Basel Committee
on Banking Supervision

Basel III regulatory consistency assessment (Level 2)

Preliminary report: European Union

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BANK FOR INTERNATIONAL SETTLEMENTS

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Foreword

This report presents the conclusions of the Basel Committee's Basel III[1] Regulatory Consistency Assessment ("Level 2") of the European Union (EU). The assessment in this report has been based mainly on the 5th Council Presidency's compromise proposal agreed on 15 May 2012.[2] Considering the draft nature of the compromise proposal and in accordance with the Committee's agreed procedures for conducting a Level 2 assessment,[3] **this assessment is considered preliminary**. A follow-up assessment will take place once the EU authorities have published the final rules that implement Basel III.

The report is based on information available at the time it was completed on 22 August 2012. The assessment was conducted over a six month period from March to August 2012, including face-to-face discussions in April 2012 and an on-site visit in July 2012. The preliminary findings of this assessment were published in a June report to the G20 leaders.[4] The assessment team consisting of six international experts was led by Mr Charles Littrell, Executive General Manager, Policy Research and Statistics, Australian Prudential Regulation Authority.

For purposes of this Level 2 assessment of the EU, the European Commission (EC) served as the assessment team's main counterpart. The bank data analysis that forms part of the assessment was coordinated directly with the nine BCBS member countries that are also members of the EU.[5] The EC, as well as representatives from the nine EU-BCBS member countries, the European Banking Authority (EBA) and the European Central Bank (ECB) participated in the meetings that were organised as part of the EU review.

The assessment team sought data and supplementary information from a sample of large internationally active banks operating in the nine EU-BCBS member countries to assist in the materiality analysis. However, given the tight timeframes and competing priorities for European banks and bank supervisors, the team did not receive complete and consistent data from all the banks. As a result, the assessment team was not able to undertake a comprehensive quantitative materiality assessment within the available time. The assessment team's materiality conclusions are therefore primarily based on qualitative expert judgement, augmented by data where applicable. The follow-up assessment should address the data limitations regarding materiality assessments.

Furthermore, it should be noted that the current assessment excludes certain sections of the Basel III rules that are under review or are being finalised by the Basel Committee. In particular, the leverage ratio, the liquidity ratios and the framework for global systemically

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1 Basel III builds upon and enhances the regulatory framework set out under Basel II and Basel 2.5 (ie the July 2009 enhancements to Basel II), which now form integral parts of the Basel III framework. The assessments thus cover the full set of components, including those introduced by Basel II and Basel 2.5. This full set of requirements is collectively referred to in this report as "Basel III" or the "Basel framework".

2 See www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/130264.pdf

3 The Committee's Level 2 assessment process is described in the document *Basel III regulatory consistency assessment programme*, available at www.bis.org/publ/bcbs216.htm.

4 The *Report to G20 Leaders on Basel III implementation* is available at www.bis.org/publ/bcbs220.htm.

5 The nine countries are Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden, and the United Kingdom.

important banks (G-SIBs) have not been assessed. The EU's implementation of these rules will be assessed once they are finalised by the Basel Committee.

The report has been written in accordance with "exception-based reporting", ie it focuses on deviations that could lead to a less robust capitalisation of the banking sector than would otherwise have been achieved if the Basel framework had been implemented in full. As such, areas of compliance are not explicitly addressed, nor are domestic measures that strengthen the minimum requirements. However, assessed jurisdictions were given the option to provide information on "super equivalence" to be included as an annex of the present document. This information on measures to strengthen the minimum requirements has not been assessed nor are they endorsed by the assessment team.

This Level 2 assessment report is part of a comprehensive review programme adopted by the Basel Committee that comprises the following three levels:

- Level 1: ensuring the timely adoption of Basel III

  The objective of the "Level 1" assessment is to ensure that Basel III is transformed into law or regulation according to the agreed international timelines. It focuses on the domestic rule-making processes and does not include the review of the content of the domestic rules. The Level 1 assessment is the foundation for the assessments at the other levels.

- Level 2: ensuring regulatory consistency with Basel III

  The "Level 2" assessment process assesses the compliance of domestic regulations implementing Basel III with the international minimum requirements defined by the Basel Committee. By identifying domestic regulations and provisions that are not consistent with the rules agreed by the Committee and by assessing their potential impact on financial stability and on the international level playing field, this process will promote full and consistent implementation of Basel III. It will also facilitate an effective dialogue among members and provide peer pressure if needed. The conclusions following each jurisdiction's assessment will be published by the Committee. This assessment programme supports the Financial Stability Board's monitoring of the implementation of the agreed G20/FSB financial reforms and is consistent with the "Coordination Framework for Monitoring the Implementation of Agreed G20/FSB Financial Reforms" put in place by the FSB.[6]

- Level 3: ensuring consistency of risk-weighted assets

  The objective of the "Level 3" assessments is to ensure that the outcomes of the new rules are consistent in practice across banks and jurisdictions. It extends the analysis of Levels 1 and 2, which focus on national rules and regulations, to supervisory implementation at the bank level. This work is currently focusing on the review and validation of how banks calculate their risk weighed assets.

The Level 2 assessment methodology includes the following key elements:

- The Level 2 assessment is factual in nature and focuses on reviewing the completeness (all required Basel III provisions have been adopted) and consistency

[6] See the "*Coordination Framework for Monitoring the Implementation of Agreed G20/FSB Financial Reforms*" put in place by the FSB at www.financialstabilityboard.org/publications/r_111017.pdf.

(differences in substance) of domestic regulations (ie binding documents that effectively implement Basel III independent of their label).

- When a gap or difference is identified, a key driver for assessing compliance is its materiality and impact.
- To the extent possible, the materiality and impact is quantified using all available data, including those submitted by the jurisdiction being assessed. The assessment, in particular, seeks to measure the significance of any identified difference(s) for internationally active banks. The assessment considers the current impact and consequences, but also the potential impact of the difference(s) in the future. The assessment team might also perform its own estimations and analyses, using all available sources of information and including in particular the Basel Committee's Quantitative Impact Study (QIS) and Capital Monitoring Group (CMG) data.
- Specificities and drivers of local implementation are not taken into account when assessing compliance: local specificities are not seen as mitigants for going beyond the scope of national discretion specified within Basel III.
- Domestic measures that strengthen the minimum requirements are not considered to compensate for inconsistencies or gaps identified elsewhere, unless they fully and directly address the identified inconsistencies or gaps.
- The level 2 assessment is limited to regulatory issues and does not consider supervisory or bank practices. The extent to which Basel III is effectively enforced by supervisors or whether firms are actually complying with the Basel III framework is assessed as part of the Level 3 assessment process.

All Level 2 assessments are graded using a four-grade scale: compliant, largely compliant, materially non-compliant and non-compliant:

- Compliant: all minimum provisions of the international framework have been satisfied and no material differences have been identified;
- Largely compliant: only minor provisions of the international framework have not been satisfied and only differences that have a limited impact on financial stability or the international level playing field have been identified;
- Materially non-compliant: key provisions of Basel III have not been satisfied or differences that could materially impact financial stability or the international level playing field have been identified; and
- Non-compliant: Basel III has not been adopted or differences that could severely impact financial stability or the international level playing field have been identified.

The assessment team would like to thank the many Europeans who contributed to this exercise. The EC coordinated the work on behalf of the EU countries, and material assistance was received from the EBA, the ECB and the Basel Committee member agencies from the nine EU countries.

The assessment team leader also thanks the assessment team members, the agencies contributing these staff and staff from the Basel Committee Secretariat for their valuable contributions.

Assessment Team

Team Leader:

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Ms Margaret Griffin	Reserve Bank of New Zealand
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Supporting members:

Mr Juan-Carlos Crisanto	Basel Committee Secretariat
Mr Rajinder Kumar	Basel Committee Secretariat
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Executive summary

This report by the Level 2 assessment team for the European Union (EU) is applicable across the EU. Consistent with the application of the Basel framework, the assessment team considered the application of the EU regulations to “internationally active” banks.[7] The assessment is based on draft EU level regulations. To assist in determining materiality, the assessment team used data from banks in nine countries that are members of both the Basel Committee and the EU. The countries are: Belgium, France, Germany, Italy, Luxembourg, the Netherlands, Spain, Sweden, and the United Kingdom. For a limited number of issues involving supervisory discretion, the assessment team also sought views from the nine member countries. There was no data or other input from the EU Member States that are not Basel Committee members. Any observations in this assessment based upon data gathered should be read only as directly applicable to the nine Basel Committee members of the EU.

Status of EU rules texts

The EU implemented Basel I, Basel II and Basel 2.5 by Capital Requirements Directives (CRDs), which required transposition by Member States into their domestic legislation. With the implementation of Basel III, the EU has proposed a Capital Requirements Regulation (CRR) that does not require transposition into national legislation to ensure a common application in all Member States. The proposed CRR, together with a new CRD, will replace the existing CRDs. However, both proposed instruments are still in draft.

In line with this, the current Level 1 assessment on the European Union indicates the following status of Basel II, Basel 2.5 and Basel III implementation:

Rules	Grading	Next steps – Implementation plans
Basel II	4	
Basel 2.5	4	
Basel III	2	5th Council Presidency's compromise proposal agreed on 15 May 2012; Draft European Parliament Legislative Resolution agreed on 14 May 2012; The European Parliament, Council and the Commission currently in discussions to agree on a final text

1 = draft regulation not published; 2 = draft regulation published; 3 = final rule published; 4 = final rule in force. Green = implementation completed; Yellow = implementation in process; Red = no implementation.

[7] Paragraph 20 of Basel II notes that “(the) Framework will be applied on a consolidated basis to internationally active banks.” See Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version (June 2006) available at www.bis.org/publ/bcbs128.htm.

For the purpose of this exercise, the assessment team evaluated compliance based on the Fifth Danish Compromise version of the CRDIV and CRR, agreed on 15 May 2012. The European Parliament has since published further updates to the documents and finalisation is expected by October 2012. Furthermore, the proposed CRR includes substantial references to technical standards and guidance to be developed by the European Banking Authority (EBA). A number of legally binding technical standards, mostly pertaining to the definition of capital, have been released for consultation and the assessment team has taken these draft standards into account in its review. A large number of technical standards, however, have yet to be drafted.

Accordingly, consistent with the Level 2 assessment process agreed by the Basel Committee, this assessment should be regarded as preliminary and will be supplemented at a later stage by a follow-up assessment when the EU rules are final and complete.

Compliance assessment

The Level 2 methodology has identified materiality and impact as a key driver for assessing compliance. For identified gaps and differences between Basel and the proposed EU rules, therefore, the assessment team has sought to quantify materiality to the extent possible. In addition, the assessment team not only considered current impact and consequences of the differences, but also their potential impact in the future.

For overall compliance, the assessment team also took account of the impact on capital ratios where a bank adopts the proposed EU rules in full instead of following Basel in full. This measure was helpful for the assessment team to understand the potential aggregate impact of a large number of individually immaterial differences. To this end, a group of 33 banks, chosen based on a combination of asset size and cross-border importance, was asked to calculate Common Equity Tier 1 (CET1), Tier 1 and Total capital ratios based on the full Basel rules and separately based on the proposed EU rules. Given the tight timeframes and competing priorities for European banks and bank supervisors, substantially complete data was received from 13 banks only.

Incomplete data has hampered the quantification process (as explained in Section 1 under *Data for materiality assessment*). In recognition of the limitation, the team refrained from using the data outcomes as the sole driver to determine materiality. Instead, the team used the submitted data in a directional way to supplement the judgement of the team experts. The full team has confidence that the data available was adequate as a secondary input to either:

1. confirm the team experts' views on items judged to be insignificant, where banks have reported nil or near zero quantitative effects; or

2. reinforce the team experts' concerns that the identified differences could be potentially material, with the submitted data showing substantial variances for some individual banks.

In accordance with the Basel Committee's methodology, the EU specific circumstances, and surveillance and enforcement by national supervisors or the EBA, are not considered for the purpose of this Level 2 assessment.

Assessment findings

Overall grading

As explained in the Foreword, considering the draft nature of the EU proposed rules that implement Basel III, this assessment is considered preliminary and therefore no overall grading has been assigned at this stage. Once the final domestic regulations are published and the follow-up assessment has been carried out, an overall grading will be assigned in line with the Level 2 assessment process agreed by the Basel Committee.

Sectional gradings

Using a standardised assessment format, the assessment team has provided compliance ratings on 14 key components of the Basel framework. Information on findings and compliance ratings for each of the 14 elements is given in more detail later in this report.

The assessment team has assessed 12 of the 14 key components as either "Compliant" (C) or "Largely Compliant" (LC). However, the proposed EU approach falls substantially short of the Basel framework in two areas: Definition of capital and the Internal Ratings-based (IRB) approach for credit risk. These components have been graded as "Materially Non-compliant" (MNC).

This finding does not mean that every European bank's reported capital ratios are materially higher than would be the case under full compliance with the Basel framework. In the limited sample of 13 internationally active banks available to the assessment team, for example, 10 banks reported CET 1 ratio overstatements ranging from 0 to 50 basis points. On the other hand, three of these banks reported CET1 ratio overstatements relative to the Basel framework exceeding 100 basis points. Furthermore, current pro forma differences may understate the degree to which European bank capital ratios would vary from the Basel framework with the passage of time, as banks could be expected to optimise their arrangements to meet the CRDIV/CRR requirements rather than to fully comply with the Basel framework.

