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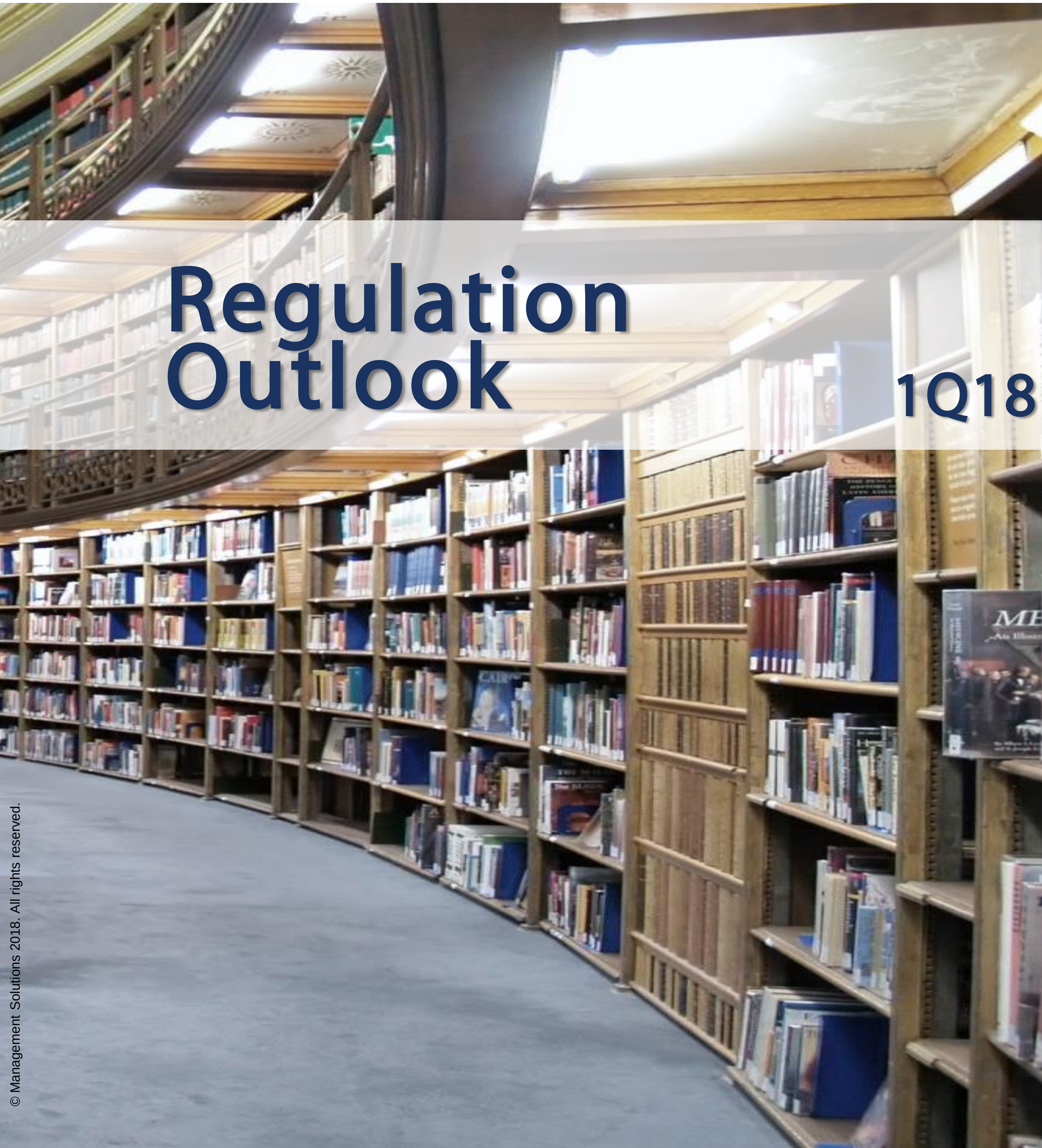

Regulation Outlook

1Q18

R & D

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Executive summary

In the first quarter of 2018, the BCBS consultative document on revisions to the minimum capital requirements for market risk stands out. In Europe, the EC, the EBA and the ECB published several documents on NPLs. Further, the EBA published the scenarios for the 2018 stress test. In Spain, the Government published the Anteproyecto de Ley de prevención del blanqueo de capitales y de la financiación del terrorismo.

Global publications

- At international level, the BCBS published a **consultative document on revisions to the minimum capital requirements for market risk** which introduces amendments on, among others, the standardised approach, the internal models approach, the scope of market risk capital requirements, etc.
- Moreover, the BCBS published a **consultative document on Pillar 3 disclosure requirements**, arising from the Basel III reform.
- Further, the BCBS released the results of its latest **Basel III monitoring report**. In parallel, the EBA conducted its **report of the CRD IV-CRR / Basel III monitoring exercise** on the European banking system.

European publications

- Regarding NPLs, the European Commission (EC) published a **comprehensive package of measures to tackle NPLs in Europe**, including, among others, a Proposal for a Regulation on amending CRR as regards NPLs' minimum loss coverage. Further, the EBA published a **consultation paper on Guidelines on management of NPEs and forborne exposures**, which specifies sound risk management practices. Finally, the ECB published an **Addendum to the ECB Guidance to banks on NPLs**, specifying quantitative supervisory expectations concerning the minimum levels of prudential provisions.
- The EBA published the **macroeconomic scenarios for the 2018 EU-wide stress test** that banks are required to consider in order to estimate the potential impact on profits and capital.
- Further, the EBA published **Final Guidelines on disclosure of IFRS 9 transitional arrangements**, which specify a uniform disclosure template to be applied by institutions in order to ensure consistency and comparability of data disclosed during the transitional period.

European publications (continuation)

- The ECB launched a public consultation on its **Draft Guides on the ICAAP and on the ILAAP** with the aim at developing a more detailed set of supervisory expectations regarding these two processes.
- Moreover, the EBA also published a **Roadmap on FinTech** setting out its priorities for 2018/2019 and a timeline for the completion of these tasks.
- Finally, the EIOPA published the **second and final set of advice on specific items in the Solvency II Delegated Regulation**, which covers, among other aspects, the recalibration of standard parameters of premium and reserve risks.

Local publications

- In Spain, the Government published the **Anteproyecto de Ley de prevención del blanqueo de capitales y de la financiación del terrorismo (AML/CFT)**, aiming to adapt the Spanish legal system to the AML IV Directive.
- In USA, the Fed published a **Proposed supervisory guidance on management of business lines and independent risk management and controls for large financial institutions** for the purpose of clarifying the Fed supervisory expectations regarding risk management for these institutions.
- Regarding the stress test and the capital adequacy in USA, the Fed also published the **instructions** as well as the **scenarios** to be used by banks and supervisors for the **2018 Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Act Stress Test (DFAST) exercises**.
- In UK, the PRA published a **consultation paper on credit risk mitigation: eligibility of guarantees as unfunded credit protection**, to clarify its expectations on the eligibility of these guarantees under the credit risk mitigation (CRM) framework of the CRR.

Regulatory projections

At European level, the General Data Protection Regulation (GDPR) and the Guidelines on the assessment of the suitability of members of the management body and key function holders of the EBA and the ESMA will be applicable. At domestic level, the publication of the Ley Orgánica de Protección de Datos Personales (LOPD) is expected in Spain. In USA, the Fed will publish the 2018 CCAR and DFAST results.

Regulatory projections

1. Next quarter

- **(Europe) May 2018**: the General Data Protection Regulation (GDPR) will be applicable.
- **(Spain) May 2018**: the publication of the new Ley Orgánica de Protección de Datos (LOPD) is expected.
- **(Europe) June 2018**: the EBA Guidelines on internal governance and the EBA and ESMA Guidelines on the assessment of suitability of the management body and key functions will be applicable.
- **(USA) June 2018**: the Fed will publish the 2018 CCAR and DFAST results.

2. Next year

- **(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 (CRD IV, CRR, BRRD, SRMR and EMIR).
- **(Europe) September 2018**: institutions are expected to start reporting under AnaCredit.
- **(Europe) October 2018**: the EC's withdrawal agreement with UK is expected.
- **(Europe) November 2018**: the EBA will publish the 2018 EU-wide stress test results.
- **(Global) December 2018**: the BCBS revised standards on IRRBB will be applicable.
- **(Global) December 2018**: the FSB will publish the new list of G-SIBs.
- **(UK) December 2018:** the BoE will publish the 2018 stress test results.
- **(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, in accordance with the FSB.
- **(Global) January 2019**: the BCBS's large exposures framework will be applicable.
- **(Europe) January 2019**: the EBA Final Guidelines on the treatment of connected clients will come into force.
- **(Europe) January 2019**: the ECB Final Guides to the ICAAP and to the ILAAP will be applicable and considered according to the SREP framework.
- **(Europe) January 2019**: the ECB Guidelines on management of NPLs and forborne exposures 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.
- **(UK) January 2019**: the BoE rules on operational continuity in resolution will enter into force.

