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Executive summary

In the first quarter of 2019, the publication of a Standard on the minimum capital requirements for market risk by the BCBS stands out. In Europe, the EBA published GL for the estimation of LGD appropriate for an economic downturn and GL on exposures to be associated with high risk. In Spain, the Guide on Nomination and Remuneration Committees by the CNMV and the creation of the AMCESFI by the Government stand out.

Global publications

- At international level, the BCBS published the **Standard on the minimum capital requirements for market risk**, and a **Statement on crypto-assets**, which sets out its prudential expectations related to banks' exposures to crypto-assets and related services.
- Moreover, the BCBS together with the EBA published their relative **Basel III reforms monitoring reports,** which set out the impact of the finalisation of the Basel III reforms with reference date 30 June 2018.

European publications

- At European level, the EBA published the **Final Guidelines (GL) for the estimation of LGD appropriate for an economic downturn**, which set out requirements for the quantification of the calibration target used for downturn LGD estimation, as well as **GL on outsourcing arrangements**, which repeal the 2006 CEBS GL, and aim to establish a more harmonised framework on outsourcing arrangements.
- Moreover, the EBA published **GL on specification of types of exposures to be associated with high risk**, aiming to clarify the criteria for identifying investments in venture capital firms and private equity as particularly high risk exposures.
- The ECB published **Recommendations on the transition path from EONIA to the €STR and on a €STR based forward-looking term structure methodology** to market participants.
- Further, the ECB published the **Final results of the SSM-wide stress test 2018**, which will feed into the SSM SREP, as well as the **Sensitivity analysis of liquidity risk** as its 2019 stress test.
- Regarding RWAs, the EBA published a **Report on the results from the 2018 market risk benchmarking exercise** as well as a **Report on the results from the 2018 high and low default portfolios (HDPs and LDPs) credit risk benchmarking** to assess the level of variability observed in RWAs.

European publications (continuation)

- Finally, the EBA published a **Consultation Paper (CP) on Guidelines on credit risk mitigation (CRM) for institutions applying the advanced internal rating-based (A-IRB) approach**, that aims to eliminate the remaining significant differences in approaches in the area of CRM.

Local publications

- In Spain, the Government approved a **Draft Royal Decree to develop the Law 5/2019 regulating real estate credit agreements**, with the aim to complete the transposition of the Directive 2014/17/UE. Moreover, it also approved **Royal Decree 102/2019, that sets out the Macroprudential Authority on the Financial Stability Council (AMCESFI), establishes its legal regime, and develops certain aspects regarding macroprudential tools**.
- Regarding to corporate governance, the CNMV published the **Technical Guide 1/2019 on Nomination and Remuneration Committees (CNR)**, in order to foster a proper functioning of CNR within the firms.
- In UK, the Bank of England (BoE) published a document on **key elements of the 2019 UK stress test scenarios**, as well as a **Guidance for participating banks** for conducting their own analysis for the 2019 stress test.
- In US, the Fed published the **2019 CCAR summary instructions**, which provide information regarding the requirements and expectations for CCAR 2019, the stress testing and capital planning cycle. Moreover, the Fed published the **2019 CCAR and DFAST scenarios** to be used by banks and supervisors. Furthermore, the Fed published a **Final rule on amendments to the Capital Plan Rule** in order to limit the scope of potential objections to a firm's capital plan.

Regulatory projections

At international level, the EBA Final GL on management of non-perfoming exposures (NPE) and forborne exposures (FBE), Final GL on interest rate risk in the banking book (IRRBB), as well as the Final GL on exposures associated with high risk will be applied. At local level, the Fed will publish the 2019 DFAST and CCAR results.

Regulatory projections

1. Next quarter

- **(Europe) June 2019**: the EBA Final Guidelines on IRRBB will be applicable.
- **(Europe) June 2019**: the EBA GL on management of NPE and FBE will be applicable.
- **(US) June 2019**: the Fed will publish the 2019 DFAST and CCAR 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) To be determined**: the EBA will publish several documents related to FinTech, among others, on cybersecurity or consumer protection.
- **(Global) July 2019**: the FSB will publish a thematic peer review on bank resolution planning.
- **(Europe) July 2019**: the EBA GL on specification of types of exposures to be associated with high risk will be applicable.
- **(Europe) September 2019**: the EBA GL on outsourcing arrangements will be applicable.
- **(Europe) September 2019**: the Delegated act on strong customer authentication and common secure communication will be applicable.
- **(Europe) September 2019**: the ECB will publish sensitivity analysis of liquidity risk results.
- **(Europe) October 2019**: the ECB will start publishing the €STR.
- **(Global) November 2019**: the FSB will update the list of G-SIBs.
- **(Global) December 2019**: the BCBS will assess G-SIBs' progress in adopting the RDA&RR principles.
- **(Global) December 2019**: the FSB is expected to conduct a review of the technical implementation of TLAC.
- **(Europe) December 2019**: the EBA final RTS on economic downturn will enter into force.
- **(Europe) December 2019**: the EBA final GL on disclosure of NPE and FBE will be applicable.
- **(UK) December 2019**: the BoE will publish the 2019 ACS results.

3. More than a year

- **(Europe) January 2020**: the EU new anti-money laundering directive will enter into force (AML V).
- **(Global) December 2020**: the BCBS GL on step-in risk will be applicable.
- **(Europe) December 2020**: the ECB Regulation on the materiality threshold for credit obligations past due will be applicable.
- **(Europe) January 2021**: the EBA GL on IRB parameters estimation will be applicable.
- **(Europe) January 2021**: the EBA GL on the new definition of default will be applicable.
- **(Europe) January 2021**: the EBA final RTS on an economic downturn will be applicable.
- **(Europe) January 2021**: the EBA GL on CRM for institutions applying the advanced internal rating-based (A-IRB) approach will be applicable.
- **(Global) December 2021**: the BCBS new assessment methodology for G-SIBs will be applicable.
- **(Global January 2022**: the revised SA for credit risk, the revised IRB framework, the revised CVA framework, the revised operational and market risk framework published in Basel III and the standard on the minimum capital requirements for market risk 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 new disclosure requirements of the BCBS Pillar III 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 will finish.
- **(Global) January 2027**: an output floor of 72.5% of RWA in the SA approach will be applicable according to the Basel III reform.

