FELABAN Board of Directors meeting

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Strengthening bank capital standards in EU: the final phase of Basel III implementation

Dear colleagues and participants,

It is a pleasure to be back at this annual conference and congratulate the organisers for setting out to take the pulse of the EU banking sector in 2024. I am happy to provide an insight into the European Banking Authority's activity in the prudential regulation area regarding how we are building today's regulatory work for tomorrow's European banking sector.

Working today to build tomorrow's banking sector

The EBA's continued focus on the long-term resilience of the EU banking sector naturally stems from our role in upholding sound prudential standards and in ensuring consistency of the regulatory framework. My remarks today will guide you through the current state-of-play (the steps we are taking to operationalise the banking package's implementation in Europe), the preparations for tomorrow (the risk perspectives we are keeping an eye on) and our outlook for the future (what we are working towards).

The value of prudential regulation – resilience, safeguarding, stability

As the European regulator, the European Banking Authority appreciates the value of prudential regulation. It serves as a critical cornerstone in ensuring the stability and resilience of the global financial system. It also serves as a protective barrier against systemic risks and financial crises. It aims to safeguard depositor funds, mitigate the probability of bank failures, and promote the overall health of financial institutions.

Moreover, prudential regulation fosters market discipline and transparency, enhancing investor confidence and facilitating efficient allocation of capital within the banking sector. The implementation of robust prudential frameworks not only protects individual institutions from excessive risk-taking, but also contributes to the broader macroeconomic stability and sustainable economic growth.

Finalisation of Basel III – resilience and level-playing field

The finalisation of the Basel III framework marked a significant milestone in strengthening global financial regulations. This framework introduced enhanced requirements with the aim of promoting a safer and more stable banking environment post-2008 by bolstering the resilience of banks and improving their ability to withstand economic shocks. Additionally, the framework underscores the importance of international cooperation in establishing harmonised regulatory standards, ensuring a level playing field for financial institutions across jurisdictions.

The EU banking package – resilience, sustainability, and market access

The operationalisation of the European implementation of the final Basel III framework represents a significant step towards strengthening the resilience and stability of the EU banking sector. With this legislation, European banks are poised to enhance their ability to weather potential economic shocks. These reforms are not only vital for ensuring the financial sector's resilience in the face of future crises but also play a pivotal role in facilitating Europe's recovery from the COVID-19 pandemic and advancing its transition towards climate neutrality. This underscores the EU's commitment to sustainability and responsible banking practices. Additionally, the package aims to deepen and facilitate access to the EU single market, bolstering supervision tools for both EU and third-country banks operating within the region, thereby contributing to enhanced financial stability and depositor protection.

Operationalisation – Roadmap

Please allow me to now do a deep dive on how the EBA is operationalising the implementation of the Basel III framework in Europe:

The EBA plays a central role in the implementation process and is tasked with delivering on a broad spectrum of technical mandates outlined in the banking package. Through a transparent and phased approach, we are developing a comprehensive set of regulatory and implementing technical standards, guidelines, and other products necessary for the effective enforcement of the banking package.

More specifically, the banking package granted the EBA 140 mandates, primarily consisting of technical standards (60), guidelines (29) and reports and opinions (37). In addition, the EBA is tasked with the development of several operational products useful for the level playing field and regulatory disclosure across the EU as well as towards efficiency gains, such as the establishment, the publication and the maintenance of various lists and databases including the EBA Data Hub (14).

To provide clarity to stakeholders on how we will develop the mandates implementing the legislation, we published in December 2023 our Roadmap for delivering on the level 2. This Roadmap lays out a meticulous plan spanning across four phases and details the sequencing and prioritisation of mandates to ensure timely implementation while addressing operational challenges. The principles we based the design of our Roadmap on were: i) giving priority to mandates in need of swift implementation – those that are vital for implementing Basel standards in Europe, ii) delivering within two years from entry into force and iii) grouping mandates to optimise finalisation.

Moreover, the EBA's commitment to stakeholder engagement and transparency is evident through our proactive approach in consulting with industry participants and regularly updating on our progress. As we move to this operationalisation phase, we remain dedicated to fostering cooperation among all stakeholders to navigate potential bottlenecks and deliver high-quality policies that align with the EU's overarching objectives of financial stability, sustainability, and market efficiency.

Operational risk

We already had to opportunity to witness this process at work when we published the first series of consultation papers, of which some dealt with operational risk mandates. Operational risk is one of the areas in the CRR3 which has gone through a complete overhaul, with substantial ramifications for the reporting framework. The priority was given to the mandates essential for the implementation of the Basel standards in Europe and in February 2024 we consulted on all the draft technical standards concerning the calculation of the Business Indicator, the main indicator used for the calculation of capital requirements for operational risk. At the same time, reporting templates were developed in a synchronised manner to reflect the policy stances.

