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Abstract

The implementation of Basel III in European law is rapidly approaching and represents the first step towards a uniform supervisory framework.

Basel III and its European implementation - creating a Single Rule Book.

The implementation of Basel III in European law is rapidly approaching. In July 2011 the European Commission adopted a bill, submitting it to the European Parliament and the EU Council for consultation. It consists of two separate legal acts, an EU directive (CRD IV)[1] and an EU regulation (CRR)[2] . The legislative procedure is nearing its finish and the bills are expected to be adopted by the Parliament or Council by the middle of the year. Amendments resulting from both the CRR and CRD IV should be put into practice as from 01/01/2013. The familiar topics generally subsumed under "Basel III" include:

- the revision of the definition of equity under banking supervision, with which the quality and quantity of the banks' equity is supposed to be improved and the ascertainment of it standardised
- an increase in the equity requirements resulting from creating additional capital buffers (gradually as from 2016), and a surcharge for accounts receivable from other major financial institutions (so-called "asset value correlation", as from 2013)
- the introduction of new liquidity metrics, i.e. a "liquidity coverage ratio" (LCR) and "net stable funding ratio" (NSFR), with the aim of better preparing the financial sector for future situations of financial distress on the money market, as well as
- the introduction of a leverage ratio as a new regulatory instrument. This is a reaction to the financial crisis, in which banks had partially built up high balance sheet and off-balance sheet indebtedness, without this being reflected to the same extent in an expansion of the equity requirements from the perspective of banking supervision.

These four items on the agenda make up a considerable proportion of the innovations. It is, however, also to be borne in mind that the amendment of the supervisory regulatory framework constitutes a change in the paradigm in regulatory law in comparison to the previous form of legislation.

Up to now, concepts of the Basel Committee on Banking Supervision (BCBS) drawn up at the international level have been taken into consideration in the corresponding European directives. The latter has been implemented by the individual member countries into national law by way of adoption or partial adoption, making use of corresponding options. In Germany, this led to corresponding regulations being

[1] "Proposal for a Directive of the European Parliament and of the Council" as amended on 20 July 2011 (the EU "Capital Requirements Directive" (CRD IV)).

[2] "Regulation on the amendment of the equity and capital requirements directive" (2006/48/EC and 2006/49/EC) (EU "Capital Requirements Regulation" (CRR)).

drafted for special regulatory situations "below the level of" the German Banking Act. The latter include, for example, the solvability regulation (SolvV) or the regulation on large- and-very-large scale loans (GroMiKV).

As the illustration below shows, with the implementation of the "Basel NT concepts" at European level a new route is being taken, which - besides the contents of the innovations already outlined - also provides for standardisation of regulatory law.

