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Regulation Outlook

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Executive summary

In the first quarter of 2017, the BCBS published final standards on the regulatory treatment of accounting provisions for an interim period, and a final document on disclosure requirements which represents the second phase of the BCBS' Pillar 3 review. In the SSM framework, the ECB issued Guides on NPL, TRIM, ICAAP and ILAAP, and announced that it will conduct a stress test focused on interest rate changes risk the banking book (IRRBB).

Global publications

- The BCBS published **final standards** retaining the **current regulatory treatment of accounting provisions** for an interim period, and setting out requirements for those **transitional arrangements** that jurisdictions may choose to implement for mitigating the impact of expected credit losses approaches on regulatory capital.
- Moreover, the BCBS issued **final standards on disclosure requirements**, which represent the second phase of the BCBS's Pillar 3 review.
- The BCBS also published the second **consultative document on Guidelines** on the identification and measurement of **step-in risk**.
- Further, the BCBS published its **fourth progress report on banks' adoption of the RDA&RR principles**.
- Finally, the BCBS published a **consultative document on a revised assessment methodology for the identification of G-SIBs**.

European publications

- Following the proposal by the EC regarding the introduction of a transitional arrangement to mitigate the effect of IFRS 9 on regulatory capital, the EBA published an **opinion on this transitional arrangement**, proposing several recommendations on how it should be set out.
- With regard to internal models, the EBA published a **consultation paper on RTS specifying the nature, severity and duration of economic downturn**, according to which institutions shall estimate the downturn parameters. Moreover, the EBA issued a **report on the results of the 2016 benchmarking exercise** for market risk and high default portfolios (HDP).
- The EBA also published final **Guidelines on the liquidity coverage ratio (LCR) disclosures**.
- Finally, the EBA updated the **2016 list of other systemically important institutions (O-SIIs)**.

European publications (continuation)

- The ECB published several guides addressed to SSM significant institutions. In particular, the ECB issued a **Guide on non-performing loans (NPL)**, a **Guide on the Targeted Review of Internal Models (TRIM)**, and **Guides on ICAAP and ILAAP**.
- Further, the ECB announced that it will conduct a **stress test** for the banks under its direct supervision **in 2017**, which will consist on a **sensitivity analysis of the banking book** with a focus on **interest rate changes**, conducted as part of the SREP.
- Finally, the ECB published a **consultative document** on amendments to the **ECB Regulation on FINREP** to adapt the reporting framework to IFRS 9.
- The Single Resolution Board (SRB) issued its **MREL approach in 2016**, which consists of informative targets that will enable banks to prepare for their future MREL requirements.

Local publications

- In Spain, the BdE initiated two **previous public consultations** on the approval of a **Circular repealing Circular 4/2004**, aimed to adapt the local accounting framework to IFRS 9 and IFRS 15; and on the approval of a **Circular amending the Circular 1/2013**, for the purpose of introducing the AnaCredit requirements into the current Risk Information Center (CIR).
- In USA, the Fed published a **final rule** on amendments to the **capital plan and stress testing framework**. Moreover, the Fed issued the 2017 CCAR and DFAST **scenarios and instructions**.
- In UK, the BoE published information on the **scenarios for the 2017 stress test** of the UK banking system. Moreover, the PRA published a **consultation paper** setting out proposed adjustments to the **Pillar 2A capital framework**.

Regulatory projections

At this moment there are several ongoing policy reforms that will be finalised in the coming months, although their specific completion dates are still unknown. In particular, the BCBS is expected to finalise the review of Basel III, whereas the European policymakers continue to deliberate on the reform package proposed by the European Commission (EC). In Spain, a Circular to align the accounting framework to IFRS 9 will be adopted in 2017.

Regulatory projections

1. Next quarter

- **(Global) To be determined**: the BCBS is expected to finalise the review of the Basel III framework by publishing standards on the revised standardised approach for credit risk, on the review of the IRB approach, on the review of the standardised approach and the basic approach for CVA, on the new approach for operational risk (SMA), on the capital floor based on the standardised methods (which will replace the Basel I floor), and on the LR (which may include a G-SIB surcharge). In this regard, consultation documents have already been published.
- **(Europe) To be determined**: the European Parliament (EP) and the Council are expected to approve the reform package of the financial system proposed by the EC, amending several legislative acts (CRR, CRD IV, BRRD, SRMR and EMIR).
- **(Europe) To be determined**: the EP and the Council are expected to approve the 5th Directive on anti-money laundering (AML), which introduces several amendments to the 4th Directive on AML.
- **(Spain) To be determined**: the BdE is expected to approve a Proyecto de Circular to adapt the accounting framework for credit institutions to IFRS 9 and IFRS 15.
- **(Europe) June 2017**: Member States shall implement the 4th Directive on AML.
- **(Europe) June 2017**: the EBA is expected to publish GL on the assessment of the Information and Communication Technology (ICT) risk.
- **(USA) June 2017**: the Fed will publish the CCAR and DFAST results.

2. Next year

- **(Global) November 2017**: the FSB will update the list of G-SIBs.
- **(Global) December 2017**: some of the Pillar 3 disclosure requirements issued by the BCBS will be applicable.
- **(UK) December 2017**: the BoE will publish the results of the 2017 stress test.
- **(Global) January 2018**: IFRS 9 will have to be implemented.
- **(Global) January 2018**: the revised IRRBB framework will come into force.
- **(Global) January 2018**: the NSFR and its disclosure requirements will be applicable.
- **(Global) January 2018**: the revised securitisation framework will come into force.
- **(Global) January 2018**: the LR will migrate to Pillar 1.
- **(Europe) January 2018**: Member States shall implement MiFID II and PSD2.
- **(Europe) January 2018**: the Regulation on key information documents for package retail and insurance-based investment products (PRIIPs) will be applicable.
- **(USA) January 2018**: the NSFR will be applicable in USA.

3. More than a year

- **(Europe) May 2018**: the General Data Protection Regulation (GDPR) will be applicable.
- **(Europe) September 2018**: institutions are expected to start reporting under AnaCredit.
- **(Global) December 2018**: the revised standards on IRRBB will be applicable.
- **(Global) January 2019**: the BCBS revised market risk framework from the Fundamental Review of the Trading Book (FRTB) will be applicable.
- **(Global) January 2019**: G-SIBs not headquartered in an emerging market economy will be required to comply with a minimum TLAC requirement of 16% of risk-weighted assets and 6% of the LR exposure.
- **(Global) January 2019**: the large exposures framework will be applicable.
- **(USA) January 2019**: the new requirements on Long-Term Debt (LTD) and TLAC will be applicable.
- **(UK) January 2019**: the ring-fencing rules will be implemented.
- **(Global) December 2019**: the FSB is expected to revise the implementation of the TLAC.
- **(Global) December 2019**: the GL on the identification and measurement of step-in risk will be applicable.
- **(Europe) December 2020**: according to the EBA's timeline, the effective implementation of the amendments to the IRB approach should take place (e.g. definition of default, estimation of IRB parameters, etc.).

Publications of this quarter

Summary of outstanding publications of this quarter.

Topic	Title	Date	Page
	Basel Committee on Banking Supervision		
Step-in risk	• Consultative Document on Guidelines on identification and management of step-in risk	16/03/2017	8
RDA&RR	• Progress in adopting the Principles for effective risk data aggregation and risk reporting	29/03/2017	9
Regulatory treatment of provisions	• Final standards on the regulatory treatment of accounting provisions – interim approach and transitional arrangements	30/03/2017	10
Pillar 3	• Final standards on Pillar 3 disclosure requirements - consolidated and enhanced framework	30/03/2017	11
G-SIBs	• Consultative document on Global systemically important banks (G-SIBs) - revised assessment framework	31/03/2017	12
	Basel Committee on Banking Supervision/ European Banking Authority		
Monitoring report	• Basel III Monitoring Report • CRD IV/CRR Monitoring exercise	01/03/2017	13
	European Banking Authority		
Internal models	• Consultation Paper on RTS on the specification of the nature, severity and duration of an economic downturn	02/03/2017	14
Internal models	• Report on results from the 2016 market risk benchmarking exercise • Report on results from the 2016 high default portfolios (HDP) exercise	06/03/2017	16
IFRS 9	• Opinion on transitional arrangements and credit risk adjustments due to the introduction of IFRS 9	07/03/2017	18
LCR	• Final Guidelines on LCR disclosure to complement the disclosure of liquidity risk management under the CRR	09/03/2017	19
O-SIIs in the EU	• 2016 List of O-SIIs in the EU notified to the EBA	16/03/2017	20
	European Central Bank		
Supervisory reporting	• Public consultation on the draft Regulation amending Regulation ECB/2015/13 on reporting of supervisory financial information • Draft Regulation on reporting of supervisory financial information – consolidated version	20/02/2017	21
Stress test	• Sensitivity analysis focused on effects of interest rate changes	01/03/2017	22
TRIM, ICAAP and ILAAP	• Guide to the Targeted Review of Internal Models (TRIM) • Guides on SSM on ICAAP and ILAAP	02/03/2017	23
Non- performing loans (NPLs)	• Guidance to banks on non-performing loans	21/03/2017	25

Topic	Title	Date	Page
Single Resolution Board			
MREL	• MREL: approach taken in 2016 and next steps	21/02/2017	27
Bank of Spain			
Risk Information Center	• Consulta pública previa sobre la nueva Circular del BdE por la que se modifica la Circular 1/2013, sobre la Central de Información de Riesgos	13/03/2017	28
Accounting framework	• Consulta pública previa sobre la nueva Circular del BdE que reemplaza la Circular 4/2004	29/03/2017	29
Dirección General de Seguros y Fondos de Pensiones			
Insurance distribution	• Borrador de Anteproyecto de Ley de distribución de seguros y reaseguros privados • Proyecto de Orden por la que se aprueban los modelos de información cuantitativa • Proyecto de Orden por la que se modifica el Plan de contabilidad de las entidades aseguradoras y reaseguradoras	28/02/2017	30
Federal Reserve			
Capital plan and stress testing	• Final amendments to the Capital Plan and Stress Test Rules	31/01/2017	32
CCAR y DFAST 2017	• Comprehensive Capital Analysis and Review 2017 Summary Instructions for LISCC and Large and Complex Firms • 2017 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule	06/02/2017	33
Bank of England / Prudential Regulation Authority			
Stress test of the UK banking system	• Stress testing the UK banking system: key elements of the 2017 stress test • Stress testing the UK banking system: 2017 guidance for participating banks and building societies • Variable paths for the 2017 stress test • Traded risk scenario for the 2017 stress test • Stress test model management	27/03/2017	35
Prudential Regulation Authority			
Pilar 2A capital	• Consultation Paper: refining the PRA's Pillar 2A capital framework	27/02/2017	37
IRB approach	• Consultation Paper on Internal Ratings Based (IRB) approach: clarifying PRA expectations	29/03/2017	38

16/03/2017
Consultative Document on Guidelines on identification and management of step-in risk.