An important area for operationalisation: reporting

In the area of supervisory reporting and Pillar 3 disclosures, the EBA is following a two-step sequential approach, prioritising in Step 1 those mandates and changes driven by the CRR3/CRDVI necessary to implement and monitor Basel III requirements in the EU, including the updated Pillar 3 framework (BCBS DIS). Any other topics which may be stable and suitable to be integrated at this state stage will also be included in Step 1. As part of Step 2, the EBA will implement those reporting and disclosure requirements not linked to Basel III implementation, together with those requirements that depend on other level 2 substance policy mandates with an extended development timeline. Coordination between the development of the reporting and the disclosure requirements will be ensured in the process.

The consultation papers on both disclosures and reporting for Step 1 were published on 14 December 2023. These consultation papers cover all the topics, except crypto assets and operational risk. The latter was consulted in February 2024 together with the consultation of the policy work (namely consultation on draft RTS and ITS that specify the components and excluded items from the Business indicator, specify the mapping to supervisory reporting and considerations on mergers, acquisitions and disposals), due to the high connection between disclosure/reporting requirements on operational risk and these Level 2 mandates. The publication of the two final draft ITS for Step 1 disclosure and reporting is expected in June/July 2024. It will cover all step 1 relevant topics, including the transitional provisions for crypto assets exposures. The first disclosure reference date is foreseen to be 31 March 2025.

Keep an eye on coherent implementation across jurisdictions

The movement towards the implementation of the Basel III framework in a harmonised manner across jurisdictions is paramount for ensuring global financial stability and fostering a level playing field within the banking sector. Harmonized implementation of Basel III standards facilitates consistency and comparability across regulatory regimes, thereby reducing regulatory arbitrage and enhancing market efficiency. Moreover, aligning regulatory frameworks enables banks to operate seamlessly across borders, promoting financial integration and supporting the smooth functioning of international financial markets.

The EU authorities monitor closely the implementations in the other major jurisdictions, both in terms of application of the discretions foreseen in the Basel accord as well as in terms of timing in its implementation. We at the EBA have always supported a faithful and timely implementation of the Basel III framework and we have always maintained that achieving internationally consistent standards is only possible via international convergence and trust across all jurisdictions. Hence the need to improve transparency of this implementation in other jurisdictions.

Future risks – EBA outlook for 2024

Now you may ask "What about the future?" – and you would be absolutely right! As a banking supervisor, you always hope for the best, while preparing for the worst. We draw up a risk plan with the EBA every year. This year, beyond the operationalisation of the EU banking package, we will focus on: managing all risks related to interest rates; banks' sustainability efforts; and technological advancements in the banking sector.

IRRBB

One of our tasks is to ensure that banks are managing interest rate risk appropriately and prudently. This is an area in which we've been very active for the last two years, together with the ECB in its supervisory work, to ensure that banks' management of interest rate risk is prudent. As part of last year's stress test exercise, for all banks in the sample we published the size of the portfolios that had the highest yield-to-maturities. We explained the size of the portfolios, the hedges that had this type of interest rate to address the risk, and the size of the accumulated losses not yet declared, to give the market transparency.

Finally, with the publication of the regulatory framework on IRRBB in the past years (guidelines, technical standards, reporting and disclosures frameworks), the EBA communicated around its scrutiny plans for IRRBB to monitor the impact on banks from further increases in policy rates, including its interaction with the management of the interest rate risk from a prudential perspective. On January 24, 2024, the EBA published its heatmap following scrutiny of IRRBB standards implementation in the EU. The heatmap incorporates three sections, which describe: i) the regulatory framework for IRRBB in the EU; ii) the EBA scrutiny plans and the work undertaken to date; and iii) the main areas of scrutiny identified with the corresponding actions/timelines. The work undertaken so far highlights that there are some policy aspects that need further scrutiny, including proportionality aspects where relevant, via the QIS/ITS, and continuous exchanges with regulators/supervisors and professional associations and institutions, according to timelines in the short/medium or medium/long terms.

Sustainability

Scientific evidence suggests that climate change and environmental degradation, and the associated need to transition to an environmentally sustainable economy, will lead to significant changes in the real economy that will in turn impact the financial sector through new risks and opportunities. Sound ESG risks management is needed as only a robust banking sector can effectively fund the transition towards a sustainable European economy. Remarkable progress has been achieved in risk management and governance practices, especially regarding climate – related financial risks. However, much remains to be done. It may seem daunting, but in practice, there is a lot of proportionality and phasing-in embedded in the regulatory approach.

