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Copenhagen Economics presents its impact analysis of proposed Basel III finalisation in EU

BRUSSELS, 22 November 2019 – Copenhagen Economics, a leading economic consultancy, has analysed the impact of the 'Finalisation of the Basel III capital requirements' at the request of the European banking sector through the European Banking Federation and a group of national banking associations. It is the first time that the full economic impact of Basel III has been calculated.

The Basel III finalisation package was agreed by the Basel Committee on Banking Supervision, the body that sets global standards, in December 2017. The package includes new capital floors for banks that define a minimum level of capital for different types of portfolios. The European Union is currently considering how to transpose this agreement into European law.

The European Banking Federation, as voice of the European banking sector, believes that a balanced implementation of the Finalisation of Basel III in the EU is essential in order to prevent potential growth risks to the European economy. As the Copenhagen Economics report points out, Basel III could reduce the investment potential of European businesses while increasing costs for households with mortgages and businesses with bank loans. Furthermore, it could distort the global level playing field in banking.

Says Wim Mijs, Chief Executive Officer of the EBF:

"This Copenhagen Economics report is an important reminder of the economic risks we face if specificities of banking in Europe are not duly considered. In its transposition of Basel III the EU needs to strike the right balance. An unbalanced implementation would undermine the EU's capacity to finance its economy."

The Basel Accord of December 2017, also called 'the Basel III endgame', is one of the most debated regulatory frameworks in recent years. The accord was supported by the G20 Finance Ministers and Central Bank Governors Meeting, under the condition: "We confirm our support for the Basel Committee on Banking Supervision's (BCBS) work to finalise the Basel III framework without further significantly increasing overall capital requirements across the banking sector, while promoting a level playing field."

The accord sets out revised international standards, which are now to be implemented on a European level. A recent impact assessment from the European Banking Authority (EBA) has shown that the Final Basel III Framework could lead to a significant increase in capital requirements for European banks. Furthermore, economic research has shown that significant shifts in capital requirements can entail significant real-economy costs and benefits in terms of financial stability.

Thus, it is important that EU legislators and stakeholders make decisions about the implementation of the Final Basel III Framework on a well-informed basis. This includes considering the economic costs and benefits of the different options of implementation, to ensure that the package delivers net economic benefits to society.

Against this backdrop, the European Banking Federation and a group of banking associations have invited Copenhagen Economics to analyse the impact of the Final Basel III Framework on European households, businesses and the real economy. Their analysis assesses if the proposed EU implementation fulfils the original spirit of the G20 mandate and if the implementation delivers net benefits to society, based on an economic cost-benefit analysis.

When calculating the impact on the real economy, Copenhagen Economics considered higher lending costs for households and businesses as well as the marginally positive benefit of an even more conservative framework for capital requirements. The net costs are projected at 0.4% of Gross Domestic Product, based on 0.1% of GDP in benefits and a reduction of 0.5% of GDP due to a decline in investments.

"We find that the costs clearly outweigh the benefits," concludes Copenhagen Economics. *"There are increasing costs and declining benefits of higher capital requirements. The task for policy makers is to balance these costs and benefits to provide a net benefit for society."*

Copenhagen Economics said the benefits of even further reductions in the risk profile for banks are limited as many new bank capital requirements already have been introduced in the decade following the financial crisis. *"The post-crisis reforms increase capitalisation of the European banking sector to a level where there are limited marginal benefits of further increases,"* it said.

'EU Implementation of the Final Basel III Framework; Impact on the banking market and on the real economy.' Published by Copenhagen Economics, November 2019.

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