Publications of this quarter

Summary of outstanding publications of this quarter

15/01/2019

- **Minimum capital requirements for market risk**
- **Explanatory note on 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, following the consultation launched in March 2018, the BCBS has now published a **Standard on 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 introduced to the following aspects: i) scope of application, ii) internal models, iii) standardised approach, and iv) simplified alternative to the standardised approach.

2. Main points

- **Scope of application**. Under the revised market risk framework, the basis for the boundary the trading book and the banking book according to the 2016 market risk framework is kept, although additional amendments are introduced:
    - <u>Additional specification on the appropriate contents of the trading book</u>, setting out a list of instruments that must be allocated to the trading book and a list of instruments that must be allocated to the banking book. A bank must receive supervisory approval for any deviations from these presumptions.
    - <u>Enhanced supervisory oversight</u>, requiring banks to make available to supervisors reports that describe the rationale for including instruments in the trading.
    - <u>Restrictions on the ability to arbitrage the boundary</u>, establishing a strict limit on the movement of instruments between the banking book and the trading book.
    - <u>Clearer treatment of risk transfers across the boundary</u>, specifying the treatment of internal risk transfers of equity risk and interest rate risk from the banking book to the trading book.
    - <u>Further refinements and clarifications in three main areas</u>, which are the following:
        - Assignment of instruments among **regulatory trading book** and **banking book**.
        - Treatment of **investments in funds** (e.g. investment funds or similar types of managed funds).
        - Treatment of **structural foreign currency positions**.
- **Internal models**. Under the revised market risk framework, the following aspects are enhanced to better address risks:
    - <u>Enhanced model approval process</u>. According to this new framework, model approval is granted at the level of banks' trading desks, and a trading desk's internal model must pass two tests: i) P&L attribution (PLA) test; and ii) backtesting. Those trading desks with internal models that fail these tests must use the standardised approach.
    - <u>New type of internal model to capture tail risk and market illiquidity: expected shortfall (ES)</u>. The revised internal models approach replaces value at risk (VaR) and stressed VaR with a single ES metric that is calibrated to a period of significant market stress. The total ES capital requirement is calculated as the average of: i) an "unconstrained" ES calculation, with diversification benefits recognised across all risk classes (e.g. across interest rate, equity, FX, commodity and credit spread risks); and ii) a simple sum of separate ES calculations for each risk class, in which no diversification benefit across risk classes can be recognised.
    - <u>Limits on the modelling of illiquid and unobservable risk factors</u>. Under this revised framework, risk factors (e.g. FX rates or equity prices) that do not have sufficient observable market data are deemed to be non-modellable (i.e. NMRFs). NMRFs are excluded from the ES calculation; instead, the capital requirement for each NMRF is determined by means of a stress test.
    - <u>Revised treatment of default risk</u>. According to this revised framework, the default risk capital (DRC) model requirement limits the choices banks can make when building the model, and requires all equity positions to be included in its scope.
    - <u>Further amendments</u> are the following:
        - Inclusion of **new PLA test metrics** to better differentiate well performing models from poorly performing models, and a 'traffic light' approach with an intermediate amber zone.
        - Revised **NMRF conditions** and **capitalisation approach**, in order to reduce the conservatism and operational burden of this element of the framework.

2. Main points (continues)

- **Standardised approach**. The January 2019 revisions include the following changes to the sensitivities-based method:
  - FX risk class. The scope of currency pairs that are considered liquid has been broadened. The overall approach to FX risk has also been amended so that banks, subject to supervisory approval, may calculate FX risk with respect to the currency in which they manage their trading business (their base currency) rather than with respect to their reporting currency.
  - Equity risk and the credit spread risk classes. These classes have been enhanced, with new “index” buckets for equity and credit spread risks introduced to provide a simple approach that does not require the identification of each underlying position in an index to calculate the capital requirements for equity and credit indices.
  - Calculation of curvature risk capital requirements for options. This calculation has been modified to: i) apply consistent shocks to similar risk factors; ii) address double-counting of FX risk for certain instruments; and iii) remove a potential cliff effect in the aggregation formula for capital requirements.
  - The low correlations scenario. It has been modified to ensure it does not produce unrealistically low correlations for risk factors that are considered to be highly correlated in stressed market conditions.
  - Revisions to risk weights. The risk weights for general interest rate risk and FX risk have been reduced by 30% and 50%, respectively.
- **Simplified alternative to the standardised approach**. The current Basel 2.5 standardised approach will be retained although the revised market risk framework sets out specific scalars (1.3 for interest rate risk; 3.5 for equity risk; 1.9 for commodity risk; and 1.2 for FX risk).

3. Next steps

- This revised standard comes into effect on **1 January 2022**.

14/03/2019
Statement on crypto-assets.

1. Context

The past few years have seen a growth in crypto-assets. Despite the crypto-asset market remains small relative to that of the global financial system, the continued growth of crypto-assets has the potential to raise financial stability concerns and increase risks faced by banks. In this regard, the Bank for International Settlements (BIS) published in March 2018 a Report on central bank digital currencies (CBDC) which addresses the CBDC's implications for payments, monetary policy and financial stability.

In this context, the BCBS has published a **Statement on crypto-assets** which sets out its prudential expectations related to banks' exposures to crypto-assets and related services for those jurisdictions that do not prohibit such exposures and services. In particular, this Statement provides that if a bank is authorised and decides to acquire crypto-asset exposures or provide related services, it should consider at a minimum certain conditions regarding: i) due diligence; ii) governance and risk management; iii) disclosure; and iv) supervisory dialogue.

