Press Release

Date **FOR IMMEDIATE RELEASE: 23rd November 2016**

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EU proposes changes to finalise Basel III and start implementing Basel IV

On Wednesday, the European Commission published its first proposals for revised rules to calibrate capital and liquidity requirements – in the form of a Directive and a Regulation ("CRD V"& "CRR II"), as well as amendments to the bank recovery and resolution Directive ("BRRD"), to implement global standards for total loss absorbing capital.

These proposals, which will be subject to further discussions with the EU Parliament and Council, represent Europe's attempt to legislate for rules being globally agreed at the Basel Committee for Banking Supervision (BCBS). For the most part, the Commission's proposals seek to implement the Basel III proposals with only limited differences in scope, timing and calibration, together with the first parts of what the banking industry community refers to as Basel IV. With this update, the Commission is also introducing the concept of "proportionality", so reporting and compliance burdens are simplified for Europe's smaller, less risky banks. Colin Brereton, PwC's EMEA FS advisory services leader says: "Europe's move to implement 'proportionality' is an important step, especially for the large number of smaller institutions in the EU. As in the US, the largest EU banks will remain subject to the full scope of regulation; ultimately, this should improve the ability of smaller banks to compete, to the benefit of bank customers."

The new rules contain, amongst other priorities, the introduction of a minimum leverage ratio (of 3%), as well as a binding liquidity requirement to ensure stable funding of banks' activities (a Net Stable Funding Ratio - NSFR), both of which would take effect in 2019. Of the so-called 'Basel IV' ruleset, the EU is planning to implement new capital and margin rules covering derivatives and market risks inherent in banks' trading activities. Together with the new bail-in capital rules to protect tax payers in the event of bank failures, and the implementation of new rules to account for non-performing loans (IFRS 9), "This could lead to a substantial increase of capital requirements and require huge efforts at implementation, due to their high complexity", says Martin Neisen, Partner and Leader of the global Basel IV initiative of PwC. These revisions are set to come into force from 2019, with some only fully implemented by 2022, a bit later than the BCBS had recommended.

Europe has been concerned to ensure that new capital requirements would have a sufficient lead-in period to minimise potential transitional impacts on the financing of economic growth across the Union. To that effect, the proposal includes, for instance, a phase-in period for the Fundamental Review of the Trading Book ("FRTB") implementation. The Commission's NSFR proposal also provides specific treatments for some instruments such as low risk covered bonds and trade finance, amongst others. Importantly, the new rules also include a provision to require non-EU banks operating multiple subsidiaries in the EU to form new EU-based 'intermediate holding company', a move which could have specific implications for international banks operating their EU base from the UK.

From an even broader international perspective, transatlantic discussions about new capital requirements remain complex and could change if the incoming US Administration takes a significantly different approach to that of the previous Administration. The Basel Committee had previously suggested that an agreement on the new credit and operational risk rules could be reached by the end of 2016. European officials will now be closely following developments in the US to understand the scope for completing implementation of Basel IV rules there, as a basis for providing the global consistency envisaged under the BCBS process.

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