3. More than a year

- **(Global) December 2019**: the BCBS assessment methodology for G-SIBs will be applicable.
- **(Global) December 2019**: the FSB is expected to conduct a review of the technical implementation of TLAC.
- **(Global) December 2020**: the BCBS Guidelines on step-in risk will be applicable.
- **(Europe) January 2021**: the EBA Guidelines on IRB parameters estimation will be applicable.
- **(Global January 2022**: the revised SA for credit risk, the revised IRB framework, the revised CVA framework, and the revised operational risk framework published by the BCBS will be implemented. Moreover, the LR framework (using the revised exposure definition) and the G-SIB buffer will be applicable.
- **(Global) January 2022**: the BCBS revised market risk framework will be applicable, as well as, the regulatory information required in this regard will be disclosed for the first time.
- **(Global) January 2022**: most of the new disclosure requirements of the BCBS Pillar 3 updated framework will be implemented.
- **(UK) January 2022**: the PRA will require firms to comply with an end-state MREL.
- **(Europe) December 2022**: the application of IFRS 9 transitional arrangements, applicable since March 2018, will finish.
- **(Global) January 2027**: an output floor of 72.5% will be applicable according to the Basel III reform.

Publications of this quarter

Summary of outstanding publications of this quarter

20/02/2018
Sound practices: Implications of FinTech developments for banks and bank supervisors.

1. Context

In August 2017, the BCBS released a consultative document on the implications of FinTech for the financial sector aiming to assess how technology-driven innovation in financial services, or FinTech, may affect the banking industry and the activities of supervisors in the near to medium term.

In this context, the BCBS has now published a document on **Sound Practices: implications of FinTech developments for banks and bank supervisors**, which provides a forward-looking perspective on FinTech and its potential impact on the banking industry and bank supervision. In particular, this document identifies ten key implications and related considerations for banks and bank supervisors in order to enhance safety and soundness and financial stability including, among others, key risks for banks related to FinTech developments, implications for banks of the use of innovative enabling technologies and adaptation of the supervisory skill set.

2. Main points

- **Overarching need to ensure safety and soundness and high compliance standards without inhibiting beneficial innovation in the banking sector**. The BCBS considers that banks supervisors should monitor current practices that might unduly or unintentionally hamper beneficial innovations in the financial system.
- **Key risks for banks related to FinTech developments, including strategic/profitability risks, operational, cyber- and compliance risks**. The BCBS recommends the implementation of supervisory programmes to ensure that banks have effective governance structures and risk management processes that appropriately identify, manage and monitor risks arising from the use of FinTech. In this regard these structures and processes may include: robust strategic and business planning, sound new product approval and change management processes, risk management processes in line with the portions of the BCBS' principles for sound management of operational risk (PSMOR), among other aspects.
- **Implications for banks of the use of innovative enabling technologies**. The BCBS establishes that banks relying on these innovative technologies should ensure they have effective IT and other risk management processes and control environments that effectively address new sources of risk.
- **Implications for banks of the growing use of third parties (via outsourcing and/or partnerships)**. The BCBS recommends the implementation of supervisory programmes to ensure that banks have appropriate risk management practices and processes over any operation outsourced. These practices and processes include due diligence; operational risk management; ongoing monitoring and appropriate execution of contracts with third-party service providers, etc.
- **Cross-sectoral cooperation between bank supervisors and other relevant authorities**. The BCBS recommends banks supervisors to communicate and coordinate with relevant regulators and public authorities (e.g. those charged with data protection and fair competition) to ensure that banks using innovative technologies are complying with the relevant laws and regulations.
- **International cooperation between bank supervisors**. The BCBS suggests, given the current and potential global growth of FinTech firms, further supervisory coordination and information-sharing where appropriate for cross-border FinTech that affects banks.
- **Adaption of the supervisory skill set**. The BCBS considers that banks supervisors should assess their current staffing and training programmes to ensure that the knowledge, skills and tools remain relevant and effective, and consider the addition of staff with specialised skills to complement existing expertise.
- **Potential opportunities for supervisors to use innovative technologies ('suptech')**. The BCBS establishes that supervisors should investigate and explore the potential of new technologies (e.g. artificial intelligence and Machine Learning) to improve their methods and processes.
- **Relevance of existing regulatory frameworks for new innovative business models**. The BCBS considers that a review by bank supervisors of their current supervisory frameworks in the light of a new evolving FinTech risks could uncover ways in which elements of these frameworks could evolve in a manner that ensures appropriate oversight of banking activities while not unduly or unintentionally hampering beneficial innovation.
- **Key features of regulatory initiatives set up to facilitate FinTech innovation**. The BCBS states that supervisors could learn from each other's approaches and practices, and consider whether it would be appropriate to implement similar approaches or practices.

27/02/2018
Consultative document on Pillar 3 disclosure requirements – updated framework.

1. Context

Pillar 3 of the Basel framework seeks to promote market discipline through regulatory disclosure requirements. In this regard, the BCBS carried out a first phase and a second phase of the revised Pillar 3 disclosure requirements in January 2015 and March 2017, respectively. Further, in December 2017 the BCBS published Basel III: finalising post-crisis reforms, which revised the framework for credit, operational and credit valuation adjustment (CVA) risks, as well as the leverage ratio; and introduced output floors.

In this context, the BCBS has now issued a **Consultative document on Pillar 3 disclosure requirements** that sets out proposals from the third phase of the Pillar 3 review. In particular, these proposals include new or revised requirements arising from the Basel III reform as well as new disclosure requirements on asset encumbrance and on capital distribution constraints (CDC).

2. Main points

- **General considerations**.
  - <u>Scope</u>: unless otherwise specified, proposed disclosure requirements apply to internationally active banks at the top consolidated level.
  - <u>Frequency and timing of disclosures</u>: the frequencies vary between quarterly, semiannual and annual reporting, depending upon the nature of the specific disclosure requirement. A bank's Pillar 3 report must be published concurrently with its financial report for the corresponding period.
  - <u>Reporting format</u>: the disclosure requirements are presented in the form of either templates or tables. Banks may disclose these templates/tables in a document separate from their Pillar 3 report.
  - <u>Assurance of Pillar 3 data</u>: the information provided must be subject to the same level of internal review and internal control processes as the information provided by banks for their financial reporting.
- **Revisions and additions to the Pillar 3 framework arising from finalisation of the Basel III post-crisis regulatory reforms**.
  - <u>Revised and additional disclosure requirements for credit risk</u>: the BCBS has amended three templates as a consequence of the revisions to the SA and IRB frameworks. Specifically, Template CR4 (SA - credit risk exposure and credit risk mitigation effect); Template CR5 (SA - exposures by asset classes and risk weights) and Template CR10 (IRB - specialised lending and equities under the simple risk-weight method) have been amended. Furthermore, a new Table CRB-A on additional disclosure related to prudential treatment of problem assets has been developed, applicable to banks only when required by their national supervisor.
  - <u>Revised disclosure requirements for operational risk</u>: the BCBS has developed a new Table ORA on general qualitative information on bank's operational risk framework; and three new disclosure templates, i.e. on historical losses (OR1), on the business indicator and subcomponents (OR2), and on minimum required operational risk capital (OR3).
  - <u>Revised disclosure requirements for leverage ratio</u>: the BCBS has amended Templates LR1 on summary comparison of accounting assets vs leverage ratio exposure measure; and Template LR2 on leverage ratio common disclosure template.
  - <u>Revised disclosure requirements for CVA</u>: the BCBS proposes to introduce the following disclosure requirements:
    - **Two new qualitative disclosure requirements** (i.e. Table CVAA on general requirements, which is mandatory for all banks; and Table CVAB on qualitative disclosures for banks using the SA-CVA).
    - **Four new quantitative disclosure requirements** (i.e. Template CVA1 on the reduced basic approach for CVA (BA-CVA), which is mandatory for banks having part or all of their CVA risk charges measured according to the reduced version of BA-CVA; Template CVA2 on the full BA-CVA, which is mandatory for banks having part or all of their CVA risk charges measured according to the full version of BA-CVA; Template CVA3 on the SA-CVA, which is mandatory for banks using this approach; and Template CVA4 on RWA flow statements of CVA risk exposures under the SA, which is mandatory for banks using the SA-CVA).

- New disclosure requirements for standardised approach RWA to benchmark internally modelled capital requirements: the BCBS proposes to introduce two new requirements, i.e. a Template BEN1 on benchmarking RWA calculated according to the standardised approaches and internally modelled approaches; and a Template BEN2 on benchmarking RWA calculated according to the standardised approach for credit risk (excluding counterparty credit risk) at asset class level.
- Revised disclosure requirements on overview of risk management, key prudential metrics and RWA: the BCBS has also revised the Template OV1 on overview of RWA (introduced in January 2015); and Template KM1 on key metrics (introduced in March 2017).

- **New disclosure requirements on asset encumbrance**. The BCBS proposes to include a new Template ENC on asset encumbrance, that would require banks to disclose information on their encumbered and unencumbered assets.
- **New disclosure requirements on CDC**. The BCBS proposes to introduce a new Template CDC that would require banks to disclose the CET1 capital ratios that would trigger CDC.

