EBA updates the estimates of the impact of the implementation of Basel III and provides an assessment of its effect on the EU economy

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**The European Banking Authority (EBA) published today the second part of its advice on the implementation of Basel III in the EU, which complements the Report published on 5 August 2019. Today’s publication includes an assessment of the impact of the revisions to the credit valuation adjustment (CVA) and market risk frameworks, and the corresponding policy recommendations. It also provides a macroeconomic impact assessment of the full Basel III package. When accounting for the 2019 FRTB standards, the impact assessment shows that the full implementation of Basel III, under conservative assumptions, will increase the current minimum capital requirement (MRC) by 23.6% on average. This impact is lower than the 24.4% originally estimated in the August 2019 report, and would imply an aggregate shortfall in total capital of EUR 124.8 billion. The macroeconomic impact assessment shows that the implementation of Basel III will have net benefits for the economy of the European Union. The EBA reaffirms its support for a full implementation of the final Basel III standards in the EU.**

**Key findings of the quantitative analysis**

Considering the 2019 FRTB standards, the revised weighted average increase in the current MRC is 23.6% for the entire sample, under conservative assumptions. The lower impact compared to the August 2019 Report (24.4%) is due to a reduction in the impact of market risk (2.2% compared to 2.5%) and the lower impact of the output floor (8.6%, compared to 9.1%). This reduction is observed almost entirely among large banks. The estimated total capital shortfall is about EUR 124.8 billion (EUR 83.0 billion in terms of CET1), down from the EUR 135.1 billion shortfall in total capital (EUR 91.1 billion in CET1) estimated in the August 2019 report.

**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** | **2.2** | **3.3** | **3.9** | **-0.5** | **8.6** | **23.6** |
| Large | 2.3 | 2.8 | 0.1 | 0.7 | 2.2 | 3.4 | 4.1 | -0.5 | 9.0 | 24.1 |
| of which: G-SIIs | 1.7 | 3.5 | -0.1 | 1.2 | 3.9 | 5.5 | 5.1 | 0.0 | 6.4 | 27.2 |
| of which: O-SIIs | 2.3 | 1.7 | 0.2 | 0.3 | 1.2 | 2.1 | 3.7 | -0.5 | 12.0 | 23.0 |
| 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 |

**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** | **11.6** | **83.0** | **15.3** | **12.4** | **119.0** | **17.9** | **14.4** | **124.8** |
| Large | 14.2 | 11.4 | 82.9 | 15.2 | 12.2 | 118.2 | 17.8 | 14.3 | 123.8 |
| of which: G-SIIs | 12.7 | 10.1 | 46.8 | 13.8 | 10.9 | 62.6 | 16.2 | 12.8 | 75.3 |
| of which: O-SIIs | 15.4 | 12.5 | 32.2 | 16.3 | 13.3 | 49.5 | 19.2 | 15.6 | 41.1 |
| Medium | 17.3 | 15.2 | 0.1 | 17.5 | 15.4 | 0.8 | 18.9 | 16.6 | 0.9 |
| Small | 17.0 | 16.0 | 0.0 | 17.2 | 16.1 | 0.0 | 18.3 | 17.1 | 0.1 |

These results reported in Tables 1 and 2 do not take into account the targeted revisions to the CVA framework proposed by the [Basel Committee in November 2019](https://www.bis.org/bcbs/publ/d488.pdf), which are expected to further reduce the overall impact. Under a scenario in which the SA-CVA and BA-CVA capital requirements are recalibrated downwards by 10%, the impact on CVA will move from 3.9% to 3.4% (reducing the total impact from 23.6% to 23.1%). Since the impact is broadly linear, a 20% reduction (the lower bound proposed by BCBS) would produce impacts of 2.9%.

**Key findings of the macroeconomic impact assessment**

The assessment of the macroeconomic costs and benefits of the finalisation of the Basel III framework was carried out in cooperation with the ECB.

The results show that the implementation of the Basel reforms will result in modest transitional costs, which fade over time. The long-term benefits are substantial and outweigh the modest transitory costs. The reform would mitigate the severity of future economic downturns through a reduction in both probability and intensity of future banking crises, leading to sizable long-term net benefits of around 0.6 percent of annual GDP level.

**Key policy recommendations**

The EBA also put forward detailed policy recommendations in the areas of CVA and market risk. Overall, it should be recalled that the EBA continues to support 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. These reforms will increase financial stability, while at the same time allowing the continued use of risk-sensitive approaches.

In the area of CVA risk the EBA recommends that:

* As the CVA risk generated by the CVA exemptions can be substantial, it should be captured prudentially. This will allow alignment with international standards on CVA risk and adherence to a risk-based capital requirements framework.
* The use of the simplified treatment for CVA risk should be based on the proportionality framework for counterparty credit risk (CCR) already envisaged in the CRR2, and its use should be allowed to firms eligible to employ the simplified SA-CCR under the CRR2.

In the area of market risk, the EBA recommendations aim to ensure a smooth and consistent implementation of the revised market risk framework in the EU and, therefore, focus on issues identified in the market risk standards as implemented in the CRR/CRR2. In particular, they clarify the treatment for unrated covered bonds under the FRTB-SA, and support the use of the recalibrated (Basel II) standardised approach as a simplified approach for institutions not subject to the FRTB reporting requirement under the CRR2.

**Notes to editors**

1. Unlike the results published in the August 2019 report, which were based on the 2016 FRTB standards, the analysis published today accounts for the 2019 FRTB standards. Already in 2016, the EBA provided its [advice on the implementation of the FRTB in the EU](https://eba.europa.eu/sites/default/documents/files/documents/10180/1648752/5ef848d1-7d52-4a80-abdf-f013e294759c/Report%20on%20SA%20CCR%20and%20FRTB%20implementation%20(EBA-Op-2016-19).pdf). The policy recommendations put forward today, therefore, build on the CRR2 implementation of the FRTB in the EU.
2. The analysis 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. Therefore, it 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 October 2019) which limit the impact analysis to Pillar 1 minimum requirements and specific buffer requirements (capital conservation buffer and G-SII buffer where applicable).
3. These results should also be read in conjunction with a set of conservative assumptions, in particular the assessment does not consider any adjustments in banks’ balance sheets nor authorities’ response to the implementation of Basel III.