2. Main points

- **Due diligence**. Banks should conduct comprehensive analyses of liquidity risk, credit risk, market risk, operational risk (including fraud and cyber risks), money laundering and terrorist financing risk, and legal and reputation risks before acquiring exposures to crypto-assets or providing related services. To this end, banks should ensure that they have the relevant and requisite technical expertise to adequately assess the risks stemming from crypto-assets.
- **Governance and risk management**.
    - Banks should have a <u>clear and robust risk management framework</u>, appropriate for their crypto-asset exposures and related services which should be fully integrated into the overall risk management processes, including those related to anti-money laundering and combating the financing of terrorism and the evasion of sanctions, and heightened fraud monitoring.
    - Moreover, banks are expected to implement <u>risk management processes</u> that are consistent with the <u>high degree of risk of crypto-assets</u>.
    - <u>Banks' senior management functions</u> are expected to be involved in overseeing the risk assessment framework, and their Boards and senior management should be provided with timely and relevant information related to the bank's crypto-asset risk profile.
    - Banks should incorporate into its <u>internal capital and liquidity adequacy assessment processes</u>, an assessment of the risk above-mentioned related to direct and indirect crypto-asset exposures and other services.
- **Disclosure**. Banks should publicly disclose any material crypto-asset exposures or related services as part of their regular financial disclosures and specify the accounting treatment for such exposures, consistent with domestic laws and regulations.
- **Supervisory dialogue**. Banks should inform their supervisory authorities of actual and planned crypto-asset exposure or activity in a timely manner and provide assurance that they have fully assessed the permissibility of the activity and the risks associated with the intended exposures and services, and how they have mitigated these risks.

3. Next steps

- The BCBS will continue to **monitor the developments in crypto-assets**, in coordination with other global standard setting bodies and the FSB.

21/03/2019
- **BCBS - Basel III Monitoring Report**
- **EBA - Basel III Monitoring Exercise**
- **EBA - Report on Liquidity Measures**

1. Context

In 2016, the BCBS published an updated standard for the regulatory capital treatment of securitisation exposures for simple, transparent and comparable (STC) securitisations. In the same year, the standard on minimum capital requirements for market risk (FRTB) was also published, and it has been recently revised in January 2019. Furthermore, in December 2017, the BCBS published the final set of revisions to the Basel III framework addressing undue variability in risk-weighted assets (RWAs) calculations and amending, credit risk calculation methods (SA and IRB), credit valuation adjustment (CVA), calculation method for operational risk (SMA) which replaces the previous ones, and establishes an output floor. It also modifies the exposure measure of the leverage ratio (LR) and introduces an additional buffer on this ratio for global systemically important banks (G-SIBs).

In this context, the BCBS has published the results of its latest **Basel III monitoring report** which sets out the impact of the finalisation of the Basel III reforms, although it does not reflect the finalisation of the market risk framework published in January 2019. In parallel with this report, the EBA has issued a **Report on its Basel III monitoring exercise** which includes a preliminary assessment of the impact of the Basel reform package on EU banks, assuming its full implementation.

Along with this document, the EBA has also published a **Report on liquidity measures** that monitors and evaluates the liquidity coverage requirements currently in place in the EU.

2. Main points

BCBS - Basel III Monitoring Report

- **Sample of banks**: 189 banks, including:
  - Group 1: 106 internationally active banks that have Tier 1 capital of more than €3 billion; and where 29 institutions have been designated as G-SIBs.
  - Group 2: 83 banks that have Tier 1 capital of less than €3 billion or are not internationally active (i.e. all other banks).
- **Reference date**: the results are based on data as of 30 June 2018.
- **General aspects**:
  - This Report does not take into account any transitional arrangements such as phase-in of deductions and grandfathering arrangements.
  - The estimates presented generally assume full implementation of the Basel III requirements.
  - This Report does not reflect any additional capital requirements under Pillar 2 of the Basel II framework, any higher loss absorbency requirements for domestic systemically important banks, nor does it reflect any countercyclical capital buffer requirements.
  - Changes in minimum required capital from fully phased-in final Basel III remain stable for large internationally active banks compared with end-2017, leaving the recently recalibrated market risk standards aside.

	31 December 2017			30 June 2018		
	Group 1	G-SIBs	Group 2	Group 1	G-SIBs	Group 2
Increase of the minimum requirement of Tier 1 MRC	3,2%	2,8%	5,8%	5,3%	5,7%	9,0%
CET1 ratio (%)	12,2%	12,0%	12,6%	11,7%	11,6%	13,0%
Target capital shortfalls* (MM€)	25,8	23,7	2,5	30,1	29,3	6,0
TLAC shortfalls (MM€)	143,6	143,6	N/A	108,8	108,8	N/A

* Tier 1 + Tier 2.

2. Main points (continues)

EBA - Basel III Monitoring Exercise

- **Sample of banks**: 133 banks form 18 European Economic Area (EEA) countries, including:
  - Group 1: 45 banks internationally active banks that have Tier 1 capital of more than €3 billion.
  - Group 2: 87 banks that have Tier 1 capital of less than €3 billion or are not internationally active (i.e. all other banks).
- **Reference date**: the results are based on data as of 30 June 2018.
- **General aspects**:
  - This Report assesses the impact on EU banks of the final revisions of credit risk, operational risk, and leverage ratio frameworks, as well as of the introduction of the aggregate output floor. It also quantifies the impact of the new standards for market risk (FRTB) and credit valuation adjustments (CVA).
  - The impact is assessed on the assumption of the full implementation of the Basel reforms (i.e. 2027).
  - The Report presents the impact of the reforms in terms of changes in Tier 1 MRC, comparing the fully implemented revised Basel III requirements with the fully phased-in CRR / CRD IV requirements.

