Deloitte Consultanta SRL
The Mark Tower, 84-98 Grivitei Road,
10th Floor
Bucharest, District 1, Romania, 010735
Tel: +40 21 222 16 61
Fax: +40 21 222 16 60
www.deloitte.ro

Deloitte Banking Alert

December 2023

The final elements for the implementation of Basel III in the EU are now agreed and will start applying on the 1st of January 2025

The banking package that implements the Basel III framework in the EU includes amendments to the Capital Requirements Regulation (‘CRR’) and to the Capital Requirements Directive (‘CRD’). These new rules will ensure that EU banks become more resilient to potential future economic shocks, while contributing to Europe's recovery from the COVID-19 pandemic as well as to the transition to climate neutrality.

The banking package provides, deepens, and facilitates access to the EU single market with stronger enforcement tools for supervisors overseeing EU banks and third-country banks operating in the EU, aiming at ensuring their sound management and, ultimately, better protecting financial stability and depositors.

These final elements are now agreed, endorsed by the Council and Parliament and will be implemented in EU law.

Co-legislators confirmed that the new CRR rules will start applying on 1 January 2025. The provision included in the CRD will need to be transposed by Member States before they start applying.

Where do we stand in this process?

In December 2023, the preparatory bodies of the Council and Parliament have endorsed the banking package. It consists of the following legislative elements:

i. a legislative act to amend the Capital Requirements Directive (Directive 2013/36/EU)
ii. a legislative act to amend the Capital Requirements Regulation (Regulation No (EU) 2013/575).

Why is the endorsement of the legal texts by Coreper and ECON important?

- The endorsement of the legal texts confirms the implementation of the final elements of the Basel III framework in the EU;
- The substance of the political agreement reached by co-legislators in June 2023 has now been transformed into a stable legal text, implementing the specifics of that agreement. Although the texts are subject to final legal revision, no changes in substance are expected until its **adoption in the European Parliament by the second trimester of 2024;**
- The stable legal **texts have also become publicly available** as they are published on the Council website and on the Parliament website, providing certainty and transparency to banks wishing to implement the final elements of the Basel III standards;
- Lastly, the endorsement allows EBA to start consulting on key technical standards (as detailed in **EBA's roadmap on Basel III implementation**) that are important for the practical implementation of the banking package across the Union, in particular with regard to the new reporting requirements.

How is the Union implementing the Basel III agreement?

1. **Introduction of the output floor to reduce excessive variability of banks' capital requirements calculated with internal models**

   One of the central questions of the negotiations was about the level at which the output floor should be applied in the case of a banking group comprising of a parent bank and one or more subsidiary banks ('level of application'). The political agreement is that the output floor is going to apply in principle both at group level ('consolidated level') and at the level of each subsidiary (solo/individual level). The final rules include an option for Member States to derogate from the individual level for banking group entities established within their territories (Member State 'subconsolidated level').

2. **Implementation of the Basel III agreement to strengthen Union banks' resilience face at the main risk areas (credit risk, market risk and operational risk)**

   In the area of **credit risk,** the key elements of the banking package include the revision of the standardized approach in line with the Basel standard, e.g. with the introduction for the preferential treatment of real estate exposures, including a new category of 'buy-to-let' exposures (Income Producing Real Estate) and exposures to real estate acquisition, development and construction (ADC).

   In the area of **market risk**, the banking package completes the implementation of the Fundamental Review of the Trading Book (FRTB). Notably, co-legislators agreed to include a number of mandates for the Commission to specify certain elements of the market risk framework, based on EBA input on a certain number of technical standards. The co-legislators have also included the power for the Commission, by means of a Delegated Act, to postpone the entry into force of this section of the CRR.

In the context of **operational risk**, the package implements the new Basel standards. The calculation of capital requirements for operational risk is made simpler, it mainly relies on the corresponding financial statements of banks. An Internal Loss Multiplier (ILM) reflecting historical losses was not included (therefore, ILM=1). This simplification is explicitly recognized in the Basel standard and aims to limit increases in capital requirements.

