EUROPEAN
COMMISSION

Brussels, 27.10.2021
SWD(2021) 321 final

COMMISSION STAFF WORKING DOCUMENT

EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT REPORT

Accompanying the document

Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions as regards requirements for credit risk, credit valuation adjustment risk, operational risk, market risk and the output floor

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/36/EU as regards supervisory powers, sanctions, third-country branches, and environmental, social and governance risks, and amending Directive 2014/59/EU

{COM(2021) 663 final} - {SEC(2021) 380 final} - {SWD(2021) 320 final}

Executive Summary Sheet

Impact assessment on a proposal amending Regulation (EU) 575/2013 and Directive 2013/36/EU

A. Need for action

What is the problem and why is it a problem at EU level?

In response to the financial crisis, the EU embarked on a wide-ranging reform of the prudential framework for banks aimed at increasing the resilience of the EU banking sector. One of the main elements of the reform consisted in **implementing international standards agreed by the Basel Committee for Banking Supervision**, specifically the so-called “Basel III reform”. Thanks to this reform, the EU banking sector entered the COVID-19 crisis on a resilient footing. However, while the overall level of capital in EU banks is now satisfactory on average, some of the problems that were identified in the wake of financial crisis have not yet been addressed. In particular, two main problems remain. First, the default methods that banks use to calculate their capital requirements (so-called “standardised approaches”) do not capture sufficiently well the risks that banks are exposed to (i.e. they are not sufficiently risk sensitive), leading to inadequate (either too high or too low) capital requirements. This, in turn, may negatively affect banks’ activities. Second, the sophisticated methods that mostly large banks are allowed to use (so-called “internal model approaches”) produce very different capital requirements for similar or even identical risks. This makes it difficult to compare capital ratios across banks and undermines the trust in those ratios and hence in the banks using internal models. Furthermore, for certain types of assets, there are not enough data of sufficiently good quality to allow for a reliable and robust modelling of capital requirements. Banks using internal models for those assets may therefore have insufficient capital to cover for the associated risks.

Beyond the need to address those deficiencies by completing the post-crisis reform agreed at international level, the transition to a more sustainable economy entails risks for banks that they will need to properly manage to ensure financial stability. The Sustainable Finance Strategy highlighted the need to include a better integration of climate and environmental risks into the EU prudential framework. The present legal requirements alone are insufficient to provide incentives for a **systematic and consistent management of environmental, social and governance (ESG) risks** by banks.

Another area of focus is the proper enforcement of prudential rules. Supervisors play a crucial role in this respect. Supervisors need to have at their disposal the necessary tools and powers to this effect (e.g. powers to authorise banks and their activities, check the suitability of their management, or sanction them in case they break the rules). While the EU legislation ensures a minimum level of harmonisation, the supervisory toolkit and procedures vary greatly across Member States. This **fragmented regulatory landscape in the definition of certain powers and tools available to supervisors and their application** across Member States undermines the level playing field in the Single Market and raises doubts about the sound and prudent management of EU banks and their supervision. This problem is particularly acute in the context of the Banking Union. Differences across 19 different legal systems prevent the Single Supervisory Mechanism from performing its supervisory functions effectively and efficiently. Moreover, cross-border banking groups have to deal with a number of different procedures for the same prudential issue, unduly increasing their administrative costs.

Market discipline is another important tool. In order for investors to exercise their role of monitoring the behaviour of banks, they need to access the necessary information. The current **difficulties related to the access to prudential information** deprive market participants from the information they need about banks’ prudential situations. This ultimately reduces the effectiveness of the prudential framework for banks and potentially raises doubt about the resilience of the banking sector, especially in periods of stress.

What should be achieved?

There are two general objectives pursued by this initiative: contributing to financial stability and contributing to steady financing of the economy in the context of the recovery post-COVID-19 crisis. These can be broken down in more specific objectives:

i) strengthen the risk-based capital framework, without significant increases in capital requirements overall;

ii) enhance the focus on ESG risks in the prudential framework;

iii) further harmonise supervisory powers and tools; and

iv) reduce banks' administrative costs related to public disclosures and improve access to banks' prudential data.

What is the value added of action at the EU level (subsidiarity)?

The objectives pursued by the envisaged measures can be better achieved at Union level rather than by different national initiatives as they represent adjustments and updates to existing EU rules. These problems and the underlying causes are the same across all Member States and potential differences pertain to the behaviour and business model of individual banks, not their location within the Union.

B. Solutions

What are the various options to achieve the objectives? Is there a preferred option or not? If not, why?

Baseline scenario. The baseline scenario consists in leaving the existing rules unchanged.