The Basel reforms to strengthen the global capital rules are aimed at achieving both a high quality capital base and a consistent definition of capital across jurisdictions. These factors are present in the EU's implementation of the Basel definition of capital rules, with comprehensive transposition of the Basel capital criteria and adjustments into the proposed CRDIV/CRR. However, the assessment team has identified gaps and differences where key Basel attributes have been either omitted or modified in the implementation process. These deficiencies are described in the "Key issues" and the "Detailed findings" sections below.

In response to the preliminary June 2012 report to the G20 Leaders and the on-site discussions, the assessment team received feedback from the EC and EU-Basel Committee members asserting that some departures from the Basel standard were necessary to accommodate certain constraints, often arising from national legislation, in the EU's different Member States. Where relevant, the rationale is noted in the respective findings set out below but was not taken into account when assessing compliance, in accordance with the Level 2 assessment methodology agreed and published by the Basel Committee.

The draft CRR has introduced safeguards to limit the effect of these omissions/modifications and the assessment team has given these safeguards due consideration. Putting aside supervisory enforcement practices and monitoring measures by the EBA, which are not within the scope of the level 2 assessment, the team is concerned that internationally active EU banks could take advantage of the modified rules in their capital structure. This potentially has material impact both in terms of financial stability and an international level playing field.

The assessment team's grading of the EU's implementation of the IRB approach to credit risk is largely based on the European application of permanent partial exemptions for material exposure portfolios. The EC has explained that the permanent partial exemption was not meant for internationally active banks. The data analysis, however, indicates a material proportion of exposures under the permanent partial exemption in many banks in a number of EU Member States, with the majority of credit exposures subject to the exemption zero risk weighted.

Main specific issues

Definition of capital

1. The CRR definition of CET1 for joint stock banks includes the 14 Basel framework criteria,[8] but does not specify that the criteria must be met by common shares. The EC's explanation for the omission is that as company law is not harmonised among the EU Member States, there is no common definition of the term "common share" for the CRR to reference. To discourage instruments other than common shares being included in CET1, Recital 53 of the CRR states that "it is expected that credit institutions or investment firms whose shares are listed on an EU regulated market should meet their capital requirements regarding the core elements of capital with those listed common shares that meet a strict set of criteria for the core capital instruments and the disclosed reserves of the institution only". The assessment team's view is that the lack of specification in the CRR itself potentially leaves open the possibility for the development of instruments, in addition to "common shares", to qualify as CET1 in the EU. Even if the Recital is regarded as legally binding, it is expressed as an expectation rather than a requirement and does not deal with non-listed entities. As a further safeguard, the EBA is tasked to establish, maintain and publish a list of the instruments that qualify as CET1 in each Member State and to notify the EC immediately where there is significant evidence of material deterioration in the quality of the listed instruments. As such, the EBA listing is an ex-post measure to facilitate monitoring of approval practices in Member States. The assessment team is concerned that "new" instruments on the list would be copied quickly as Member States race to level the playing field within the EU, but at a level potentially below the international playing field.

2. The CRR has modified three of the 14 criteria for application to mutuals and cooperatives. The EC explained that the modifications are necessary to accommodate governing laws for mutuals and cooperative banks in some Member States. This is consistent with the Basel Committee's stipulation that application of the CET1 criteria can take into account the specific constitution and legal structure of non joint stock companies. However, Basel is very specific that "the application of the criteria should preserve the quality of the instruments by requiring that they are deemed fully equivalent to common shares in terms of their capital quality as regards loss absorption and *do not possess features which could cause the condition of the bank to be weakened as a going concern during periods of market*

[8] These criteria are set out from paragraph 53 of *Basel III: A global regulatory framework for more resilient banks and banking systems* (revised version June 2011), which is available at www.bis.org/publ/bcbs189.htm.

stress".[9] In this regard, the assessment team found the CRR modifications to limit the CET1 holders' claims and restrict maximum level of distributions both acceptable, but had difficulty with the modification to allow co-operative banks to issue instruments redeemable at the option of the holder and include them as CET1. The team also considered redemption limitations proposed in the draft EBA technical standards but is concerned that if an institution has historically met all requests for repayment of a capital instrument, it would be very difficult for the institution itself to delay or limit repayment without undermining confidence in the institution and putting it under additional stress. Also, any exercise of supervisory discretion to prohibit a non joint stock bank from repurchasing its capital instruments would also likely increase the market pressure on an already stressed institution.

3. The Basel framework's treatment of minority interests limits the amount that can be recognised in capital at the group level. The CRR proposes a more generous treatment of minority interests for inclusion in the parent's capital as it allows the systemic risk buffer, the Pillar 2 buffer and the countercyclical buffer to be taken into account when calculating the amount of minority interest to be recognised in the consolidated capital. Inclusion of the first two buffers will likely have the effect of causing some permanent deviation vis-à-vis Basel rules, which could increase further in a situation where the countercyclical capital buffer is also in place. The materiality would depend on the size of the Pillar 2, the countercyclical and systemic risk buffers applicable to the consolidated subsidiary from which the minority interest arises.

4. The Basel framework requires derecognition from CET1 of all unrealised gains and losses from changes in fair value liabilities due to changes in a bank's own credit standing. The proposed CRR allows an offset for changes in fair value of hedges or other financial instruments also due to changes in the bank's own credit standing. This difference could be highly material for a bank in financial difficulty that has attempted to hedge its own credit position. The limited data review undertaken for this element has already identified one bank with an offset amounting to more than 10% of its CET1.

5. Basel has adopted a broad definition of "indirect holdings" to minimise double gearing. The CRR proposes a narrower definition of "indirect holding", opening up the potential for a bank to avoid any deduction of its exposures to the capital of another financial institution. This is apparently an inadvertent outcome in the proposed CRR, but is nonetheless a deficiency that has potential material impact on the international level playing field.

6. The CRR proposes to allow banks to consolidate significant investments in insurance entities as an alternative to deducting the investments from CET1. In addition, the CRR has stipulated that the EBA, European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA) should jointly develop regulatory technical standards to specify the conditions of application of the calculation methods as alternatives to deduction. Basel is very specific that consolidation must result in a minimum capital standard that is at least as conservative as that applicable under deduction. The assessment team has not been able to identify such a specification in the CRR. On the basis that EU financial conglomerates can, subject to supervisory approval, potentially adopt

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[9] Footnote 12 in *Basel III: A global regulatory framework for more resilient banks and banking systems* (revised version June 2011)

the consolidation approach without regard to whether it would result in a less conservative capital requirement, the assessment team judged this finding to be material in terms of international level playing field. The finding should be revisited when the technical standards become available.

7. The EU will implement the loss absorbency at the point of non-viability (PON) requirement through a statutory resolution regime. Domestic legislation will need to be enacted to give effect to the Bank Resolution Directive.[10] Although a statutory approach is permitted under Basel, the EU's implementation of the Basel PON loss absorbency requirement is incomplete in a number of areas. Notable shortfalls include the failure to incorporate the PON loss absorbency requirement as an eligibility criterion for Additional Tier 1 (AT1) and Tier 2 instruments and to address group treatment.[11] This finding is potentially material as EU banks may not be restricted to count AT1 and Tier 2 instruments as eligible capital notwithstanding adverse findings by the Basel peer review of the EU's statutory approach.

Credit risk: Internal Ratings-based approach

In its implementation of the IRB approach, the EU provided for a "permanent partial exemption" under which an IRB bank may continue to risk-weight certain exposures based on the standardised approach. The provision was meant to apply only in exceptional circumstances, not broadly. The data analysis confirms a restrictive application of the exemption in some national jurisdictions. However, in other national regimes, based on data from 16 banks, the notional amount of exposures to sovereigns exempted under Article 145(1)(d) typically averages at 5.49%[12] of total exposures of the bank, with the most affected bank reporting permanent partial use under this Article at around 20%. The assessment team recommends that the conditions for granting permanent partial use in practice and the materiality in terms of capital impact be further assessed under the Level 3 assessment.

Maximum harmonisation

In its June 2012 preliminary report on the EU, the assessment team indicated it would consider further whether the concept of a maximum harmonisation regulation, as proposed by the EU, is at odds with the concept of minimum requirements established in the Basel rules.

The assessment team has concluded that the proposed EU concept is not inconsistent with the Basel framework, albeit in a way which reflects the supra-national structure of European regulation.

1. The team considers that the "national authority" for European regulation should be interpreted as the European level process of making regulations, directives and technical standards. It is clear that at this level, the relevant authorities could, if they chose, set higher standards than those applicable under the Basel framework.

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[10] See http://ec.europa.eu/internal_market/bank/crisis_management/index_en.htm

[11] See point 6 in the Annex to Final elements of the reforms to raise the quality of regulatory capital issued by the Basel Committee (January 2011)

[12] This does not include exposures enjoying exemption under article 145(d) in one of the countries reported to be accounting for 15% of the total exposure of banks in that country (the review team does not have the absolute figures of these exposures).

2. Supervision is not centralised in Europe, but remains under the control of the responsible national authorities. The review team is satisfied that the proposed European regulation and other powers will give national supervisors sufficient flexibility, under Pillar 2 adjustments, to respond appropriately to identified shortcomings and other issues for individual banks. This is perhaps not as flexible as allowing national supervisors to vary Pillar 1 requirements, particularly for issues which may be common risks across a number of banks. But the overall assessment is that the combined regulatory and supervisory approach is sufficient to comply with the Basel framework.

Summary

The EU's Basel implementation task is more complex than in other jurisdictions, given its membership. In most parts, the proposed CRDIV and CRR have fully transposed the Basel framework. The assessment team has, however, identified several key gaps and differences, some of which have been explained by the EC as necessary to address specific constraints faced by its Member States. In many cases, the CRR has provided safeguards or the EBA will develop legally binding technical standards to limit the impact of the gaps or deficiencies. The EU has also asserted that "tailored supervisory approaches" by national supervisors to internationally active banks would "remedy" the identified differences, which were intended to apply only to smaller banks. The assessment team has no reason to doubt that this would ensue but subsequent implementation and enforcement are beyond the scope of this review. The Level 2 assessment has produced findings showing that the proposed CRDIV and CRR have departed from the Basel framework in many areas. Some and possibly many of the identified non-compliant items may be resolved as the CRDIV/CRR proposals progress to their conclusion. The assessment team recommends a follow-up review of this report when the EU rule-making process is complete.

Overview table of compliance grading

Key components of the Basel framework	Grade
Overall Grade	Not yet assigned given the preliminary nature of the findings
Capital requirements	
Scope of application	(C)
Transitional arrangements	(C)
Definition of capital	(MNC)
Pillar 1: Minimum capital requirements	
Credit Risk: Standardised Approach	(LC)
Credit risk: Internal Ratings-Based approach	(MNC)
Credit risk: securitisation framework	(C)
Counterparty credit risk rules	(LC)
Market risk: standardised measurement method	(LC)
Market risk: internal models approach	(C)
Operational risk: Basic Indicator Approach and Standardised Approach	(LC)
Operational risk: advanced measurement approaches	(LC)
Capital buffers (conservation and countercyclical)	(C)
G-SIB additional loss absorbency requirements	(1)
Pillar 2: Supervisory Review Process	
Legal and regulatory framework for the Supervisory Review Process and for taking supervisory actions	(C)
Pillar 3: Market Discipline	
Disclosure requirements	(C)
Liquidity standards	
Scope of application	(1)
Liquidity Coverage Ratio	(1)
Net Stable Funding Ratio	(1)
Leverage ratio	
Leverage ratio	(1)

Compliance assessment scale: C (compliant), LC (largely compliant), MNC (materially non-compliant) and NC (non-compliant). Definitions of the compliance scale are found in the foreword of this document. Ratings that are based on draft or proposed rules are indicated within parentheses. Ratings based on final rules are indicated without parentheses. (1) To be assessed after the Committee concludes its review on any revisions or final adjustments of these elements of Basel III.

Response from the European Commission

The European Union remains firmly committed to the robust implementation of the internationally agreed capital standards. It is of utmost importance that the Basel III agreement is applied consistently around the world, in order to ensure global financial stability and a level playing-field. Therefore, the European Commission fully supports the Basel Committee's intention to assess consistent implementation of these rules for all internationally active banks worldwide and thanks the Basel Committee for the efforts made so far.

In 12 out of 14 areas of the present report, the draft European legislation has been fairly assessed to be "compliant" or "largely compliant". The European Commission would like to express, however, its reservations about the preliminary findings and gradings in the remaining two areas, which do not appear to be supported by rigorous evidence and a well-defined assessment methodology. The European Commission is concerned that this has led to an apparently significant lack of consistency in the way judgement and gradings have, in this preliminary phase, been applied for those two areas across jurisdictions. The European Commission, and the European members of the Basel Committee, have provided extensive information and clarifications to the Basel Committee during the process, but unfortunately this has only been partially reflected in the present report. The Commission stands ready to support the further work by the Basel Committee to improve its assessment of standards implementation and is confident that the final report of the Basel Committee will constitute an improvement both in the assessment of the EU and in the coherence across jurisdictions.

