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# Basel III: Now the hard part for European banks

**New banking rules will squeeze capital and profits. But there are ways that banks can cope.**

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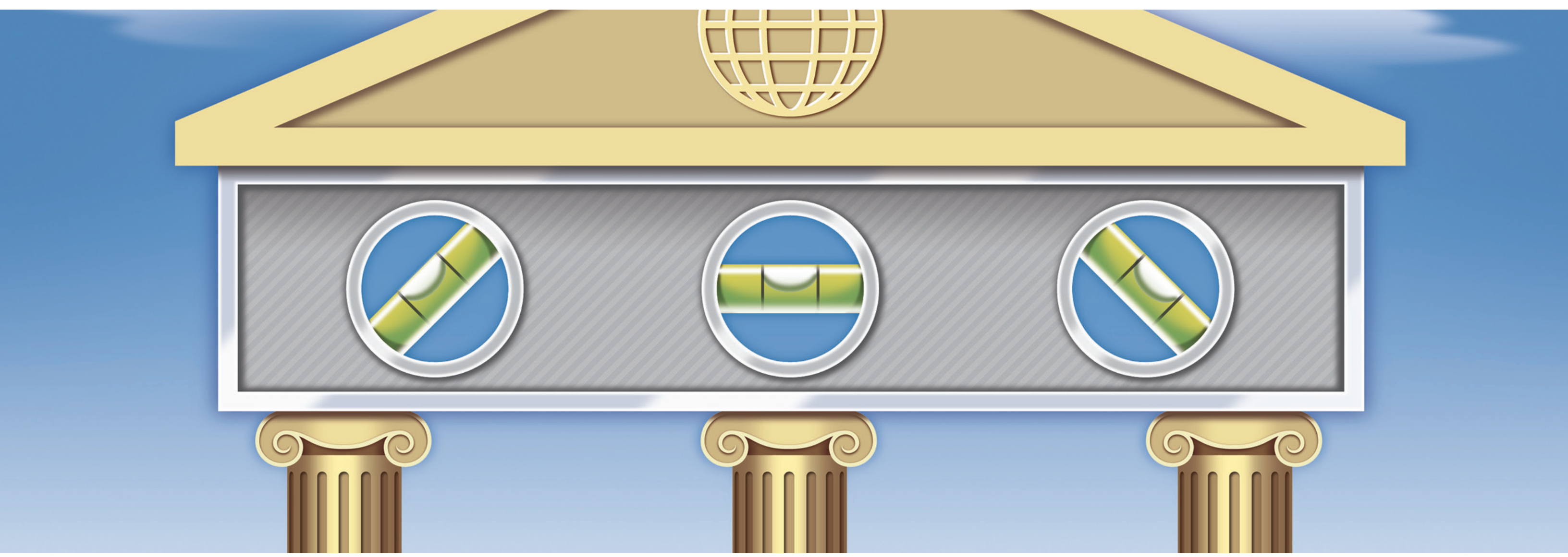


**At this month's G-20 summit** in Seoul, South Korea, global leaders endorsed the new rules on bank capital and funding issued by the Basel Committee on Banking Supervision. Now, banks in Europe and the United States face the challenge of finding ways to substantially boost their stocks of capital and funding under the new rules, which are intended to make the international banking system more resilient by addressing many of the flaws that became apparent during the credit crisis.

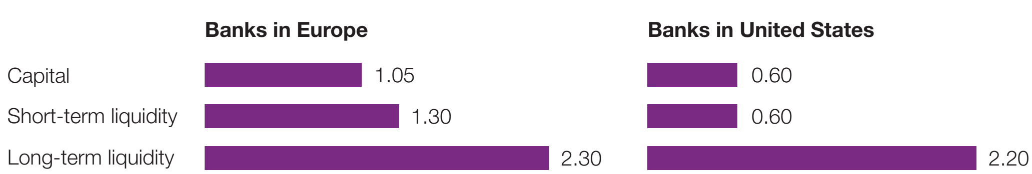
Our research suggests that the task will not be easy. Barring any mitigating actions, we estimate that banks in Europe and the United States will have to raise about €1.65 trillion of new capital, about €1.9 trillion of short-term liquidity, and about €4.5 trillion of long-term funding. The capital shortfall is equivalent to about 60 percent of all outstanding Tier 1 capital, and the short-term liquidity gap is about 50 percent of all the liquidity that banks currently hold. Banks are already mobilizing to reprice assets and cut costs further. Whatever they do, the new rules are sure to dent their profits. Our analysis shows that these rules could reduce return on equity (ROE) for the average European bank by between 3.7 and 4.3 percentage points by 2019, from the pre-crisis ROE average of 15 percent (pre-tax). Some banks might be hit even harder.

We believe banking leaders can respond through several actions. Among them is a set of "no regret" interventions to reduce capital and liquidity inefficiency. Banks can go further to restructure their balance sheets to improve the quality of capital and funding while also developing approaches to manage these scarce resources more thoughtfully. Some banks may recover up to 1.5 percentage points of ROE through these steps. Finally, several banks

Exhibit

**Basel III compliance may cause significant capital and liquidity shortfalls for Europe and the United States.**

Projected 2019 shortfalls assuming no mitigating actions, € trillion




Source: Annual reports; Global Insight; McKinsey analysis

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may seize the opportunity to effect substantial changes to their business model, making it more capital- and liquidity-efficient, adding new products, or scaling back some capital-intensive businesses. These steps may also help banks regain lost ground.

Download the full report, *Basel III and European banking: Its impact, how banks might respond, and the challenges of implementation*, at the McKinsey & Company Web site.

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