3. Next steps

- Comments to this consultative document shall be submitted by **25 May 2018**.
- Different implementation dates have been proposed for the new disclosure requirements. Most of them will be implemented in January 2022, although there are a few exceptions (e.g. Template CC1 will be implemented at the end of 2018; and Table CRB-A, Template ENC and Template CDC at the end of 2019).

22/03/2018

Technical Amendment on Pillar 3 disclosure requirements: regulatory treatment of accounting provisions.

1. Context

Pillar 3 of the Basel framework seeks to promote market discipline through regulatory disclosure requirements. In this regard, the BCBS carried out a first phase and a second phase of the revised Pillar 3 disclosure requirements in January 2015 and March 2017, respectively. Further, in February 2018, the BCBS published a Consultative document on Pillar 3 disclosure requirements that sets out relevant proposals from the third phase of this review.

In this context, the BCBS has now issued a **Technical Amendment on Pillar 3 disclosure requirements** in order to provide users with disclosures that fully reflect any transitional effects for the impact expected credit loss (ECL) accounting on regulatory capital, as well as to provide further information on the allocation of accounting provisions in the regulatory categories of general provisions and specific provisions for standardised exposures during the interim period

In particular, this document introduces amendments to two templates (KM2 and CR1) and one table (CRB) of the Pillar 3 standard.

2. Main points

- **Template KM2 (Key metrics – Total Loss-Absorbing Capacity (TLAC) requirements at resolution group level)**. Additional disclosure requirements are proposed to require banks to disclose the fully loaded impact of ECL transitional arrangements used in TLAC resources and ratios.
- **Template CR1 (Credit quality of assets)**. Given that the existing regulatory distinction between general and specific provisions does not directly correspond to how provisions would be measured under the new ECL accounting standards, additional disclosure requirements are proposed on the allocation between general and specific provisions for standardised approach exposures.
- **Table CRB (Additional disclosures related to credit quality of assets)**. This amendment accompanies those related to CR1. Banks are required to disclose the rationale for their categorisation of accounting provisions in general and specific categories for standardised approach exposures.

3. Next steps

- Comments to this document shall be submitted by **4 May 2018**.
- As the application of ECL accounting models and introduction of any transitional arrangements take effect from 1 January 2018, the BCBS proposes that the additional amendments to the Pillar 3 standard will come into effect from **1 January 2019**.

23/03/2018
Consultative document on revisions to the minimum capital requirements for market risk.

1. Context

In January 2016, the BCBS published the standard Minimum capital requirements for market risk which was developed to address a number of structural shortcomings in the Basel II market risk framework, and its subsequent revisions. This minimum standard served as a key component of the BCBS's reform of global regulatory standards in response to the global financial crisis.

In this context, the BCBS has now published a **Consultative document on revisions to the minimum capital requirements for market risk** which aims at addressing those issues that have been identified in the course of monitoring the implementation and impact of the standard published in 2016. In particular, amendments are proposed to the following aspects: i) standardised approach, ii) internal models approach, iii) scope of market risk capital requirements; and iv) simplified alternative to the standardised approach.

2. Main points

- **Standardised approach**. The BCBS proposes:
  - Revisions to the treatment of liquid FX pairs. It is proposed to allow banks to combine two currency pairs in the current list of liquid pairs and treat the resulting new FX pair as liquid.
  - Revisions to correlation scenarios. It is proposed to revise the 'low correlations' scenario by limiting the reduction in correlations in those cases where the low correlations scenario produce correlations that are more conservative than empirical data would support.
  - Revisions to capital requirements for non-linear instruments. It is proposed to apply minor changes to three aspects of the curvature risk measurement, in particular: i) to revise the approach to apply shock scenarios; ii) to address cliff effects; and iii) to address potential double-counting of FX curvature risk.
  - Revisions to risk weights. It is proposed to reduce the risk weights for the general interest rate risk class by 20–40%, and equity and FX risk classes by 25–50%. No specific revision is proposed to the risk weights applied for the credit spread and commodity risk classes. The BCBS may also consider making changes to risk weights used in the standardised approach to credit valuation adjustment risk (SA-CVA).
  - Other clarifications. It is proposed to revise the treatment of multi-underlying options and index instruments in the revised standardised approach.
- **Internal models approach**. The BCBS proposes:
  - Revisions to the P&L attribution test. It is proposed to revise: i) the P&L attribution (PLA) test input data (e.g. definitions of the hypothetical P&L and the risk-theoretical P&L); ii) PLA test metric design (e.g. the frequency at which the test is to be conducted and the length of the time series to be used); iii) PLA test failure consequences (e.g. the capital requirements for a trading desk in the amber zone); and iv) trading desk requirements.
  - Revisions on non-modellable risk factors (NMRF). It is proposed to provide clarifications to the risk factor eligibility test (RFET) and number of principles to inform assessments of the quality of data that banks use to calibrate their internal models.
- **Scope of market risk capital requirements**. The BCBS proposes:
  - Revisions to the treatment of structural FX positions. It is proposed to allow the amount of structural FX positions that may be exempted from market risk capital requirements to be measured based on the FX risk stemming from an investment, rather than the amount of investment itself; and to clarify that structural FX positions in foreign branches of a bank can be included in the scope of the structural FX exemption.
  - Revisions to the boundary between the trading book and the banking book. It is proposed to amend this part of the standard to clarify the approach. Thus, under the proposals, banks may assign to the trading book funds when certain conditions are met (e.g. daily price quotes are available).
- **Simplified alternative to the standardised approach**. The BCBS proposes the recalibration of the Basel II standardised approach by applying a multiplier to the capital requirements in each risk class of the Basel II standardised approach (e.g. for general and specific interest rate risk a 1.50-2.00 multiplier will applied). However, no other amendment to the approach is proposed.

3. Next steps

- Comments to this consultative document shall be submitted by **20 June 2018**.
- In December 2017 the BCBS set out that both the implementation and regulatory reporting date for the revised market risk framework (published in January 2016) will be **1 January 2022**. Therefore, the BCBS intends to finalise any revisions to the market risk standard resultant from this consultative document **as soon as practicable**.

06/03/2018

- **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 twelfth report of the **CRD IV - 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, 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) and it also provides not only global averages but also a regional breakdown for many key metrics. However, the BCBS's finalisation of the Basel III reforms published in December 2017, has not been considered in his report.

Both exercises classify banks in Group 1 (those internationally active banks with a Tier 1 capital of more than €3billion) and Group 2 (all other banks). For the BCBS exercise, data were provided for a total of 193 banks from several geographies, mainly from Europe and America, including 106 Group 1 banks and 87 Group 2 banks. The EBA exercise included a sample of 138 European banks, comprising 45 Group 1 banks and 93 Group 2 banks.

2. Main points

- The results are based on data as of **30 June 2017**.
- 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	12.5%	0	109.0bn€	5.8%	134.0%	116.9%
	2	14.7%	0	N/A	5.6%	174.9%	117.6%
EBA	1	13.5%	0	-	4.9%	137.6%	111.1%
	2	15.0%	0	N/A	5.6%	178.5%	117.5%

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

** Applying the 2022 minimum requirement for G-SIBs. Data only available in the BCBS' report, The EBA has not assessed this impact.

12/03/2018
Supplementary Guidance to the Principles and Standards on Sound Compensation Practices.

1. Context

In 2009 the FSB issued its Principles and Standards (P&S) on Sound Compensation Practices, addressed to significant financial institutions, which are aimed at aligning compensation with prudent risk-taking.

In this context, following the consultation launched in June 2017, the FSB has now published the **Supplementary Guidance to the FSB Principles and Standards on Sound Compensation Practices** that provides firms and supervisors with a framework to consider how compensation practices and tools can be used to reduce misconduct risk and address misconduct incidents. In particular, this document sets out 8 recommendations on better practice regarding the following aspects: i) governance of compensation and misconduct risk; ii) effective alignment of compensation with misconduct risk; and iii) supervision of compensation and misconduct risk.

This Supplementary Guidance, which as the P&S is designed to apply to significant financial institutions, does not establish additional P&S beyond those already set out in 2009.