1. Context

During the financial crisis, banks preferred to support certain shadow banking entities in financial distress, rather than allowing them to fail and facing a loss of reputation, even though they had neither ownership interests in such entities nor any contractual obligations to support them.

In this context, the BCBS has published the **second consultative document on Guidelines on the identification and measurement of step-in risk**, which is defined as the risk that a bank decides to provide financial support to an unconsolidated entity that is facing stress, in the absence of (or in excess of) any contractual obligations to provide such support.

The BCBS has recognized the need of a tailored rather than a standardized approach. Thus, this framework entails no automatic Pillar 1 capital or liquidity charge additional to the existing Basel standards. Rather, it provides banks and supervisors with a method for identifying step-in risk and a list of possible responses.

2. Main points

- **Entities to be evaluated**. Banks should define all entities to be evaluated for potential step-in risk, taking into account their relationship with the bank. To this end, the following shall be considered:
  - The scope of application of the step-in risk framework includes any unconsolidated entities, which are those out of the regulatory scope of consolidation.
  - A bank is not required to evaluate all entities with which it has a relationship, but those to which the bank has one of the following relationships: i) sponsor; ii) debt or equity investor; or iii) other contractual and non-contractual involvement.
  - Banks should identify entities that are immaterial (or subject to collective rebuttals) and exclude them from the initial set of entities to be evaluated.
- **Identification of step-in risk**. Banks should assess the remaining entities against the step-in risk indicators. A non-exhaustive list of indicators is provided, including the nature and degree of the sponsorship, the degree of influence, the implicit support, etc.
- **Potential responses**. For entities where step-in risk is identified, banks should use the appropriate method to estimate the potential impact on liquidity and capital positions and determine the appropriate internal risk management action. The following responses may be applied:
  - Comprehensive measures, such as the inclusion of an entity in the bank's regulatory scope of consolidation or the use of a conversion factor to estimate step-in risk.
  - Targeted measures, such as including entities for which step-in risk has been identified in their stress testing framework, building upon the accounting framework to measure the impact of a step-in event (e.g. through the potential impact on provisions), applying a punitive capital charge if a bank actually steps in to support an entity beyond its contractual obligations, etc.
- **Role of banks**. For the purpose of identifying and assessing step-in risk, banks must:
  - Establish and maintain policies and procedures.
  - Regularly identify all entities giving rise to step-in risk and estimate the potential impact on liquidity and capital.
  - Regularly report the results of their self-assessment of step-in risk to their supervisor. The reporting is expected to become mandatory and to be submitted annually.
- **Role of supervisors**. Among others, supervisors should review banks' policies and procedures and also their regular step-in risk self-assessments. Supervisors should have the authority to ask banks to remedy any deficiencies in their risk management approach, considering any of the potential responses outlined above.

3. Next steps

- Comments to this consultative document shall be submitted by **15 May 2017**.
- The proposed framework should enter into force as soon as possible and no later than **end-2019**.

29/03/2017

Progress in adopting the Principles for effective risk data aggregation and risk reporting.

1. Context

In January 2013, the BCBS issued the principles for effective risk data aggregation and risk reporting (RDA&RR). These principles, which became effective in January 2016, aim to improve risk management practices and decision-making processes by strengthening banks' risk data aggregation and risk reporting practices. Since the publication of this framework, the BCBS has been monitoring banks' implementation.

In this context, the BCBS has published its fourth **Progress report on bank´s adoption of the RDA&RR principles**. This report provides an overview of banks' extent of compliance with the principles, including key observations by supervisors; discusses implementation of the principles by domestic systemically important banks (D-SIBs); and proposes key recommendations to further facilitate implementation.

2. Main points

- **Scope of the assessment**. 7 supervisors with G-SIBs under their supervision completed an assessment questionnaire, whose responses included 30 banks designated as G-SIBs in 2011 or 2012.
- **Assessment results**. Supervisors were asked to rate their banks' current levels of compliance with each of the principles.
    - Overall, banks have not complied fully with the principles, even though the implementation deadline of January 2016 has now lapsed. Indeed, there was not full compliance by all assessed banks for any of the principles.
    - Although all principles (except principle 2, on data architecture and IT infrastructure) were largely or fully complied with by over half of the assessed banks, only 1 bank fully complied with all the principles.
    - Banks would take about 5 to 6 years to achieve full compliance, assuming that they started implementation work when the Principles were published in January 2013.
- **Key observations by supervisors**. The assessment reflects that:
    - Banks have made some improvements in implementing the principles in 2016 (e.g. most G-SIB boards are increasingly recognising the importance of the principles, senior management are appropriately involved in the implementation process, etc.) but substantial work towards full implementation is needed.
    - Banks continue to face challenges when implementing the principles, in terms of: i) technical issues (e.g. difficulties in management of complex and large-scale IT projects, weaknesses in data quality controls, etc.); and ii) defining and assessing materiality (e.g. review of what risk types, functions, business units are considered material, etc.).
    - Banks need to periodically assess and make needed improvements to IT systems, policies and processes to effectively implement the principles.
    - Supervisors have structured supervisory approaches and toolkits (e.g. regular supervisory reviews, thematic reviews, etc.) to assess banks' compliance and deal with banks' deficiencies.
- **Implementation by D-SIBs**. The BCBS strongly encourages national supervisors to apply the principles to banks identified as D-SIBs, three years after their designation as D-SIBs.
- **Key recommendations**. The BCBS proposes three new recommendations:
    - Banks should develop clear roadmaps to achieve full compliance with the principles, (detailing how banks intend to move towards full compliance by including a timeline for closing compliance gaps, dedicated resources and oversight form board and senior management, etc.) and to comply with the principles on an ongoing basis.
    - Supervisors should communicate assessment results with individual banks, incentivise banks to achieve full compliance with the principles and continue to refine assessment techniques.
    - The BCBS should continue to monitor the implementation of the principles by banks and supervisors.

30/03/2017

Final standards on the regulatory treatment of accounting provisions – interim approach and transitional arrangements.

1. Context

Both the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) adopted provisioning standards that require the use of expected credit losses (ECL) models rather than incurred loss models. The BCBS supports the use of ECL approaches, but also recognises that the new accounting provisioning models introduce fundamental changes to banks' provisioning practices.

In this context, the BCBS has published **final standards** setting out the regulatory treatment of accounting provisions for an interim period. Given the limited time until the effective date of IFRS 9, the BCBS has decided to retain the current treatment under the Basel framework for an interim period. This will allow the BCBS to consider more thoroughly the longer-term regulatory treatment of provisions.

Further, the final standards also set out the transitional arrangements to take effect from 1 January 2018, should individual jurisdictions choose to implement them to smooth any potential significant negative impact on regulatory capital arising from the introduction of ECL accounting.

2. Main points

- **Regulatory treatment of accounting provisions for an interim period**.
    - The BCBS has decided to retain the current treatment under both the standardized approach (SA) and IRB frameworks:
        - SA: banks are permitted to include general provisions (GP) in Tier 2 capital up to a limit of 1.25% of credit RWAs, whereas specific provisions (SP) do not qualify for inclusion in Tier 2 capital. Exposures are net of SP and gross of GP.
        - IRB approach: any shortfall between total eligible provisions (as defined in Basel II) and the regulatory expected loss (EL) is fully deducted from CET1, whereas any excess is added to Tier 2 capital, up to a limit of 0.6% of credit RWAs. Neither SP nor GP are deducted from EAD.
    - During the interim period jurisdictions would extend their existing approaches to categorising provisions as GP or SP to provisions calculated under the applicable ECL model. The BCBS recommends that regulatory authorities provide guidance, as appropriate, on how they intend to categorise ECL provisions as GP or SP.
- **Transitional arrangements**.
    - The BCBS confirms that there are a number of reasons why it may be appropriate for a jurisdiction to introduce transitional arrangements. In this regard, the BCBS has determined a number of high-level requirements for jurisdictions choosing to adopt them:
        - Capital metric. The transitional arrangements should involve adjusting CET1.
        - Approach. Jurisdictions should choose between a static vs. a dynamic approach.
        - Period for transition. It should not be longer than 5 years.
        - Amortisation and capital impact. The BCBS regards straight line amortisation as preferable. Moreover, amortisation must not allow the impact of ECL provisions on CET1 capital to be fully neutralised during the transition period.
        - Other adjustments. The transitional arrangements must be accompanied by consequential adjustments in other areas of the regulatory framework (e.g. tax effects in calculating the impact of ECL accounting on CET1 capital shall be taken into account).
        - Disclosure. Jurisdictions must publish details of any transitional arrangement applied, whereas banks must be required to disclose through their Pillar 3 disclosures certain information (e.g. comparison of capital and leverage ratios to the 'fully loaded' metrics had the transitional arrangement not been applied).
    - Based on the high-level requirements set out above, the BCBS proposes two approaches:
        - Approach A: day 1 impact on CET1 capital spread over a specified number of years (i.e. static approach that addresses a possible capital shock at the point of transition to the ECL accounting).
        - Approach B: phased prudential recognition of IFRS 9 Stages 1 and 2 provisions (i.e. dynamic approach that would take account of the ongoing evolution of ECL provisions during the transition period).

3. Next steps

- The BCBS will focus its efforts on considering alternative approaches for the **longer-term regulatory capital treatment of accounting provisions** that ultimately would replace the interim approach.

30/03/2017
Final standards on Pillar 3 disclosure requirements - consolidated and enhanced framework.

1. Context

In January 2015 the BCBS published its revised Pillar 3 disclosure requirements, which superseded those issued in 2004, and completed the first phase of the review of Pillar 3. Following the completion of this first phase, the BCBS has published now **final standards on Pillar 3 disclosure requirements** that represent the second phase of the BCBS' review.

In particular, the disclosure requirements in these standards cover three elements: i) consolidation of all existing BCBS disclosure requirements into the Pillar 3 framework; ii) two enhancements to the Pillar 3 framework; and iii) revisions and additions to reflect ongoing reforms to the regulatory framework, such as the TLAC regime for G-SIBs and the revised market risk framework.