The present preliminary report is based on the EU Council's general approach unanimously agreed by all Member States.[13] The final legislation will be applied to more than 8,000 banks in Europe, representing more than 50% of world banking assets. Application to all banks necessitates some flexibility for non-internationally active banks. However, at the same time, the proposed legislation gives supervisors the necessary tools to ensure that internationally active banks fully comply with Basel III.

Intransparent section grading

It is not transparent how the individual "potentially material" findings translate into a section grading. In the case of the IRB, a single – questionable – finding, regarding permanent partial use, seems to have turned the whole IRB section grading for the EU into "materially non-compliant." This does not seem justified given the unclear Basel rule on this point and the unquantified impact of this legislative choice on capital requirements. This finding is also not comparable to the situation in the securitisation section of one other report, where a "materially non-compliant" grading has been attributed because a methodology for assigning capital requirements is used that is not based on credit quality assessments and therefore completely different from Basel II.

In the section about the definition of capital, a section grading of materially non-compliant has been assigned even though none of the seven "main specific issues" has been clearly

[13] This "general approach" builds on the Commission's proposals of July 2011 and constitutes an important step in the legislative process, but not the final legislation. The existing Basel II and Basel 2.5 agreements, which form an integral part of Basel III, have already been implemented for all EU banks in accordance with the internationally agreed timeframe. For Basel 2, a phased implementation starting in 2006 and for Basel 2.5, an unambiguous start date of 31 December 2011 have been agreed internationally.

demonstrated to be material. Moreover, the assessments of these issues contain material shortcomings, which are explained further below. At the same time, again comparing with one of the other reports, a similar number of individual findings in the definition of capital section that are comparable, or even identical, on substance lead to a section grading of "largely compliant".

Shortcomings in individual findings

The report fails to explain what quantitative importance a finding must have in order to be classified as material. Moreover, the "main specific issues" identified in the report are in all instances of "potential", rather than actual, materiality. The findings are usually ascribed to concerns about possible future behaviour by banks and their supervisors. However, it is never spelled out what future behaviour has been assumed by the assessors for this "potential" to materialise. Worse still, it appears that assumptions have not been made consistently across the three jurisdiction assessments. It appears that in the other two reports, more often than in the EU report, findings have been considered non-material based on an expectation that they will be mitigated by informal rules or certain behaviour of supervisors. A case in point is the recognition of capital instruments, where the proposed rules in one of the other two assessed jurisdictions give supervisory authorities far greater leeway than the EU rules do. However, only in the EU report there seems to be an assumption that competent authorities will not act appropriately, despite the existing safeguards of disclosure and discipline through the European Banking Authority.

It appears that at times, individual bank data has been used, but no account is given of the specific instance of the bank in question and of whether or not the relevant finding can plausibly be extrapolated to other banks. A case in point is the finding on non-joint stock companies. This indeed concerns a single internationally active bank. It is unclear that the issue is really material in the specific case and it is unreasonable to assume that a similar concern, which is specific to the cooperative legal form and applicable laws in one Member State, could arise at other internationally active banks. Another instance is the permanent partial use of the IRB. The concern seems to relate to the observation that up to "around 20%" of the exposures of one of the banks surveyed are treated under the standardised approach instead of the IRB approach. However, the average for the surveyed banks is only 5.49% and no estimate of the impact on capital requirements is provided in order to confirm the materiality of the finding. Notably, when comparing again the three reports, it turns out that the Basel Committee's assessors are much less concerned if in another jurisdiction, all internationally active banks are still subject to the outdated Basel 1 framework and this leads to around 20% lower capital requirements overall according to local supervisors. In any case, the finding is questionable given that limited permanent and transitional partial use is in principle allowable according to the Basel II accord and it is not clear that the identified partial use in the EU banks goes beyond the allowable extent envisaged by the Basel Committee. It is also not clear that the impact of applying the Standardised rather than the IRB approach to the exposures in question is actually material in terms of resulting capital requirements. As mentioned above, the grading in the IRB approaches section is based on a single finding that has been considered material. Regarding the definition of capital section, there are the following concerns with the individual findings:

Common shares: The CRR requires that the instruments fall under the Article 22 of Directive 86/635 and that these instruments meet the 14 criteria set by the Basel III agreement." The term "common share" that is used in the Basel III agreement is not defined in European legislation and different definitions of common shares exist in Member State company law. For this reason, the articles of the proposed regulation do not use the term common share, which the preliminary report correctly points out. The preliminary report however fails to show that the instruments that will be eligible under the proposed regulation and meet the substance of the 14 criteria could indeed fall short of the Basel Committee's expectations as to what "common shares" deliver. Moreover, the recital No. 53 explaining the relevant stipulations clearly expresses the legislator's expectations that the instruments are indeed "common shares" for banks that have such shares listed on a regulated market – the report does not explain why it expects supervisors not to live up to the legislators' expectations. It would have been fair to announce further work in the "level 3" assessment, but the report does not do it. In the case of one other assessment, on a similar issue, the assessors have been satisfied with a simple promise from the local authorities to use their discretions only "in case of emergencies" and to disclose the use when it occurs. Notably, the public disclosure of all instruments recognised is also a requirement in the draft EU law.

Treatment of insurance subsidiaries: The assessment team concludes that the impact is material, disregarding that the issue can arise only in very few banks that formally constitute "financial conglomerates". Further, as the report concedes, the verdict is made without actually knowing what the consolidation method, which is still being defined, is and what its precise impact will be. However, even absent a detailed definition of the consolidation method it is clear that the additional consolidation at the level of the conglomerate effectively prevents double gearing. It ensures that at least the capital requirements of the insurance subsidiary have to be supported by consolidated capital of the group. The approach is prudentially sound, not least because by contrast to a simple deduction it avoids negative incentives for the level of capital held at the insurance subsidiaries. It should be noted that draft rules in another jurisdiction also allow for a consolidation method as an alternative to deduction, but this seems not to have affected the section grading for that jurisdiction in the same way.

Loss absorbency at the point of non-viability: The absence of a requirement for a contractual clause to that effect can have some transitional impact, but that impact cannot be material once a statutory regime will be introduced with the adoption of the bank resolution proposals. This proposal will enter in force at most two years later than the legislation implementing Basel III. However, given that Basel III requires a phasing out of 10% of the relevant instruments only in 2014, there is no impact of this difference in 2013 and a negligible impact in 2014.

Minority interests: The additional discretionary capital requirements that can be included in the minority interests are likely to be of low materiality. Moreover, the proposed treatment is sound, as only minority interest that are used to meet legally binding capital requirements at the level of subsidiaries are included in the consolidated capital. In that sense, Pillar 1 and 2 capital requirements as well as systemic risk and countercyclical buffer requirements are all equivalent. In particular, the EU Council has introduced the systemic risk buffer as a functional equivalent to higher Pillar 1 capital requirements in order to give Member States' public authorities some flexibility; and Pillar 1 capital requirements are actually included in the Basel II eligible minority interests. In addition, some supervisors have indicated that the current Pillar 2 requirements had been introduced to pre-empt the more stringent Pillar 1 minima under Basel III; hence, once the new rules will enter in force, they will be materially reduced as will be the related minority interests.

Non-joint stock companies: The Basel III agreement recognises in a footnote the particularities of non-joint stock companies. This recognition is also reflected in the EU draft law and should not be seen as a compliance issue. Moreover, it is unclear what the report's view on materiality is based on. According to information provided by the EU supervisors to the assessment team, there is a single internationally active bank that can only issue cooperative shares that are, subject to conditions, redeemable. It is not a case where it could be reasonably assumed that other internationally active banks would turn into cooperatives and get into the same position in the future. At the same time, the actual impact of potential redemption on that one bank's capital position has not even been assessed; even in the case of that bank, it is not clear whether potential redemptions could become material given that the redeemable share capital as opposed to reserves etc constitutes only a fraction of CET1 capital for cooperative banks.

Assessment

1. Introduction

Overview of the EU banking sector

Banks remain the dominant suppliers of financing in the EU representing 75% of the combined assets of banks, insurance corporations, and pension and investment funds. Comparing the supply of credit with the size of capital markets, bank credit comprises half of the sum of credit, stock market capitalisation and outstanding debt securities in the EU. Despite the financial crisis and the stagnating assets in nominal terms, bank intermediation in EU in relation to GDP represents on average 360% (and 120% on average in new EU member countries), mainly reflecting the decline experienced in GDP.[14]

There are more than 8,000 deposit taking credit institutions in the EU of which around 6,800 are banks.[15] Fifteen of these banks have been designated global systemically important by the Financial Stability Board.[16] However, according to the EC, the proposed CRDIV/CRR rules will continue to apply to around 8,000 firms, including credit institutions and investment firms, not just banks.[17]

In terms of concentration, banking assets of the top 6 and 10 banks in the EU, as a percentage of total banking assets, account for 24% and 35% respectively.[18] The banking market is dominated by pan-European groups active in several Member States. Currently around 70% of EU banking assets is in the hands of some 40 banking groups with substantial cross-border activities. Especially in the EU countries, banking markets are dominated by foreign (mostly Western European) financial groups. In these countries, on average 65% of banking assets are in foreign-owned banks.

According to the ECB reported data, at the end of 2010, EU-based banks had a Tier 1 capital ratio of 10.42%. The same ratio was estimated at 7.7% in 2007.[19] Looking at the largest 90 banks in the EU, in the context of the July 2011 stress tests conducted by the EBA, they were calculated to hold, on average, Tier 1 capital ratio of 8.9%.[20] With respect to a subset of 71 banks,[21] EBA made a formal recommendation to national authorities that these banks raise their Tier 1 capital ratio to 9%, after accounting for an additional buffer against

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14 European Central Bank, EU Banking Structures, September 2010.

15 European Banking Federation, EU Banking Sector, Facts and Figures 2011/2012.

16 www.financialstabilityboard.org/press/pr_111104cc.pdf

17 European Commission response to the Level 2 Self-Assessment Questionnaire.

18 See European Banking Federation above.

19 See European Banking Federation above.

20 European Banking Authority, 2011 EU-wide Stress Test Aggregate Report, July 2011.

21 The sample included all the 90 banks that participated in the 2011 EU-wide stress test although the EBA considered it appropriate to exclude a subset of small non cross-border banks from the package. The total sample encompassed 71 banks.

sovereign risk holdings.[22] EBA has recently expressed that these banks are generally on track to comply with its recommendation.[23]

Broader context of the level 2 assessment

The regulatory consistency assessment (Level 2) for the European Union is part of the Financial Stability Board's (FSB) mandate of monitoring the implementation of the agreed G20/FSB financial reforms. The Level 2 assessment seeks to assess regulatory consistency with the Basel framework. Specifically, the Level 2 process is meant to

1. Identify the domestic regulations and provisions that are, in terms of content (ie scope and substance) not compliant with the rules agreed by the Basel Committee; and

2. Assess the potential materiality of the deviations and impact on financial stability and the international level playing field.

It should also be noted that the Basel Committee's implementation assessment programme complements the Financial Sector Assessment Program,[24] which is conducted by the International Monetary Fund and the World Bank. In particular, the Basel implementation assessment provides a comprehensive examination of regulatory consistency with the agreed Basel framework, while the FSAP considers the full range of the regulatory framework and supervisory practices.

Documents used for the assessment

The Level 2 assessments are benchmarked against Basel II, 2.5 and Basel III rules. Some Basel III rules were left out because they are still in the process of being completed by the Basel Committee. This applies for the framework for global systemically important banks (G-SIBs), the liquidity requirements and the leverage ratio.[25] For a complete list of Basel documents that are included in the assessment, see Annex C.

Regarding the EU documents, the assessment is based on 5th Presidency Council Compromise Proposals.[26] In addition, assessment takes into account a number of complementary documents issued by the EU authorities. See, for an overview of the EU public documents that have been consulted, Annex C.

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[22] European Banking Authority, Recommendation on the creation and supervisory oversight of temporary capital buffers to restore market confidence, December 2011.

[23] European Banking Authority, Update on the implementation of Capital Plans following the EBA's 2011 Recommendation on the creation of temporary capital buffers to restore market confidence, July 2012.

[24] The FSAP assesses country's compliance with the Basel Committee's Core Principles for Effective Banking Supervision (BCPs).

[25] See www.bis.org/publ/bcbs216.pdf, p.8, for an overview.

[26] Council of the European Union, PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate - Council general approach, 15 May 2012. Council of the European Union, PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on prudential requirements for credit institutions and investment firms - Council general approach, 15 May 2012.

Data for the materiality assessment

One of the factors that the assessment team took into account for the materiality assessment of its findings was the data received through the data requests. Via the national supervisors, the assessment team sought data from an agreed sample of 33 banks, chosen based on a combination of asset size and cross-border importance. Given the tight timeframes and competing priorities for European banks and bank supervisors, the team did not receive data from all banks. Furthermore, a full data set was not provided by every bank that responded. After applying quality checks, data from a subset of 20 banks was used for the materiality analysis. The assessment team's deliberations were therefore based on a partial data sample. Within the subset of 20 banks, 13 banks reported data that allowed the team to assess the pro forma differences in overall capital ratios.