Change in total T1 MRC (weighted average in %)

Group	Credit Risk				Market risk	CVA	Op. risk	Output floor	Total risk-based	Revised LR	Total
	SA	IRB	Securit.	CCPs							
All banks	2.2	2.0	0.7	0.0	2.3	4.7	5.5	8.0	25.4	-6.2	19.1
1	1.8	1.7	0.8	0.0	2.5	4.9	6.1	8.5	26.3	-6.0	20.3
G-SIIs	2.2	2.1	1.1	0.0	3.3	5.4	7.4	7.3	28.8	-0.3	28.4
2	4.3	3.7	0.1	0.0	0.9	3.6	1.7	5.1	19.4	-7.7	11.8

EBA - Report on Liquidity Measures

- **Objective**. This Report provide a biannual update on the monitoring of the liquidity coverage requirements. The analysis is based on the Common Reporting Framework (COREP) data of June 2018.
- **Main results**.
  - The weighted average liquidity coverage ratio (LCR) across banks is 146% and it has increased since September 2016.
  - In June 2018, there were only four banks with LCR levels below 100%, as they monetised their liquidity buffers during times of stress.
  - The LCR levels of GSIIs (i.e. 142%) and O-SIIs (i.e. 144%) are lower than that of other banks (i.e. 167%).
  - The breakdown by country shows that the average LCR level for the majority of the countries is within the 100-200% range, although there are some differences in terms of the dispersion of banks' LCR levels within countries.

27/03/2019
Work program for 2019.

1. Context

The IOSCO is the leading international policy forum for securities regulators and is recognized as the global standard setter for securities regulation. Among its main tasks, it should be highlighted that it cooperates in developing, implementing and promoting adherence to internationally recognized and consistent standards of regulation; enhances investor protection and promotes investor confidence in the integrity of securities markets; as well as exchanges information at both global and regional levels to assist the development of markets.

In this context, the IOSCO has published its **work program for 2019**, in order to enhance its own effectiveness and the impact of its policy work on global securities markets. In particular, it has identified five priority issues for 2019 in accordance with the risks, trends and other issues addressed in its annual Risk Outlook, namely: i) crypto-assets, ii) artificial intelligence and machine learning, iii) passive investing and index providers, iv) retail distribution and digitalization, and v) market fragmentation. This document summarises ongoing and planned initiatives relating to these priorities.

2. Main points

- **Crypto-assets**. In recent years concerns have emerged about trading, custody and settlement, accounting, valuation, intermediation as well as the exposure of investment funds to crypto-assets. To enhance investor protection, the IOSCO will focus on how platforms where crypto-assets are traded are regulated and will also examine regulation of investment funds with exposures to crypto-assets. Further, it will create a portal through which its members can access and share information on enforcement relevant to crypto-assets and will continue work on initial coin offerings (ICOs). The IOSCO expects to publish the following documents:
    - Consultation report on crypto-asset trading platforms.
    - Report to the G-20 on crypto-asset trading platforms.
    - Final IOSCO Report on crypto-asset trading platforms.
- **Artificial Intelligence and Machine Learning (AIML)**. The use of these techniques by firms is increasing in a number of areas regarding financial services, including to optimize order execution strategies, portfolio management and research. During 2019, the IOSCO will examine the supervision of market intermediaries, including asset managers, that use AIML and examine ethical challenges that may arise from the use of AIML in securities markets. Further, the IOSCO expects:
    - To publish a consultation report on systems and controls surrounding the general use of artificial intelligence and machine learning by market intermediaries, including asset managers.
    - To carry out a conference on technology applied to securities market enforcement.
- **Passive investing and index providers**. In 2017, passive asset management strategies were estimated to represent $8 trillion globally, representing 20% of assets under management. To assess the impact of the passive investment's growth, the IOSCO will initiate a review of the impact of passive investing on markets. It will also undertake a conduct-focused mandate on the role of index providers in asset management.
- **Retail distribution and digitalization**. The rapid growth in digitalization, especially social media, has changed the way financial products are promoted and distributed. In this regard, the IOSCO will conduct work on these issues including consideration of whether it needs to expand on its OTC Leveraged Products Report to take account of these developments.
- **Market fragmentation**. This aspect is a high priority for 2019, and the IOSCO will analyse potentially harmful market fragmentation, including that attributable to cross-border regulation, and will take stock of members' progress in assessing and deferring to foreign regulatory regimes, and any further policy implications. In this regard, the IOSCO expects to publish a Report to G-20 on market fragmentation.

10/01/2019

- **Report on the results from the 2018 market risk benchmarking exercise**
- **Report on the results from the 2018 low and high default portfolios exercise**

1. Context

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 2018 market risk benchmarking exercise** as well as a **Report on the results from the 2018 high and low default portfolios (HDPs and LDPs) credit risk benchmarking**. In particular, the objective of the market risk report is to assess the level of variability observed in risk-weighted assets (RWAs) for market risk produced by banks' internal models whereas the HDPs and LDPs report assesses not only the overall level of variability in RWAs but also examine and highlight the different drivers of the dispersion observed.

2. Main points

Report on the results from the 2017 market risk benchmarking exercise

- **Sample**. 50 banks from 12 jurisdictions that submitted data for 27 market portfolios in all asset classes (e.g. equity, interest rates) and 3 correlation trading portfolios.
- **Main findings**.
  - Reduction in the dispersion in the initial market valuation (IMV) due to the simplification in the market risk benchmark portfolios.
  - Interest rates portfolios exhibit a lower level of dispersion than other asset classes due to the use of more consistent practices and more homogeneous assumptions across the banks for modelling interest rate risk.
  - Across all asset classes, the overall variability for value at risk (VaR) is lower than that observed for stressed VaR (20% and 30%, respectively). More complex measures such as incremental risk charge (IRC) and all price risk (APR) show a much higher level of dispersion (37% and 57%, 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 dispersion of empirical estimates of expected shortfall (EES) at a 97,5% confidence level across risk factors is similar than that found for VaR and P&L VaR.
- **Dispersion in capital outcome**. The average variability across the sample, measured by the inter-quantile dispersion statistic (IQD) coefficient, is around 27% (considered significant by the EBA), especially for the most complex portfolios in the credit spread asset class.
- **CAs' assessments based on supervisory benchmarks**. Overall, CAs planned some actions for 13 banks (e.g. reviewing the banks' internal VaR and IRC models, alongside the Targeted Review of Internal Models or TRIM in-depth assessment; a supervisory extra charge).