2. Main points

- **General considerations**.
  - These standards apply the same scope, guiding principles and presentation of the disclosure requirements of the January 2015 standards (e.g. requirements apply to internationally active banks at the top consolidated level).
  - Moreover, the BCBS provides certain additional clarifications, such as the following:
    - Unless explicitly stated, disclosure for the previous period is not required when a metric from a new standard is reported for the first time.
    - Unless otherwise specified, when a bank is under a transitional regime permitted, the transitional data should be reported unless the bank already complies with the fully-loaded requirements.
- **Consolidation of all existing BCBS disclosure requirements into the Pillar 3 framework**.
  - These standards consolidate the disclosure requirements previously issued by the BCBS, in particular those regarding the composition of capital, the leverage ratio, the Liquidity Coverage Ratio (LCR), the Net Stable Funding Ratio (NSFR), the indicators for determining G-SIBs, the countercyclical capital buffer, interest rate in the banking book (IRRBB) and remuneration.
  - These standards do not make any fundamental changes, although minor changes have been made to the format and frequency of some of the existing disclosure requirements.
- **Two enhancements to the revised Pillar 3 framework**.
  - Dashboard of key prudential metrics. Two new templates are introduced:
    - Template KM1, covering a bank's available capital (including buffer requirements and ratios), RWAs, leverage ratio, LCR and NSFR.
    - Template KM2, requiring G-SIBs to disclose key metrics on TLAC.
  - Prudential Valuation Adjustments (PVAs). A new template (PV1) is introduced consisting on a detailed breakdown of how the aggregate PVA has been derived.
- **Revisions and additions to reflect ongoing reforms to the regulatory framework**.
  - TLAC of G-SIBs. 4 templates are introduced which should be only disclosed by G-SIBs (KM2, TLAC1, TLAC2 and TLAC3).
  - Market risk. Revised market risk disclosures are introduced to reflect the changes in the revised market risk standard published in January 2016, derived from the FRTB.

3. Next steps

- The disclosure requirements in these standards will come into force at different times, in line with the following general criteria:
  - Where the disclosure requirements are already in place, the implementation date has been set for a bank's **2017 financial year-end**.
  - Where the disclosure requirements are new and/or depend on the implementation of another policy framework, the implementation date for those disclosure requirements has been **aligned with the implementation date of that framework** (e.g. TLAC in January 2019).
- The BCBS has commenced the third phase of its review of Pillar 3, which aims to develop disclosure requirements regarding: i) the standardised approach RWA to benchmark internally modelled capital requirements, ii) asset encumbrance, iii) operational risk, and iv) ongoing policy reforms which have yet to be finalized.

31/03/2017
Consultative document on Global systemically important banks (G-SIBs) - revised assessment framework.

1. Context

In July 2013, the BCBS published the global systemically important banks (G-SIB) assessment methodology and the higher loss absorbency (HLA) requirement. This methodology assesses the relative systemic importance of internationally active banks based on 12 indicators in 5 categories (i.e. cross-jurisdictional activity, size, interconnectedness, substitutability, and complexity) resulting in a score of systemic importance for each bank. The FSB publishes the list of G-SIBs according to this methodology.

When the G-SIB assessment framework was first published, the BCBS agreed to review the framework every 3 years. In this context, the BCBS has published a **Consultative document on G-SIB revised assessment framework**, which is intended to enhance the framework and ensure that it remains consistent with its objectives.

In particular, the BCBS has proposed 7 changes to the G-SIB assessment methodology and seeks feedback on the introduction of a new indicator for short-term wholesale funding.

2. Main points

- **Proposed changes to the G-SIB assessment methodology**.
    - Removal of the 500bp cap on the substitutability category, with the aim of providing banks with an incentive to reduce concentration in the provision of infrastructure services (e.g. payments, custody, etc.).
    - Expansion of the scope of consolidation to include exposures under insurance subsidiaries in the categories that best reflect the systemic risks common to banks and insurers (i.e. size, interconnectedness and complexity).
    - Amendment to the definition of cross-jurisdictional indicators, to include derivatives calculated on a consolidated basis in both indicators, cross-jurisdictional claims and liabilities.
    - Inclusion of a new indicator of trading volume in the substitutability category, weighted at 3.33%, and reduction of the underwriting indicator from 6.67% to 3.33%.
    - Revision to the disclosure requirements to ensure consistency with the revised Pillar 3 reporting requirements. In this regard:
        - Banks are required to disclose at least the 12 high-level indicators used in the G-SIB assessment based on financial year-end data, on an annual basis.
        - They must further publicly disclose if the data used to calculate the G-SIB scores differ from the figures previously disclosed.
        - Their disclosures must follow Pillar 3 reporting requirements and timelines.
    - Further guidance regarding bucket migration and the associated HLA surcharge. In particular, the BCBS specifies that where a bank's G-SIB score has declined substantially from one year to the next resulting in a lower HLA requirement, it is allowed to immediately adhere to the new, lower HLA requirement (instead of waiting 12 months before doing so).
    - Introduction of a transition schedule, according to which any revisions to the G-SIB framework announced in November 2017 would take effect in 2019 (based on end-2018 data) and the resulting HLA requirement would be applied in January 2021.
- **Issue for discussion**.
    - The BCBS is considering introducing a new indicator for short-term wholesale funding as a fourth indicator in the interconnectedness category. This would comprise the proportion of all sources of a bank's wholesale funding with a maturity of less than six months (based on data used to compute the NSFR).
    - This approach produces almost no changes to current G-SIB scores.

3. Next steps

- Comments to this consultative document shall be submitted by **30 June 2017**.
- Following the 3 month consultation period, the BCBS will conduct a comprehensive quantitative impact assessment to analyse the impact of the proposed changes, after which it will publish the revised version of the G-SIB framework.

01/03/2017

- **Basel III Monitoring Report.**
- **CRD IV/CRR Monitoring exercise.**

1. Context

The BCBS has published the results of its latest **Basel III monitoring report**. In parallel with this report, the EBA has conducted its eleventh report of the **CRDIV-CRR / Basel III monitoring exercise** on the European banking system. In particular, these exercises allow gathering aggregate data on capital, leverage ratio (LR), liquidity coverage ratio (LCR) and net stable funding ratio (NSFR).

Moreover, for the first time the BCBS report provides information on the progress made by global systemically important banks (G-SIBs) in meeting the requirements for additional loss-absorbing capacity (TLAC).

Both exercises classify banks in Group 1 (those internationally active banks with a Tier 1 capital exceeding €3billion) and Group 2 (all other banks). For the BCBS exercise, data were provided for a total of 210 banks from several geographies (e.g. Europe, America, etc.), including 100 Group 1 banks and 110 Group 2 banks. The EBA exercise included a sample of 164 European banks, comprising 44 Group 1 banks 120 Group 2 banks.

2. Main points

- The results are based on data as of **30 June 2016**.
- The main **average results** obtained (assuming full implementation of the Basel III / CRD IV-CRR framework) were:

Organism	Group	CET1 ratio	Capital shortfall*	TLAC shortfall	LR	LCR	NSFR
BCBS	1	11.9%	0	318.2bn€	5.6%	126.2%	114.0%
	2	13.4%	0	N/A	5.6%	155.4%	114.9%
EBA	1	12.7%	0	-	4.6%	127.7%	106.3%
	2	13.2%	0	N/A	5.2%	165.5%	113.9%

* Shortfall with respect to the target level (CET1 + Capital Conservation Buffer).

02/03/2017
Consultation Paper on RTS on the specification of the nature, severity and duration of an economic downturn.

1. Context

Under the CRR, institutions shall use LGD and conversion factor (CF) estimates that are appropriate for an economic downturn if those are more conservative than the respective long-run average.

In this regard, the EBA has published a **Consultation Paper on RTS specifying the nature, severity and duration of an economic downturn**, according to which institutions shall estimate the downturn LGD and CF. These RTS are part of the EBA's broader work on the review of the IRB approach aimed at reducing the unjustified variability in the outcomes of internal models.

These RTS do not cover the methods used by institutions to reflect these downturn conditions. Thus, the methods to be used regarding the LGD parameters are included in a separate section as a proposed amendment to the Guidelines on PD estimation, LGD estimation and the treatment of defaulted assets (hereinafter the 'Guidelines'), published by the EBA in November 2016.

2. Main points

- **General aspects**. The RTS specifies the following:
    - A sequential approach to identify the economic downturn conditions is established:
        - First, institutions should identify the model components.
        - Then, they should establish in sequence the nature, the duration and the severity of an economic downturn.
    - This approach shall be done separately for LGD estimates and CF estimates.
    - The economic downturn conditions shall be identified:
        - For each type of exposure (i.e. at the level of model estimation)
        - For each jurisdiction, although institutions may apply the same downturn conditions for different jurisdictions in some cases.
- **Identification of model components**. The RTS define the model components for own-LGD and own-CF estimates as quantitative variables describing relevant features which drive the shape of realised losses and drawings. In this regard:
    - Institutions shall perform an analysis to identify all the relevant model components based on the specificities of each type of exposure.
    - If institutions already use model components in their LGD and CF models, they shall at least use these as a starting point for the analysis of the relevant economic indicators.
- **Nature**. With regard to the nature, institutions shall:
    - Identify the nature of an economic downturn according to at least one economic factor for each model component.
    - Consider all relevant economic factors (e.g. GDP, unemployment rate, etc.).
    - Not limit the analysis of dependency to statistical correlation but consider expected dependencies, benchmarking and stress scenarios.
- **Duration**. Institutions shall apply a one year duration of an economic downturn for each relevant economic factor affecting each model component.
- **Severity**. Institutions shall select the worst period for each economic factor based on historical values observed in the preceding 20 years (a period shorter than 20 years may be used if structural changes have been observed). Where the severity identified according to the preceding 20 years is not considered sufficiently severe, thy shall look further back in the historical data.
- **Economic downturn**. Institutions shall determine the overall nature, severity and duration of an economic downturn by assessing the joint impact of all the relevant economic factors, for the corresponding duration and severity identified, in relation to all types of exposures. This shall be done separately for own-LGD estimates and for own-CF estimates.
- **Amendments to the downturn adjustment section of the 'Guidelines'**. The specifics on how to perform the downturn adjustment to the LGD risk parameter are provided, covering the following: i) estimation of the prudential downturn LGD; ii) downturn adjustment; and iii) documentation.
- **Alternatives approaches**. Given the relatively high degree of prescriptiveness of the proposed approach, the EBA seeks feedback on two alternative approaches:
    - The reference value approach.
    - The supervisory add-on approach.

3. Next steps

- Comments to this consultation paper shall be submitted by **29 May 2017**.
- Considering the material changes that these RTS may require for the modelling of downturn LGD and CF, the EBA is proposing to implement these standards by **end-2020**. This deadline refers to the implementation of all changes stemming from the regulatory review of the IRB approach.

06/03/2017

- **Report on results from the 2016 market risk benchmarking exercise.**
- **Report on results from the 2016 high default portfolios (HDP) exercise.**

1. Contexto

Under the CRD IV, competent authorities (CAs) shall carry out supervisory benchmarking studies of internal approaches for calculating own funds requirements. Moreover, the EBA is mandated to produce a report to assist the CAs in the assessment of the quality of the internal approaches.

In this regard, the EBA has published two reports on the consistency of RWAs: a **Report on the results from the 2016 market risk benchmarking exercise** as well as a **Report on the results from the 2016 high default portfolios (HDP) exercise**. In particular, the market risk report presents the observed variability measures in terms of the inter-quantile dispersion statistic (IQD), whereas the HDP report explains the overall level of variability in RWAs and examines the different drivers that explain the dispersion observed.

For the first time, all EU institutions authorised to use internal approaches for the calculation of capital requirements participated. The results confirm previous findings.

