Basel 3.1 / CRR 3

Preliminary agreement in the trilogue procedure on the new EU banking package

After a preliminary agreement was reached in the trilogue procedure between the EU Commission, Parliament and Council on 27 June 2023, nothing more stands in the way of implementing the Basel 3.1 finalisation in the EU. For credit institutions in the EU, comprehensive new regulations for determining risk-weighted assets are expected to apply as of January 2025.

Background

Basel 3.1 finalisation is being implemented in the EU through the banking package. Due to the COVID-19 pandemic, the date of first application, originally planned for 2022, was postponed. With the preliminary agreement on 27 June 2023, the trilogue between the EU Commission, Parliament and Council has now reached a provisional conclusion. Even though numerous technical details still have to be worked out, nothing stands in the way of the EU implementation of the Basel 3.1 finalisation. The CRR 3 is to apply from 1 January 2025. Institutions now have 18 months left for implementation.

The new EU banking package aims above all to strengthen the capital adequacy framework, take greater account of ESG risks in the supervisory framework, harmonise supervisory powers and instruments, and improve access to supervisory data. It takes into account numerous European specificities and supplements the more risk-sensitive risk-weighted assets (RWA) calculation with, among other things, aspects of proportionality, third-country branches and admission of members of management bodies. The political agreement in the trilogue allows for better planning of the implementation.

The preliminary agreement in the trilogue is subject to the formal approval of the EU finance ministers and the European Parliament and without prejudice to further "technical" work on the legal texts under the Spanish Council Presidency which started on 1 July 2023. Numerous other regulatory and technical standards will accompany the introduction of CRR 3 and will probably be consulted by the European Banking Authority (EBA). Both the details of the agreement and the delivery of notified EBA mandates are of decisive importance for the implementation in the institutions.

Even before the last trilogue meeting, numerous political compromises and an agreement on essential discussion topics could be reached (see table).

Final point set: output floor, fit & proper and third-country branches

In the last trilogue meeting before the end of the Swedish Presidency, an agreement was reached on the most contentious issues, in order not to jeopardise a first application from 2025 and in recognition of the EU's aspired leadership role in the implementation of the framework agreed at the global level to finalise Basel 3.1.

Output floor

As a central element of the new reform package, the output floor limits the capital benefit from the use of internal models compared to the use of standardised approaches. In the future, credit institutions with internal models for determining their risk assets must also apply the revised standard approaches to their overall portfolio. The output floor limits the RWA calculated by banks on the basis of internal models to a minimum percentage of 72.5 percent of the capital requirement calculated according to standardised approaches.

In the provisional compromise now found, the trilogue parties accept "in full" the EU Council proposal of November 2022 on the scope of application of the output floor (Art. 92 (3) and 92a CRR). According to this proposal, the output floor will be applied both at the group and individual institution level, whereby member states may waive the application at the individual institution level for domestic subsidiaries of domestic banking groups ("opt-out").

In addition to an amendment to the recitals on the output floor, the EU Commission will also receive a mandate to present a report by 31 December 2028 to assess the "overall situation" of the EU banking market. This report is to be prepared in close cooperation with the European Central Bank (ECB) and the EBA. The report should also take stock of the adequacy of the reform package, especially with regard to depositor protection and financial stability in the Member States, the Banking Union and the European Union, as well as with regard to the effects of the output floor on the institutions' capital requirements.

The EU Commission added a commitment to a "fair and balanced" assessment and consideration of different perspectives (ECB, EBA, interested parties), in particular on the application of the output floor and the waiver rules, and, if necessary, the presentation of a legislative proposal.

The introduction of the new output floor also takes place in the preliminary compromise proposal, including the (time-limited) transitional arrangements for residential real estate and companies without an external rating (Art. 465 CRR), so that EU institutions have sufficient time to adapt to the new capital requirements.

Capital and liquidity waiver

The trilogue parties also agreed "in full" on the EU Council proposal on the topic of capital and liquidity waivers (Art. 7 and 8 CRR).

The preliminary compromises on the output floor and waiver were driven in particular by concerns about undercapitalised subsidiaries of foreign banking groups, as observed in the major financial crisis of 2008. Thus, an essential competence to set the capital level of foreign subsidiaries remains at the national level.

Fit & proper

Agreement was also reached on the new regulations on fit & proper provisions/verification of the professional suitability of management bodies. Although a basic ex-ante suitability assessment will be dispensed with in future, it will nevertheless be introduced for large institutions for (newly appointed) members of the management and senior supervisory boards. The competent supervisory authorities of large institutions are to receive the application for approval at least 30 days before they take office, so that approval can be given in due time.