The objective of the data analysis was not to quantify the impact of every individual difference between the proposed EU and Basel rules. Team experts sought data only on items of difference identifed as potentially material, and used the data aggregates and ranges computed to supplement their qualitative assessment on materiality.

All bank level data has been provided by the national supervisors to the BCBS Secretariat members working with the assessment team. The confidentiality protocol does not allow the assessment team members to access data that would allow identification of an individual bank.

EU review visit

On 16-20 April, the leader of the EU Review Team held face-to-face discussions with senior representatives from the EC, the nine EU-BCBS countries, EBA and the ECB. The purpose of these meetings was to share the work programme of the assessment team and to provide an initial indication of the areas where the team would be focusing its work.

Preliminary report

On 11 June, the EU Review Team shared the preliminary findings of its work as part of the Basel Committee's "Report to G20 Leaders on Basel III Implementation".[27] This initial assessment identified a large number of features of the current EU Basel III proposals that required further investigation but anticipated that most of these issues had the potential to prove either consistent with the Basel framework, or immaterial in practice. Similarly, the interim report highlighted a small number of issues (ie maximum harmonisation, definition of capital and the credit risk's internal ratings-based approach) as potentially material and in need of a detailed assessment by the review team.

On-site review meetings

From 9 July until 13 July, the assessment team held on-site review meetings in Brussels. The main objective of these meetings was to discuss in detail the team's provisional list of inconsistent items between Basel III and the corresponding European proposals. The team also took advantage of the on-site review to share the preliminary results of its banking data materiality analysis.

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[27] www.bis.org/publ/bcbs220.htm, pages 7 to 10.

The EC hosted these meetings and was the main counterpart of the review team during the technical discussions. The nine EU-BCBS countries as well as EBA and the ECB were invited to take part in these meetings and importantly contributed to the discussions.

During the week of the on-site review meetings in Brussels, the leader of the EU review team also met with senior representatives from the European Parliament and the Presidency of the European Council to discuss key aspects of the work of the EU Review Team.

2. Detailed findings

In the next sections, the detailed assessment findings are presented together with an assessment of their materiality. The sections correspond with the sections in the overview table on page 12.

As remarked in the foreword, only deviations that could lead to a less robust capitalisation of the banking sector are reported. Areas of compliance are not explicitly addressed, nor are areas where the EU approach would be super-equivalent vis-à-vis the Basel standards. Areas where the domestic rules strengthen the minimum requirements have not been taken into account in the section gradings.

The following findings are not in order of importance, but in the order of assessment through the relevant Basel rules texts.

2.1 Scope of application

Section Grading	(Compliant)
Summary	Overall, the CRR/CRDIV is assessed as compliant with the Basel scope of application. Although there are a few differences, their impacts are unlikely to be material.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	28: Treatment of significant minority interest
Reference in the domestic regulation	CRR: Articles 16-17
Findings	There are a few instances where the CRR allows exceptional treatments of prudential consolidation which may not be fully compliant with the Basel texts. One example is that pro rata consolidation could be permitted beyond the minority-owned entities in the EU. That said, the exceptions are mostly subject to supervisory approval or under strict thresholds for the application.
Materiality	Materiality was not assessed quantitatively as the team experts considered the impact would not be material for the internationally active banks of the EU.

2.2 Transitional arrangements

Section Grading	(Compliant)
Summary	CRR allows jurisdictions to waive the application of the Basel I floor but data analysis suggests that the finding is not material.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	45-49: Transitional arrangements (amended by BIS press release 13 July 2009)
Reference in the domestic regulation	CRR: Article 476
Findings	Basel II introduced a Basel I floor as a transitional arrangement. In July 2009, the BCBS decided to keep in place the Basel I capital floors beyond the end of 2009. The CRR allows jurisdictions to waive the application of the Basel I floor but there is no guidance for such waivers. The CRR also permits an alternative calculation of the floor based upon the Basel II standardised approach.
Materiality	The data analysis indicates that the finding is unlikely to be material.

2.3 Definition of capital

Section Grading	(Materially non-compliant)
Summary	The assessment team considered the following findings to have material impact on the consistency in the definition of capital across jurisdictions: • no stipulation that CET1 must be "common shares"; • redemption on demand for "CET1" instruments issued by mutuals and cooperative institutions in some Member States; • offset against unrealised gains/losses due to changes in banks' own credit standing; • narrow definition of "indirect holdings"; • consolidation of insurance entities; and • incomplete implementation of the PON loss absorbency requirement. In addition, there are other differences between the CRR and Basel which, though not material in isolation, may in aggregate have significant impact on the quality and level of bank capital in the financial system, especially in times of stress.
Overview of findings by Basel III paragraph(s):	
Basel paragraph(s)	52- 53: Common Equity Tier 1
Reference in the domestic regulation	CRR: Articles 24, 26, 75, and 424(1)(a) and Recital 53
Findings	Basel stipulates that internationally active joint stock companies must meet the 14 criteria for CET1 instruments solely with common shares. The CRR requires instruments to satisfy the 14 criteria to qualify as CET1 capital but makes no reference to the "common shares"

	requirement. The EC explained that since company law is not harmonised among the EU countries, there is no common definition of the term "common share" for the CRR to reference. Furthermore, the term "common share" is not used in some Member States. According to the EC, the 14 criteria define a common share so meeting the 14 criteria is adequate to give effect to the Basel requirement. To safeguard against instruments other than common shares getting included, Recital 53 of the CRR states that "it is expected that credit institutions or investment firms whose shares are listed on an EU regulated market should meet their capital requirements regarding the core elements of capital with those listed common shares that meet a strict set of criteria for the core capital instruments and the disclosed reserves of the institution only". But this is expressed as an expectation rather than a requirement, and does not deal with non-listed entities. The EBA is also tasked to establish, maintain and publish a list of the instruments that qualify as CET1 in each Member State and to notify the EC immediately where there is significant evidence of material deterioration in the quality of the listed instruments. As such, the EBA listing is an ex-post measure to facilitate monitoring of approval practices in Member States.
Materiality	Materiality could not be assessed quantitatively. The team experts considered this finding to be potentially material as the lack of specification of the requirement in the CRR itself potentially leaves open the possibility for the development of instruments, in addition to "common shares", to qualify as CET1.
Basel paragraph(s)	53 footnote 12: Application of Common Equity Tier 1 criteria to non-joint stock companies
Reference in the domestic regulation	CRR: Articles 24-28, 72, 73, 75, and 424(1)(a)
Findings	The CRR has modified the 14 criteria for mutual and co-operative institutions in the following aspects: • instead of requiring that CET1 instruments give holders a claim on residual assets, the CRR allows instruments a fixed claim limited to the nominal value of the instruments in the event of insolvency or liquidation subject to the limitation being applied to all other CET1 instruments issued by the institution; • where refusal to redeem is prohibited by national law, the instrument may be redeemed subject to limits. Redemption is subject to the institution obtaining the prior permission of the supervisor in a manner that is permitted under national law. This is contrary to the Basel criteria that an instrument must never be repaid outside of liquidation, and that there is no expectation at issuance that the instrument will be redeemed; • the instrument may include a cap or restriction on the maximum level of distributions where that cap or restriction is specified under national law or the statute for that institution. This departs from the Basel requirement that distributions must not be subject to a contractual cap. To limit the scope of the modifications, the CRR requires the EBA to develop regulatory technical standards to specify the nature of limitations on redemption necessary where the refusal of the institution to redeem is prohibited under applicable national law. The EBA has issued draft technical standards proposing that the ability of an institution to limit redemption shall encompass both the right to

	defer redemption and the right to limit the amount to be redeemed for an unlimited period having regard to, in particular, but not limited to, the overall financial, liquidity and solvency situation of the institution and the institution's capital position. The EBA proposals also specify the nature and extent of the features that could cause the condition of an institution to be weakened as a going concern during periods of market stress and the market stress under which such features could cause the condition of the institution to be weakened as a going concern. While Basel notes that the 14 criteria to classify common shares as CET1 are also applicable to non-joint stock companies, taking into account their specific constitution and legal structure, the application of the criteria should preserve the quality of instruments by requiring that they are deemed fully equivalent to common shares in terms of loss absorption and absence of features that could cause the condition of the bank to be weakened as a going concern in times of stress. The assessment team do not consider that instruments redeemable at the option of the holder, albeit subject to the limitations set out in the EBA regulatory technical standards, can be deemed equivalent to common shares in terms of loss absorption. If an institution has in practice been meeting all requests for repayment of a capital instrument, it would be very difficult for the institution itself to delay or limit repayment, or for the supervisor to refuse consent for a repayment, without undermining confidence in the institution and putting it under additional stress.
Materiality	The data analysis indicates that the finding is potentially material for a few internationally active banks.
Basel paragraph(s)	62- 65: Minority interest
Reference in the domestic regulation	CRR: Articles 76- 83
Findings	The Basel adjustments for minority interest are based on the minimum capital requirements plus the capital conservation buffer. The CRR allows, in addition to the above elements, the systemic risk buffer, Pillar 2 buffer and the countercyclical buffer to be taken into account when calculating the amount of minority interest to be recognised in consolidated capital. This has the effect of increasing the amount of minority interest recognised in the parent bank's capital. While the inclusion of the systemic risk buffer, Pillar 2 buffer will likely have the effect of causing some permanent deviation vis a vis Basel rules, the countercyclical capital buffer, when in place, will have the effect of increasing this deviation further. The EC explained that Member States were concerned that Basel rules would lead to capital in subsidiaries being reduced if recognition of minority interests were limited to the extent of the conservation buffer.
Materiality	The data analysis indicates that the finding is potentially material for a few internationally active banks.
Basel Paragraph(s)	75: Cumulative gains and losses due to changes in own credit risk on fair valued financial liabilities.
Reference in the domestic regulation	CRR: Article 30
Findings	Basel derecognises in the calculation of CET1, all unrealised gains and losses resulting from changes in the fair value of liabilities that are due to changes in the bank's own credit standing. The CRR provides

	for an exception by allowing such gains and losses to be offset by a change in the fair value of another financial instrument resulting from changes in the bank's own credit standing. This means that a failing bank could owe money on out-of-the-money hedges because the holders of these liabilities will demand full repayment, rather than a discounted market value, while the underlying mark-to-market discount on liabilities evaporates. The EC's explanation that the exception is consistent with IFRS does not change the fact that the finding is a departure from Basel.
Materiality	The team experts considered this finding to be potentially material as the CRR treatment of allowing offsets could result in materially higher capital ratios particularly for banks that are under stress.
Basel paragraph(s)	80 footnote 26: Definition of indirect holdings
Reference in the domestic regulation	CRR: Article 22(17)
Findings	Under Basel rules, an indirect holding of capital arises when a bank invests in an unconsolidated intermediate entity to gain an exposure to the capital of another financial institution. The CRR defines "indirect holding" as a direct holding of capital instruments issued by an intermediate entity that has an exposure to capital instruments issued by a financial sector entity where, in the event the capital instruments issued by the financial sector entity were permanently written off, the loss that the institution would incur as a result would not be materially different from the loss the institution would incur from a direct holding of those capital instruments issued by the financial sector entity. By restricting the definition to holdings of capital instruments, the CRR would not capture exposures to financial sector entities gained through other forms of investments in the unconsolidated intermediate entity.
Materiality	Materiality could not be assessed quantitatively. The team experts considered this finding to be potentially material as the CRR definition could encourage banks to attempt highly structured arrangements to avoid the capital effects of holding capital in another financial institution.
Basel paragraph(s)	83: Pro rating of investments below the threshold
Reference in the domestic regulation	CRR: Article 43(4)
Findings	Under Basel rules direct, indirect and synthetic investments in the capital of financial sector entities that are outside the scope of regulatory consolidation must be deducted from capital above a threshold. Amounts below the threshold which are not deducted will continue to be risk weighted. For the application of the risk weighting the amount of the holdings must be allocated on a pro rata basis between those above and those below the threshold. The CRR does not explicitly specify pro rating of holdings above and below the threshold for the application of risk weightings and therefore banks could allocate holdings in a way that maximises the bank's capital leading to an overstatement of the bank's capital positions. The EC disagrees with our interpretation but acknowledges that the CRR is not worded in a way that is sufficiently clear.
Materiality	Materiality was not assessed quantitatively as the team experts judged this finding unlikely to be material.
Basel paragraph(s)	84-85: Investments in the capital of insurance entities