Report on the results from the 2018 low and high default portfolios exercise

- **Sample**. 118 banks from 17 jurisdictions that submitted data for both LDPs (i.e. exposures to large corporates, sovereigns and institutions) and HDPs (i.e. residential mortgages, small and medium-sized enterprise (SME) retail, SME corporate and corporate-other portfolios). In this report, three main analyses have been performed this year to examine drivers of risk weight (RW) variability: i) a top-down study (for both HDPs and LDPs); ii) a common counterparties analysis (only for LDPs) and; iii) an outturn analysis (only for HDPs).
- **Main findings from the top-down approach**:
  - Differences in the share of the defaulted exposures and the portfolio mix effect explain around 50% of global charge (GC) variability observed in the data.
  - The remaining 50% may be due to differences in collateralization and other institution-specific factors, such as risk strategy and management practices, portfolio composition and client structure.
  - The above-mentioned results confirm that RWA variability can be explained, to a large extent, by looking at some measurable features of institutions' exposures.

2. Main points (continues)

- **Main findings from the common counterparties analysis**:
    - Most of the interquartile ranges of the RW deviations resulting from benchmark substitutions are below 10%.
    - These interquartile differences are greater under the advanced internal ratings-based (AIRB) approach than under the foundation internal ratings-based (FIRB) approach for large corporates and sovereigns. In the AIRB approach, these interquartile differences are greatest for exposures to large corporates, and this stems from the variability introduced by the PD and the unsecured LGD.
    - Variability in the maturity parameter is the greatest contributor to the RW dispersion for sovereign exposures.
    - There is a strong non-linearity effect, in the sense that the variability of the different risk parameters has a compensating effect (the total deviation is well below the sum of the deviation of each risk parameter).
- **Main findings from the outturn ('backtesting') approach**:
    - The analysis does not reveal a material negative deviation of the estimated level of risk compared with the observed level of risk for the vast majority of EU institutions.
    - Regarding the ratio of the default rate to the PD estimate, the results show that the great majority of institutions have conservative estimates, in particular when compared with the observed values for 2017.
    - Related to the ratio of the loss rate and the LGD estimate, the results show that for at least 75% of institutions the portfolio estimated LGD is higher than the loss rate observed either in the past year or over the past 5 years, which could again indicate conservative behavior on the part of the institutions.
- **Main findings from CAs' assessments based on supervisory benchmarks**. For the majority of the institutions, the RW deviations from the EU benchmarks were deemed by the CAs to be justified. The highest share of unjustified negative deviations from the benchmark were observed for exposures to corporates (corporate SME exposures, corporate-other exposures and large corporate exposures), for which such deviations have been flagged in the case of around 15% of institutions. Further, problems with the calibration of the risk parameters are mentioned as the main reason for the unjustified underestimations, but there are other concerns related to, inter alia, data quality, differences in definitions used, the absence of models for LGD-in default estimates and best estimate of expected loss (EL_{BE}), etc.

18/01/2019
Final Guidelines on specification of types of exposures to be associated with high risk under Article 128(3) of the CRR.

1. Context

The CRR sets out in article 128 the requirements for classifying an exposure as item associated with particular high risk, which result in an assignment of a 150% risk weight for the considered exposure. In this regard, the CRR gives mandate to the EBA for drafting Guidelines specifying which types of exposures other than those mentioned are associated with particularly high risk and under which circumstances.

In this context, following the consultation launched in April 2018, the EBA has now published **Final Guidelines (GL) on specification of types of exposures to be associated with high risk under Article 128 of the CRR** aiming to clarify the criteria for identifying investments in venture capital firms and private equity as particularly high risk exposures (both are included in the article 128 of the CRR), and to specify which other types of exposures should be considered as high risk and under which circumstances. These Final GL also sets out notification requirements for institutions regarding those exposures carrying a particularly high risk of loss, other than those identified according to these GL.

2. Main points

- **Investments in venture capital firms**. Institutions should consider that investments in venture capital firms include, at a minimum, any investment that meets both of the following conditions:
  - It is either: i) non-debt exposures not listed on an exchange conveying a subordinated, residual claim on the assets or income of an enterprise not listed on an exchange, or ii) debt exposures and other securities, partnerships, derivatives or other vehicles, the economic substance of which is similar to the exposures previously specified and not listed on an exchange.
  - It is held with the objective of providing funding to newly established enterprises (e.g. expansion of the business of the enterprise).
- **Investments in private equity**. Institutions should consider that investments in private equity include, at a minimum, any investment that meets both of the following conditions:
  - It is either: i) all non-debt exposures not listed on an exchange conveying a subordinated, residual claim on the assets or income of an enterprise, or ii) debt exposures and other securities, partnerships, derivatives, or other vehicles the economic substance of which is similar to the exposures previously specified and not listed on an exchange.
  - It is held with the intention of generating a profit through a leveraged buyout, an initial public offering, sale of the equity stake by other means or any transaction with a similar economic substance.
- **Other types of exposures to be considered high risk exposures**. Institutions should consider as such, at a minimum, those exposures which exhibit levels and ranges of risk drivers that are not common to other obligors or transactions of the same exposure class. In this regard:
  - Institutions should consider, at a minimum, all of the following exposures:
  - Any financing of speculative investments in both financial and non-financial assets other than immovable property, in which the obligor has the intention to resell the assets for profit, and where there is a particularly high risk of loss in cases of default of the obligor, and there are insufficient other incomes and assets of the obligor for mitigating the loss risk for the financing institution.
    - Any exposure for which an issue-specific external credit assessment is not available, which is to an entity created specifically to finance or operate physical assets other than immovable property, and where the institution has identified a high risk of loss (e.g. significant uncertainty related to the political and legal environment of the location of the project; or exposure related to project finance).
  - Moreover, all equity exposures to a given issuer should be considered whether to be classified as items associated with particularly high risk where either of the following conditions is met:
    - The **risk weight** for any debt exposure of the institution to the same issuer is **150%**.
    - Any debt of such an issuer would receive a **150% risk weight** if these debt obligations were exposures of the institution due to either of the following reasons: i) the associated credit assessment of an external credit assessment institution (ECAI) nominated by the institution for the corresponding debt obligation warrants a 150% risk weight; or ii) the issuer is in default in accordance with the CRR.
- **Notification requirements**. Institutions that identify any types of exposures carrying a particularly high risk of loss in accordance with the CRR, other than those identified above, should notify the competent authorities in their jurisdiction, together with a brief description of the main characteristics of these exposures.