2. Principales aspectos

Report on the results from the 2016 market risk benchmarking exercise

- **Sample**. 50 banks from 12 jurisdictions that submitted data for 35 market portfolios in all asset classes (e.g. equity, interest rates, etc.) and 3 correlation trading portfolios.
- **Main findings**.
    - Interest rates show a lower level of variability than other asset classes because of the more consistent practices and more homogeneous assumptions used across the banks for modelling interest rate risk.
    - High dispersion in the initial market valuation (IMV) is observed as a result of the different interpretations and market practices adopted by banks.
    - Across all asset classes, the overall variability for VaR is lower than that observed for stressed VaR (23% and 30%, respectively). More sophisticated measures such as the Incremental Risk Charge (IRC) and the All Price Risk (APR) show a much higher level of dispersion (42% and 52%, respectively).
    - A lack of consistent practice among banks for modelling some of the risk factors was found (e.g. basis risk between a credit default swap and its equivalent bond).
    - The results for those portfolios comprising sovereign positions exhibit a significantly higher level of dispersion (59%).
    - The dispersion of empirical estimates of expected shortfall (proposed in the FRTB) at a 95% confidence level across risk factors is lower than that found for VaR and P&L VaR.
- **Dispersion in capital outcome**. The average variability across the sample, measured by the IQD coefficient, is over 30% (considered quite high by the EBA).
- **Supervisory recommendations**. Some areas may require further investigations by CAs, such as accentuated pricing variability for equity derivatives, commodities trades and credit spreads products.

Report on the results from the 2016 high default portfolios (HDP) exercise

- **Sample**. 114 banks across 17 jurisdictions that submitted data on residential mortgage, SME and other corporate portfolios (collectively referred to as HDP). In this report two indicators are used to summarise the results, the risk weight (RW) -or RWA density- and the global charge or GC (i.e. considering expected and unexpected losses).
- **Approach**. Two main approaches were developed to explain the drivers of RW variability: a top-down approach and a backtesting approach. Moreover, they were complemented by a cross-sectional approach.

- **Main findings from the top-down approach**.
  - The GC increased if compared with previous exercises (on average to 75%). The GC variability is also greater than in previous exercises (ranging from 8% to 293%).
  - A key finding is that more than 80% of the GC variability could be explained by few drivers: the proportion of defaulted exposures in the portfolio, the country of the counterparty, and the portfolio mix. The remaining variability could be attributed to differences in riskiness, modelling assumptions and risk management practices by banks, and supervisory practices.
  - The RW average per institution varies from 7% to 129% (simple average of 33%).
- **Main findings from the backtesting approach**.
  - The estimated values for PDs and LGDs are, in general, higher than the observed default rates and loss rates, which suggests that banks are, on average, conservative.
  - The country of the reporting bank and of the counterparties is an important driver of RW variability.
- **Main findings from the cross-sectional approach**.
  - For EU non-defaulted exposures, the RW interquartile ranges show significant variability per portfolio, in particular for SMEs and other corporates.
  - There are not significant differences for RWs between regulatory approaches (i.e. the FIRB and AIRB approaches), although there are differences for risk parameters.
- **CAs' assessments based on supervisory benchmarks**. CAs provided individual assessments on the quality of the benchmarked models for each bank. For the majority of the banks, the RW deviations from the EU benchmarks were deemed by the CAs to be justified and not significant.
- **Possible impact on the CET1 ratio based on observed defaults**. If the reported RWAs were replaced by higher RWAs driven by more conservative estimated PDs, the average CET1 ratio would decrease only slightly, by 17 bps.

3. Next steps

- In **2017** the EBA will conduct a **new benchmarking exercise**, whose instructions were already published.

07/03/2017

Opinion on transitional arrangements and credit risk adjustments due to the introduction of IFRS 9.

1. Context

In November 2016, IFRS 9 was adopted in the EU to replace the previous accounting standard IAS 39, with the initial application date scheduled for January 2018. Further, the European Commission (EC), as part of its CRR II / CRD V proposals, made certain suggestions on transitional arrangements to mitigate the effect of the introduction of IFRS 9 on CET1 capital resulting from the impairment requirements of IFRS 9.

In this context, the EBA has published an **Opinion on transitional arrangements and credit risk adjustments due to the introduction of IFRS 9**, addressed to the EC, European Parliament and Council and to all competent authorities (CAs) across the EU.

2. Main points

- **EC's proposal published in November 2016**. With regard to the EC's proposal, the following observations are made:
    - Static or dynamic approach. It is a dynamic approach, as the adjustment in CET1 takes into account the amount of stage 1 and stage 2 provisions in each reporting period. Each year a different factor is applied.
    - Scope. The transitional arrangements would apply only to the impairment requirements of IFRS 9 and would not take into account the full impact of IFRS 9.
    - Neutralisation of IFRS 9 impact. The transitional arrangements would result in the full neutralisation of any impact from the application of IFRS 9 during the first year (in 2018).
    - Duration. The period for the transitional arrangements is 5 years.
    - Mandatory regime or institution's decision. The proposal provides the option for institutions to apply the transitional arrangements (it is not up to CAs to decide whether they should be applied).
- **EBA's opinion**. Among other aspects, the EBA considers that:
    - Static or dynamic approach. A static approach would be simpler than a dynamic approach, as the initial one-off impact could be clearly identified and could be calculated only once (on the initial application of IFRS 9) and amortised over a number of years.
    - Scope. The EBA considers that both approaches -transitional arrangements applying to IFRS 9 as a whole or only to the impairment requirements of IFRS 9- have limitations. Depending on the final transitional arrangements to be agreed, it will be necessary to strike an appropriate balance between prudence and simplicity.
    - Neutralisation of IFRS 9 impact. The transitional arrangements should apply from the initial application of IFRS 9 on 1 January 2018 and onwards, and there should not be full neutralisation of its impact during the first year or any of the years following that.
    - Duration. A phased-in period of 4 years would be appropriate (factors of 80% in 2018, 60% in 2019, 40% in 2020, 20% in 2021 and 0% beyond that).
    - Mandatory regime or institution's decision. The application of transitional arrangements should be a baseline regulatory requirement (mandatory application), while allowing the option for institutions to recognize the full impact of IFRS 9 on 1 January 2018. However, it should not be possible for institutions to apply transitional arrangements later if they initially decided not to apply them.
- **Criteria for the classification of provisions as general (GCRAs) or specific (SCRAs) credit risk adjustments**. As a result of the move from the incurred losses of IAS 39 to the expected losses of IFRS 9, more forward-looking, there may be different interpretations of whether provisions classified under IFRS 9 in stages 1 and 2 should be considered SCRAs or GCRAs under the RTS on Credit Risk Adjustments. In this regard, the EBA believes that all IFRS 9 provisions should be considered SCRAs.

09/03/2017

Final Guidelines on LCR disclosure to complement the disclosure of liquidity risk management under the CRR.

1. Context

In January 2015, the European Commission published the LCR Delegated Act to specify the liquidity coverage ratio (LCR) for credit institutions, which is applicable from 1 October 2015.

In this regard, the EBA has published **Final Guidelines (GL) on the LCR disclosure**, which harmonise and specify both the qualitative and quantitative information that institutions are required to disclose on liquidity, and namely on the LCR. In particular these GL include a qualitative and quantitative harmonised table for the disclosure of general information on liquidity risk management, as well as a quantitative template, a qualitative template and relative instructions for the disclosure of information on the LCR composition.

These GL build on the LCR disclosure standard published by the BCBS in January 2014. Further, they are consistent with the EBA Final GL on disclosure requirements under the CRR published in December 2016.

2. Main points

- **Scope and level of application**: these GL apply to those credit institutions that have to comply with the EBA GL on disclosure requirements under the CRR and which are covered by the LCR Delegated Act.
- **Table on liquidity risk management**: it includes qualitative and quantitative information of liquidity risk. In particular, it covers:
    - Strategies and processes in the management of the liquidity risk.
    - Structure and organisation of the liquidity risk management function (authority, statute, other arrangements).
    - Scope and nature of liquidity risk reporting and measurement systems.
    - Policies for hedging and mitigating the liquidity risk and strategies and processes for monitoring these policies.
    - A declaration approved by the management body on the adequacy of liquidity risk management systems.
    - A concise liquidity risk statement approved by the management body describing the institution’s overall liquidity risk profile associated with the business strategy. This statement shall include key ratios.
- **LCR disclosure template (quantitative) and template on qualitative information on the LCR**.
    - The LCR disclosure templates on quantitative information requires credit institutions to provide data on high-quality liquid assets (HQLA), cash outflows and inflows, liquidity buffer, and LCR, among others.
    - Nonetheless, those credit institutions that have not been identified by competent authorities as a global systemically important institutions (G-SIIs) neither as other systemically important institution (O-SIIs) should disclose a simplified LCR disclosure, which only includes three times (liquidity buffer, total net cash outflows and LCR).
    - The template on qualitative information on the LCR, which complements the LCR disclosure template, covers aspects such as the concentration of funding and liquidity sources, the currency mismatches in the LCR, etc.

3. Next steps

- These GL will apply from **31 December 2017**.

16/03/2017
2016 List of O-SIIs in the EU notified to the EBA.

1. Context

In December 2014, the EBA published Guidelines on the criteria for the assessment of Other Systemically Important Institutions (O-SIIs) in the EU, which build on the criteria for Domestic Systemically Important Banks (D-SIBs) established by the BCBS.

In this regard, the EBA has published the **2016 list of O-SIIs in the EU**. This list has been drawn up by relevant authorities across the EU jurisdictions on the basis of the criteria provided in the EBA Guidelines, namely the size, importance (substitutability or financial system infrastructure), complexity (or cross-border activities) and interconnectedness of such institutions.

2. Main points

- Relevant authorities identified a total of **199 institutions as O-SIIs** in the EU, based on 2016 data.
- This list also includes the **additional capital buffers** that the relevant authorities have set for each O-SII identified. The buffers applied range between 0% and 2%.

3. Next steps

- Updated lists of O-SIIs will be disclosed on an **annual basis**, along with the definition of any CET1 capital buffer requirements which may need to be set.
- Additional capital buffers will become applicable at least **1 year** after the publication of the O-SIIs list.

EUROPEAN CENTRAL BANK
EUROSYSTEM

20/02/2017

- **Public consultation on the draft Regulation amending Regulation ECB/2015/13 on reporting of supervisory financial information.**
- **Draft Regulation on reporting of supervisory financial information – consolidated version.**

1. Context

In July 2014, the International Accounting Standards Board (IASB) issued 'IFRS 9 – Financial Instruments' which supersedes IAS 39. Further, the EBA published in November 2016 the Final ITS amending the Commission Implementing Regulation (EU) 680/2014 on supervisory reporting with regard to FINREP, with the aim of aligning the reporting framework with the new IFRS 9 requirements.

In this context, the ECB has published a **consultative document** on draft amendments to the ECB **Regulation on reporting of supervisory financial information**. The amendments update the regulation mainly to reflect the introduction of IFRS 9. In addition, other clarifications and amendments are also proposed.