How can we ensure an effective prudential framework for ESG risks, and what are the actions taken by the EBA? The EBA has an important role in providing the supervisory tools towards supporting the European banking sector towards the objectives of transitioning to a more sustainable economy and mitigating risks stemming from climate change and broader ESG factors. We are addressing our regulatory mandates in a holistic and sequenced approach, covering all three pillars of the prudential framework (disclosures, supervision/risk management, prudential treatment) as well as other areas related to ESG risks and sustainable finance (e.g. fighting greenwashing, standards and labels, monitoring ESG risks). The EBA's agenda is set out in the EBA roadmap on sustainable finance and ESG risks, published in 2022.

To reflect the growing importance of ESG risks, the banking package introduces several provisions aimed at accelerating the integration of ESG risks across all three pillars. Several mandates for the EBA are introduced, covering topics such as supervisory reporting, disclosures, stress testing, and the prudential treatment of exposures. Many of these mandates were anticipated and included in the EBA roadmap on sustainable finance outlining key objectives and timeline.

Finally, regulators and supervisors are committed at the international level to delivering an effective prudential framework to facilitate this transition. The EBA supports and contributes to international and European initiatives on ESG risks and sustainable finance, including BCBS work and initiatives from the European Commission (such as the Platform on sustainable finance).

Technology

From an EBA perspective, the cyber and innovation agenda can be divided into: i) implementing existing legislation: DORA and MiCAR; ii) taking forward the EBA's thematic priorities on innovative applications in 24/25; iii) monitoring of policy initiatives; and iv) ensuring that supervision keeps up with technological advances.

DORA entered into force on 16 January 2023, starting the clock on the ESAs' delivery of 13 joint products (8 RTS, 2 ITS, 2 GL, and 1 report). The first batch of DORA policy products was submitted to the European Commission on 17 January 2024. The public feedback received during the public consultation on the second batch of DORA policy products is being assessed by the ESAs and will contribute to the finalisation of the products to be submitted to the European Commission in July 2024. The EBA is also in full implementation mode following the entry into force on 29 June 2023 of MiCAR. Under MiCAR, the EBA has 20 Level 2 and Level 3 mandates. All but one of these must be completed by end-June 2024. The EBA has so far published for consultation 19 of the 20 mandates under MiCAR (as of March 2024), and consultations are now closed for 17 of those mandates. The final consultation paper, on the joint-ESA guidelines on the classification of crypto-assets, will soon be published as well.

Under MiCAR the EBA also has responsibility for supervising issuers of significant asset-referenced and e-money tokens (and those issuers who voluntarily submit to EBA supervision). This supervision function will be activated from (and including) Q4 2024, albeit it remains to be seen if there will be any issuers of significant ARTs/EMTs to be supervised. This supervisory work will start in 2025. But active engagement is already taking place to ensure coordination and proper preparation.

Beyond the policy and supervisory work in DORA and MICAR, the work that we will be doing around technological innovation during the next twelve months focuses on monitoring the most salient trends. I envisage thematic work from the EBA in three broad areas encompassing: (i) tokenisation, crypto and DeFi, (ii) artificial intelligence/machine learning, and (iii) value chain evolutions.

Beyond these areas of thematic focus, and as a final remark, I would draw attention to our ongoing efforts to facilitate dialogue between industry and supervisors on RegTech and SupTech developments, not only to foster the development of complementary technologies, but to 'deep dive' into specific cases that could support EBA and competent authorities in performing the new oversight and supervision tasks under MiCAR and DORA. This is important work to ensure that, as a supervisory community, we too reap the benefits of innovation in the performance of these tasks, and in other areas, such as the sustainable finance initiatives.

Conclusion

In the end, I would like to leave you with my belief and hope that the completion of the BU will remain a high priority for Europe. The recent crisis cases have reminded us of the crucial importance of completing the Banking Union, particularly the importance of establishing an European Deposit Insurance Scheme (EDIS), as this is an essential step to reduce fragmentation and divergences across the Banking Union. A completed Banking Union, with an upgraded crisis management and EDIS is necessary to improve the resilience of the safety nets, further reinforce depositor confidence and allow the sector and the wider economy to truly benefit from the Banking Union and the Single Market.

I am hopeful that a successful strengthening of the EU crisis framework via the CMDI review could help move forward and in a pragmatic way, towards the completion of the Banking Union.