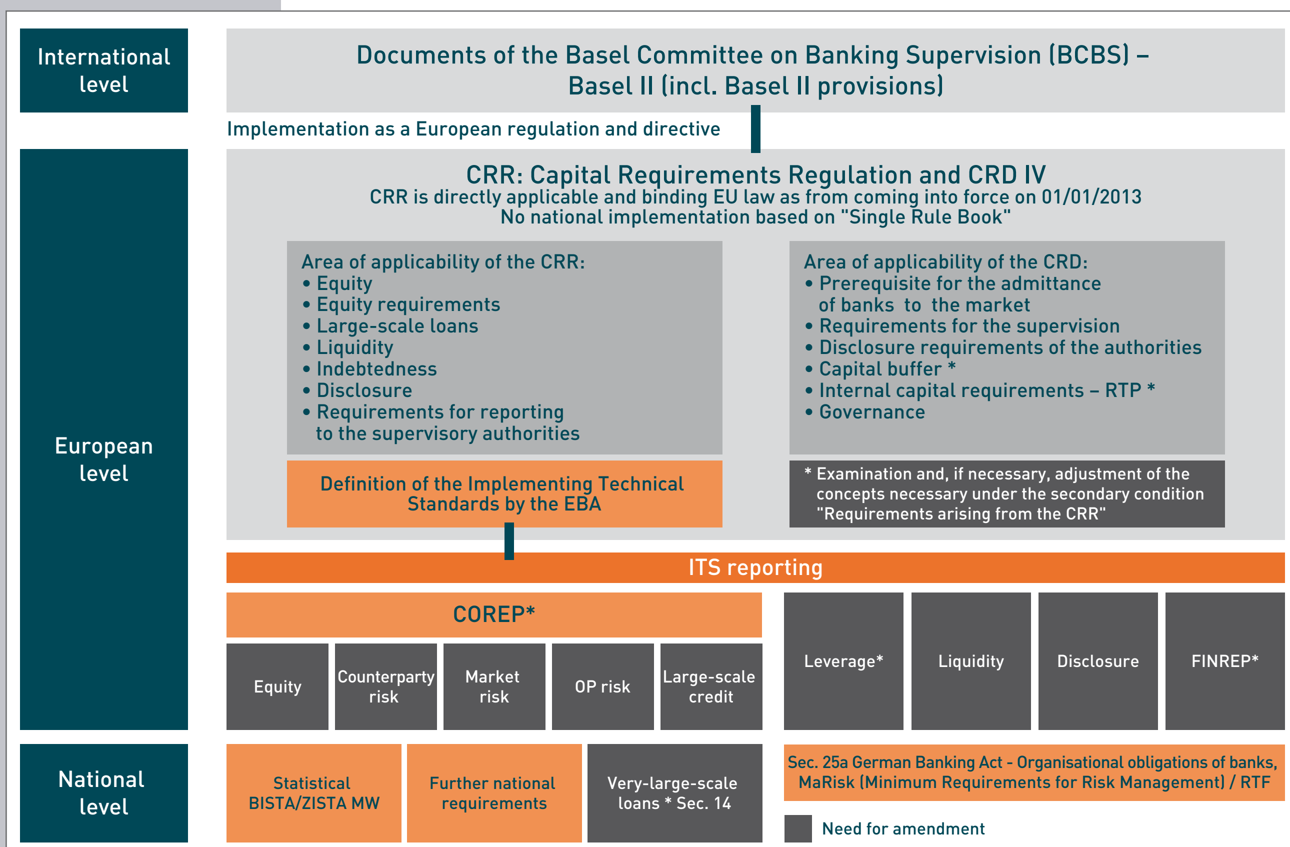

Figure 1: New regulations from "Basel III" and the principle of the Single Rule Book

The implementation of most of the requirements through a regulation, viz. the Capital Requirements Regulation (CRR), means that national scope for leeway, as well as the time-consuming process of national implementation, are dispensed with: The CRR will become directly applicable and binding EU law, which, as per the Single Rule Book policy, does not leave any more leeway for national interpretations and country-specific options. The regulations of individual countries already in place will thereby become devoid of power as well. The national legislator as a "filter" en route to the actual harmonisation of the supervisory regime throughout the EU will therefore lapse.

The harmonisation of the regulatory package will be increased by intensifying the sovereignty of the European Banking Authority (EBA) to interpret the regulations. The CRR forms the basis for regulatory standards and standards of implementation to be decreed by the EBA in the form of executionary legal acts, namely the "Implementing Technical Standards" (ITS). The aim is to make any requirements of the CRR requiring interpretation more specific, such as what adjustments of rating systems or internal models are to be classified as essential, and thus as subject to approval.[3]

[3] See, in this respect, also the published work programme of the European Banking Authority (EBA) for 2012.

Within the scope of these standards, reporting for solvency reporting is also standardised under the term "Common Solvency Reporting" (COREP)[4]. Also in this case, the national discretionary powers are dispensed with. Besides information on the solvency, which, in Germany, is currently part of the Solvency Regulation Reports, the large-scale loan notices and the notifications on the liquidity metrics should also be issued along with COREP. The objective of COREP is also to obtain more detailed information on the solvency in regard to the equity and positions requiring equity backing.