3. Next steps

- These GL apply from **1 July 2019**.

25/02/2019
Final Guidelines on outsourcing arrangements.

1. Context

In December 2006, the Committee of European Banking Supervisors published Guidelines on outsourcing (CEBS GL) in order to promote greater consistency of supervisory approaches regarding outsourcing within the national legal frameworks. Further, the EBA published recommendations on outsourcing in December 2017. In the context of digitalisation and the increasing importance of new financial technology (FinTech) providers, outsourcing is a way to get relatively easy access to these new technologies and to achieve economies of scale.

In this regard, following the consultation launched in June 2018, the EBA has published Final **Guidelines (GL) on outsourcing arrangements**, which repeal the existing CEBS GL, and aim to establish a more harmonised framework for all financial institutions that are within the scope of the EBA's mandate. In particular, these GL cover the following aspects: i) governance of outsourcing arrangements; ii) IT outsourcing, including FinTech and outsourcing to cloud service providers; and iii) supervision and concentration of risks.

These GL apply to credit institutions and investment firms subject to CRD IV (both referred to as institutions), but also payment institutions subject to the Payment Services Directive (PSD2) and electronic money institutions subject to the e-money Directive (EMD) (both referred to as payment institutions).

2. Main points

- **Governance of outsourcing arrangements**. These GL set out that, among others:
  - Institutions and payment institutions should have robust internal governance arrangements, that include a clear organisational structure, and which aim at ensuring that there is effective day to day management and oversight by the management body, or there are a sound outsourcing policy and outsourcing processes, among others.
  - Institutions and payment institutions must determine whether the function to be outsourced is considered critical or important. They should consider certain criteria (e.g. whether the outsourcing arrangement is directly connected to the provision of banking activities or payment services for which they are authorised), to ensure that the assessment of the criticality or importance of functions is more harmonised.
  - In order to manage all risks, institutions and payment institutions should assess the risks that result or may result from IT services' outsourcing arrangements to third parties, in particular their operational and reputational risk.
  - Regarding intragroup outsourcing, institutions and payment institutions need to take into account conflicts of interests that may be caused by outsourcing arrangements (e.g. between different entities within the scope of consolidation).
  - Institutions and payment institutions need to manage the contractual relationship; this includes evaluating and monitoring the ability of the service provider to fulfil the conditions included in the written outsourcing agreement.
  - Outsourcing arrangements also need to be considered in the context of institutions recovery and resolution planning. Business decision to outsource a function should not in any way impede the resolvability of the institution.
- **IT outsourcing, including FinTech and outsourcing to cloud service providers**. These GL establish that, among others:
  - Institutions and payment institutions must ensure that personal data are adequately protected and kept confidential. In this regard, when outsourcing IT or data services, it is imperative that business continuity and data protection are appropriately considered.
  - Cloud service providers often operate a geographically dispersed computing infrastructure that entails the regional and/or global distribution of data storage and processing; therefore, the security and privacy of data and their processing requires particular attention.
  - With regard to sub-outsourcing, it requires ex ante notification to institutions and payment institutions in the case of outsourcing of critical or important functions.

2. Main points (continues)

- **Supervision and concentration risks**. These GL set out that, among others:
  - Competent authorities (CAs) should have a comprehensive overview of the outsourcing arrangements of institutions and payment institutions, as this enables them to exercise their supervisory powers. Institutions and payment institutions should therefore document all their outsourcing arrangements.
  - CAs should identify concentrations of outsourcing arrangements at service providers, as the need to monitor and manage concentration risk is particularly relevant for certain forms of IT outsourcing, including cloud outsourcing, which is dominated by a small number of highly dominant service providers.

3. Next steps

- These GL will enter into force on **30 September 2019**.
- The 2006 CEBS GL and the EBA recommendations on outsourcing to cloud service providers issued in December 2017 will be repealed with effect from **30 September 2019**.

25/02/2019
Handbook on valuation for purposes of resolution.

1. Context

The Directive 2014/59/EU establishing a framework for recovery and resolution of credit institutions and investment firms (BRRD) provides a comprehensive framework of powers for resolution authorities (RAs) to intervene in failing banks to protect the public interest and financial stability. To ensure that authorities exercise these powers in such a way, the BRRD requires independent valuations to be carried out to informs RAs' decisions.

In this context, the EBA has published a **Handbook on valuation for purposes of resolution**, which is addressed to national and EU RAs, aiming to foster the convergence and consistency of valuation practices as well as the interaction with independent valuers across the EU. In particular, this Handbook aims to bridge the resolution regulatory approach with the valuation practices, by providing concrete guidance on the practical steps of the valuation process, on the specific valuation criteria applicable to the various resolution tools. Further, with a view to facilitating the adoption of an informed decision by the RA, it indicates the content that is expected to be included in the valuation report.

Whilst **this Handbook is not binding** nor subject to comply/explain by the RA, it is an instrument to promote convergence of approaches, practices and processes of resolution.