The agreement provides for a further specification of the submission/approval process and a further EBA mandate to review the appropriateness of the new framework by 31 December 2028.

Branches of third-country banks

With regard to the regulations for branches of banks from third countries, the compromise now found provides, among other things, for the introduction of a revised Article 21c in the CRR, which contains further important elements such as grandfathering for existing contracts and a longer implementation period. The assessment of systemic importance as well as measures for branches in third countries are to continue to be carried out at national level.

Subject area	Key agreements in the trilogue procedure on CRR 3
Output floor	✓ **Level of the scope of application (Art. 92 (3) CRR)** ✓ **Waiver on capital and liquidity (Art. 7 and 8 CRR)** ✓ Transitional provisions (Art. 465 CRR) ✓ Review of macroprudential buffers and Pillar 2 requirements (Art. 104a, 104b, 131, 133 CRD)
Operational risks	✓ Calculation of ILDC as part of the business indicator (Art. 314 (2) CRR) ✓ Calculation of SC as part of the business indicator in IPS (Art. 314 (3a) CRR) ✓ Threshold for exemption from losses (Art. 320 (1) (b) lit i. CRR) ✓ Review of loss data (Art. 322 (2) CRR)
Credit risk	✓ Off-balance sheet exposures: Credit assessment for contractual agreements, transitional arrangement UCC-CCF ✓ Bank exposures: SCRA-C, definition of risk weighting for covered bonds, due diligence requirement ✓ Delimitation of special financing ✓ Real estate exposures: Hard test for third countries, averaging of value write-ups, statistical/mathematical methods for revaluation requirements, value increase for energy efficiency measures, delimitation ADC, monitoring and valuation of real estate (Art. 208 (3a)) ✓ Permanent Partial Use (Art. 149 – 151 CRR) ✓ Participations: Privileging of state participation programmes, phasing-in of new risk weights (Art. 495a CRR) ✓ Delimitation of exposures to regional or local authorities or public bodies (Art. 115, 116 CRR)
Economic outlook and EU specifics	✓ Unrealised valuation effects on own funds (Art. 468 CRR) ✓ Treatment of sovereign debt in the currency of another member state (Art. 500a CRR) ✓ Monitoring and valuation of real estate (Art. 208, 229 CRR)
Other capital adequacy items	✓ Minority interests (Art. 84, 85, 87, respectively (1) (a) CRR) ✓ Regional government, local authorities and public bodies (Art. 115, 116 CRR) ✓ Special financing (Art. 122a (3a) CRR) and transitional provision (Art. 495b (2) CRR)
New risks	✓ Treatment of crypto-assets (incl. Art. 5a, 451b, 501x, 461b CRR) ✓ Shadow banks (disclosure and, if necessary, limitation) ✓ Integration of ESG (inter alia Art. 4 (1) lit. 152a-b, 135 (3a), 177 (2a), 193 (7a), 210 (2), 430 (1) (h), 430 (7) no. 4c, 449a, 501 cd, 501a (1) CRR. ✓ Privileged treatment of infrastructure financing (Art. 501a (1) lit o. CRR)
Other aspects of supervision	✓ Treatment of third-country branches ✓ Large investment institutions ✓ Proportionality ✓ **Fit & proper** ✓ Independence in supervision (Art. 4 CRD) ✓ Sanctions (Art. 65-57, 70 CRD) ✓ Mandates to the EBA (including reports, reviews)

Note: Bold text indicates political issues in the trilogue procedure that were contentious until the end.

What happens next?

After the preliminary agreement in the trilogue procedure, the technical elaboration of the legal texts on the compromise solutions found now follows, as well as a review of the final CRR 3 draft version. The comprehensive overview of selected controversial points shown above indicates the complexity of this task. In parallel, a translation into the 23 official EU languages is taking place. Once the final version of the EU banking package has been adopted by the EU Commission, Parliament and Council, it will be published in the EU Official Journal and enter into force as expected 20 days after publication. This is expected at the beginning of 2024.

How can KPMG help?

KPMG is closely monitoring the current legislative process on the new EU banking package and has extensive experience in supporting the implementation of Basel 3.1 / CRR 3. We have at our disposal tools and structural templates for the systematic identification of the need for action, the technical implementation support, the simulation of capital effects as well as extensive experience in the integration of the CRR 3 effects into the overall bank management.

Our teams of experienced professionals in the areas of regulatory, finance, risk and business technology will be happy to support you at the interface between technical and IT requirements in order to help you efficiently prepare for the changes.

Further KPMG Insights

Read KPMG's recent series to understand the regulatory expectations globally and the actions insitutions may wish to consider in the immediate rerm as banks around the world prepare for the implementation of Basel 3.1.

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