Reference in the domestic regulation	CRR: Article 46
Findings	Under Basel rules, jurisdictions can permit or require banks to consolidate significant investments in insurance entities as an alternative to the deduction approach on the condition that the method of consolidation results in a minimum capital standard that is at least as conservative as that which would apply under the deduction approach. In order to ensure this outcome banks that apply a consolidation approach are required to calculate their capital ratios under both the consolidation approach and the deduction approach, at each period that they report or disclose these ratios. In cases where the consolidation approach results in lower capital ratios than the deduction approach banks must report these lower ratios. If the consolidation approach results in a higher capital ratio than the deduction approach the bank must adjust the ratio downwards through a regulatory adjustment. The CRR allows, subject to supervisory approval, using a consolidation approach as an alternative to deduction, but does not mandate the critical additional requirement that any consolidation method must not produce a capital ratio benefit compared to deduction. The CRR also provides that the EBA, EIOPA and ESMA should jointly develop regulatory technical standards to specify the conditions of application of the calculation methods as alternatives to deduction.
Materiality	The finding is material, with the potential for financial conglomerates to report materially higher capital ratios than would apply in a regime fully compliant with the Basel framework. It is possible that upcoming technical standards could correct this defect, but there is no statutory instruction to the national authorities to ensure this outcome.
Basel paragraph(s)	90: Former deductions from capital
Reference in the domestic regulation	CRR: Articles 33(1)(k), 85 and 369
Findings	Basel applies a risk weight of 1250% to certain items which were deducted 50 % from tier one and 50% from tier two (or had the option of being deducted or risk weighted). The CRR allows banks to deduct these items from CET1 as an alternative to applying a risk weight of 1250%. This is a deliberate departure from Basel. In most cases using a deduction approach will result in a higher capital ratio than risk weighting at 1250%.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	95: Transition for CET1
Reference in the domestic regulation	CRR: Articles 463-464
Findings	Basel allows instruments that do not meet the CET1 criteria to be grandfathered as CET1 only if they are issued by a non-joint stock company. The CRR allows grandfathering as CET1 instruments issued by joint-stock companies that today qualify as core T1 capital under national implementations of the CRD, notwithstanding that they do not meet the CET1 criteria.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	96: Eligibility for transitional arrangements

Reference in the domestic regulation	CRR: Article 463
Findings	To qualify for Basel transitional arrangements under paragraph 94, capital instruments must be issued before 12 September 2010. The CRR grandfathering provisions apply to capital instruments issued before 31 December 2011.
Materiality	Materiality could not be assessed due to lack of data.
Basel paragraph(s)	BIS press release 13 January 2011: Loss absorbency at point of non-viability
Reference in the domestic regulation	CRR: Recital 27 Bank Resolution Directive: 51-55, 115
Findings	The EU will implement the loss absorbency at the point of non-viability (PON) requirement through a statutory resolution regime. The EC explained that the resolution authorities in the EU will, after transposing the Bank Resolution Directive into domestic legislation, have the power to write down AT1 and T2 capital instruments issued by banks at pre-defined trigger events (eg a bank is judged no longer viable or a decision is made to provide extraordinary support to a bank). Although a statutory approach is permitted under Basel, the EU's implementation of the Basel PON loss absorbency requirement is incomplete as the Bank Resolution Directive does not address all the Basel PON criteria. First, the EU has so far failed to incorporate the PON loss absorbency requirement as an eligibility criterion for AT1 and T2 capital instruments. Basel stipulates that AT1 and T2 instruments will not qualify as regulatory capital from 1 January 2013 unless the instruments have a PON loss absorbency feature. EU Member States are expected to transpose the Bank Resolution Directive into their national legislation by 31 December 2014. As a result, EU banks may not disqualify AT1 and T2 capital instruments that do not have the PON loss absorbency feature from 1 January 2013. Second, Basel has stipulated group treatment when issuing banks are part of a wider banking group. Neither the CRR nor the Bank Resolution Directive addresses group treatment. The consequence is that EU banks may receive more generous recognition of regulatory capital at the group level than banking groups complying with Basel. Third, for a statutory approach to be acceptable as an alternative to the contractual approach, it must be confirmed by a peer review. It is possible that some EU Member States could fail the peer review because the transposition of the Directive into national legislation was ineffective. There is no provision in the CRR to disqualify the AT1 or T2 instruments issued by affected banks of such Member States. Last, Basel requires the relevant regulator and the issuing bank to disclose the statutory approach in issuance documents of any instruments subject to the PON loss absorbency requirement by legislation. The EU has yet to implement such a disclosure requirement.
Materiality	This finding is potentially material as EU banks may not be restricted to count AT1 and Tier 2 instruments as eligible capital notwithstanding adverse findings by the Basel peer review of the EU's statutory approach.

2.4 Pillar 1: minimum capital requirements

2.4.1 Credit risk: standardised approach

Section Grading	(Largely compliant)
Summary	There are a number of variances from the Basel framework, some with the potential to be significant for some EU banks. But the overall effect of these variances is unlikely to be material for any internationally active EU bank.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	57-58, 64: Claims on non-central government public sector entities (PSEs)
Reference in the domestic regulation	CRR: Articles 110-111
Findings	Under Basel rules claims on domestic PSEs should be risk weighted under either option 1 or 2 for claims on banks (Option 1 assigns a risk weight one category less favourable than the sovereign rating while option 2 assigns a risk weight based on the rating of the PSE). The CRR applies option 1 to unrated PSEs and option 2 to rated PSEs. Depending on the sovereign rating, the CRR approach can result in a higher or lower capital position. Further, the CRR applies a risk weight of 20% to all PSEs with an original maturity of 3 months or less. This deviates from Basel under which the preferential risk weight may be applied to short term exposures (3 months or less) denominated and funded in the domestic currency. This condition has not been imposed in the CRR.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	60-64: Claims on banks
Reference in the domestic legislation	CRR: Articles 114-116,126
Findings	1. Basel provides that claims on banks are to be risk weighted based on either one of two options – the sovereign rating or the bank's own credit rating. The CRR, on the other hand, applies both options - the sovereign rating for unrated banks and the bank's credit rating for rated banks. Under the CRR risk weightings for unrated banks can be higher or lower depending on the sovereign's rating. 2. Basel provides for preferential treatment of short term claims, defined as those with an original maturity of 3 months or less. The CRR defines short term claims as those with a residual maturity (as opposed to original maturity) of 3 months or less, allowing more exposures to qualify for short term preferential treatment. 3. Under Basel rules, where the national supervisor has chosen to apply a lower risk weight to exposures to their sovereign of incorporation denominated and funded in the domestic currency, it can assign a risk weight one category less favourable than that assigned to claims on the sovereign, subject to a floor of 20%, to claims on banks with original maturity of 3 months or less denominated and funded in the local currency. The CRR has adopted this approach for short term claims

	on unrated banks but there is no condition that the exposure has to be denominated and funded in the domestic currency. The EC explained that the impact of this would be very limited as unrated institutions are generally small local banks that are engaged almost exclusively in local business denominated and funded in domestic currency. 4. Basel specifies that claims with contractual maturity of under 3 months which are expected to be rolled over do not qualify for preferential treatment. The CRR is silent on this requirement. National supervisors are provided with powers (per CRDIV Article 100) to monitor this aspect especially for internationally active banks.
Materiality	The data analysis on this item is inconclusive as the great majority of banks in the data sample group use the IRB approach for credit risk capital calculations.
Basel paragraph(s)	60-64: Claims on banks
Reference in the domestic regulations	CRR: Article 124
Findings	Basel does not specify a capital treatment for covered bonds. Claims on covered bonds issued by banks would be risk-weighted based on the capital rules for claims on banks and recognition of eligible financial collateral under the standardised approach. The CRR contains specific rules for risk weighting covered bonds, resulting in capital ratios that are higher than those calculated under Basel. The covered bonds eligible for such treatment may be secured by immovable property or ships, which are not eligible financial collateral under the standardised approach. The EC considers there is a need for specific rules on the treatment of covered bonds as they are different from securitisation instruments and from ordinary bank bonds.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	70: Claims included in the regulatory retail portfolios
Reference in the domestic regulations	CRR: Article 118
Findings	The CRR does not apply the same product criterion for claims to be included in the regulatory retail portfolio as Basel. In particular, the CRR does not specify which products are eligible for inclusion in the regulatory retail portfolios.
Materiality	Materiality was not assessed quantitatively. However, the team experts judged this finding unlikely to be material.
Basel paragraph(s)	72-73: Claims secured by residential property
Reference in the domestic regulation	CRR: Articles 119-120
Findings	CRR requirements for risk weighting exposures secured by residential mortgages are consistent with those specified by Basel. However the team experts did not investigate issues such as the treatment of property leasing transactions, splitting of loans into secured and unsecured parts for risk weighting purposes and the types of property classified as residential.
Materiality	Materiality was not assessed as the team experts considered the finding unlikely to be material for the Level 2 assessment.

Basel paragraph(s)	74: Claims secured by commercial real estate
Reference in the domestic regulation	CRR: Articles 121, 203, 224(1)
Findings	Basel risk-weighs mortgages on commercial real estate at 100%. Footnote 29, however, provides that, for well-developed and long-established markets, mortgages on office and/or multi-purpose commercial premises and/or multi-tenanted commercial premises may have the potential to receive a preferential risk weight of 50% for the tranche of the loan that does not exceed the lower of 50% of market value or 60% of mortgage lending value of the property securing the loans. Countries applying this treatment must publicly disclose that limits on loss rates and other conditions as set out in the Basel paper "Criteria in defining exceptional treatment of commercial real estate lending" are met. The CRR's capital treatment of claims secured by commercial real estate differs from Basel in the following aspects: 1. CRR permits the 50% risk weights to be applied as long as certain conditions are met; primarily that the exposure is fully and completely secured. Exposures are considered fully and completely secured if the value of the property does not materially depend upon the credit quality of the borrower, the risk of the borrower does not materially depend upon the performance of the underlying property or project and specified valuation requirements are met. Unlike Basel, the limits on loss rates are not the pre-condition for applying the 50% risk weight. The CRR instead permits the institution to apply the 50% risk weight in cases where the condition that the risk of the borrower does not materially depend upon the performance of the underlying property or project is not satisfied, provided that the limits on loss rates are met. 2. The Basel paper explicitly excludes mortgages in the form of leases from the definition of commercial real estate lending. The CRR, however, gives exceptional treatment to exposures related to property leasing transactions concerning offices or other commercial premises under which the institution is the lessor and the tenant has an option to purchase, provided that the exposure of the institution is fully and completely secured by its ownership of the property. 3. The CRR sets out the condition that the competent authority of the Member State has published evidence that the limits on loss rates are met, but does not require disclosure that the conditions in the Basel paper are met. The EC justified the extension of concessional treatment to exposures related to property leasing transactions on the basis that property leasing provides a level of surety that is at least equivalent, and sometimes superior, to that of a mortgage.
Materiality	Materiality was not assessed quantitatively. However, the team experts considered the findings unlikely to be material for internationally active banks.
Basel paragraph(s)	76: Past due loans
Reference in domestic regulations	CRR: 118

Findings	Basel requires past due retail loans to be excluded from the regulatory retail portfolio, when assessing the granularity criterion. There is no similar provision in the CRR.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the findings are unlikely to be material.
Basel paragraph(s)	94: Implementation considerations
Reference in domestic regulations	CRR: Articles 131,133, and 429
Findings	There is no explicit requirement in the CRR that banks are required to use chosen ECAIs and their ratings consistently for both risk weighting and risk management purposes, as set out in Basel.
Materiality	Materiality was not assessed quantitatively. The team experts considered that institutions' credit risk management practices would be reviewed under Pillar 2.
Basel paragraph(s)	145-146: Eligible financial collateral
Reference in domestic regulations	CRR: 193-194
Findings	Basel recognises Undertakings for Collective Investments in Transferable Securities (UCITS) and mutual funds as eligible financial collateral only where the UCITS/mutual fund is limited to investing in instruments listed in paragraphs 145 and 145 ("eligible instruments"). The CRR allows UCITs/mutual funds that are not limited to investing in eligible instruments as eligible financial collateral. In such cases, institutions may use units or shares in the UCITS/mutual fund as collateral up to an amount equal to the value of eligible assets held by the UCITS/mutual funds.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	189: Guarantees and credit derivatives
Reference in domestic regulations	CRR: 208, 210
Findings	Basel requires that all guarantees and credit derivatives to be unconditional. Specifically the guarantees or credit derivatives (a) must not contain any clause outside the direct control of the bank that could prevent the protection provider from being obliged to pay out in a timely manner; and (b) must provide that the bank may pursue the guarantor in a timely manner for any monies outstanding under the documentation governing the transaction, in the event that the original counterparty fails to make the payments due. In the case of credit protection covering residential mortgage loans, the CRR allows the Basel requirements to be satisfied within 24 months.
Materiality	Materiality was not assessed quantitatively. The team experts considered the findings unlikely to be material.