Policy options. The following high level policy options are considered in the impact assessment:

- in relation to the improvement of the current prudential framework for calculating risk-based capital requirements, options considered are: (1) to implement the final elements of the Basel IIII reform as literally agreed at international level; (2) implement them with certain adjustments to take into account EU specificities, and (3) implement them with the adjustments and the transitional arrangements introduced in response to the COVID-19 crisis (preferred option);
- in relation to the **dedicated capture of ESG risks in the prudential framework**, options considered are (1) to introduce measures for a better management of ESG risks by banks (preferred option), and (2) adapt minimum capital requirements to reflect ESG risks;
- in relation to **improving the consistency in the application of supervisory powers**, options considered are (1) to clarify and complement certain provisions on supervisory and sanctioning powers while leaving ample flexibility to Member States, and (2) to ensure a greater level of harmonisation of the provisions on supervisory and sanctioning powers by narrowing down the flexibility of Member States (preferred option); and
- in relation to **reducing disclosure costs and improving market access to bank prudential information**, options considered are to require the European Banking Authority (EBA) to provide a single electronic access to EU banks' (1) quantitative disclosures only or (2) also qualitative disclosures (preferred option).

What are different stakeholders' views? Who supports which option?

Overall, stakeholders agree on the necessity to implement the final elements of the Basel IIII reform, but have diverging views on how this should be done. Supervisors take a conservative approach and prefer a faithful implementation of those standards, while the financial industry argues in favour of making several adjustments to those standards and of spreading the impacts of the reform over several years.

Most stakeholders (banks, supervisors, civil societies) recognise that prudential requirements for banks must reflect ESG risks and many agree that any change in capital requirements must be based on solid evidence of risk differentials based on ESG factors, which they do not consider to be available at present.

The views of supervisors and banks on potential changes to the supervisory toolkit and fit-and-proper assessment framework largely depend on their current practices but are supportive overall.

Views are all in all also positive on the initiative to centralise supervisory reporting and public disclosure: a majority of industry stakeholders supported the approach while supervisors pointed to the need to address concerns about wrong expectations that the European Banking Authority (EBA) would be responsible for the quality of the information disclosed by banks.

C. Impacts of the preferred option

What are the benefits of the preferred option (if any, otherwise of main ones)?

Implementing the preferred option to implement the final elements of the Basel IIII reform would enhance the reliability and robustness of the bank prudential framework and hence increase the resilience of the EU banking sector. This would have positive effects to foster economic growth in the EU in the medium to long term. In particular, the reforms would reduce the severity of future economic downturns through a reduction in both the probability and the intensity of future banking crises.

Furthermore, the other adjustments to the prudential framework would i) help ensuring that EU banks properly manage the transition to a more sustainable economy, ii) facilitate the application of the single rulebook and iii) decrease the administrative and compliance burden for banks and their supervisors.

What are the costs of the preferred option (if any, otherwise of main ones)?

Implementing the preferred option and taking into account all the measures in the proposal is expected to lead to a weighted average increase in EU banks' minimum capital requirements of +6.4% to +8.4% in the long term (by 2030), after the envisaged transitional period. In the medium term (in 2025), the increase is expected to range between +0.7% and +2.7%.

According to estimates provided by the EBA, this impact could lead a limited number of large EU banks (10 out of 99 banks in the test sample) to raise collectively additional capital amounts (less than EUR 27bn for the 10 banks) in order to meet the new minimum capital requirements under the preferred option. To put this amount into perspective, the 99 banks in the sample (representing 75% of EU banking assets) held a total amount of regulatory capital worth EUR 1414bn at the end of 2019 and had combined profits of EUR 99.8bn in 2019.

While banks would incur one-off administrative and operational costs to implement the changes in the rules, the simplifications implied by several of the preferred options (e.g. removal of internally modelled approaches) are expected to reduce the recurring costs compared to today.

What are the impacts on SMEs and competitiveness?

The preferred policy options would confirm existing measures aimed at minimising any impact on lending to SMEs. They also do not contain measures that would have a significant negative impact on SME lending. Finally, the preferred options that contemplate measures aimed at reducing compliance costs for banks, in particular for smaller and less complex ones, could, if the cost reductions are passed on, reduce borrowing costs for SMEs.

While the reform may increase costs for some EU banks in the short term, in the medium to long term it would make them more resilient in the face of economic shocks thereby restoring confidence in the EU banking sector in the eyes of investors. This would in turn reduce the cost of their funding and therefore increase the competitiveness of EU banks with respect to their international peers.

Will there be significant impacts on national budgets and administrations?

No significant impacts on national budgets and administrations are expected.

Will there be other significant impacts?

No other significant impacts are expected.

Proportionality?

The preferred options contain measures that are deemed to be strictly necessary to achieve the abovementioned objectives.

D. Follow up

When will the policy be reviewed?

The evaluation of the impact of this package will be conducted five years after the legislation enters into force, which is consistent with the methodology agreed before launching the evaluation.