On 29 January 2020 the European Commission’s new work programme was published. Under the third priority - ‘an Economy that Works for People’, the Commission announced its intention to review the regulatory framework on bank capital requirements, set out in the capital requirements directive (CRD) and regulation (CRR), to complete the implementation of the international regulatory standards agreed within the Basel Committee on Banking Supervision (BCBS) in December 2017. These standards are known as ‘Basel III finalisation’.

On 27 October 2021, the European Commission proposed a package of two proposals amending CRR and CRD. The package implements the international Basel III standards, while taking into account the specificities of the EU’s banking sector, for example when it comes to low-risk mortgages. The proposed rules would require banks to systematically identify, disclose and manage sustainability risks (environmental, social and governance or ESG-risks) as part of their risk management. They also provide stronger enforcement tools for supervisors overseeing EU banks.

The legislative package includes:

- a proposal for a directive amending the CRD (Directive 2013/36/EU);
- a proposal for a regulation amending the CRR (Regulation 2013/575/EU);
- a separate proposal for a regulation to amend the CRR in the area of resolution (the so-called “daisy chain” proposal).

In its opinion of 25 March 2022, the European Central Bank (ECB) welcomes the proposal, which would enhance the prudential framework for credit institutions in various areas, emphasising the importance of finalising the EU implementation of the Basel III reforms in a ‘timely, full, and faithful manner’, because there are key shortcomings in the current EU legislative framework.

In its opinion of 29 July 2022, the European Economic and Social Committee (EESC) supports a forward-looking capital policy using risk-weight approach, while also considering the ‘need to boost the competitiveness of EU banks and to increase the financing of sustainable growth’.
In October 2021, Parliament’s Committee on Economic and Monetary Affairs (ECON) appointed Jonás Fernández (S&D, Spain) as a rapporteur for three legislative proposals. The report was adopted by the Committee on 24 January 2023, and the Committee decision to enter into interinstitutional negotiations was announced in plenary on 13 February 2023.

The most notable changes include chapters affirming that the involvement of institutions in crypto-assets related activities should be thoroughly reflected in the EU prudential framework, which inadequately capture the risks inherent to crypto-assets. The report calls the Commission to adopt a proposal by 31 December 2024 to transpose the international standards adopted in December 2022. As regards the output floor, the transitional provisions were retained with an extension of the derogations limited to up to four years. Moreover, the report would amend the proposal in such a way that risk-weighted exposure should be calculated on a consolidated basis. However, the competent authority responsible for the supervision of a subsidiary of an EU parent institution may submit a capital redistribution proposal to the parent institution’s supervisor. Where the authorities do not reach a joint decision, the EBA shall have a ‘legally binding mediation role’ to resolve disputes between competent authorities.

In November 2022, the Council agreed on its position. In particular, for the Council, the ‘output floor’ should apply both at banking group level and at the level of each individual bank, although Member States can allow application of the output floor at the highest level of consolidation for entities in their country. The Council also added ‘technical improvements’ to the areas of credit risk, market risk and operational risk, and added ‘enhanced’ proportionality rules for small banks, particularly concerning disclosure requirements for small and non-complex institutions. Lastly, the Council’s position aims to harmonise minimum requirements applicable to branches of third-country banks and the supervision of their activities in the EU.

On 26 June 2023, the European Parliament and the Council reached a provisional agreement with the following main components:

• Capital requirements: The ‘output floor’ would be applied at an entity level, and fully implemented within a transitional period. However, the Commission will assess the overall situation of the banking system by the end of 2028, and report to Parliament and to the Council on the appropriateness of the framework.

• Environmental social and governance (ESG) risks are an important aspect of the amendments. When assessing the value of collateral, banks will take into account ESG risks. They also agreed on lower risk weight for exposures to the EU Emissions Trading System (40%).

• Crypto-asset risks: Banks will have to disclose their exposure to crypto-assets, and capital requirements will be put in place until the Commission makes a legislative proposal.

• Management board and conflicts of interest: New provisions would promote diversity and gender balance on management boards. A harmonised ‘fit and proper’ framework for assessing the suitability of members of the institutions’ management bodies and key function holders will be implemented, and their suitability will require the approval of the competent authorities. Moreover, a ‘cooling-off period’ will be required for staff and members of governance bodies of competent authorities.
• Third-country regime: The agreement would harmonise minimum requirements applicable to branches of third-country banks and the supervision of their activities in the EU.

Next steps

The provisional political agreement will have to be approved first by the ECON committee, then by a plenary vote. The Council also has to approve the deal before it can come into force.

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• European Economic and Social Committee, Opinion on the Proposal for a Regulation amending Regulation (EU) No 575/2013 as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor, 2022/C 290/07
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Further reading:

• European Parliament, EPRS, Amendments to banking capital requirements legislation, EPRS Legislative briefing, Briefing, February 2023.