2. Main points

- **Governance of compensation and misconduct risk**. The Supplementary Guidance establishes the following recommendations:
  - The board should oversee and senior management should implement a compensation system designed to promote ethical behaviour and compliance with laws, regulations, and internal conduct standards.
  - Sound governance, robust risk management frameworks and adequate involvement by control functions in compensation design and decision-making are critical to the effectiveness of compensation incentives in addressing misconduct risk.
  - The ultimate responsibility for ensuring accountability for misconduct lies with the board of directors. Boards are accountable for overseeing compensation systems that promote prudent risk-taking behaviours and business practices. They should hold senior management accountable for implementing and participating in the design of a compensation system that effectively delineates how compensation tools address misconduct risk.
  - Senior management should hold line of business management accountable for communicating, implementing and meeting expectations regarding ethical behaviours and business practices in compliance with laws, regulations, and internal conduct standards. Internal communications should ensure that the potential consequences of misconduct on compensation are clearly explained to all employees.
- **Effective alignment of compensation with misconduct risk**. The Supplementary Guidance sets out the following recommendations:
  - Compensation should be adjusted for all types of risk, including difficult to measure risks, that can result in harm to firms, customers and other stakeholders.
  - Compensation systems should provide for mechanisms to adjust variable compensation to effectively accommodate the potentially longer-term nature of misconduct risk (e.g. through malus or clawback arrangements, etc.).
  - Compensation policies and procedures are an important control on misconduct. They should decide cases that could result in reductions to variable compensation, based on clear specification, ex ante, of the misconduct triggers.
- **Supervision of compensation and misconduct risk**. The Supplementary Guidance recommends that:
  - Supervisors should monitor and assess the effectiveness of firm's compensation policies and procedures.

European Commission

14/03/2018

- **Proposal for a Regulation on amending the CRR as regards minimum loss coverage for non-performing exposures**.
- **Proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral**.
- **Blueprint on the set-up of national asset management companies (AMCs)**.
- **Second progress report on the reduction of non-performing loans (NPLs)**.

1. Context

In July 2017, the European Council concluded an Action Plan to tackle non-performing loans (NPLs) in Europe in order to prevent the emergence and accumulation of new non-performing exposures (NPEs) on banks' balance sheets. Despite significant progress has been made since then, NPLs are one of the key remaining legacy risks in Europe's banking system.

In this context, the European Commission (EC) has published a **comprehensive package of measures to tackle NPLs in Europe**. In particular, this package sets out a comprehensive approach with a mix of complementary policy actions focused on: i) ensuring banks set aside funds to cover the risks associated with loans issued in the future that may become non-performing; ii) facilitating debt recovery; iii) encouraging the development of secondary markets where banks can sell their NPLs to credit servicers and investors; and iv) assisting Member States in the restructuring of banks, by providing non-binding guidance (i.e. a blueprint) for establishing Asset Management Companies (AMCs) or other measures dealing with NPLs.

2. Main points

- **Proposals for ensuring sufficient loss coverage by banks for future NPLs**. These proposals introduce amendments to the CRR aimed at:
  - Establishing common minimum levels for the amount of money banks need to set aside to cover losses caused by future loans that turn non-performing. In case a bank does not meet the applicable minimum level, deductions from own funds would apply.
  - Introducing minimum coverage levels that will act as a statutory prudential backstop for newly originated loans that become non-performing.
  - Setting a common definition of NPE, in accordance with the one already used for supervisory reporting purposes.
- **Proposals for enabling accelerated out-of-court enforcement of loans secured by collateral**. These proposals set out that:
  - Banks and borrowers can agree in advance on an accelerated mechanism to recover the value from loans guaranteed with collateral.
  - If a borrower defaults, the bank or other secured creditor is able to recover the collateral that underpins a loan in an expedited way, without going to court.
  - Out-of-court collateral enforcement is strictly limited to loans granted to businesses and subject to safeguards. Consumer loans are excluded.
- **Proposals for establishing a secondary market for NPLs**. These proposals aim at:
  - Further developing of secondary markets for NPLs by harmonising requirements and creating a single market for credit servicing and the transfer of bank loans to third parties across the EU.
  - Defining the activities of credit services, setting common standards for authorisation and supervision, and imposing conduct rules across the EU. It means that operators respecting those rules can be active throughout the EU without separate national authorisation requirements.
  - Requiring purchasers of bank loans to notify authorities when acquiring a loan. Third-country purchasers of consumer loans are required to use authorised EU credit servicers.
- **Proposals for providing technical guidance to set up national AMCs**. This technical guidance aims at:
  - Guiding Member States on how they can set up national AMCs, in full compliance with EU banking and State aid rules.
  - Clarifying the permissible design of AMCs receiving public support, even if these State aid elements are considered as an exceptional solution. The blueprint also sets out alternative impaired asset measures.
  - Suggesting a number of common principles on the set-up, governance and operations of AMCs. The blueprint draws on experience and best practices from AMCs already set up in Member States.

3. Next steps

- The Regulation shall enter into force on the **day following** that of its publication in the Official Journal of the European Union (OJEU).
- The Directive shall enter into force on the **twentieth day** following that of its publication in the OJEU.

15/01/2018

Final Guidelines on uniform disclosures under the proposed draft Article 473a of CRR as regards the transitional period for mitigating the impact on own funds of the introduction of IFRS 9.

1. Context

Following the application of IFRS 9 as of 1 January 2018, institutions will be allowed to phase-in the impact on capital and leverage ratios of the impairment requirements resulting from the implementation of the new accounting standard and the new article 473a of the CRR. Further, institutions that decide to apply the IFRS 9 or analogous expected credit losses (ECLs) transitional arrangements are required to publicly disclose their own funds and capital and leverage ratios both with and without the application of these arrangements.

In this context, following the consultation launched in July 2017, the EBA has published **Final Guidelines (GL) on disclosure of IFRS 9 transitional arrangements**, which specify a uniform disclosure template to be applied by institutions in order to ensure consistency and comparability of data disclosed during the transitional period.

2. Main points

- **Scope of application**.
  - Institutions that choose to apply Article 473a of the CRR should disclose the quantitative template contained in Annex I of the GL, including the accompanying qualitative narrative.
  - Institutions mentioned in that article that are subject to CRR disclosure requirements but choose not to apply the transitional arrangements should instead disclose a narrative commentary explaining that they are not applying the transitional arrangements, the reasons behind that decision and that their own funds, capital and leverage ratios already reflect the full impact of IFRS 9 (or analogous ECL models).
- **Annex I of the Guidelines**.
  - Content:
    - The template includes regulatory own funds, risk-based capital ratios and leverage ratio compared with the same metrics as if they were not subject to the transitional arrangements for IFRS 9 (or analogous ECLs).
    - As for the accompanying qualitative narrative, institutions should explain the key elements of the transitional arrangements (e.g. explanations of the changes to RWA and leverage exposure measure that are due to the application of the transitional arrangements, where these changes are material).
    - Some amendments have been introduced to the GL compared to the quantitative template published in July (e.g. now is required to disclosure the total risk-weighted assets as if IFRS 9 or analogous ECLs transitional arrangements had not been applied as part of the risk-weighted assets of the quantitative template).
  - Disclosure frequencies: those specified in the EBA GL on disclosure requirements.
  - Format: a fixed format for the quantitative template is prescribed.

3. Next steps

- These GL will apply from **20 March 2018** until the **end of the transitional period** referred to in Article 473a of the CRR (i.e. December 2022).
- Competent authorities should report whether they comply with the GL, two months after the publication of the GL.

01/02/2018

- **2018 EU-wide stress test – Methodological Note** (amended version).
- **Adverse macro-financial scenario for the 2018 EU-wide banking sector stress test**.
- **FAQs on 2018 EU-wide stress test**.
- **2018 EU-wide stress test templates**.

1. Context

The objective of the 2018 EU-wide stress test is to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks and the EU banking system to shocks. In particular, this exercise is designed to inform the Supervisory Review and Evaluation Process (SREP) that competent authorities (CAs) will carry out in 2018, and will consider, for the first time, the impact of the implementation of IFRS 9.

In this context, the EBA has now published the **2018 EU-wide stress test macroeconomic scenarios** that banks are required to consider in order to estimate what the potential impact may be on profits and capital. In this regard, the baseline scenario is in line with the 2017 December forecast published by the ECB, while the adverse scenario assumes the materialisation of four systemic risks, which are currently deemed as representing the most material threats to the stability of the EU banking sector.

Along with this document the EBA has published a revised version of the 2018 EU-wide stress test Methodological Note which updates the sample of the exercise and introduces some additional corrections; the FAQs on the 2018 EU-wide stress tests; and the set of templates for the 2018 exercise.

2. Main points

- **General considerations on the macroeconomic scenarios**:
  - The stress test scenarios cover a period of <u>three years</u>, starting from the 1Q18 and ending in the 4Q20.
  - The exercise is conducted on the assumption of <u>static balance sheet</u>.
- **Macroeconomic scenarios**:
  - The <u>baseline scenario</u>, which is developed by the ECB, provides the base macroeconomic projections for the EU (e.g. real GDP growth is projected to slow gradually, from 2.2% in 2018 to 1.8% in 2020; and the HICP inflation is expected to be broadly stable in the coming quarters before picking up to 1.7% in 2020).
  - The <u>adverse scenario</u>, which is developed by the European Systemic Risk Board (ESRB) and the ECB, covers the followings aspects:
    - The **adverse macroeconomic projections for the EU**. In this regard, it states out the deviation of EU GDP from its baseline level by 8.3% in 2020, resulting in the most severe scenario in terms of GDP deviation from baseline levels compared with the previous EBA exercises.
    - The **main systemic risks** that threat the stability of the EU financial sector, which consist of: i) abrupt and sizeable repricing of risk premia in global financial markets – triggered e.g. by a policy expectation shock – leading to a tightening of financial conditions; ii) adverse feedback loop between weak bank profitability and low nominal growth, amid structural challenges in the EU banking sector; iii) public and private debt sustainability concerns amid a potential repricing of risk premia and increased political fragmentation; and iv) liquidity risks in the non-bank financial sector with potential spillovers to the broader financial system.