2. Main points

- **Valuation before resolution**. The BRRD requires a definitive valuation to be conducted before resolution, which is a valuation fulfilling the general requirements set out in the Directive (e.g. it shall be based on prudent assumptions, including as to rates of default and severity of losses or it shall not assume any potential future provision of extraordinary public financial support) and conducted by an independent valuer. In this regard, this Handbook provides horizontal issues common to the valuations before resolution (i.e. valuation 1 and 2), including questions related to the valuation date, definitive and provisional valuation, best point estimates and value range; and specifies the following:
  - Valuation 1. This valuation has to inform the determination of whether the conditions for resolution or the write-down or conversion of capital instruments (WDCCI) are met. In this regard, this Handbook establishes that valuation 1 should rely on fair and realistic assumptions to determine that the entity is balance-sheet solvent.
  - Valuation 2. This valuation informs the resolution action to be adopted (once the RA determines that an entity meets the previous conditions), the extent of any eventual write-down or conversion of capital instruments, and other decisions on the implementation of resolutions tool. In this regard, this Handbook covers the following aspects:
    - An **outline of the purposes and conceptual remarks** of valuation 2, giving attention to considerations of operational costs and the determination of the buffer for additional losses in cases of provisional valuation.
    - The **asset valuation under hold** and **disposal value assumptions** outlining, among other things, considerations related to the application of cash flows and discount rates in valuation 2.
    - The **assessment of the value of liabilities** and of **contingent assets** and **contingent liabilities**.
    - The **equity valuation** of the institution itself, dealing with notably aspects of the dividend discount model and market value methodology.
    - The **implementation of the resolution tools** (i.e. WDCCI, bail-in tool, sale of business tool, bridge institution tool, and asset separation tool).
    - The **process and report** of the valuation 2, including the appointment of the independent valuer, and the potential content of the valuation report (e.g. the valuation methodology) to be submitted by the valuer to the RA.
- **Valuation 3**. This valuation is carried out after the execution of the resolution action to assess differences in treatment of shareholders and creditors in resolution and in hypothetical insolvency proceedings. In this regard, this Handbook provides guidance on the following aspects: i) conceptual and procedural aspects; ii) methodologies for assessing realisation from assets (e.g. discounted cash flow methodology or market value methodology); iii) specific considerations for certain assets/liabilities (i.e. goodwill, deferred tax assets and deferred tax credits, as well as franchise value); iv) determination of recoveries to creditors; and v) potential content of the valuation report (e.g. description of the assumed insolvency strategy).
- **Management information system (MIS)**. This Handbook provides guidance on the assessment by RAs, in business as usual, of institutions' valuation preparedness, and focuses on the capabilities to develop and/or adjust MIS to meet expectations about data and information to be swiftly provided to the RA or the valuer to support a robust valuation.

25/02/2019
CP GL on CRM for institutions applying the IRB Approach with own estimates of LGDs.

1. Context

The EBA's review of the internal rating-based (IRB) approach overall aims to reduce unjustified variability stemming from different supervisory and bank-specific practices, while preserving the higher risk sensitivity associated with internal models. To this end, in March 2018 the EBA published a Report on credit risk mitigation (CRM), focusing on the standardised approach (SA) and the foundation-IRB approach (F-IRB), which set out a mapping for the techniques, eligibility and methods of the CRM available to institutions under the SA and the F-IRB approach.

In this context, the EBA has published a **Consultation Paper (CP) on Guidelines (GL) on CRM for institutions applying the advanced internal rating-based (A-IRB) approach**, that aims to eliminate the remaining significant differences in approaches in the area of CRM, which are either due to different supervisory practices or bank-specific choices. In particular, this CP provides guidance on the application of the CRM provisions of the CRR; and clarifies the eligibility requirements for different CRM techniques, namely funded and unfunded credit protection (e.g. collateral and guarantees), available to institutions.

2. Main points

- **General provisions**. This CP carries out a mapping of those articles of the CRR regarding the IRB approach detailing the provisions for the eligibility and methods of CRM at institutions' disposal for exposures under A-IRB. In particular, it establishes that:
  - The requirements of the CRR regarding the CRM only apply to exposures treated under A-IRB, where the chapter of the CRR regarding IRB explicitly cross-referenced the chapter of the CRR regarding the CRM regard to the IRB approach.
  - The CRM effects of master netting agreements (MNA) and on-balance sheet netting (OBSN) should be recognised in the exposure value in accordance with the CRR. Institutions should take into account all requirements regarding the CRM, including the eligibility criteria and methods.
  - Any reference to the term collateral should be understood as a reference to funded credit protection other than MNA and OBSN. For the types of exposures for corporates, institutions, central governments and central banks and retail exposures, where institutions have received permission to use own LGD estimates, institutions may recognise funded credit protection (FCP) only where it has not already been recognised in the exposure value.
  - For the types of exposures where institutions have received permission to use own LGD estimates, the CP details those provisions that determine the eligibility of the unfunded credit protection (UFCP).
  - In the context of A-IRB, credit insurance may be recognised as a guarantee (or a credit derivative) where it effectively functions in an equivalent manner. As the CRR does not give a definition of guarantees or credit derivatives, the credit insurance has to meet the UFCP definition given in the CRR.
- **Eligibility requirements**. This CP clarifies the eligibility requirements for FCP and UFCP, as under the A-IRB, risk sensitivity is enhanced through the broader eligibility of CRM techniques provided that institutions can adequately reflect the lowered efficiency of instruments not eligible under SA and F-IRB in the PD or LGD estimates.
  - Eligibility requirements for FCP. This CP provides clarification regarding the following:
    - The general principles on **legal certainty**.
    - The general principles on **collateral valuation**.
    - The **legal opinion** needed to confirm the legal effectiveness and enforceability of the collateral arrangement in all relevant jurisdictions.
  - Eligibility requirements for UFCP. This CP provides clarification regarding the following:
    - The **legal opinion** needed to confirm that the UFCP arrangement is legally effective and enforceable in all relevant jurisdictions.
    - The consideration of **defaulted guarantors** as ineligible according to the eligible requirements of UFCP.
    - The criteria for **adjusting LGD estimates** (i.e. where the guarantor is in defaulted status before the default of the obligor, institutions should treat the exposure as if the exposure was not benefiting from the UFCP).
- **The effects of CRM**. This CP provides additional guidance on how institutions may recognise the CRM effects of FCP such as MNA and OBSN, and UFCP (e.g. on the methods available, the institution's policies and criteria for recognising the effects of UFCP, or the calculation of the risk weight floor).