2.4.2 Credit risk: Internal ratings-based approach

Section Grading	(Materially non-compliant)
Summary	The assessment team considered the findings in the following areas to be potentially material:

	• Conditions for permanent partial use, which permit the permanent application of the standardised approach to sovereigns, public sector bodies and certain other exposures, irrespective of their materiality or risk; • Deviation in application of LGD floor for residential mortgages; • Lack of clarity in the scope of entities included in the computation of the total assets threshold for the purpose of the asset valuation correlation multiplier for exposures to large regulated financial institutions; and • Deviation in definition of total eligible provisions for comparison with expected loss.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	220-228, 275, 412-413: Slotting criteria for specialised lending
Reference in the domestic regulation	CRR: Articles 142(8), 148(5) and 148(9)
Findings	Basel sets out the definitions of the five sub-classes of specialised lending (namely project finance, object finance, commodities finance, income-producing real estate, and high-volatility commercial real estate and the risk weights for each of the five supervisory categories, stipulating that the mapping of internal grades to the five supervisory categories be based on the slotting criteria in Annex 6. CRR sets out the criteria for specialised lending exposures and the risk weights to be applied. However, the CRR neither mentions nor defines the five sub-classes of specialised lending exposures. It also does not set out the slotting criteria for mapping of internal grades to the five supervisory categories. The EBA shall develop draft regulatory technical standards (by 31 Dec 2014) to specify the factors for assigning risk weights to specialised lending exposures. CEBS Guideline (paragraph 181-189) on the Implementation, Validation and Assessment of Advanced Measurement and Internal Ratings Based Approaches was in place to provide guidance to national authorities in this regard.
Materiality	Materiality was not assessed quantitatively given limitations on the available data.
Basel paragraph(s)	231: Definition of retail exposures
Reference in the domestic regulation	CRR: Article 142(5)
Findings	Basel provides that residential mortgage loans are eligible for retail treatment regardless of exposure size so long as the credit is extended to an individual that is an owner-occupier of the property (with the understanding that supervisors exercise reasonable flexibility regarding buildings containing only a few rental units). The CRR permits loans to a natural person or persons secured by immovable property as eligible for retail treatment, without any condition that the individual has to be an owner-occupier of the property.
Materiality	Materiality was not assessed. This item does not affect the compliance assessment of the EU review, as the Basel rule allows flexibility.
Basel paragraph(s)	231: Definition of retail exposures

Reference in the domestic regulation	CRR: Article 142(5)
Findings	Basel provides that loans extended to small businesses and managed as retail exposures are eligible for retail treatment provided the "total exposure" of the banking group to the small business borrower is less than EUR 1 million. The corresponding criterion in the CRR is based on "total amount owed" which would exclude undrawn commitments.
Materiality	Materiality was not assessed quantitatively. Thethe team experts judged the finding unlikely to be material.
Basel paragraph(s)	234: Definition of qualifying retail exposures
Reference in the domestic regulation	CRR: Article 149(4)
Findings	Basel II requires exposures treated as qualifying revolving retail exposures to be unsecured. The CRR allows an exception in respect of collateralised credit facilities linked to a wage account. In such cases, amounts recovered from the collateral shall not be taken into account in the LGD estimate.
Materiality	Materiality could not be assessed quantitatively. Based on the judgement of the team experts this finding is considered unlikely to be material.
Basel paragraph(s)	256-261: Permanent Partial Use
Reference in the domestic regulation	CRR: Articles 143 and 145
Findings	Basel allows a bank using the IRB approach to permanently apply the standardised approach for exposures in insignificant business units or asset classes only if they are immaterial in terms of size and perceived risk profile, and subject to supervisory approval. The CRR, however, includes specific provisions that permit a bank using the IRB approach to permanently apply, subject to supervisory approval, the standardised approach to sovereigns, public sector bodies and certain other exposures, without the condition in Basel that this may be applied only if they are immaterial in terms of size and perceived risk profile. The specific exemptions in the CRR are: 1. Article 145(1)(d)[28] – exemption for exposures to central governments and central banks of Member States, and their regional governments, local authorities and administrative bodies and public sector entities, provided exposures to the central government and central bank are assigned a 0% risk weight under the standardised approach, and there is no difference in risk between exposures to the sovereign and those other exposures because of specific public

[28] The EC has highlighted that CRR Articles 145(1) (a) and 145(1) (b) permit permanent partial use for exposures to central governments and central banks and exposures to institutions, subject to supervisory approval, where the number of material counterparties is limited and it would be unduly burdensome for the institution to implement a rating system for these counterparties. Nonetheless, the assessors note that the exemption as drafted under CRR Article 145(1) (d), which covers exposures to central governments and central banks of Member States, does not set out these same conditions for the application of the exemption.

	arrangements; 2. Article 145(1)(e) – exemption for exposures to a counterparty which is its parent or related company, provided the counterparty is a financial institution subject to prudential requirements;[29] 3. Article 145(1)(f) – exemption for exposures to counterparties with which the institution has entered into an institutional protection scheme that is a contractual or statutory liability arrangement which protects those institutions and in particular ensures their liquidity and solvency to avoid bankruptcy in case it becomes necessary. 4. Article (145) (j) – State and State-reinsured guarantees. The EC explained that the exemptions were not meant to apply to internationally active banks so national supervisors should have disallowed the exemptions as intended. The data analysis, however, indicated a material proportion of exposures under the permanent partial exemption in many banks in a number of EU Member States.
Materiality	The data analysis indicates that the finding is material. Based on data from 16 banks, the notional amount of exposures to sovereigns exempted under Article 145(1)(d) typically averages at 5.49%[30] of total exposures of the bank, with the most affected bank reporting permanent partial use under this Article at around 20%. This is material in terms of exposure size. The assessment team did not consider the capital impact of these exposures, as to do so would require an assessment of the appropriate IRB weighting for the exempted exposures. This exercise is left for the eventual Level 3 assessment of the EU.
Basel paragraph(s)	264, 265, 472 and 478: data requirements
Reference in the domestic regulation	CRR: Articles 176-178
Findings	Basel sets a minimum period of historical observation of data for the estimation of PD, LGD and EAD under the IRB approach, and the application of transition periods (during which the minimum period of data can be shortened). Under the Basel rules, the transition period commences from the date of implementation of the framework by the national authority and no transition period is provided for the estimation of LGD and EAD of wholesale exposures. The CRR, in contrast, allows a transition period for the estimation of LGD and EAD for wholesale exposures, without requiring permission of the national authorities. For estimates of PD for wholesale exposures and parameters for retail exposures, the CRR allows the transition period to commence from the date of adoption of the IRB approach by the bank, subject to permission of the national authorities. The EU explained that the more relaxed approach adopted was meant for smaller, non-internationally active banks to encourage them to use

[29] Exposures under Article 145(1) (e) include exposures to the parent of the institution and subsidiaries of the parent. Exposures to the parent of the institution would not be eliminated in the institution's own consolidated accounts under International Financial Reporting Standards.

[30] This does not include exposures enjoying exemption under article 145(d) in one of the countries reported to be accounting for 15% of the total exposure of banks in that country (the review team does not have the absolute figures of these exposures).

	the IRB approach, given many of these smaller banks were not ready at the time the national authority implemented the framework. National supervisors should not allow the option for internationally active banks.
Materiality	Responses from a limited number of national authorities indicate that the transition period is provided for internationally active banks from the date of their adoption of the foundation IRB or advanced IRB approaches. The materiality could not be assessed quantitatively. The effect of the shorter data requirement during the transition period is that EU banks could effectively adopt the foundation IRB or advanced IRB approaches earlier than what is otherwise possible under Basel. However, in view that most internationally active EU banks have already been on IRB approaches for several years, the finding is considered not material.
Basel paragraph(s)	266: LGD floor for residential mortgages
Reference in the domestic regulation	CRR: Article 160
Findings	Basel requires the LGD for any sub-segment of exposures for which the formula in paragraph 328 is applied to be floored at 10%. Paragraph 328 defines the formula for calculating capital requirements for residential mortgage exposures. The CRR applies a 10% floor to the exposure weighted average LGD of all residential mortgages exposures. The CRR floor is significantly less binding because individual sub-segments of residential mortgage exposures could receive a capital requirement based on an LGD of less than 10%, provided that the overall average residential mortgage LGD is at least 10%.
Materiality	Materiality could not be assessed quantitatively. Based on the judgement of the team experts this finding is considered potentially material.
Basel paragraph(s)	272 (amended by Basel III paragraph 102): Asset value correlation multiplier for large financial institutions
Reference in the domestic regulation	CRR: Articles 137(1)(5), 148(2)
Findings	Basel applies a multiplier of 1.25 to the correlation parameter of all exposures to large "regulated financial institutions" whose total assets are greater than or equal to US$100 billion, based on the most recent audited financial statement of the parent company and consolidated subsidiaries. Basel defines "regulated financial institution" as a parent and its subsidiaries where any substantial legal entity in the consolidated group is supervised by a regulator that imposes prudential requirements consistent with international norms. The CRR defines a "large financial sector entity" as any financial sector entity whose total assets, calculated on an individual or consolidated basis, are greater than or equal to the EUR 70 billion threshold. The EBA has commented that the definition of "large financial sector entity" in the CRR should be interpreted as including the assets of the financial sector entity's parent and consolidated subsidiaries of the parent. The team experts were nonetheless not able to confirm any legal provision that "total assets, calculated on a consolidated basis" for the purpose of the CRR Article 137(1)(5) would include the financial sector entity's parent and consolidated subsidiaries of the parent, as opposed to being interpreted as the consolidation of the assets of the financial sector entity and subsidiaries of the financial sector entity only. The effect of excluding

	the financial sector entity's parent and the consolidated subsidiaries of the parent is that fewer large "regulated financial institutions" would be caught by the 1.25 asset value correlation multiplier.
Materiality	Materiality could not be assessed quantitatively. The team experts considered this finding as potentially material as fewer regulated financial institutions may be caught by the 1.25 asset value correlation multiplier under the CRR.
Basel paragraph(s)	287: Loss given default
Reference in the domestic regulation	CRR: Article 157(1)(d)
Findings	Under the foundation IRB approach, Basel assigns a 45% LGD to senior claims on corporates, sovereigns and banks not secured by eligible collateral. Collateral is to be taken into account based on the capital rules for recognising the effects of collateral that is eligible under Basel. There is no special treatment for covered bonds. The CRR sets out a LGD of 11.25% for covered bonds (defined in Article 124).
Materiality	The data analysis from a limited number of banks indicates that the finding is unlikely to be material.
Basel paragraph(s)	288: Loss given default
Reference in the domestic regulation	CRR: Articles 157, 223(2), 225(1)-(2)
Findings	Under the foundation IRB approach, Basel assigns a 75% LGD to all subordinated claims on corporates, sovereigns and banks. The CRR specifies a LGD of 75% only for unsecured subordinated exposures. For secured subordinated exposures, the CRR allows financial collateral to be recognised in the LGD estimate. For non-financial collateral, the CRR sets minimum LGD for exposures secured by receivables, residential real estate or commercial real estate at 65%, and at 70% for exposures secured by other physical collateral.
Materiality	The data analysis from a limited number of banks indicates that the finding is unlikely to be material.
Basel paragraph(s)	319: Effective maturity
Reference in the domestic regulation	CRR: Article 158(4)
Findings	Basel allows discretion for national supervisors to exempt exposures to small domestic corporate obligors from calculating the maturity adjustment, if the reported sales as well as total assets for the consolidated group of which the firm is a part of are less than EUR 500 million. In such a case, all exposures to qualifying small domestic corporate obligors will apply a maturity of 2.5 years. The CRR applies the national discretion, but sets a higher threshold of EUR 1000 million for corporates which primarily own and let non-speculative residential property.
Materiality	The materiality could not be assessed quantitatively. As the capital requirements under Basel rules could be higher or lower depending on the effective maturity of the exposure, the team experts considered this finding unlikely to be material.
Basel paragraph(s)	320- 324, 368: maturity floors

Reference in the domestic regulation	CRR: Article 158(2)(e)
Findings	Basel sets a maturity floor of 1 year for purchased corporate receivables. The CRR sets a maturity floor of 90 days, with the effect that capital computed for purchased corporate receivables under the CRR can be lower.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	344- 355: Rules for equity exposures
Reference in the domestic regulation	CRR: Articles 150, 161
Findings	The capital computation rules for equity exposures in the banking book in the CRR under the IRB approach differs from Basel in the following aspects: 1. For the simple risk weight method, Basel applies a 300% risk weight to equity holdings that are publicly traded and a 400% risk weight to all other equity holdings. The CRR sets a risk weight of 190% for private equity exposures in sufficiently diversified portfolios, 290% for exchange traded equity exposures and 370% for all other equity exposures. 2. For the PD/LGD approach, the CRR applies a LGD of 65% for private equity exposures in diversified portfolios, which is lower than the LGD of 90% specified by Basel. 3. For the internal models approach and PD/LGD approach, minimum risk weights are based on the simple risk weight approach under Basel. The CRR sets minimum PDs and LGDs for different types of equity exposures. The effective minimum risk weight under the CRR approach is significantly lower for private equity exposures in diversified portfolios.
Materiality	The data analysis indicates the finding is unlikely to be material.
Basel paragraph(s)	360-361: Equity exposures to funds
Reference in the domestic regulation	CRR: Article 147
Findings	Basel permits investments in funds to be treated either as an investment based on the majority of a fund's holdings or based on a look-through approach. The CRR permits a bank, when applying the look-through approach, to use an adjusted form of the standardised approach if it cannot use the IRB approach to determine risk-weighted asset amounts for the underlying exposures. Effectively this is a form of permanent partial use.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the finding is unlikely to be material.
Basel paragraph(s)	369: Dilution risk
Reference in the domestic regulation	CRR: Articles 156(6), 159(3), 157(1)(g), 160(1) and 153(4)
Findings	1. Basel uses the corporate risk-weight function for the purpose of calculating risk weights for dilution risk, with PD set equal to the estimated expected loss and LGD set at 100%. The CRR similarly sets PD to the estimated Expected Loss, but a lower LGD value of 75%. 2. Basel provides that the supervisor may allow a bank to apply a one-year maturity if a bank can demonstrate that the dilution risk