3. Next steps

- The EBA expects to publish the results of the exercise by **2 November 2018**.

09/03/2018
Consultation Paper on Draft Guidelines on management of non-performing and forborne exposures.

1. Context

In July 2017, the European Council concluded an Action Plan to tackle non-performing loans (NPLs) in Europe in order to prevent the emergence and accumulation of new non-perfoming exposures (NPEs) on banks' balance sheets. The EBA was invited by the Council to contribute to this Action Plan by providing supervisory actions to work with banks to improve strategies to reduce NPEs.

In this context, the EBA has now published a **Consultation Paper (CP) on Guidelines (GL) on management of NPEs and forborne exposures (FBE)** which specifies sound risk management practices for credit institutions for managing NPE and FBE; sets out requirements on processes to recognise NPEs and FBEs, as well as a forbearance granting process with a focus on the viability of forbearance measures; establishes requirements for competent authorities' (CA) assessment of credit institutions' NPE management activity as part of the SREP; and asks for views on the threshold for assessing high NPE banks whose NPL ratio is 5% or above.

In this regard, according to this CP, credit institutions whose NPL level is above 5% or below but with a high share or material amount of NPEs in an individual portfolio or with a specific concentration of NPEs towards a geographic region, an economic sector or group of connected clients should have in place a NPE strategy as well as a NPE governance and operations framework. Nevertheless, all credit institutions should apply the remain aspects included in these GL.

2. Main points

- **NPE strategy**. Credit institutions should establish a NPE strategy to target a time-bound reduction of NPEs over a realistic but sufficiently ambitious time horizon. To this end, the following steps should be taken:
    - Assessment of the operating environment, including internal capabilities to effectively manage and reduce NPEs, external conditions and operating environment, and capital implications of the NPE strategy.
    - Development of the NPE strategy over short, medium and long-term time horizons, including time-bound quantitative NPE targets and foreclosed assets targets where appropriate supported by a corresponding comprehensive operational plan.
    - Implementation of the operational plan, which should rely on suitable policies and procedures, clear ownership and suitable governance structures in order to integrate the NPE framework as a key element in the corporate culture.
    - Fully embedding the NPE strategy into the management processes of the credit institution, including regular review and independent monitoring.
- **NPE governance and operations**. Credit institutions should have in place appropriate governance structure and operational set-up to address their NPE issues in an efficient and sustainable manner. To this end, this governance and operations framework should cover: i) steering and decision making by the management body, ii) NPE operating model, iii) internal control framework, iv) NPE monitoring, and v) early warning processes.
- **Forbearance**. Credit institutions should consider and comply with consumer protection requirements when deciding on which forbearance measures to take. In this regard, they should take into account the forbearance measures and their viability (distinguishing between short-term and long-term measures); as well as sound forbearance processes, covering the forbearance policy, borrower creditworthiness assessment, etc.
- **NPE recognition**. Credit institutions should, among others:
    - Use the definition of NPE as defined in the Commission Implementing Regulation (EU) 680/2014 on supervisory reporting, in their risk management.
    - Recognise exposures as being past due and exposures as unlikely to pay in accordance with EBA GL on the application of the definition of default.
    - Reclassify NPEs, including forborne exposures, as performing in accordance with Commission Implementing Regulation (EU) 680/2014.

- **NPE impairment measurement and write-offs**. Credit institutions should estimate loss allowances for NPEs and FBEs subject to impairment in accordance with the EBA GL on credit risk management and accounting for expected credit losses (ECL). Further, they should consider in their governance and operations framework the following: i) individual estimation of loss allowances, ii) estimating future cash flows, iii) loss allowances for financial guarantee contracts and loan commitments given, iv) NPE write-offs, v) NPE impairments and write-off, and vi) impairment and write-off procedures.
- **Collateral valuation for immovable and movable property** (e.g. commercial real estate, residential real estate, land, and shipping vessels). Credit institutions should obtain periodic financial information from borrowers and update property valuations regularly in order to assess the quality of exposures on their balance sheets and the adequacy of collateral. To this end, they should consider guidance provided on, among other aspects, governance, procedures and controls; frequency of valuations; valuation methodology; etc.
- **Supervisory evaluation of management of NPEs and FBEs**. CAs should monitor that credit institutions, which have elevated NPE levels, have developed and implemented an NPE strategy and related governance and operational framework regarding the elements covered in these GL. In this regard, CAs should request further actions from the credit institutions, if they assess that the proposed remediation actions are not sufficiently effective to eliminate the deviation from the plan.

3. Next steps

- Comments to this CP shall be submitted by **8 June 2018**.
- The GL will apply from **1 January 2019**.

16/03/2018

- **Roadmap on FinTech**.
- **Q&A on FinTech Roadmap**.

1. Context

In August 2017, the EBA published a Discussion Paper on its approach to financial technology ('FinTech'), which, among other things, requires the EBA to contribute to enhancing consumer protection, promoting a sound, effective and consistent level of regulation and supervision, preventing regulatory arbitrage and promoting equal competition, and its duty to monitor new and existing financial activities.

In this context, the EBA has now published a **Roadmap on FinTech** setting out its priorities for 2018/2019 as well as the establishment of a FinTech Knowledge Hub to enhance knowledge sharing and foster technological neutrality in regulatory and supervisory approaches. In particular, these priorities focused on: i) authorisation and regulatory perimeter issues relating to FinTech; ii) impact on incumbent institutions' business models and prudential risks and opportunities arising from the use of FinTech; iii) cybersecurity; iv) consumer protection; and v) anti-money laundering and countering the financing terrorism (AML/CTF).

Along with these priorities, the EBA has provided an indicative timeline for the completion of these tasks.

2. Main points

- **Authorisation and regulatory perimeter issues relating to FinTech**. The EBA will monitor the regulatory perimeter, including assessing current authorisation and licencing approaches to FinTech firms, and analyse regulatory sandboxes and innovation hubs in order to identify a set of best practices to enhance consistency and facilitate supervisory coordination.
- **Impact on incumbent institutions' business models and prudential risks and opportunities arising from the use of FinTech**. The EBA will monitor emerging trends and analyse the impact from the use of FinTech (e.g. biometric technology, blockchain, or artificial intelligence). Further, the EBA may also analyse how institutions are responding to these risks and how they adopt their internal governance, control and risk management frameworks.
- **Cybersecurity**. The EBA will promote best supervisory practices on assessing cybersecurity and promoting a common cyber threat testing framework.
- **Consumer protection**. The EBA will address consumer issues arising from FinTech, in particular in the areas of unclear regulatory status of FinTech firms and related disclosure to consumers, potential national barriers preventing FinTech firms from scaling up services to consumers across the single market, and the appropriateness of the current regulatory framework for virtual currencies.
- **AML/CFT**. The EBA will identify and assess AML/CFT risks associated with regulated FinTech firms, technology providers and FinTech solutions.

3. Next steps

- The EBA will issue in **2018** publications spanning all priority policy areas identified in this Roadmap.

01/03/2018

- **Second and final set of advice to the European Commission on specific items in the Solvency II Delegated Regulation**.
- **Annex to section 6: Natural catastrophe risks –Zonal Calibration**.
- **Frequently Asked Questions (FAQs)**.

1. Context

In October 2014, the European Commission (EC) published a Delegated Regulation (EU) 2015/35 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II). The EC has expressed its intention to review methods, assumptions and standard parameters used when calculating the Solvency Capital Requirement (SCR) with the standard formula, and has asked the EIOPA to provide technical advice.

In this context, following the consultation launched in November 2017, the EIOPA has now published the **Second and final set of advice to the European Commission on specific items in the Solvency II Delegated Regulation**, which covers, among other aspects, the recalibration of standard parameters of premium and reserve risks, volume measure for premium risk, recalibration of mortality and longevity risks, man-made catastrophe risk, natural catastrophe risk, interest rate risk, market risk concentration, unrated debt, unlisted equity, simplification of the look-through approach, risk margin, capital instruments only eligible as tier 1 up to 20% of total tier 1, etc.

