EUROPEAN COMMISSION

Commissioner Mairead McGuinness
Financial Services, Financial Stability and Capital Markets Union

Brussels, 18 February 2022
Ares(2022) 4553107

Dear [redacted] and [redacted],

Thank you for your letter of 12 July 2021, in which you outlined your concerns on the then-forthcoming implementation of the final elements of Basel III, in particular with regard to the implications the output floor may have on real estate exposures. Commissioner Gentiloni has received your letter and has asked me to reply to you on his behalf.

You have also kindly shared with us your own study on the impact of the revised Basel III framework and of the output floor on individual real estate exposures. In light of that study, you expressed your support to implement the output floor based on the so-called parallel stack approach.

As you know, the Commission adopted its legislative proposal to implement the outstanding elements of the Basel III reform on 27 October 2021. In doing so, the Commission has been carefully analysing the impact that the implementation of the standards will have on the ability of banks to finance the EU economy, especially in the post pandemic context.

One of the key policy questions for the legislative proposal was certainly the design of the output floor. According to the Basel standards, the output floor has two broad objectives, which are inherently linked: i) to reduce the excessive variability of capital requirements for the same risks and ii) to enhance the comparability of the risk-weighted capital ratios. The approach proposed by the Commission maintains the existing CRR logic of one single capital stack for risk-based capital requirements. Moreover, this approach reflects the logic and objective of the output floor as agreed in Basel.

The European Central Bank has conducted a study on the macroeconomic impact of the Basel III finalisation in the euro area. The study concluded that the moderate transitory costs

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of the reform are outweighed by its permanent long-term benefits. Banks will be in a better position to absorb losses in adverse economic conditions and will face lower funding costs. This would result in a permanent long-run increase in economic resilience and a permanent upward shift in the lower tail of the GDP growth distribution, according to the study. The ECB also outlined that a possible implementation of the output floor as a parallel stack approach would have markedly reduced the long-run economic benefits of the reform.

Under the Commission proposal, to ensure a smooth and gradual application of the new prudential regime, the output floor itself will be gradually introduced from 1 January 2025 over a period of five years. In addition, the Commission proposed some targeted transitional provisions to further spread out the impact of the output floor over up to eight years. Banks should thus have sufficient time to adapt to the new prudential regime and to adjust their balance sheets to the steady-state treatment.

The Commission is of the view that the legislative proposal would deliver on the commitment to implement faithfully international standards, contribute to making the banking sector more resilient, and support the financing of the EU economy.

We look forward to a continued good cooperation with you on this important topic.

Yours sincerely,

Mairead McGuinness