	is appropriately monitored and managed to be resolved within one year. The CRR sets maturity at one year for the calculation of capital of dilution risk without any qualifications.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	380-383: Calculation of provisions
Reference in the domestic regulation	CRR: Articles 105, 155
Findings	Basel requires total eligible provisions to be measured against expected loss. Expected loss in excess of total eligible provisions are deducted from capital, while total eligible provisions in excess of expected loss may be recognised in capital. The CRR includes “additional value adjustments” on fair valued positions and “other own funds reductions”, which are not recognised under Basel, in the total eligible provisions for comparison with expected loss.
Materiality	Materiality could not be assessed quantitatively. Based on qualitative considerations of the team experts, this finding may be potentially material.
Basel paragraph(s)	396-397: Ratings system design
Reference in the domestic regulation	CRR: Articles 166, 168
Findings	Basel requires that a borrower be assigned a single PD, with two exceptional cases. The CRR adds a third exceptional case, permitting a borrower to be assigned multiple PDs when “consumer protection, bank secrecy, or other legislation prohibits the exchange of client data”.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the finding is unlikely to be material.
Basel paragraph(s)	415: Definition of PD
Reference in the domestic regulation	CRR: Article 167(2)
Findings	Basel states that PD estimates must represent borrowers’ willingness and ability to repay despite adverse economic conditions or the occurence of unexpected events, whereas the CRR sets out that the institution shall take all relevant information into account in assigning obligors and facilities to grades or pools, and that the information shall be current and shall enable the institution to forecast the future performance of the exposure.
Materiality	Materiality could not be assessed quantitatively. The team experts considered that the CRR is less specific than Basel in setting out important criteria for PD estimation. The team experts recommend that this be followed up under the Level 3 assessment.
Basel paragraph(s)	441-442: Credit risk control
Reference in the domestic regulation	CRR: Article 186
Findings	Basel requires that a bank’s independent credit risk control unit be responsible for the production and analysis of summary reports from the bank’s rating system, which must include historical default data sorted by rating at the time of default and one year prior to default; grade migration analysis; and monitoring of trends in key rating criteria. The CRR includes the general production and analysis of summary reports requirement, but does not specify the content of

	those reports.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the finding is unlikely to be material.
Basel paragraph(s)	510: Collateral management
Reference in the domestic regulation	CRR: Articles 195 and 203
Findings	Basel includes as collateral management requirements that a bank must monitor on an ongoing basis the extent of any permissible prior claims on a property and the risk of environmental liability arising from collateral. The CRR does not include these specific requirements.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the finding is unlikely to be material.
Basel paragraph(s)	524: Recognition of leasing
Reference in the domestic regulation	CRR: Article 152
Findings	Basel requires the residual value of a lease be risk weighted at 100%. The CRR uses the formula (1/t)*100% (where t is the number of years of lease outstanding) to determine residual value. The risk weight will be 100% in the final year of the lease, but decreases as the number of years of lease outstanding increase.
Materiality	The data analysis indicates that the finding is not material.
Basel paragraph(s)	Treatment of trade finance under the Basel capital framework (October 2011 release)
Reference in the domestic regulation	CRR: Article 116
Findings	Basel allows the risk weight for short-term, self-liquidating letters of credit with unrated banks to be lower than the risk weight of the bank's sovereign of incorporation; the CRR does not include a similar provision.
Materiality	Materiality was not assessed quantitatively as the team experts judged that the capital requirement under the CRR would always be at least as conservative as, and possibly super-equivalent to, the Basel framework.

2.4.3 Securitisation framework

Section Grading	(Compliant)
Summary	Although some aspects of the proposed CRR vary from the Basel framework governance and risk management requirements, the aggregate effect was assessed as unlikely to be material.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	565 (amended by Basel III): Operational criteria for credit analysis
Reference in the domestic regulation	CRR: Article 396
Findings	Basel requires that securitisation exposures for which a bank does not meet the operational criteria for credit analysis be risk weighted at 1250%. The CRR requires that a bank meet the operational criteria specified in the Basel 2.5; however, the penalty for not meeting them

	is a risk weight determined by the national supervisor ranging between 250% and 1250%.
Materiality	Materiality could not be assessed quantitatively. The team experts considered this finding to be potentially material given financial stability implications as the CRR signals regulatory tolerance for banks investing in securitisation exposures based solely on credit ratings.
Basel paragraph(s)	586: Eligible securitisation guarantors
Reference in the domestic regulation	CRR: Article 242
Findings	Basel prohibits special purpose entities from being recognised as eligible guarantors. Article 242 of the CRR permits recognition of special purpose entities as guarantors provided they meet a specified ECAI rating threshold or they own assets that qualify as eligible financial collateral and meet certain other requirements.
Materiality	Materiality was not assessed quantitatively. The CRR may allow more complex structuring of securitisation arrangements.
Basel paragraph(s)	594 and 610: Maximum capital requirement
Reference in the domestic regulation	CRR: Article 247
Findings	Basel does not cap the capital requirement for securitisation exposures subject to the standardised approach for a bank not subject to the early amortisation treatment, whereas the CRR imposes a cap based on the risk-weighted exposure amounts of the underlying exposures.
Materiality	Materiality was not assessed quantitatively. According to the expert judgement of the team, the finding was unlikely to be material.
Basel paragraph(s)	Internal Ratings-Based Approach for Securitisation Exposures (no specific paragraph)
Reference in the domestic regulation	CRR: Article 261
Findings	Basel does not specify the amount of a securitisation exposure to be risk weighted under the IRB approach. The CRR requires the notional amount to be risk weighted, but then allows the risk-weighted asset amount to be reduced by 12.5 times any specific credit risk adjustment, a reduction that is also not specified in Basel II. As a result, the capital requirement for a securitisation exposure with a high risk weight for which a bank has taken a partial write-down can be quite low relative to the capital requirement determined by risk weighting the carrying value of the exposure.
Materiality	Materiality was not assessed quantitatively as there is no specific Basel text against which to make the comparison.

2.4.4 Counterparty credit risk rules

Section Grading	(Largely compliant)
Summary	The EU provisions are consistent with most of the Basel counterparty credit risk rules. Certain transcription differences exist concerning minor provisions and certain CCR methods (the so-called EU “original exposure method” and “extended maturity ladder approach”) are not

	recognised by Basel. Together, these observations justify a "largely compliant" grading. The EU exemption of capitalisation of CVA risk related to pension funds is non-compliant with Basel. The assessment team judged that the likely impact of this non-compliance would not be sufficiently material to result in a "materially non-compliant" grade for the CCR segment.
Overview of findings by Basel paragraph(s):	
Basel paragraph(s)	69-96 of Basel II Annex 4: Standardised method
Reference in the domestic regulation	CRR: Articles 269-270
Findings	The CRR's "Mark-to-market method" recognises an extended maturity ladder approach for defined commodity exposures; Basel's Standardised method has no such provision. The CRR's "Original exposures method" is not recognised under Basel's Standardised method. The CRR approach is considered to be a simpler and more conservative version of the Basel Standardised method.
Materiality	Materiality was not assessed quantitatively as the team experts expect most internationally active banks in Europe would use the internal models approach for CCR. It is noted that the CRR (Article 482) proposes to clarify these impacts in a report to be submitted by the Commission by 31 December 2016.
Basel paragraph(s)	99 of Basel III: Treatment of mark-to-market counterparty risk losses (CVA capital charge)
Reference in the domestic regulation	CRR: Article 461
Findings	The CRR provides for institutions to be exempted from CVA capital charges for derivatives transactions entered into with pension scheme arrangements. Basel does not exempt any counterparty types from the CVA capital charge.
Materiality	Materiality could not be assessed quantitatively.

2.4.5. Market risk: standardised method

Section Grading	(Largely compliant)
Summary	The CRR provisions are consistent with most of the Basel market risk rules, except the EU so-called "extended maturity ladder approach" and the EU provisions for underwriting and collective investment undertaking (CIU) which are not market risk methods recognised by Basel II.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	683(i)-718: Market risk
Reference in the domestic regulation	CRR: Articles 334, 337, and 348-350
Findings	CRR provisions on own funds requirements for CIUs (position risk of 32%), reduction of net underwriting positions (short term reduction up to 5 days), and an extended maturity ladder approach for defined commodity exposures, are not recognised under the Basel

	standardised method. The extended maturity ladder approach is targeted at specialised commodities dealers that have not implemented internal models but want to use a more risk sensitive approach. Basel expects institutions engaging in sophisticated commodities activities to use the internal models approach.
Materiality	Materiality could not be assessed quantitatively but as per the judgement of the team experts the finding is unlikely to be material.
Basel paragraph(s)	689(i): Internal hedge
Reference in the domestic regulation	CRR: Articles 97-101
Findings	CRR defines and recognises internal hedges in the calculation of capital requirements for position risk provided they are held with trading intent and that the requirements of Articles 98 to 101 are met. These EU provisions focus on internal hedges between trading and banking books. They do not refer explicitly to the treatment of internal hedges between trading books in different legal entities. Basel is far less explicit on the definition of internal hedges and their inclusion as part of the trading book consolidation.
Materiality	This item does not affect the compliance assessment for the EU review. It is included here as an item that would benefit from more clarity in the Basel framework.
Basel paragraph(s)	16 and footnote 3 of Basel II (amended by Basel 2.5): Exclusion from trading book
Reference in the domestic regulation	Nil
Findings	Under Basel, open equity stakes in hedge funds, private equity investments, positions in a securitisation warehouse and real estate holdings do not meet the definition of trading book. The Basel view is not reflected in the CRR.
Materiality	Materiality was not assessed quantitatively. However, because the financial instruments referred to above are generally recognised as banking book exposures and cannot fulfil the Basel trading book eligibility criteria, the team experts considered the absence of specific reference in the CRR tunlikely to be material.
Basel paragraph(s)	718 (Lviii), 718(Lix)-718(Lxii), 718(Lxiii)-718(Lxix) (amended by Basel 2.5): Treatment of second order market risks
Reference in the domestic regulation	CRR: Article 318
Findings	The CRR provisions corresponding to the market risk standardised approach do not include the explicit approaches defined by Basel to calculate the market risk requirements beyond delta risks for options, equity position risks or foreign exchange risks. These provisions will be covered by EBA technical standards due by 31 December 2013.
Materiality	Materiality was not assessed quantitatively as the team experts expect most internationally active banks in Europe would use the internal models approach for market risk.

2.4.6 Market risk: internal models approach

Section Grading	(Compliant)
Summary	No significant differences have been identified.
Overview of findings by Basel paragraph(s):	
Basel paragraph(s)	
Reference in the domestic regulation	
Findings	
Materiality	

2.4.7 Operational risk: basic indicator approach and standardised approach

Section Grading	(Largely compliant)
Summary	The CRR provisions regarding implementation of the Basic Indicator Approach and The Standardised Approach for operational risk are largely compliant with the corresponding Basel provisions. However, the CRR does not enjoin upon the supervisory authorities responsibility for reviewing the capital requirement produced by the operational risk approach used by a bank for general credibility and, especially ensuring that the internationally active banks and banks with significant operational risk exposures use a more sophisticated approach commensurate with their operational risk profile. The CRR also allows the regulated institutions to reduce the operational risk exposure indicator (Gross income) by the amount of expenditure incurred from an undertaking subject to the CRR or equivalent rules. Collectively, the above exceptions raise some concerns regarding proper capitalisation of operational risk exposure of EU banks as envisaged under the Basel framework.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	647: Adoption of approaches by internationally active banks
Reference in the domestic regulation	Nil
Findings	Basel requires that supervisors will review the capital requirement produced by the operational risk approach used by a bank (whether Basic Indicator Approach, Standardised Approach or AMA) for general credibility, especially in relation to a firm's peers. In the event that credibility is lacking, appropriate supervisory action under Pillar 2 will be considered. Internationally active banks and banks with significant operational risk exposures (for example, specialised processing banks) are expected to use an approach that is more sophisticated than the Basic Indicator Approach and that is appropriate for the risk profile of the institution. The CRR does not contain corresponding provisions. Absence of corresponding provisions in the CRR could potentially lead to banks continuing to follow a particular approach even if it has ceased to reflect its operational risk profile appropriately.

Materiality	The data analysis indicates that a significant number of internationally active banks follow the standardised approach for operational risk. However, in the judgement of the team experts, the finding is unlikely to be material.
Basel paragraph(s)	650: Gross income as an indicator of operational risk exposure
Reference in the domestic regulation	CRR: Article 305
Findings	Basel defines gross Income to be gross of operating expenses, including fees paid to outsourcing service providers. However, the CRR allows an exception "for expenditure on the outsourcing of services rendered by third parties where the expenditure is incurred from an undertaking subject to rules under, or equivalent to this Regulation". The exception may result in undercapitalisation of operational risks by banks that outsource services to other financial entities.
Materiality	Materiality could not be assessed quantitatively. Based on the likely small impact on the capital position of banks, the team experts considered the finding unlikely to be material.