2. Main points

- **Recalibration of standard parameters of premium and reserve risks**. The EIOPA recommends new calibrations for the premium (e.g. 6.4% for assistance, 5.3% for health medical expense) and reserve risks (e.g. 22.0% for assistance, 5.7% for health medical expense).
- **Volume measure for premium risk**. The EIOPA suggests that the definition of the volume measure for premium risk should be reassessed for continued appropriateness, as the standard parameters for non-life premium and reserve risk, and for medical expense risk should be calibrated.
- **Recalibration of mortality and longevity risks**. The EIOPA advices to maintain the -20% stress factor for longevity risk, and the 15% stress factor for mortality risk, and not to improve the granularity of the mortality and longevity stresses.
- **Man-made catastrophe risk**. The EIOPA provides advice regarding the fire risk sub-module, marine risk sub-module, motor vehicle liability risk sub-module, and reinsurance basis risk sub-module.
- **Natural catastrophe risk**. The EIOPA considers that, among others, mapping non-allocated exposure to the zone with the highest zonal weight is the most appropriate simplification option for the calculation of capital requirements for natural catastrophe risks.
- **Interest rate risk**. The EIOPA deems the current approach for calculating capital requirements for interest rate risk leads to a severe under-estimation of the risks (e.g. as it does not stress negative rates). Thus, the EIOPA advises to adjust the current interest rate risk module according to the newly calibrated relative shifted approach.
- **Market risk concentration**. The EIOPA provides the assumptions that should be used in the calculation of the market risk sub-module.
- **Unrated debt**. The EIOPA provides criteria (e.g. on transparency, adverse selection) applicable to bonds and loans for which no credit assessment by a nominated External Credit Assessment Institution (ECAI) is available, in order to identify certain instruments, which would then be allowed to receive the calibration associated with credit quality step 2.
- **Unlisted equity**. The EIOPA provides criteria (e.g. on underlying investment, diversification, transparency) applicable to portfolios of equity from the European Economic Area (EEA) which are not listed, in order to identify those instruments which could benefit from the same risk factor as listed equity.
- **Simplification of the look-through approach**. The EIOPA proposes to, among others, 'carve-out' from the 20% limit for assets corresponding to unit/index linked products (e.g. insurance products without significant guarantees), and to impose an additional qualitative condition for the application of a simplified look-through.
- **Risk margin**. The EIOPA recommends that the currently applicable cost of capital (CoC) rate of 6% should not be changed.
- **Capital instruments only eligible as tier 1 up to 20% of total tier 1**. The EIOPA advises to retain the 20% limit. If the 20% were removed, there are no changes to the features of hybrid instruments that would fully mitigate the resulting loss in capital quality.
- **Other elements revised**. The EIOPA also includes recommendations on the following aspects: health catastrophe risk, currency risk at group level, strategic equity investments, simplification of the counterparty default risk, treatment of exposures to CCPs and changes resulting from EMIR, look-through approach at group level, loss-absorbing capacity of deferred taxes, comparison of own funds in insurance and banking sectors, article 209(3): allowed adjustments, USP for lapse risk, risk mitigation techniques, and impact assessment.

3. Next steps

- The SCR review is planned to be finalised by the EC by **the end of 2018**.
- The review of the Solvency II framework as a whole, including the treatment of long-term guarantees, is planned to be completed by **2021**.

EUROPEAN CENTRAL BANK
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05/03/2018

- **Draft Guide to the internal capital adequacy assessment process (ICAAP)**.
- **Draft Guide to the internal liquidity adequacy assessment process (ILAAP)**.
- **FAQ**.

1. Context

In 2016, the ECB published its expectations for ICAAPs and ILAAPs for supervised banks. After careful assessment, the ECB identified significant differences in the approaches taken by individual banks and a need for improvements at all banks. Further, in early 2017 the ECB launched a multi-year plan for ICAAP and ILAAP for significant institutions in order to foster improvements.

In this context, the ECB has now launched a public consultation on its **Draft Guide to the ICAAP** and on its **Draft Guide to the ILAAP** with the aim at developing a more detailed set of supervisory expectations regarding these two processes. In particular, these Draft Guides include seven principles for the ICAAP and seven principles for the ILAAP, which are defined in parallel taking into account each risk's specifications, regarding several aspects such as internal governance, management, continuity of the institutions, and material risks.

These Draft Guides are relevant for any credit institution which is considered to be a significant supervised entity according to the SSM Framework Regulation.

2. Main points

Draft Guide to the ICAAP

- **Principle 1. The management body is responsible for the sound governance of the ICAAP**. The ECB establishes that the management body shall approve the key elements of the ICAAP (e.g. governance framework and internal documentation requirements) and shall provide an assessment of the capital adequacy of the institution by producing the capital adequacy statement (CAS). Further, it is expected to approve an ICAAP governance framework with a clear and transparent assignment of responsibilities, adhering to the segregation of functions.
- **Principle 2. The ICAAP is an integral part of the overall management framework**. The ECB sets out that, among others, the quantitative and qualitative aspects of the ICAAP are expected to be consistent with each other and with the institution's business strategy and risk appetite. The ICAAP is expected to be integrated into the business, decision-making and risk management processes of the institution, as well as to be consistent and coherent throughout the group.
- **Principle 3. The ICAAP contributes fundamentally to the continuity of the institution by ensuring its capital adequacy from different perspectives**. The ECB states that the ICAAP plays a key role in maintaining the continuity of the institution by ensuring its adequate capitalisation. In this regard, the institution is expected to implement a normative perspective (i.e. fulfillment of capital-related regulatory and supervisory requirements) and an economic perspective (i.e. identification and quantification of all material risks that may cause economic losses and deplete internal capital).
- **Principle 4. All material risks are identified and taken into account in the ICAAP**. The ECB establishes that the institution is expected to identify at least annually risks that are material, using its own internal definition of materiality. This risk identification process is expected to result in a comprehensive internal risk inventory.
- **Principle 5. Internal capital is of high quality and clearly defined**. The ECB establishes that the definition of internal capital is expected to be consistent with the economic capital adequacy concept and internal risk quantifications of the institution. Further, internal capital is expected to be of sound quality, and determined in a prudent and conservative manner.
- **Principle 6. ICAAP risk quantification methodologies are adequate, consistent and independently validated**. The ECB sets out that the institution is responsible for implementing adequate risk quantification methodologies under both the economic and normative perspectives, and for establishing and implementing an effective data quality framework. The key parameters and assumptions are expected to be consistent throughout the group and between risk types; and all risk quantification methodologies are expected to be subject to independent internal validation.
- **Principle 7. Regular stress testing is aimed at ensuring capital adequacy in adverse circumstances**. The ECB states that the institution is expected to define an adequate stress-testing programme for both normative and economic perspectives. In addition, the institution is expected to conduct reverse stress testing in a proportionate manner.

Draft Guide to the ILAAP

- **Principle 1. The management body is responsible for the sound governance of the ILAAP**. The ECB establishes that the management body shall approve the key elements of the ILAAP (e.g. governance framework and internal documentation requirements) and shall provide an assessment of the capital adequacy of the institution by producing the capital adequacy statement (LAS). Further, it is expected to approve an ILAAP governance framework with a clear and transparent assignment of responsibilities, adhering to the segregation of functions.
- **Principle 2. The ILAAP is an integral part of the overall management framework**. The ECB sets out that, among others, the quantitative and qualitative aspects of the ILAAP are expected to be consistent with each other and with the institution's business strategy and risk appetite. The ILAAP is expected to be integrated into the business, decision-making and risk management processes of the institution, as well as to be consistent and coherent throughout the group.
- **Principle 3. The ILAAP contributes fundamentally to the continuity of the institution by ensuring its liquidity adequacy from different perspectives**. The ECB states that the ILAAP plays a key role in maintaining the continuity of the institution by ensuring an adequate liquidity and funding position. In this regard, the institution is expected to implement an economic and a normative perspectives (as set out for the ICAAP); and to have a formal liquidity contingency plan (LCP) that clearly sets out the measures for addressing liquidity difficulties under stressed circumstances.
- **Principle 4. All material risks are identified and taken into account in the ILAAP**. The ECB establishes that the institution is expected to identify at least annually risks that are material, using its own internal definition of materiality. This risk identification process is expected to result in a comprehensive internal risk inventory.
- **Principle 5. The internal liquidity buffers are of high quality and clearly defined; the internal stable sources of funding are clearly defined**. The ECB states that the institution is expected to define, assess and maintain internal liquidity buffers and stable sources of funding under the economic perspective.
- **Principle 6. ILAAP risk quantification methodologies are adequate, consistent and independently validated**. The ECB sets out that the institution is responsible for implementing adequate risk quantification methodologies under both the economic and normative perspectives, and for establishing and implementing an effective data quality framework. The key parameters and assumptions are expected to be consistent throughout the group and between risk types; and all risk quantification methodologies are expected to be subject to independent internal validation.
- **Principle 7. Regular stress testing is aimed at ensuring liquidity adequacy in adverse circumstances**. The ECB states that the institution is expected to define an adequate stress-testing programme for both normative and economic perspectives. In addition, the institution is expected to conduct reverse stress testing in a proportionate manner.

3. Next steps

- Comments to these Draft Guides on ICAAP and ILAAP shall be submitted by **4 May 2018**.
- The final Guides will not replace or supersede any applicable law implementing provisions on ICAAP and liquidity risk as set out in the CRD IV, and will be considered in the assessment of institutions' ICAAPs and ILAAPs as part of the SREP as **from 2019**.

EUROPEAN CENTRAL BANK
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15/03/2018
Addendum to the ECB Guidance to banks on non-performing loans: supervisory expectations for prudential provisioning of non-performing exposures.