2. Main points

- **Proposed changes to the Regulation**.
    - The current references to FINREP templates in Annex I ("Simplified supervisory financial reporting") and Annex II ("Over-simplified supervisory financial reporting") of the Regulation should be replaced by references to the new FINREP templates 4.2.1, 4.2.2, 4.4.1, 5.1, 6.1, 9.1, 9.1.1, 12, 12.1, 16.3 and 16.4.
    - Annex IV ("FINREP data points" under IFRS or National GAAP compatible with IFRS) and Annex V ("FINREP data points" under National GAAP not compatible with IFRS) of the Regulation should be also updated owing to changes to Annexes III and IV of the ITS.
    - Annexes I, II, and VI clarify that the relevant national competent authorities (NCAs) have to decide whether entities applying the relevant national GAAP should report either template 9.1 or 9.1.1, 11.1 or 11.2, 12 or 12.1 and 16.3 or 16.4, respectively.
- **Other clarifications and amendments**.
    - Applicability of some FINREP templates to certain solo reporters. It is clarified that templates 17 and 40.2 of Annexes III and IV of the ITS are also applicable to all significant credit institutions that are not part of a supervised group within the SSM but that are required to produce financial statements for accounting purposes on a consolidated basis.
    - Responsibility for reporting in respect of subsidiaries established in a non-participating Member State or a third country. Significant credit institutions within participating Member States should ensure that financial information in respect of these subsidiaries.
    - Removal of solo reporting requirements for (mixed) financial holding companies. Financial reporting requirements for these institutions on an individual basis have been removed, although ad hoc solo financial information could still be required.
    - Application of the individual consolidation method and reporting on an "individual basis". Where institutions apply the individual consolidation method, they shall report financial information taking into account the subsidiaries that they incorporate in the calculations of their individual requirements.
    - Reduction of transitional period for reporting after change of reporting requirements.
        - The transitional period for supervised entities changing their status from less significant to significant has been shortened from 18 months to 12 months.
        - Supervisory financial information concerning subsidiaries of significant credit institutions established in a non-participating Member State or a third country will be required to be reported from the next reference date where the total value of the assets of a subsidiary exceeds €3bn on two consecutive reference dates.
    - Dates for submission of financial information reported from NCAs to the ECB. These dates have been aligned to those of the ITS, although the proposed amendment does not affect the remittance dates for supervised entities.

3. Next steps

- Comments to this consultation document shall be submitted by **27 March 2017**.
- The date of application of this Regulation shall be **1 January 2018**. However, a 12-month transition period will be granted to less significant institutions that apply national GAAP. Thus, for these institutions, the date of application will be **1 January 2019**.

EUROPEAN CENTRAL BANK
EUROSYSTEM

01/03/2017
Sensitivity analysis focused on effects of interest rate changes.

1. Context

Under the CRD IV, the ECB is required to organise annual supervisory stress tests. In this regard, the ECB has announced that it will conduct such an exercise for the banks under its direct supervision in 2017, which will consist of a **sensitivity analysis of the banking book**, with a focus on **interest rate changes**. This exercised is conducted as part of its annual Supervisory Review and Evaluation Process (SREP).

In particular, the exercise is designed to provide the ECB with sufficient information to understand the interest rate sensitivity of a bank's assets and liabilities in the banking book and of net interest income to hypothetical interest rate changes.

As a result of this exercise, the banks' overall capital demand (requirements and guidance) is not expected to change.

2. Main points

- **Approach**. This sensitivity analysis is a <u>bottom-up exercise</u>, in which <u>banks provide the projections</u> for given interest rate shocks based on their own models.
- **Parts of banks' balance sheets subject to the sensitivity analysis**.
    - Positions subject to the exercise are those is the <u>banking book</u> (i.e. those assets and liabilities that are not related to the banks' trading activities).
    - For each bank, the scope is limited to assets and liabilities denominated in the <u>major currencies</u> for that specific bank. Thus, it only covers assets and liabilities in a currency in which more than <u>20%</u> of a bank's banking book assets are denominated.
- **Assumptions for changes in interest rates**.
    - <u>6 different interest rate shocks</u> are used, which are drawn from the shocks set by the BCBS in the Standards on the Interest rate risk in the banking book (IRRBB).
    - In analysing how an interest rate shock would affect banks, the exercise focuses on the changes in the <u>economic value</u> of the banking book assets and liabilities and on the development of <u>net interest income</u> generated by those assets and liabilities.
- **Use**. The results of the exercise will feed in a non-mechanical way into the <u>SREP</u> of 2017. In particular, the results will inform the assessment of how much capital an institution needs to hold as part of <u>Pillar 2 requirements</u> and <u>Pillar 2 guidance</u> (P2G).

3. Next steps

- Results will be discussed between banks and Joint Supervisory Teams (JSTs) at the beginning of 3Q17.

EUROPEAN CENTRAL BANK
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02/03/2017

- **Guide to the Targeted Review of Internal Models (TRIM).**
- **Guides on SSM on ICAAP and ILAAP.**

1. Context

The Targeted Review of Internal Models (TRIM) carried out by the ECB is aimed at enhancing the credibility and confirming the adequacy of approved Pillar I internal models (for credit, market and counterparty credit risks) permitted for use by significant institutions when calculating own funds requirements.

In this regard, the ECB has published a **Guide to the TRIM** addressed to the management of significant institutions, which sets out its view on the appropriate supervisory practices and spells out how the ECB intends to interpret the relevant EU law on internal models and on general model governance topics.

Further, in January 2016 the ECB published its expectations on the ICAAP and the ILAAP, in order to encourage significant banks to develop and maintain high quality ICAAPs and ILAAPs, and to clarify the type of information they should share with the SSM.

In this regard, the ECB has initiated a multi-year project to develop comprehensive **SSM Guides on ICAAP and ILAAP** for significant institutions.

2. Main points

Guide to the Targeted Review of Internal Models (TRIM)

- **General topics**.
    - This section aims to inform institutions on the principles for the general topics (i.e. non-model specific) selected for harmonisation under TRIM, relating to the IRB approach.
    - In particular, this section covers the following areas: overarching principles for internal models, roll-out and permanent partial use, internal governance, internal audit, internal validation, model use, management of model changes, data quality, and third party involvement.
- **Credit risk**. This section covers the following areas: data requirements, PD, LGD, CCF, model-related margin of conservatism, review of estimates, and calculation of maturity for non-retail exposures.
- **Market risk**. This section covers the following areas: scope of the internal model approach (IMA), regulatory back-testing of VaR models, internal back-testing of VaR models, methodology for VaR and stressed VaR, methodology for incremental risk charge (IRC), models focusing on default risk, and risks not in the model.
- **Counterparty credit risk**. This section covers the following areas: trade coverage, margin period of risk and cash flows, collateral modelling, modelling of initial margin, maturity, granularity, number of time steps and scenarios, calibration frequency and stress calibration, validation, effective expected positive exposure, and alpha parameter.

Guides on ICAAP and ILAAP

- **Guide on ICAAP**. This Guide establishes a set of principles with regard to 7 areas that will be also considered within the harmonized assessment of ICAAPs as part of the Supervisory Review and Evaluation Process (SREP). In particular, the ICAAP principles are related to the following:
    - The management body and its responsibility for the sound governance of the ICAAP.
    - Integration of ICAAP into the institution's management framework.
    - Assessment of the institution's viability, covering short and medium-term assessments from a normative and economic internal perspective.
    - Identification of all material risks considered in the ICAAP.
    - Quality of internal capital.
    - Proportionality and consistency of ICAAP assumptions and risk quantification methodologies.
    - Regular stress testing.

- **Guide on ILAAP**. This Guide established a set of principles with regard to 7 areas that the ECB will focus on within our harmonised assessment of ILAAPs as part of the SREP in 2017 and onwards. In particular, the ICAAP principles are related to the following:
    - The management body and its responsibility for the sound governance of the ILAAP.
    - Integration of ILAAP into the institution's management framework.
    - Assessment of the institution's viability by ensuring adequate supply of liquidity and stable funding on the short and medium term.
    - Identification of all material risks considered in the ILAAP.
    - Quality and diversity of the internal liquidity buffer as well as stability of funding sources.
    - Proportionality and consistency of ILAAP assumptions and risk quantification methodologies.
    - Regular stress testing.

3. Next steps

- The Guide on the TRIM will be refined during the **coming months** and before its finalisation, a public consultation will be launched for each risk type.
- Comments to the Guides on ICAAP and ILAAP shall be submitted by **31 May 2017**. Meanwhile, institutions are expected to comply with the 2016 expectations and submit the corresponding documentation in accordance with the EBA Guidelines on ICAAP and ILAAP by **30 April 2017**.
- The ECB plans to review the Guides on ICAAP and ILAAP and publish it for consultation in the **beginning of 2018**.

21/03/2017
Guidance to banks on non-performing loans.

1. Context

Although non-performing loans (NPLs) have started to decline, a number of banks in Member States across the Euro area are still experiencing high levels, which ultimately have a negative impact on bank lending to the economy. In this regard, addressing asset quality issues is one of the key priorities for ECB banking supervision.

In this context, the ECB has published its **final guidance to banks on NPLs** with the objective of developing a consistent supervisory approach regarding the identification, measurement, management and write-off of NPLs. In particular, this document provides recommendations to banks and sets outs a collection of best practices regarding NPLs that will constitute ECB's supervisory expectations from now on.

2. Main points

- **Level of application**: the guidance is applicable to all significant institutions supervised directly under ECB banking supervision, including their international subsidiaries. The guidance is non-binding, although deviations should be explained upon supervisory request. Moreover, it is taken into consideration in the SSM SREP and non-compliance may trigger supervisory measures.
- **Scope**: the guidance addresses all non-performing exposures (NPEs) following the EBA definition, as well as foreclosed assets and performing exposures with an elevated risk of turning non-performing.
- **Recommendations and best practices**:
  - NPL strategy. To develop, implement and embed a fit strategy banks should:
    - assess and review their operating environment (e.g. internal capabilities, external conditions, capital implications, etc.).
    - develop the NPL strategy, including targets in terms of development of operational capabilities (qualitative) and projected NPL reductions (quantitative) over the short, medium and long-term time horizons.
    - implement operational plans (including investments, staffing, etc.).
    - fully embed NPL strategy into the management processes of the bank (e.g. NPL strategy aligned with and integrated into the ICAAP).
    - provide an annual summary of NPL strategy and targets to the ECB.
  - Governance and operations. To address NPL issues in an efficient way:
    - The management body should annually approve the NPL strategy and the operational plan, oversee the implementation of the NPL strategy, etc.
    - Banks should establish: (i) separate and dedicated NPL workouts units; (ii) a control framework that clearly assign roles across all three lines of defence; (iii) a monitoring framework by setting key performance indicators (KPIs) to measure progress on NPL; and (iv) an early warning process (i.e. adequate internal procedures and reporting to identify non-performing clients at a very early stage).
  - Forbearance. Guidance is provided regarding viability of forbearance solutions; forbearance processes (e.g. using standardised forbearance products); affordability assessment (e.g. criteria to analyse the affordability of a borrower); and supervisory reporting and public disclosure (e.g. disclosing credit quality of forborne exposures). This guidance is not related to forbearance classification.
  - NPL recognition. Banks should, among others:
    - Implement the EBA's definition of NPE.
    - Align regulatory and accounting definitions.
    - Use the EBA ITS on supervisory reporting for NPEs and forbearance.
  - NPL impairment measurement and write-offs. A set of best practices on NPL impairment recognition that banks should apply are provided, with regard to individual and collective estimations of provisions (e.g. defining criteria for exposures requiring individual assessment of provisions); furthers aspects to provisioning and write-off (e.g. fostering timely provisioning and write-off through internal policies); and documentation, reporting and disclosure (e.g. keeping sufficient level of documentation detailing provisioning methodology and parameters). These best practices are consistent with the Guidance on accounting for expected credit losses published by the BCBS.