Beyond implementing the final Basel III elements, the banking package also covers improvements in other important areas of bank prudential regulation.

3. Environmental, Social, and Governance risks ("ESG risks')

Co-legislators further strengthened the provisions related to Environmental, Social, and Governance risks ("ESG risks'), as proposed by the Commission, on a number of aspects:

- Co-legislators agreed that banks will have to draw up transition plans under the prudential framework that will need to be consistent with the sustainability commitments banks undertake under other pieces of Union law, such as the Corporate Sustainability Reporting Directive (CSRD).
- Bank supervisors will oversee how banks handle ESG risks and include ESG considerations in the context of the annual supervisory examination review (SREP).
- ESG reporting and disclosure requirements will apply to all EU banks, with proportionality for smaller banks.
- Lastly, the co-legislators agreed to allow banks to enjoy a favourable risk weight treatment only where they finance an infrastructure project that have a positive or neutral environmental impact assessment.

4. Clear rules for third country banks operating in the Union

The package introduces minimum harmonizing conditions for on the establishment of branches of third-country banks in the EU. While third country banks' branches will continue to be subject to national supervision, supervisory powers have been strengthened to make sure supervisors remain able to manage risks related to these entities, which have significantly increased their activity in the EU over recent years. New rules will ensure a higher degree of cooperation among national supervisors and a stronger role for the EBA

Co-legislators also agreed to introduce, in minimum standards for the regulation and supervision of branches of third-country banks in the EU, including a clear set of rules on when such branches need to be established (Article 21c). In addition they have clarified the delineation towards the rules governing investments services under **MiFID (Directive 2014/65/EU)**.

5. Strengthened supervision

Co-legislators have increased the harmonisation of certain supervisory powers and tools. Notably, supervisors will be given more powers to check if certain transactions (e.g. large acquisitions) undertaken by banks are sound and do not entail excessive risks for banks.

The **package also enhances and further harmonises supervisory sanctioning powers to enforce rules** and provides authorities with better oversight of complex banking groups, including fintechs.

6. Governance: fit and proper assessment for bank managers

Co-legislators harmonised the checks carried out on bank managers ('fit-and-proper'), requiring that, except in specific cases, banks conduct the suitability assessment before the managers take up their

Deloitte.

positions. They also extended the scope of the rules to include other influential managers ('key function holders') and ensured that the bank supervisors are equipped with the appropriate powers and tools to perform their task.

The co-legislators also agreed to introduce a minimum common set of procedural rules and standardised information requirements for verifying the suitability of bank managers and key function holders of large banks by their supervisors. Moreover, in those Member States where the fit-and-proper assessment is carried out after the manager has taken up the position in the management body, **a specific regime will apply to the key positions on the board of large banks**: bank supervisors will receive the relevant information sufficiently in advance of the appointment taking effect, so as to ensure a meaningful cooperation between the bank and the supervisor in the suitability assessment.

Finally, the co-legislators further **strengthened anti-money laundering suitability requirements for bank managers and key function holders, as well as the promotion of diversity** in the composition of the management body as the basis for banks' sound governance.

Next steps

The legislative package will now be submitted to the European Parliament Plenary and Council for adoption, after which the legal texts will be published in the Official Journal of the EU.

For further questions regarding the aspects mentioned in this alert, please don't hesitate to contact us:

Dimitrios Goranitis
Deloitte Global leader FSI Risk and Regulatory
Central Europe FSI leader
Tel: +40 751 250 884
Email: **digoranitis@deloittece.com**

Cristina Tache
FSI Risk & Regulatory Advisory
Manager, Deloitte Central Europe
Tel: +40 73 377 11 04
Email: **ctache@deloittece.com**

Sources:
https://finance.ec.europa.eu/news/latest-updates-banking-package-2023-12-14_en