the indirect subscription of minimum requirement for own funds and eligible liabilities (MREL) instruments in chains of subsidiaries.

I Main amendments introduced by CRR-III

In order to reduce the unwarranted variability and lack of comparability of risk-weighted assets (RWAs) resulting from the use of internal models, it incorporates a number of measures, including:

— Establishment of floors for some components of credit risk models.

— Elimination of the possibility of modelling certain risks or categories of exposures (e.g. operational risk or equities).

— Setting the output floor in capital requirements calculated under internal models: Basel III establishes a floor at 72.5% of overall RWAs of any institution based on the RWAs that would result from calculating its exposures and risks under the standardised approach. The European Commission's proposal requires this limit at the consolidated level, with a certain distribution among subsidiaries. Also, it provides for a more lax transitional period by allowing a more favourable treatment for certain exposures (e.g. unrated firms or residential mortgages) and leaving open the possibility of this treatment lasting over time.

In addition, other measures, that seek to improve the regulatory framework's risk sensitivity, are included:

— Greater granularity in certain categories of credit risk exposures.

— Introduction of the new approaches to market risk calculation (alternative internal model, alternative standardised and standardised).

— Amendments to the regulation of counterparty risk and credit valuation adjustment risk.

II Main amendments introduced by CRD-VI

The most significant amendments are:

— Temporary freeze of Pillar 2 requirements, and of the buffers for other systemically important institutions and the systemic risk buffer for institutions affected by the output floor.

— Approval by the supervisory authority of certain transactions carried out by a credit institution.

— Harmonisation of the treatment of incoming third country branches, that had been mainly national to date.

— Definition of environmental, social and governance risks and their incorporation into the processes for assessing capital requirements.

1 Basel III is a set of internationally agreed measures developed by the Basel Committee on Banking Supervision in response to the 2007-2009 financial crisis, with the aim of strengthening the regulation, supervision and risk management of banks.