- Collateral valuation of immovable property. Guidance is provided regarding governance, procedures and controls (e.g. independent control process for appointment of appraisers, for back-testing of valuations, etc.); frequency and methodology of valuations (e.g. updating valuations for all NPL collateral at least annually); valuation of foreclosed assets (e.g. banks should apply IFRS 5); and disclosure (e.g. disclosure of NPL collateral and foreclosed assets separately).

3. Next steps

- This guidance should be applicable as of its date of publication.
- In order to ensure consistency and comparability, the expected enhanced disclosures on NPLs should start from **2018 reference dates**.

21/02/2017
MREL: approach taken in 2016 and next steps.

1. Context

The Bank Recovery and Resolution Directive (BRRD) requires banks to meet a minimum requirement for own funds and eligible liabilities (MREL) so as to be able to absorb losses and restore their capital position, allowing them to continuously perform their critical economic functions during and after a crisis.

In this regard, the SRB has published its **MREL approach in 2016**, which has started to develop together with the national resolution authorities (NRAs). This preliminary approach consists of informative targets that sought to enable banks to prepare for their future MREL requirements.

The SRB has determined that a final MREL methodology would not be available in 2016, which is partly due to the fact that the current rules on the MREL are likely to change following the release by the European Commission (EC) of a legislative proposal on TLAC in November 2016.

2. Main points

- **Informative targets level**.
    - The informative MREL targets were based on the default formula included within the Delegated Regulation (DR) on MREL of the EC, which comprise:
        - A <u>default loss absorbing amount</u> (LAA) that consists of the higher of: i) the aggregate of a bank's minimum capital requirement (Pillar 1), its Pillar 2 requirement, and its fully-loaded combined buffer requirement (CBR); or ii) the amount that is required to meet the Basel 1 floor.
        - A <u>recapitalization amount (RCA)</u> that consists of the higher of: i) a bank's minimum capital requirement (Pillar 1) and Pillar 2 requirement; or ii) the amount that is required to meet the Basel 1 floor.
    - Additionally, these targets were complemented by a <u>market confidence charge (MCC)</u> set for 2016 at the level of the fully-loaded CBR less 125 basis points. The leverage ratio was not computed.
    - The informative MREL targets were set at <u>consolidated level only</u> and did not attempt to address the interplay between entities which form part of the same banking group (i.e. through internal MREL). Further, they were assessed with bail-in as the main resolution tool in combination with a single-point-of-entry (SPE) strategy.
    - In addition to the DR formula, the SRB took into account an <u>8% benchmark</u>. In this regard, the SRB considered that a MREL level of at least 8% of total liabilities and own funds (TLOF) would generally be required for all major banking groups.
    - Firms are expected to comply with the binding targets (once they have been defined) at the end of an appropriate <u>transition period</u>, and failure to do so may result in <u>banks being deemed unresolvable</u>.
- **MREL-eligible liabilities**.
    - The calculation of a bank's available MREL-eligible liabilities in 2016 followed the criteria set out in the BRRD. The SRB took a <u>cautious approach</u> to eligibility, and in particular:
        - <u>Excluded</u> structured notes and special purpose vehicles (SPVs), liabilities governed by the law of a country outside the EU, and liabilities issued by entities incorporated outside the EU.
        - <u>Included</u> non-covered and non-preferred term deposits, whose term was greater than one year; liabilities held by retail investors (if they met the eligibility criteria set out in the BRRD); and cross-holdings of MREL-eligible instruments.
    - With respect to subordination, the SRB considered that Global Systemically Important Institutions (G-SIIs) must meet, at a minimum, a <u>subordination target equal to 13.5% of RWAs plus their CBR</u>, assuming compliance with the TLAC standard by 2019.

3. Next steps

- As a first step, the SRB intends to set **binding MREL targets at consolidated level** for major banking groups in **2017**, followed by determining targets at **solo level in late 2017/2018**. Future targets will consider bank-specific features (e.g. risk profile, business model, etc.).
- Other actions to be taken by the SRB in the future include the definition of its approach to subordination, the establishment of an operational framework for internal MREL, the setting of appropriate transition periods, etc.

BANCO DE ESPAÑA
Eurosistema

13/03/2017
Consulta pública previa sobre la nueva Circular del BdE por la que se modifica la Circular 1/2013, sobre la Central de Información de Riesgos.

1. Context

In May 2016, the ECB approved the Regulation 2016/867 on the collection of granular credit and credit risk data (commonly known as the AnaCredit Regulation). In this regard, an information reporting system, namely the Risk Information Centre (CIR) already exists in Spain, established under the Circular 1/2013 published by the BdE.

In this context, the BdE has launched a **consultation on a new Circular intended to amend the Circular 1/2013**. This consultation aims to receive feedback from the institutions potentially affected by the amendments for the purpose of introducing the AnaCredit requirements into the Circular 1/2013.

The BdE has not yet published any draft rule. The institutions potentially affected by the amendments are referred to the existing documents in this regard (the current version of the Circular 1/2013; the AnaCredit Regulation, and an AnaCredit manual) for the purpose of submitting their comments.

2. Main points

- The existing **information model** established under the Circular 1/2013 is **similar** to the one specified in the AnaCredit Regulation (e.g. the reporting is made at operation level, the information blocks include very similar information, etc.). Nevertheless, the implementation of AnaCredit requires some amendments to the Circular 1/2013.
- In particular, the **amendments to Circular 1/2013** that need to be introduced may be classified into 3 different categories:
  - <u>Information on new credit operations</u>. In particular, certain operations between the institution and its branches or between different branches of the same institution should be reported.
  - <u>New information on interest rates and on the accounting situation of the reported operations, as well as financial data and information on guarantees received</u>.
  - <u>Alignment</u> of the <u>attributes, concepts and definitions</u> of the Circular 1/2013 with those of the AnaCredit Regulation.
- The BdE will report the AnaCredit information using the data that institutions report under the CIR to the ECB. This approach will avoid imposing new obligations to institutions subject to the new Circular, which should only **report the data once** to comply with both regulatory frameworks.

3. Next steps

- Comments to this consultation shall be submitted within **15 calendar days**.
- The AnaCredit Regulation specifies that the reporting shall be established in stages, with the first stage starting on **1 September 2018**. The first stage of reporting under AnaCredit should include credit granted by institutions to legal entities.

BANCO DE ESPAÑA
Eurosistema

29/03/2017
Consulta pública previa sobre la nueva Circular del BdE que reemplaza la Circular 4/2004.

1. Context

IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from Contracts with Customers) were adopted in the EU in 2016. These standards will be applicable to banking groups for preparing their consolidated annual accounts for the financial years starting from 1 January 2018.

In this regard, the BdE has launched a **previous public consultation on the approval of a Circular repealing Circular 4/2004** on public and confidential financial information standards and financial statement formats, aimed to adapt this Circular to the above-mentioned accounting standards. Further, the BdE will accomplish a formal comprehensive review of the Circular 4/2004, since it has been partially amended several times over time.

The BdE has not yet published any draft rule. The institutions potentially affected by the amendments are referred to the existing documents (Circular 4/2004, IFRS 9 and IFRS 15) for the purpose of submitting their comments.

2. Main points

- **Objectives**.
    - Aligning the local accounting framework for credit institutions with the IFRS accounting framework.
    - Accomplishing a formal comprehensive review of the Circular 4/2004. Thus, this review could result in the amendment of certain provisions not directly affected by IFRS 9 or IFRS 15.
- **Possible solutions**. The introduction of IFRS 9 and IFRS 15 through targeted amendments to the Circular 4/2004 was considered. However, due to the scope and significance of the expected amendments and in order to ensure an appropriate understanding of the accounting framework, the BdE will produce a new circular repealing Circular 4/2004.

3. Next steps

- Comments to this consultation shall be submitted within 15 calendar days. The consultation period finalises on **12 April 2017**.
- The BdE expects to finalise the new circular in **2017**, so its entry into force meets the agreed date for the implementation of IFRS 9 and IFRS 15 (1 January 2018).

GOBIERNO DE ESPAÑA MINISTERIO DE ECONOMÍA Y HACIENDA
DIRECCIÓN GENERAL DE SEGUROS Y FONDOS DE PENSIONES

28/02/2017

- **Borrador de Anteproyecto de Ley de distribución de seguros y reaseguros privados.**
- **Proyecto de Orden por la que se aprueban los modelos de información cuantitativa.**
- **Proyecto de Orden por la que se modifica el Plan de contabilidad de las entidades aseguradoras y reaseguradoras.**

1. Context

In January 2016, the European Parliament and the Council published the Directive 2016/97 on insurance distribution, aimed at harmonizing national provisions on this matter. In this context, the DGSFP has published a **draft Anteproyecto de Ley de distribución de seguros y reaseguros privados**, which will transpose the European Directive.

This draft aims to modify the previous law by: i) extending its scope; ii) reinforcing the requirements regarding organization, professional skills, information and conduct when distributing insurance; and iii) establishing an enhanced customer protection framework for Insurance-Based Investment Products (IBIPs).

Further, the DGSFP has published two **Proyectos de Orden**, one on quantitative information models and the other on accounting rules for insurance and reinsurance undertakings.

