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The EU should stick to the Basel III agreement

The European Commission is currently preparing a legislative proposal to implement the final parts of the globally agreed Basel III framework for banks. The global financial crisis of 2007-2010, clearly demonstrated the need to strengthen the prudential treatment of banks and it took about 8 years to agree on all the aspects of the Basel III agreement. We, as prudential supervisors and central banks in the EU, very much support a full, timely and consistent implementation of all aspects of this framework. In our view, this implementation should adhere to both the letter and the spirit of the Basel III agreement. Diluting the framework would not be in the best interests of Europe. The pandemic shows that more resilient banks are better able to support the real economy, even during times of crisis. Ensuring that banks are resilient is therefore good for economic growth, something Europe clearly needs. Adhering to the Basel framework would also facilitate market monitoring, as it simplifies comparisons of different banks. This, in turn, would assist in the much-needed restructuring of the European banking industry.

Both the global financial crisis and the pandemic have demonstrated the interdependencies between economies globally. What happens in the US sub-prime market or in Wuhan affects us all. In such an environment, we are all better off implementing the minimum standards to ensure the resilience we all need. The EU is no exception to this. Furthermore, if the EU deviates from the agreement, implementation may also be derailed in other countries. It is therefore in the long term interests of the EU to implement globally agreed standards, including all aspects of the Basel III-agreement, in a full, timely and consistent way.

This has three important implications. Firstly, the output floor should be implemented as agreed in Basel, with all risk-based capital measures and buffers calculated on the basis of one single set of risk-weighted assets. This has several benefits. It is simple and transparent. It reduces the variability of risk-weighted assets. It builds confidence in banks’ capital structures. It improves the level playing field between banks using internal models and banks using standardised models, as well as between different banks using internal models worldwide. It also increases the usability of the capital buffers. A parallel stack approach to the output floor does not attain these benefits and therefore should not be pursued. Furthermore, it should be considered to apply the output floor to all levels of consolidation, consistent with other prudential requirements, such as the leverage ratio.
Secondly, the new Basel standardised approach for credit risk should be implemented as agreed globally. This new approach is more risk sensitive than the old one. It entails a delicate balance between the risks in different exposure types and we should preserve that balance.

Thirdly, EU specific deviations should be minimised. There are already some deviations from Basel and these should be re-assessed. In addition, the EU should refrain from making further exemptions from Basel III or from making the banking regulatory framework more complex.

To conclude, we want to stress the need for the full, timely and consistent implementation of all Basel III standards. This has been agreed globally, both by the Governors and Heads of Supervision of the Basel Committee members¹, and by the G20-leaders². The EU should follow through on this commitment. It is in our common interest.

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¹ See https://www.bis.org/press/p200327.htm