Besides standardising the solvency reporting, via Article 95 CRR the CRR also creates the basis for uniform reporting of financial figures, by homogeneous reporting formats explicitly being required within the meaning of FINREP (Financial Reporting Standards). The latter currently apply to banks which prepare their balance sheet according to the accounting regulations as per the International Financial Reporting Standards (IFRSs)/International Accounting Standards (IASs). An extension to banking groups which balance their accounts based on national GAAP is cited within the scope of the consultation paper published by the EBA, "Implementing technical standards on supervisory reporting requirements for institutions (CP 50)". In that regard, there are also considerable changes to the original intention of FINREP, which is reflected in an increasing scope of reported data in 69 tables.

CRD IV/CRR
Interdependencies in regard to financial accounting

By introducing financial data reporting to regulatory law based on the CRR, a further overlap with financial accounting based on balancing of accounts under IFRSs is established. This is, however, not the only interdependency. The subject of "Taking into account international financial accounting regulations in the context of regulatory reporting" is promoted even further by the harmonisation described above. Under Sec. 10a(7) German Banking Act, banking and financial holding groups which, either mandatorily or voluntarily (cf. paras. 2 and 3 of Sec. 315a German Commercial Code), prepare their consolidated financial statements in line with IFRSs are obliged, at the latest upon expiry of the year 2013, to draw upon their consolidated financial statements prepared in accordance with IFRS to determine the equity level and risk positions.

Besides these interdependencies with the balancing of accounts under IFRSs already directly at this point in time arising from regulatory law, upcoming changes to balancing of accounts in line with IFRSs - IFRS 9 and IFRS 10 - also have an impact upon the regulatory regulations.

The IFRS 10 standard, which is to be applied for reporting periods as from 1 January 2013, refers to consolidation matters. For regulatory law concerns, the supervisory law scope of consolidation continues to be authoritative. Due to the differences between IFRSs and regulatory law, different companies are, however, to be included in the basis of consolidation, from which issues in regard to reconciling the accounts may result. In addition, different consolidation methods are available. In regard to

[4] At the present time, two consultation papers exist for reporting (COREP/FINREP), as well as for the large-scale loans. CP 50: Supervisory reporting requirements for institutions and CP 51: Supervisory reporting requirements for large exposure.

the basis of consolidation under German GAAP (in line with the German Commercial Code) and supervisory law, we are drawing the reader's attention to our own contribution in this edition of "Banking Secrecy" at this point.

The regulations of IFRS 9 - the mandatory application of which has been postponed by the International Accounting Standards Board (IASB) to reporting periods as from 1 January 2015 - will have major repercussions on metrics and control parameters under regulatory law. One or two significant repercussions are outlined below from the present-day perspective:

- IFRS 9 will lead to changing prerequisites compared to the previous classification of financial instruments if measured at fair value or amortised cost, and thus to repercussions as to the determination of the risk-weighted assets (RWA) by changing the basis for assessment. The latter may result in a change in the leverage ratio and the liquidity metrics.
- The expected loss approach / recognition under IFRS 9 will probably differ from the expected loss approach currently still applying under regulatory law. The risk management as per IFRS 9 will, in addition, have repercussions on the equity level under supervisory law and the determination of the RWA.
- The changes in the fair value of liabilities, for which the fair value option used to be exercisable, induced by the credit rating are in the future, as per IFRS 9, to be recognised under other comprehensive income. The provisions of the CRD-IV regulatory package make up for the latter through items to be deducted or a prudential filter. Also in regard to the prudential filter, reference is made to the independent article in this edition of "Banking Secrecy".

The following illustration should indicate the existing interdependencies schematically.