2. Principales aspectos

<u>Borrador de Anteproyecto de Ley de distribución de seguros y reaseguros privados</u>

- **Scope**. The draft widens the scope of the insurance distribution rules:
  - Not only intermediaries are considered distributors, but also <u>insurance undertakings</u> and other market participants that offer <u>ancillary products</u> (e.g. travel agents).
  - The activity of insurance '<u>comparators</u>' is included within the concept of distribution (provision of information on insurance contracts according to criteria selected by the customer, whether via a website or other media, or the provision of a ranking of products).
- **Training**. The draft includes <u>training requirements</u>, in particular regarding risks in non-life insurance products, IBIPs and life insurance products.
- **Information to be provided to customers**. The draft specifies the general information that distributors shall provide to clients. In this regard:
  - Distinct information requirements are established depending on whether the <u>sale includes advice</u> or not.
  - Information about the <u>type of remuneration</u> which the person who sell insurance receive shall be given to the customer.
  - An <u>insurance product information document</u> should provide standardised information for <u>non-life insure products</u>. It should be drawn up by the relevant insurance undertaking (or by the insurance intermediary that manufactures the insurance product).
- **IBIPs**. A set of enhanced requirements are established for IBIPs. Among other aspects:
  - Distributors shall operate effective organisational arrangements to prevent <u>conflicts of interest</u>.
  - They shall provide guidance to customers on the <u>risks</u> associated with the IBIPs, information on all <u>costs</u> and, where appropriate, and an <u>assessment of the suitability</u>.
  - They shall ensure that the product is <u>suitable for the customer</u>, considering among other aspects that customer's risk tolerance and ability to bear losses.
- **Cross-selling**. The draft introduces the concept of cross-sales, establishing among others aspects that when an insurance product is offered together an with ancillary product or service, the distributor shall <u>inform the customer</u> whether it is possible to buy the different components separately and, if so, shall provide an adequate description of the <u>costs</u> of each component.
- **Product oversight and governance**. The draft enhances the requirements on the design, approval and oversight of products, and regarding governance:
  - The distributors that manufacture any product for sale to customers shall maintain, operate and review a <u>process for the approval</u> of each of these products, identifying the <u>target market</u> and assessing all relevant <u>risks</u> to such target market, among others.
  - The insurance products offered in the market should be <u>regularly reviewed</u>.

Proyecto de Orden por la que se aprueban los modelos de información cuantitativa

This Proyecto de Orden approves the **quantitative information models** (e.g. models for statistical and accounting purposes or models for supervision, statistical and accounting purposes). All of them are **adapted to Solvency II**.

Proyecto de Orden por la que se modifica el Plan de contabilidad de las entidades aseguradoras y reaseguradoras

- This Proyecto de Orden amends the accounting framework for **individual financial statements** of insurance and reinsurance undertakings regarding **intangible assets and goodwill**, and removes the provision on '**Memoria Abreviada**' from the accounting plan of insurance and reinsurance undertakings and from the rules on the preparation of consolidated financial statements of insurance groups.

3. Next steps

- Comments to these draft rules shall be submitted by **16 March, 2017**.

31/01/2017
Final amendments to the Capital Plan and Stress Test Rules.

1. Context

The Fed's capital planning and stress testing framework for large financial companies consists of two related programs: the Comprehensive Capital Analysis and Review (CCAR), and the Dodd-Frank Act Stress Test (DFAST).

In particular, the Fed conducts an annual assessment of the capital planning and post-stress capital adequacy of Bank Holding Companies (BHCs) with total consolidated assets of $50 billion or more. Moreover, all U.S. Intermediate Holding Companies (IHCs) of Foreign Banking Organizations became subject to the Fed's capital plan rule beginning in 2017.

In this regard, the Fed has published a **final rule to modify its capital plan and stress testing rules for the 2017 cycle**. In particular, this rule includes amendments that apply to large and noncomplex firms, as defined below; and other general amendments that apply to firms with more than $50 billion in total consolidated assets.

2. Main points

- **Definition of 'large and noncomplex firm'**. A BHC or U.S. IHC with total consolidated assets of $50 billion or greater but less than $250 billion, nonbank assets of less than $75 billion, and that is not identified as a global systemically important banks (G-SIB).
- **Amendments applying to large and noncomplex firms**. The final rule will:
    - Remove the qualitative assessment of CCAR for these firms. Instead, the qualitative assessment will be conducted outside of CCAR through the supervisory review process. These firms remain subject to a quantitative assessment in CCAR.
    - Modify certain regulatory reporting requirements to collect less detailed information on these firms' stress test results and raise materiality threshold for reporting on specific portfolios.
    - Amend the Parent Company Only Financial Statements for Large Holding Companies (FR Y-9LP) to include a new line item for purposes of identifying the large and noncomplex firms.
- **General amendments applying to firms with more than $50 billion in total consolidated assets**. The final rule will:
    - Simplify the timing of the initial applicability of the capital plan and stress test rules. In particular, the cutoff date for the capital plan rule will be moved to September 30, instead of December 31 (a firm that crosses the $50 billion asset threshold in the fourth quarter will not have to submit a capital plan until April 5 of the second year after it crosses the threshold).
    - Revise the amount of capital that any firm subject to the quantitative requirements of CCAR can distribute to shareholders outside of an approved capital plan without seeking prior approval from the Fed ('de minimis exception'). In particular, it will:
        - Decrease the 'de minimis exception' amount from 1% of the firm's tier 1 capital to 0.25%.
        - Establish a blackout period (the second quarter of the year), during which firms will not be able to submit a notice to use the 'de minimis exception'.
    - Regarding the trading and counterparty component of the stress test, the final rule extends the range of dates from which the Fed may select the as-of date for the global market shock from October 1 of the calendar year preceding the year of the stress test cycle to March 1 of the calendar year of the stress test cycle.

3. Next steps

- The final rule will take effect for the **2017 CCAR**.
- Amendments regarding the trading and counterparty component of the stress test will take effect for the **2018 stress test cycle**.
- The scenarios and instructions for the 2017 CCAR cycle will be released by the **end of this week**.

06/02/2017

- **Comprehensive Capital Analysis and Review 2017 Summary Instructions for LISCC and Large and Complex Firms.**
- **2017 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule.**

1. Context

The Fed's capital planning and stress testing framework for large financial companies consists of two related programs: the Comprehensive Capital Analysis and Review (CCAR), and the Dodd-Frank Act Stress Test (DFAST).

In particular, the CCAR evaluates the capital planning processes and capital adequacy of the largest U.S Bank Holding Companies (BHCs), including the firms' planned capital actions such as dividend payments, share buybacks and issuances, etc. The DFAST is a forward-looking assessment to help assess whether firms have sufficient capital and will be able to lend to households and businesses in a serious recession.

In this regard, the Fed has published the **instructions** to firms participating in CCAR and the **scenarios** to be used by banks and supervisors for the 2017 CCAR and DFAST exercises.

2. Main points

<u>Comprehensive Capital Analysis and Review 2017 Summary Instructions for LISCC and Large and Complex Firm</u>

- **Scope**. These instructions apply to firms subject to the Large Institution Supervision Coordination Committee framework (<u>LISCC firms</u>), specified in a list published by the Fed, and to <u>large and complex firms</u>. For the 2017 cycle, 13 BHCs are subject to both a quantitative and qualitative assessment, whereas 21 firms with less complex operations are not subject to the qualitative assessment.
- **Content**. Similar to the instructions in previous years, the instructions provide information on:
    - Logistics for a BHC's capital plan submissions.
    - Expectations regarding the mandatory elements of a capital plan.
    - Qualitative assessment of a BHC's capital plan.
    - Quantitative assessment of a BHC's post-stress capital adequacy.
    - Fed's response to capital plans and planned capital actions.
    - Limited adjustments a BHC may make to its planned capital distributions.
    - Planned public disclosures by the Federal Reserve at the end of the CCAR exercise.
- **New elements included in the CCAR 2017 instructions**. The instructions have been updated to reflect the recent phase-in of certain regulatory requirements and amendments to the capital plan rule. Thus, among others aspects, the instructions require BHCs to maintain a <u>supplementary leverage ratio above 3%</u>; include the amendments to the capital plan rule regarding the '<u>de minimis exception' threshold</u>; remove large and noncomplex firms from the <u>qualitative review</u>; etc.

<u>2017 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule</u>

- **General aspects to the supervisory scenarios**.
    - The scenarios start in <u>1Q17</u> and extend through <u>1Q20</u>.
    - Each scenario includes <u>28 variables</u> (e.g. GDP, stock market prices, and interest rates, etc.), as in the 2016 exercise.
    - Along with the variables, a <u>narrative</u> describing the general economic conditions in the scenarios and changes in the scenarios from the previous year has been provided.
- **Supervisory scenarios**.
    - <u>Baseline scenario</u>. It features a moderate economic expansion in the U.S. (e.g. real GDP grows on average about 2.25% per year, the unemployment rate declines to slightly under 4.25% in 4Q18, etc.), and an expansion in international economic activity.
    - <u>Adverse scenario</u>. It is characterized by a moderate recession in the U.S. (e.g. GDP falls slightly more than 2% from the 4Q16, the unemployment rate rises steadily, peaking at about 7.25% in the 3Q18, etc.) and a weakening economic activity across all countries included in the scenario.
    - <u>Severely adverse scenario</u>: is characterized by a severe global recession that is accompanied by a period of heightened stress in corporate loan markets and commercial real estate markets. In particular, the U.S. real GDP begins to decline in 1Q17 and in 2Q18 is about 6.5% below the pre-recession peak, unemployment rate rises to 10%, etc.

- **Global market shock components for adverse and severely adverse scenarios**.
    - 6 BHCs (Bank of America, Citigroup, Goldman Sachs, JP Morgan, Morgan Stanley and Wells Fargo) are required to factor in a global market shock as part of their scenarios.
- **Counterparty default component for adverse and severely adverse scenarios**.
    - 8 BHCs (the above-mentioned BHCs, Bank on New York Mellon and State Street) are required to incorporate a counterparty default scenario.

3. Next steps

- BHCs participating in CCAR are required to submit their capital plans and stress testing results to the Fed on or before **April 5, 2017**.
- The Fed will announce the results of its supervisory stress tests by **June 30, 2017**.

BANK OF ENGLAND

BANK OF ENGLAND PRUDENTIAL REGULATION AUTHORITY

27/03/2017

- **Stress testing the UK banking system: key elements of the 2017 stress test.**
- **Stress testing the UK banking system: 2017 guidance for participating banks and building societies.**
- **Variable paths for the 2017 stress test.**
- **Traded risk scenario for the 2017 stress test.**
- **Stress test model management.**

1. Context

The BoE's concurrent stress-testing framework is designed to examine the potential impact of hypothetical adverse scenarios on the health of the UK banking system and individual institutions within it.

In this regard, the BoE has now published **key elements of the 2017 stress test**, specifying that in 2017 the BoE's stress test will include two stress scenarios: an annual cyclical scenario (ACS); and a biennial exploratory scenario (BES), which is run for the first time. Moreover, the BoE has released a document providing **guidance for participating banks** for conducting their own analysis for the 2017 stress test.

Further, the PRA has published a **letter on stress test model management**, addressed to firms participating in the 2017 stress test regarding the BoE's current thinking around four principles of stress test model management.