1. Context

In March 2017, the ECB published its final guidance to banks on non-performing loans (NPLs) which clarifies supervisory expectations regarding identification, management, measurement and write-offs of NPLs. This guidance stresses the need for timely provisioning and write-off practices related to NPL as these serve to strengthen the balance sheet of banks enabling them to (re)focus on their core business, most notably lending to the economy.

In this context, after the consultation launched in October 2017, the ECB now has published the final **Addendum to the ECB Guidance to banks on NPLs**, specifying quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures (NPEs). In particular, this Addendum aims at avoiding an excessive build-up of non-covered aged NPEs on banks' balance sheets in the future, which would require supervisory measures.

This Addendum does not substitute or supersede any applicable regulatory or accounting requirement or guidance from the existing EU regulatory framework.

2. Main points

- **Scope**. This Addendum specifies the ECB's supervisory expectations relating to the significant banks directly supervised by the ECB and, although it is non-binding, it serves as a basis for a supervisory dialogue. The ECB will assess any differences between banks' practices and the prudential provisioning expectations laid out in the Addendum a least annually.
- **Definitions**. This Addendum sets out, among others, some definitions to be considered:
  - New NPEs: all those exposures that are reclassified from performing to non-performing in line with the EBA's definition after 1 April 2018, irrespective of their classification at any moment prior to that date.
  - NPE vintage: number of days from the date on which an exposure was classified as non-performing to the relevant reporting or reference date, regardless of what triggered the NPE classification. The vintage count for 'unlikely to pay' and 'past due' exposures is the same; and for exposures moving from 'unlikely to pay' to 'past due', the counting continues and is not reset.
  - Secured and unsecured parts of NPEs. The addendum distinguishes between fully unsecured NPEs (if they do not benefit from the credit risk protection, which are assessed in the context of the supervisory dialogue using the supervisory expectations for unsecured exposures); fully secured NPEs (if the credit risk protection exceeds the current drawn and potential undrawn credit facilities of the debtor, which are assessed in the context of the supervisory dialogue using the supervisory expectations for secured exposures); and partially secured exposures (if the value of eligible credit risk protection does not exceed the current drawn and potential undrawn credit facilities).
- **Prudential provisioning expectations**.
  - Functioning. A bank's supply for the purposes of the prudential provisioning expectations is made up of the following items:
    - All accounting provisions under the applicable accounting standard including potential newly booked provisions.
    - Expected loss shortfalls for the respective exposures in default in accordance with the CRR.
  - Application. If the applicable accounting treatment does not match the prudential provisioning expectations, banks also have the possibility to adjust their CET1 capital on their own initiative.
  - Categories. There are two types of provisioning expectations: i) supervisory expectations for unsecured exposures, that apply to fully unsecured NPEs and to the unsecured balance of partially secured NPEs; and ii) supervisory expectations for secured exposures, that apply to fully secured NPEs and the secured balance of partially secured NPEs.
  - Quantitative expectations. To avoid cliff edge effects, a suitably gradual path towards those supervisory expectations is important, starting from the moment of NPE classification until the moment when 100% prudential provisioning is expected (two and seven years for unsecured and secured exposures, respectively).
  - Reporting. During the supervisory dialogue all banks are expected to inform their respective JSTs of coverage levels by NPE vintage with regard to NPEs classified after 1 April 2018. Deviations from the prudential provisioning expectations as outlined in this Addendum will be carefully scrutinised.
  - Disclosure. Banks are encouraged to include in their public disclosures the provisions by type of asset and different NPE vintages, as this is an important means of conveying their credit risk profiles comprehensively to market participants.

3. Next steps

- The expectations are applicable at a minimum to new NPEs classified as such from **April 2018** onward.
- Banks will be asked to inform the ECB of any differences between their practices and the prudential provisioning expectations, as part of the SREP supervisory dialogue, from **early 2021 onwards**.

12/02/2018
Anteproyecto de Ley de prevención del blanqueo de capitales y de la financiación del terrorismo.

1. Context

In May 2015, the European Parliament and the Council published the Directive 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (AML IV Directive), with the aim of establishing a framework that guarantees the soundness, integrity and stability of credit and financial institutions, as well as the confidence in the financial system as a whole due to illicit activities for terrorist purposes.

In this context, the Spanish Government has published the **Anteproyecto de Ley (APL) de prevención del blanqueo de capitales y de la financiación del terrorismo**, with the aim at adapting the Spanish legal system (Ley 10/2010 sobre prevención del blanqueo de capitales y de la financiación del terrorismo) to AML IV Directive. In particular, this APL covers aspects regarding the scope, due diligence measures, reporting obligations, internal control or payment methods, among others.

2. Main points

- **Scope**. This APL applies to credit and insurance institutions, investment firms, mutual guarantee societies, payment service providers, among other institutions.
- **Customer due diligence measures**. The APL distinguishes between:
    - <u>General measures</u> that involve the formal identification of natural or legal persons that aim at establishing business relationships or transactions; the identification of the beneficial owner; or regular monitoring of the business relationships, among others.
    - <u>Simplified measures</u> that determine the customers (e.g. public law entities of the EU Member States) and the products or transactions (e.g. life insurance policies whose annual premium does not exceed 1,000€) on which general due diligence measures could not be applied.
    - <u>Enhanced measures</u> that will be applied in those cases where there is a high risk of money laundering or terrorist financing (e.g. individuals who hold public functions).
- **Reporting obligations**. This APL covers aspects such as the special review of payments that require the obliged entities to examine any fact or transaction regardless its amount, that could be related with money laundering or terrorist financing; or the singular reporting of transactions where an indication or certainty of its relationship with illicit activities exists, among others.
- **Internal control**. The APL establishes internal control measures for which the obliged entities must adopt the adequate policies and procedures in terms of due diligence, reporting, document recording, internal control, risk assessment and management, and compliance with relevant provisions and communication, with the aim of preventing and avoiding transactions related to money laundering or terrorist financing. In this regard, the APL also includes aspects on external examinations, training, security and eligibility of employees, personal data protection, etc.
- **Payment methods**. Among other aspects, the APL determines that a natural person, acting on their own behalf or as a third party, are required to declare when performing the following transactions: i) payment methods for an amount equal or greater than 10,000€ or its equivalent value in foreign currency that enter or exist from Spain; ii) transactions across Spain for an amount equal or greater than 100,000€ or its equivalent value in foreign currency.
- **Penalty regime**. The APL establishes the following infringements: i) very serious (e.g. the refusal to provide documentation or information requested); ii) serious (e.g. the breach of the obligation of formal identification or the beneficial owner's identification); and iii) minor (e.g. breaches that do not constitute serious or very serious infringements).
- **Other aspects**. This APL also covers aspects about foundations and associations, managers of payment and compensation systems, international financial countermeasures, etc.

3. Next steps

- This APL will be submitted to the Consejo de Estado to receive an opinion, then it will go back to the Consejo de Ministros, and then it will be submitted to the Parliament for its approval and entry into force.

05/01/2018

Proposed supervisory guidance on management of business lines and independent risk management and controls for large financial institutions.

1. Context

In August 2017, the Fed invited comment on two proposals: i) a new rating system for large financial institutions (proposed LFI rating system), which would reflect assessments of a firm's capital, liquidity, and governance and controls; and ii) proposed guidance addressing supervisory expectations for boards of directors (BE proposal), identifying attributes of effective boards of directors.

In this context, the Fed has now published a **Proposed supervisory guidance on management of business lines and independent risk management and controls for large financial institutions** aiming to clarify the Fed supervisory expectations regarding risk management for large financial institutions, and delineate the roles and responsibilities for individuals and functions related to such risk management.

In particular, this proposed guidance identifies three core principles of: i) effective senior management, ii) management of business lines, and iii) independent risk management (IRM) and controls.