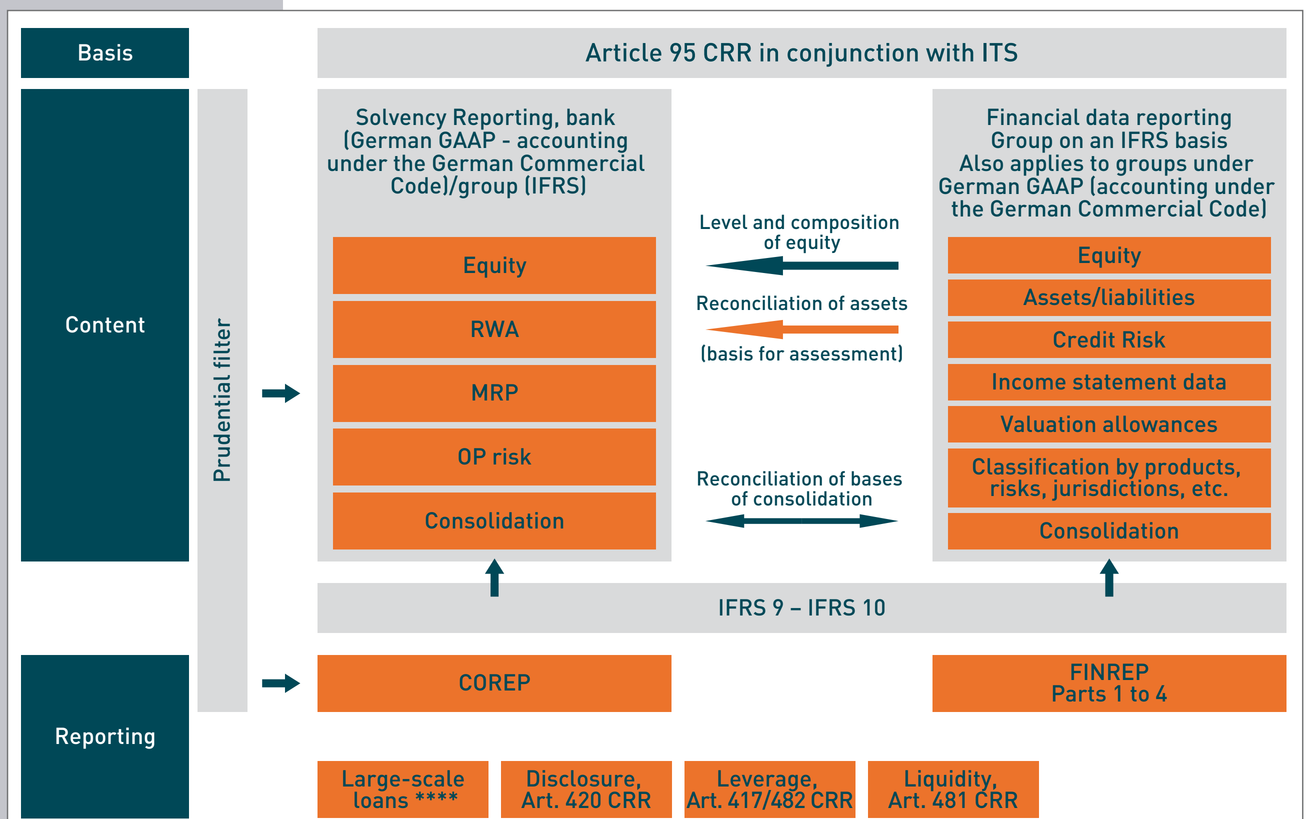

Figure 2: Interdependencies between financial accounting and regulatory law

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Conclusion

The interdependencies between regulatory law and balancing of accounts under IFRS indicated should allow for pointing out the multifaceted nature of the interrelations and the necessity of an integrated way of contemplating Besides creating a Single Rule Book, which is equivalent to a change of paradigm in regulatory law, all these new regulations make a more ex ante-orientated involvement necessary, instead of mere ex post reporting to regulatory reporting offices. In addition, the work of regulatory reporting offices, the financial accounting departments and the risk management departments does, as a result, become much more inter-connected.

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