2.4.8 Operational risk: advanced measurement approaches

Section Grading	(Largely compliant)
Summary	The CRR provisions regarding implementation of the Advanced Measurement Approaches for operational risk are largely compliant with the corresponding Basel provisions. However, in the case of banks which are subsidiaries of other financial institutions, the CRR does not require that the supervisory authorities confine the use of allocation mechanisms and incorporation of diversification benefits to situations where the subsidiaries are considered not significant. The CRR also allows AMA banks to use operational risk mitigants other than insurance but information provided by the banks indicated that such mitigants were not in use. Collectively, the above exceptions raise some potential concerns regarding proper capitalisation of operational risk exposure of EU banks as envisaged under Basel II Framework.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	656- 658: AMA capital allocation mechanisms and incorporation of diversification benefits
Reference in the domestic regulation	CRR: Article 18(1), and Paragraphs 58 and 597 of CEBS Guideline 10
Findings	Under Basel, a bank adopting the AMA may, with the approval of its host supervisors and the support of its home supervisor, use an allocation mechanism for the purpose of determining the regulatory capital requirement for internationally active banking subsidiaries. However, this allocation mechanism is to be considered only in cases where the subsidiaries are not deemed to be significant relative to the overall banking group. Similarly, the diversification benefits should not be incorporated in cases where the stand alone capital requirements are considered appropriate (eg where the subsidiary is considered to be significant). The CRR provisions and the CEBS guideline do not require that the

	allocation mechanism and diversification benefits be permitted only in cases where the subsidiaries are not considered significant, though the provisions do require the supervisors to call for information relating to allocation mechanisms and diversification benefits while processing applications for adopting AMA. The absence of a corresponding provision in the CRR could potentially lead to some supervisory authorities not restricting the allocation mechanisms and diversification benefits only to subsidiaries which are not deemed significant.
Materiality	The data analysis indicates that the finding is unlikely to be material.
Basel paragraph(s)	677: Risk mitigation
Reference in the domestic regulation	CRR: Article 312 and Paragraph 578 of CEBS Guideline 10
Findings	Basel does not explicitly allow banks to use operational risk mitigants other than insurance, though footnote 110 notes that the Committee intends to continue an ongoing dialogue with the industry on the use of risk mitigants for operational risk and, in due course, may consider revising the criteria for and limits on the recognition of operational risk mitigants on the basis of growing experience. However, CRR explicitly allows other risk transfer mechanisms where the institution can demonstrate that a noticeable risk mitigating effect is achieved.
Materiality	The data analysis indicates that AMA banks are not generally using any risk mitigants other than insurance in their operational risk capital computations. Given that Guideline 10 of CEBS expects competent authorities to apply an appropriate level of standards for the recognition of other risk transfer mechanisms, and to count these mechanisms within the limit of 20% of operational risk capital, the team experts considered this finding unlikely to be material.

2.4.9 Capital buffers (conservation and countercyclical)

Section Grading	(Compliant)
Summary	No significant differences have been identified.
Overview of findings by Basel III paragraph(s):	
Basel paragraph(s)	
Reference in the domestic regulation	
Findings	
Materiality	

2.5 Pillar 2: Supervisory review process

Section Grading	(Compliant)
Summary	The CRD requires institutions to undertake internal capital adequacy assessment processes to assess and maintain adequate capital to cover their risks. It provides broad supervisory powers to national authorities (under Article 100) to, among other things, impose additional reporting and require additional disclosures, and require

	institutions to hold additional capital, improve internal processes, present capital remediation plans, apply specific provisioning policy, restrict or limit businesses, reduce risk, and restrict distributions. The CRD also imposes obligations on national authorities to assess internal capital adequacy assessment processes and risk management systems of institutions. On the basis that the CRD has set out the powers and responsibilities of the national authorities in respect of the supervisory review process, the team experts considered the EU rules to be compliant. For the purpose of this review, the team experts did not review the regulations of each national regulator in respect of their Pillar 2 requirements.
Overview of findings by Basel paragraph(s):	
Basel paragraph(s)	
Reference in the domestic regulation	
Findings	
Materiality	

2.6 Pillar 3: Market discipline

Section grading	(Compliant)
Summary	The CRR provisions are overall consistent with Basel requirements for Pillar 3 disclosures. National supervisory authorities can require disclosures beyond the Basel standards. The differences noted below between certain CRR provisions and the Basel texts are not material.
Overview of findings by Basel II paragraph(s):	
Basel paragraph(s)	818: Frequency of disclosure
Reference in the domestic regulation	CRR: Article 420 and CRD: Article 100(k)
Findings	Basel II states that internationally active banks must disclose their Tier 1 and total capital adequacy ratios, and their components, on a quarterly basis. The CRR requires Pillar 3 disclosures to be "at least on an annual basis". The CRR does not specify requirements for "internationally active banks" but instead requires institutions to take account of their business characteristics to assess the need to disclose more frequently than annually. The CRD stipulates that supervisors shall have the power to require additional disclosures by institutions. For the purpose of this review, the team experts did not review the regulations or practice of each national regulator in respect of this provision.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the finding is unlikely to be material.
Basel paragraph(s)	Table 4 paragraphs (a) and (i): IRB qualitative and quantitative disclosures
Reference in the domestic regulation	CRR: Articles 425-428

Findings	The CRR requires a breakdown of exposures by exposure class and approach, and disclosures both for the use of standardised and IRB approach. But the CRR does not reproduce fully the Basel II qualitative disclosure requirements for banks that have partly but not fully adopted either the foundation IRB or the advanced-IRB approach.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the finding is unlikely to be material.
Basel paragraph(s)	Pillar 3 Disclosure Requirements for Remuneration, July 2011
Reference in the domestic regulation	CRR: Article 435 and EBA standards
Findings	Basel requires disclosure of the number of meetings held by the main body overseeing remuneration and of the number and total amount of guaranteed bonuses awarded during the financial year. These requirements are not stated in the CRR.
Materiality	Materiality was not assessed quantitatively. In the judgement of the team experts, the finding is unlikely to be material.

Annexes

A. Glossary

ABCP	Asset Backed Commercial Paper
AMA	Advanced Measurement Approach (operational risk)
AT1	Additional Tier 1 (capital)
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CCP	Central Counterparty
CCR	Counterparty Credit Risk
CEBS	Committee of European Banking Supervisors
CET1	Common Equity Tier 1 (capital)
CIU	Collective Investment Undertaking
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CVA	Credit Valuation Adjustment
EAD	Exposure at Default
EBA	European Banking Authority
EC	European Commission
ECAI	External Credit Assessment Institution
ECB	European Central Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
EU	European Union
FSB	Financial Stability Board
GDP	Gross Domestic Product
G-SIB	Global Systemically Important Bank
IFRS	International Financial Reporting Standards
IRB	Internal Rating Based approach (credit risk)
LGD	Loss Given Default
PD	Probability of Default
PON	Point of Non-Viability
PSE	Public Sector Entity
RBA	Ratings-Based Approach
RWA	Risk weighted Asset
SFA	Supervisory Formula Approach (for securitisations)
SFT	Securities Financing Transactions
SIG	Standards and Implementation Group (BCBS working group)
SSFA	Simplified Supervisory Formula Approach (for securitisations)
UCITS	Undertakings for Collective Investments in Transferable Securities

B. List of findings for follow-up assessment

- Inclusion of other than “common shares” in CET1
- Cumulative gains and losses from changes in fair valued liabilities due to changes in own credit standing
- The capital treatment of investments in the capital of insurance entities
- Transitional arrangements for capital instruments issued after 12 September 2010
- Implementation of PON loss absorbency requirement
- Claims on banks under the standardised approach
- Slotting criteria for specialised lending
- Permanent partial use under the IRB approach
- LGD floor for residential mortgages
- Asset value correlation multiplier for large regulated financial institutions
- Eligible provisions under the IRB approach
- Determination of PD estimates
- Operational criteria for use of external credit assessments in securitisation
- Use of an extended ladder approach for defined commodity exposures and “original exposures method” under standardised approach
- Exempting pension scheme arrangements from CVA capital charges
- Link between treatment of incurred CVA and calculation of EL excess/shortfall for IRB banks
- Market risk treatments of CIUs, underwriting positions and the extended maturity ladder approach for defined commodity exposures
- Definition of trading book

C. Referenced documents

List of consulted public EU documents (chronological order)

- European Banking Authority, Consultation Paper on Draft Regulatory Technical Standards for credit valuation adjustment risk on the determination of a proxy spread and the specification of a limited number of smaller portfolios (EBA/CP/2012/09), 11 July 2012
- European Banking Authority, Consultation Paper on the concept of Gain on Sale associated with future margin income in a securitisation context (EBA/CP/2012/07), 12 June 2012
- European Commission, Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directives 77/91/EEC and 82/891/EC, Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC and 2011/35/EC and Regulation (EU) No 1093/2010, 6 June 0212
- Council of the European Union, PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate - Council general approach, agreed on 15 May 2012 and published on 21 May
- Council of the European Union, PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on prudential requirements for credit institutions and investment firms - Council general approach, agreed on 15 May 2012 and published on 21 May
- European Banking Authority, Guidelines on Stressed Value At Risk (Stressed VaR), EBA/GL/2012/2, 16 May 2012
- European Banking Authority**,** Guidelines on the Incremental Default and Migration Risk Charge (IRC) (EBA/GL/2012/3), 16 May 2012
- European Parliament, DRAFT EUROPEAN PARLIAMENT LEGISLATIVE RESOLUTION on the proposal for a regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms Draft Legislative Resolution, agreed on 14 May 2012 and published on 24 May 2012
- European Banking Authority, Consultation Paper on Draft Regulatory Technical Standards on Own Funds – Part one (EBA/CP/2012/02), 4 April 2012
- Council of the European Union, PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate – Presidency Compromise, 2 April 2012
- Council of the European Union, PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on prudential requirements for credit institutions and investment firms - Presidency Compromise, 2 April 2012

- European Commission, PROPOSAL FOR A DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, 20 July 2011
- European Commission, PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on prudential requirements for credit institutions and investment firms, 20 July 2011
- DIRECTIVE 2006/48/EC OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (recast), 9 December 2011
- European Banking Authority, Guidelines on the implementation, validation and assessment of Advanced Measurement (AMA) and Internal Ratings Based(IRB) Approaches, 4 April 2006

List of Basel documents

- Basel II: International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version (June 2006)
- Enhancements to the Basel II framework (July 2009)
- Guidelines for computing capital for incremental risk in the trading book (July 2009)
- Basel III: International framework for liquidity risk measurement, standards and monitoring (December 2010)
- Final elements of the reforms to raise the quality of regulatory capital issued by the Basel Committee (January 2011)
- Revisions to the Basel II market risk framework - updated as of 31 December 2010 (February 2011)
- Basel III: A global regulatory framework for more resilient banks and banking systems - revised version (June 2011)
- Treatment of trade finance under the Basel capital framework (October 2011)
- Interpretive issues with respect to the revisions to the market risk framework (November 2011)
- Global systemically important banks: Assessment methodology and the additional loss absorbency requirement (November 2011)
- Basel III definition of capital - Frequently asked questions (update of FAQs published in October 2011)

D. EU authorities met by the EU Assessment Team

EU-wide authorities

Council of the European Union

European Commission (Main Counterpart of the EU Review Team)

European Banking Authority

European Central Bank

European Parliament

Banking authorities in the European Union

Belgium:	National Bank of Belgium
France:	Autorité de Contrôle Prudentiel
Germany:	Deutsche Bundesbank
	German Financial Supervisory Authority (BAFin)
Italy:	Bank of Italy
Luxembourg:	Surveillance Commission for the Financial Sector
Netherlands:	The Netherlands Bank
Spain	Bank of Spain
Sweden:	Sveriges Riksbank
	Finansinspektionen
United Kingdom:	Bank of England
	Financial Services Authority

E. List of EU banks

The assessment team sought data, through the supervisory authorities, from the following banks in nine countries that are members of both the Basel Committee and the EU. The list of banks was agreed with the supervisory authorities based on a combination of asset size and cross-border importance. Given the tight timeframes and competing priorities for European banks and their supervisory authorities, the team did not receive a full response from every bank listed below.

Belgium

1. KBC Bank NV

France

2. BNP Paribas
3. Crédit Agricole Group
4. BPCE Group
5. Société Générale

Germany

6. Deutsche Bank AG
7. Commerzbank AG
8. Hypo Real Estate Holding AG
9. Landesbank Baden-Wuerttemberg
10. Bayerische Landesbank
11. DZ Bank AG DT. Zentral-Genossenschaftsbank
12. Norddeutsche Landesbank –GZ
13. Deutsche Postbank AG
14. WestLB AG

Italy

15. UniCredit
16. Intesa Sanpaolo
17. Monte Dei Paschi Di Siena
18. Banco Popolare – S.C.

Luxembourg

19. Banque et Caisse d'Épargne de L'État

Netherlands

20. ING Bank
21. Rabobank Group
22. ABN/FORTIS Bank Nederland (Holding) N.V.

Spain

23. Grupo Santander
24. Grupo BBVA
25. CaixaBank

Sweden

26. Nordea Bank
27. Skandinaviska Enskilda Banken AB (SEB)
28. Svenska Handelsbanken
29. Swedbank

UK

30. Royal Bank of Scotland
31. HSBC Holdings PLC
32. Barclays
33. Lloyds Banking Group