2. Main points

- **Scope of application**. This proposed guidance would apply to large financial institutions, including: domestic bank holding companies and savings and loan holding companies with $50 billion or more in total consolidated assets; foreign banks operating in the United States with $50 billion or more in combined U.S. assets; and nonbank financial companies designated by the Financial Stability Oversight Council for supervision by the Board of the Fed.
- **Core principles of effective senior management**. This proposed guidance establishes that senior management is responsible for managing the day-to-day operations of the firm and ensuring safety and soundness and compliance with internal policies and procedures, laws, and regulations, including those related to consumer protection.
- **Core principles of the management of business lines**. This proposed guidance defines business lines management as the core group of individuals responsible for prudent day-to-day management of a business line and accountable to senior management for that responsibility. In this regard, business line management should:
    - Implement and execute business line activities consistent with the firm's strategy and risk tolerance.
    - Identify, measure, and manage the risks associated with the business activities under a broad range of conditions, incorporating input from IRM.
    - Provide a business line with the resources and infrastructure sufficient to manage the business line's activities in a safe and sound manner, and in compliance with applicable laws and regulations, including those related to consumer protection.
    - Ensure that the internal control system is effective for the business line operations.
    - Be accountable, along with the staff, for operating within established policies and guidelines, and acting in accordance with applicable laws, regulations, and supervisory guidance, including those related to consumer protection.
- **Core principles of IRM and controls**. This proposed guidance covers key areas regarding:
    - Governance, independence and stature, which should include a Chief Risk Officer (CRO) and a Chief Audit Executive (CAE), who establish and maintain IRM and internal audit function, respectively, that is appropriate for the size, risk and complexity, and risk profile of the firm.
    - IRM, which should, in particular:
        - Evaluate whether the firm's risk tolerance appropriately captures the firm's material risks and confirm that the risk tolerance is consistent with the capacity of the risk management framework, as well as establish enterprise-wide risk limits consistent with the firm's risk tolerance and monitor adherence to such limits.
        - Identify and measure the firm's risks, as well as aggregate risks and provide an independent assessment of the firm's risk profile.
        - Provide the board and senior management with risk reports that accurately and concisely convey relevant, material risk data and assessments in a timely manner.
    - Internal controls, which should be commensurate with, among others, the firm's size, scope, risk profile and strategy, and consistent with all applicable laws and regulations, including those related to consumer protection. Further, the firm should regularly evaluate and test their effectiveness, and monitor functioning controls so that deficiencies are identified and communicated in a timely manner.
    - Internal audit, which should examine, evaluate, and perform independent assessments of the firm's risk management and internal control systems and report findings to senior management and the firm's audit committee.

3. Main points

- Comments to this proposed guidance shall be submitted by **15 March 2018**.
- Comment period for the proposed LFI rating system and BE proposal has been extended until **15 February 2018**.

02/02/2018

- **Comprehensive Capital Analysis and Review 2018 Summary Instructions**.
- **2018 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 is an intensive assessment of the capital adequacy of the largest U.S bank holding companies (BHCs) and U.S. intermediate holding companies of foreign banking organizations (IHCs) and of the practices that these firms use to assess their capital needs. The DFAST, applicable to the above-mentioned companies, 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 2018 CCAR and DFAST exercises.

2. Main points

Comprehensive Capital Analysis and Review 2018 Summary Instructions

- **Scope**. These instructions apply to firms subject to the Large Institution Supervision Coordination Committee framework (LISCC firms), specified in a list published by the Fed, and to large and complex firms. Large and noncomplex firms are required to submit capital plans and are only subject to the quantitative assessment. For the 2018 cycle, 18 BHCs are subject to both a quantitative and qualitative assessment, whereas 21 firms with less complex operations, including the U.S. operations of one foreign firm, will only be subject to the quantitative portion of CCAR.
- **Content**. Similar to the instructions in previous years, firms should provide information on:
  - Logistics for a firm's capital plan submissions
  - Expectations regarding the mandatory elements of a capital plan
  - Qualitative assessment of a firm's capital plan
  - Quantitative assessment of a firm's post-stress capital adequacy
  - Fed's response to capital plans and planned capital actions
  - Limited adjustments that a firm may make to its planned capital distributions
  - Public disclosures by the Fed at the end of the CCAR exercise
- **New elements included in the CCAR 2018 instructions**. The instructions have been updated to reflect changes to certain regulatory and reporting requirements. Thus, among others aspects, the Fed requires firms to consider the impact of the new tax law (Tax Cut and Jobs Act); and to reduce supporting documentation by only submitting documentation related to those elements in scope for this year's exercise. Moreover, firms that are not subject to the capital rules' advanced approaches framework are required to continue to apply the transition provisions in the capital rules applicable for calendar year 2017 for certain items (e.g. certain deferred tax assets).

2018 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule

- **General aspects to the supervisory scenarios**.
  - The scenarios start in 1Q18 and extend through 1Q21.
  - Each scenario includes 28 variables (e.g. GDP, stock market prices, and interest rates, etc.), as in the 2017 exercise.
  - Along with the variables, a narrative describing the general economic conditions in the scenarios and changes in the scenarios from the previous year has been provided.
- **Supervisory scenarios**.
  - Baseline scenario. It features a moderate economic expansion in the U.S. (e.g. real GDP grows on average between 2% and 2.5% over the scenario period, the unemployment rate falls below 4% in 2Q18, etc.), and an expansion in international economic activity.
  - Adverse scenario. It is characterized by a moderate recession in the U.S. (e.g. GDP falls slightly more than 2,25% from the 4Q17, the unemployment rate rises steadily, peaking at about 7% in the 3Q19, etc.) and a weakening economic activity across all countries included in the scenario.
  - Severely adverse scenario. It is characterized by a severe global recession that is accompanied by a global aversion to long-term fixed-income assets. In particular, the U.S. real GDP begins to decline in 1Q18 and in 3Q19 is about 7.5% below the pre-recession peak, unemployment rate rises to 10%, etc.
- **Global market shock component**.
  - The following 12 firms are required to include in the adverse and severely adverse scenarios a set of instantaneous, hypothetical shocks to a large set of risk factors (e.g. changes in asset prices, in interest rates): Bank of America, Barclays US, Citigroup, Credit Suisse Holdings (USA), DB USA Corporation, Goldman Sachs, HSBC North America Holdings, JP Morgan, Morgan Stanley, RBC USA, UBS Americas Holdings, and Wells Fargo.
- **Counterparty default component**.
  - The following 8 firms are required to include in the adverse and severely adverse scenarios an additional component which involves the instantaneous and unexpected default of the firm’s largest counterparty: Bank of America, Bank on New York Mellon, Citigroup, Goldman Sachs, JP Morgan, Morgan Stanley, State Street, and Wells Fargo) are required to incorporate a counterparty default scenario.

3. Next steps

- Firms participating in CCAR are required to submit their capital plans and stress testing results to the Fed on or before **April 5, 2018**.
- The Fed will announce the results of its supervisory stress tests by **June 30, 2018**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

19/02/2018
Consultation Paper 6/18 on Credit risk mitigation: Eligibility of guarantees as unfunded credit protection.

1. Context

In December 2013, the PRA published Supervisory Statement (SS) 17/13 on Credit risk mitigation (CRM), which included its own expectations regarding these CRM techniques used by firms to reduce the credit risk associated with an exposure. Subsequently, this SS was updated in April 2017 aiming to provide clarification to firms of its expectations in respect of the recognition of these CRM techniques in the calculation of certain risk-weighted exposures amounts.

In this context, the PRA has published the **Consultation Paper (CP) 6/18 on Credit risk mitigation: eligibility of guarantees as unfunded credit protection**, which proposes changes to SS 17/13 to clarify the PRA expectations regarding the eligibility these guarantees under CRM of the CRR. In particular, this CP sets out four criteria that must be met in order to be eligible as a guarantee for CRM: i) it is legally effective and enforceable; ii) it is clearly defined and incontrovertible; and iii) does not contain any clauses that will render the guarantee ineligible for CRM. Further, this CP covers the exclusion of certain types of payments and limited coverage.

The proposals included in this CP relate to the eligibility of guarantees as CRM in Pillar 1 of a firm's capital requirements. Therefore, the guarantees that do not meet these expectations should not be recognised in Pillar 1.

2. Main points

- **Legally effective and enforceable**. The guarantee must be legally effective and enforceable in all relevant jurisdictions, which will require the firm, at a minimum, to satisfy itself that the guarantee is enforceable under its governing law, and in the jurisdiction where the guarantor is incorporated. Further, the PRA would expect an independent legal opinion to consider the eligibility criteria.
- **Clearly defined and incontrovertible**. The wording of the guarantee should be clear and unambiguous, and leave no practical scope for the guarantor to dispute, contest and challenge or otherwise seek to be released from, or reduce, their liability. Likewise, the PRA would expect firms to consider the terms of the guarantee itself, the remedies available, and whether there are scenarios in which the guarantor could in practice successfully seek to reduce or be released from liability under the guarantee.
- **Without any clauses that will render the guarantee ineligible for CRM**. The guarantee must not contain a clause that prevents the guarantor from being obliged to pay out in a timely manner (i.e. the pay out should be made without delay and within days, but not weeks or months, of the date on which the obligor fails to make payment due under the claim in respect of which the protection is provided). Further, the firm must have the right to pursue the guarantor for any monies due under the guarantee, and that payment shall not be subject to the firm first having to pursue the defaulting obligor for recovery. In this regard, in accordance with the CRR, the only exceptions to the timeliness requirement are:
  - Guarantees covering residential mortgage loans.
  - Provisional payments made under guarantees provided by mutual guarantee schemes or by public sector bodies.
  - Securitisation positions.
- **Exclusion of certain types of payments and limited coverage**. The guarantee must cover all types of payments the obligor is expected to make; or where certain types of payment are excluded from the guarantee, the lending institution has adjusted the value of the guarantee to reflect the limited coverage. In this regard, the PRA considers:
  - Limited coverage: quantifiable portion of exposure.
  - Certain types of payment: different sums the obligor may be required to pay to the firm under the contract (e.g. principal and interests).

3. Next steps

- Comments to this CP shall be submitted by **16 May 2018**.

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Alert System on Regulation

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