2. Main points

<u>Stress testing the UK banking system: key elements of the 2017 stress test</u>

- **2017 ACS**. This scenario aims at ensuring that the banking system have sufficient capital to absorb losses and maintain the supply of credit to the real economy.
    - Three types of stress (as in the 2016 exercise), which are assumed to be synchronized, are included: a <u>macroeconomic</u> stress; a <u>traded risk</u> stress; and a <u>misconduct costs</u> stress.
    - Underlying <u>domestic vulnerabilities</u> are judged to be broadly unchanged compared to the 2016 ACS (e.g. UK GDP falls by 4.7%, unemployment remains at 9.5%, UK residential property price falls by 33%, etc.).
    - The <u>stressed outcome for the global economy</u> is worse than in 2016, largely reflecting continued rapid growth of credit in China (e.g. world GDP falls by 2.4%, Chinese GDP decreases by 1.2%, etc.).
    - The <u>Bank Rate peaks at 4%</u> in the 2017 ACS, differentiating it from the 2016 exercise, in which Bank Rate was cut to zero.
    - The <u>hurdle rates</u> above which banks will be expected to maintain their capital positions in the 2017 ACS have been set on the same basis as in the 2016 test.
        - All participating banks will be expected to meet their minimum CET1 capital requirements (i.e. Pillar 1 capital requirement plus any uplift set by the PRA).
        - G-SIBs will be held to a higher standard (i.e. minimum CET1 plus the associated G-SIB capital buffer).
        - Failure to meet these standards in the stress will generally result in banks being required to take action to improve their positions.
- **2017 BES**. This scenario aims at examining how the UK banking system might evolve if recent headwinds to bank profitability persist or intensify.
    - The scenario includes the following <u>headwinds</u>: weak global growth, persistently low interest rates, stagnant world trade and cross-border banking activity, increased competitive pressure, and a continuation of costs related to misconduct.
    - The test will have a <u>seven-year horizon</u> to capture these long-term trends.
    - The exploratory scenario is <u>not focused on bank capital adequacy</u>.
    - The results of the BES will be used by policymakers to understand and anticipate potential future developments in the financial system.

<u>Stress testing the UK banking system: 2017 guidance for participating banks and building societies</u>

- **Participating banks**. The 2017 stress test will cover <u>seven major UK banks and building societies</u> (same group of banks that participated in 2016): Barclays, HSBC, Lloyds Banking Group, Nationwide, The Royal Bank of Scotland Group, Santander UK and Standard Chartered.

- **Scope of consolidation**. Banks should provide results at the highest level of UK consolidation. The scope is the perimeter of the banking group as defined by the CRR and the CRD IV, which includes investment banks and excludes insurance activities.
- **Guidance**. The documents provides: i) guidance that relates to both the ACS and BES (Sections 1 to 7); ii) ACS-specific guidance (Sections A8 to A14); iii) BES-specific guidance (Sections B8 to B14); and iv) detailed guidance related to the traded risk element of the test (in the annex).

3. Next steps

- The submission date for the ACS projections will be **30 June**, whereas the date for submission of BES projections will be **14 July**.
- The results will be published in **2017 Q4**.
- The PRA will invite feedback from firms to ascertain how useful the principles have been in informing their stress testing model management processes and internal governance. Should the BoE decide that adherence to the principles be set as a supervisory expectation it will consult in the usual way.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

27/02/2017
Consultation Paper: refining the PRA's Pillar 2A capital framework.

1. Context

The PRA sets Pillar 2A capital for risks which are not fully captured under the CRR. The PRA assesses those risks as part of the SREP, in light of both the calculations included in a firm's ICAAP document and the PRA's Pillar 2A methodology, which is based on a comparison of firms' standardised approach (SA) risk weights to risk weights derived from IRB models ('IRB benchmark).

In this regard, the PRA has published a **Consultation Paper** setting out **proposed adjustments to the PRA's Pillar 2A capital framework**, which came into force on 1 January 2016.

The proposals cover three areas: i) adjustments to the PRA's Pillar 2A approach for firms using the SA for credit risk; ii) revisions to the IRB benchmark; and iii) additional considerations, as part of the SREP, for SA firms using IFRS as their accounting framework.

2. Main points

- **Adjustments to the PRA's Pillar 2A approach for firms using the SA for credit risk**. The PRA is proposing, among other aspects, the following:
  - In setting Pillar 2A capital, the PRA would carry out an overall assessment of the level of capital that would be sufficient to ensure a sound management and coverage of risks.
    - A judgement on the higher degree of conservatism that may apply to certain asset classes under the SA, as informed by comparing firms' SA Pillar 1 capital charges to the IRB benchmark, would inform the setting of Pillar 2A capital.
    - The overall assessment would not mechanically link to the benchmark but would also be informed by other factors (e.g. ICAAP, business model analysis, etc.).
  - As part of this approach, the PRA would estimate the extent to which the application of the PRA's Pillar 2A methodologies for credit risk would lead to a firm maintaining capital in excess.
    - Any excess could be used to adjust the variable Pillar 2A capital add-ons. The fixed elements of Pillar 2A would not be adjusted.
  - The PRA would require firms using the SA to report on a regular basis the Pillar 2 data items on wholesale and retail credit exposures (FSA076 and FSA077 in Appendix 5) alongside their ICAAP.
  - Where the PRA determines that the arrangements, strategies and mechanisms implemented by a firm do not ensure a sound management and coverage of its risks, its Pillar 2A capital add-ons would not be adjusted as part of the proposed refined approach.
- **Revisions to the IRB benchmark**. The PRA is proposing to update its IRB benchmark using end-2015 data:
  - This updated benchmark would continue to underpin the PRA's methodology for credit risk and would also be used as part of the proposed Pillar 2A approach for SA firms.
  - Two adjustments are proposed to the coverage of the benchmark:
    - A benchmark for personal loans would be added.
    - The benchmark for sovereigns within credit quality step six ('substantial risks') would be removed because the sample size is too small.
  - The PRA also proposes a change to the application of the benchmark for commercial real estate (CRE) exposures. Thus, for the purpose of assessing potential conservatism in SA risk weights, SA firms with material CRE exposures should assign these, as part of their ICAAP, to the risk weight category for specialised lending exposures.
- **Additional considerations, as part of the SREP, for SA firms using IFRS as their accounting framework**. The PRA is proposing the following:
  - A separate IRB benchmark, based on unexpected losses, would be introduced. Expected loss would be removed from the calculations of the average IRB risk weights.
  - This benchmark would inform the assessment of credit risk and the setting of Pillar 2A capital as part of the proposed adjusted Pillar 2A approach for IFRS firms.

3. Next steps

- Comments to this consultation paper shall be submitted by **31 May 2017**.
- The proposed implementation date for the updated Pillar 2A capital framework is **1 January 2018**.
- The PRA will assess whether ongoing adjustments may be required in light of developments on the proposed revisions by the BCBS to the standardised and IRB approaches for credit risk. Moreover, the PRA will consider transitional measures proposed by the BCBS and the European Commission to smooth the impact of IFRS 9 on regulatory capital.

BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

29/03/2017

Consultation Paper on Internal Ratings Based (IRB) approach: clarifying PRA expectations.

1. Context

In its 2016 Annual Competition Report, the PRA set out several areas of the IRB framework that had been identified by firms as lacking clarity.

In this regard, as part of a suite of enhancements to improve the IRB approach, the PRA has published a **Consultation Paper (CP) on the IRB approach**, which aims to introduce certain changes to the Supervisory Statement (SS) 11/13.

In particular, this CP clarifies PRA's expectations on how firms can demonstrate that they meet the CRR requirements on 'prior experience' of using IRB approaches, and on the use of external data to supplement internal data for estimating PD and LGD for residential mortgages. Further, the PRA is also proposing to set two reference points for estimating the Probability of Possession Given Default (PPGD) for residential mortgages for firms that lack significant possession data.

2. Main points

- **Prior experience of using the IRB approach**. A firm should be able to evidence that:
    - Its complete IRB governance framework has been through at least one annual cycle since internal approval.
    - It has used its internal rating systems in credit decisions, lending policies, risk appetite polices and credit risk monitoring for at least 3 years.
    - There has been at least 3 years of monitoring, validation and audit of the firm's IRB framework.
- **Use of external data in the estimation of PD for residential mortgages**. The PRA proposes that:
    - Where firms have low levels of actual internal default data, external data may be used as a supplement to internal data for the purposes of rank-ordering different borrowers by credit quality. Firms attempting to evidence comparability with third-party data should include a comparison of default rates.
    - The 'primary source' requirement in the CRR may be met where an applicant assigns sufficient weight to internal data, but uses external data to achieve greater discrimination.
    - Where firms lack sufficient internal defaults to support rank-ordering or a reliable calibration, they shall accept models that rank order using an early-arrears definition.
    - Firms with low levels of internal default data will be expected to include an additional margin of conservatism (MoC) at every step of the process, which the PRA will assess.
- **Use of external data in the estimation of LGD for residential mortgages**. The PRA proposes that:
    - Firms with limited internal default data may use external data as a supplement when estimating LGD, applying additional MoC.
    - Firms with no internal repossession data for use in their Forced Sale Discount (FSD) modelling could initially rely on external data. This would not remove the requirement for firms to run an FSD model with appropriate governance and monitoring requirements.
- **Use of PRA reference points for calculating PPGD for residential mortgages**. Regarding the calculation of the PPGD, which is one of the main drivers of LGD and a firm-specific parameter linked to banks' recovery and repossession processes, the PRA proposes the following:
    - To set the following reference points for calculating PPGD MoCs to be used by firms with low levels of internal default and possession outcome data. In this regard, it considers the following reference points to be appropriate:
        - PPGD reference point of 100% where there are very low default volumes, regardless of the length of observed outcomes.
        - PPGD reference point of 70% where firms are able to demonstrate they have greater, but still not considerable, volume and history of data to estimate future possession rates.
    - The PRA would expect firms to assess on a case-by-case basis whether they should sit above or below these levels (although PPGD cannot be higher than 100%).

3. Next steps

- Comments to this CP shall be submitted by **28 June 2017**.
- The PRA aims to issue the updated SS11/13 in **October 2017**

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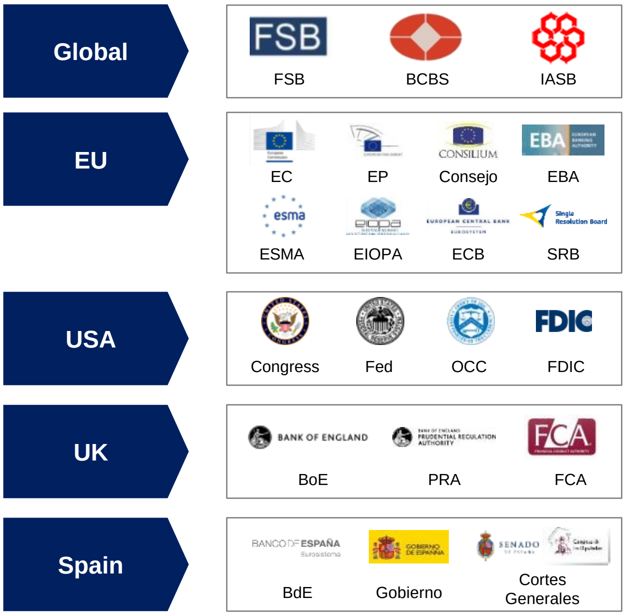

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