3. Next steps

- Comments to this CP shall be submitted by **25 May 2019**.
- The Final GL are expected to be applicable by **1 January 2021**.

04/03/2019
Opinion on deposit protection issues stemming from the withdrawal of the UK from the EU.

1. Context

Once the UK leaves the EU, and barring any transitional arrangements that are specified in the ratified withdrawal agreement, branches of UK credit institutions in the EU, and branches of EU-27 credit institutions in the UK, will become third country branches. The Deposit Guarantee Schemes Directive (DGSD) requires Member States to check that branches established in their territory by a credit institution which has its head office outside the EU have protection equivalent to that prescribed in the DGSD. When performing the equivalence check, Member States shall at least check that depositors benefit from the same coverage level and scope of protection as provided for in the DGSD.

In this context, the EBA has published an **Opinion on deposit protection issues stemming from the withdrawal of the UK from the EU**, which is addressed to Deposit Guarantee Schemes Designated Authorities (DGSDAs), in order to ensure that depositors in the branches of the UK credit institutions in the EU are adequately protected by the EU Deposit Guarantee Schemes (DGSs), in case of a withdrawal of the UK from the EU with no ratified agreement in place.

In particular, this Opinion aims to: i) make the competent authorities (CAs) aware that, if no equivalent protection is provided by the UK at the point of withdrawal from the EU, deposit-taking branches of UK credit institutions established in the EU should be required to join a DGS operating within the EU; ii) recommend to the CAs and the credit institutions when depositors should be informed about impending changes; iii) remind the CAs of the applicable provisions regarding transfers of previous DGS contributions where a credit institution changes its DGS affiliation; and iv) make the CAs aware of the potential issues associated with deposits in some branches being protected by two DGSs.

2. Main points

- **Coverage of branches of UK credit institutions located in the EU**. The Bank of England (BoE) has proposed that European Economic Area (EEA) branches of UK credit institutions will no longer be protected by the UK DGS. The UK's intended approach means that, in the absence of any action taken by the CAs, depositors at branches set up by UK credit institutions in the EU will lose coverage, unless these branches join a local DGS in the EU. To this end, CAs are advised to make preparations (including active and prompt engagement with the relevant branches of UK credit institutions) before the UK's withdrawal from the EU, so that the membership of the local DGS starts at the point of withdrawal.
- **Depositor information**. The EBA recommends that:
    - CAs should promptly engage, directly or indirectly through the relevant national supervisory authorities, with DGS member institutions. If is already known which DGS the institution will be joining and when, the CA should request that institution to inform depositors about it as soon as possible; and in the event that is not yet known which DGS the institution will be joining or when, allow that institution, to inform depositors less than 1 month before the end of their current DGS affiliation or at the point of the UK's withdrawal from the EU, whichever is earlier.
    - CAs should request the relevant DGS member institution to provide the depositors in the branch with a depositor information template (including information about the prospective DGS protection).
    - Where depositors are no longer protected by a DGS, conditions should be created to allow depositors to withdraw or transfer to another credit institution, without incurring any penalty, their eligible deposits, including all accrued interest and benefits.
    - Any information provided to depositors should be clear and written in plain language, with next steps expressed simply, advice on what action to take where applicable and realistic timelines.
    - Credit institutions should be requested by the respective CAs to inform the CA in the UK and the relevant CA in the Member State where the branch operates of their communication with depositors.
    - All relevant EU DGSs in Member States where there are deposit-taking branches of UK credit institutions should publish a press release clearly explaining any changes to DGS affiliation and what it means for depositors' protection.

2. Main points (continues)

- **Transfers of DGS contributions**. The EBA recommends that, if a credit institution changes its DGS affiliation from the UK DGS to an EU DGS, or vice versa, before the UK's withdrawal, that institution's new DGS should receive a transfer of DGS contributions paid by that institution in the preceding 12-month period. However, if the change of affiliation happens after the UK's withdrawal, no such transfer will be required.
- **Coverage of branches of EEA institutions in the UK**. The BoE has also required branches of EEA credit institutions operating in the UK to become member of the UK DGS. Where an EU DGS covers branches in third countries, that branch may be covered by both the UK DGS and an EU DGS, resulting in double coverage. This issue poses a number of potential challenges such as a lack of clarity in relation to each DGS's liability and obligation in the event of a payout; confusion on the part of depositors; an impact on that institution's DGS contributions; or potentially costly IT adjustments to comply with any UK requirements.

07/03/2019

Final Guidelines for the estimation of LGD appropriate for an economic downturn ('Downturn LGD estimation').

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 November 2018, the EBA issued Final RTS on the nature, severity and duration of an economic downturn, which require institutions to consider relevant macroeconomic and credit factors when specifying the nature of an economic downturn, among other aspects.

In this context, following the consultation launched in May 2018, the EBA has published **Final Guidelines (GL) for the estimation of LGD appropriate for an economic downturn**, which set out requirements for the quantification of the calibration target used for downturn LGD estimation.

These GL are an addendum to the GL on PD estimation, LGD estimation and the treatment of defaulted assets which were published by the EBA in November 2017, in order to reduce unwarranted variability of risk parameters and own funds requirements.

2. Main points

- **Types of approaches for calibrating downturn LGD**. According to the downturn periods identified in accordance with the RTS, these GL differentiate three types of approaches:
  - Type 1: downturn LGD calibration based on observed impact. Where sufficient (in terms of timespan covered and quantity of data, to arrive at stable estimates) loss data are available to assess the impact for the downturn period under consideration, the institution should conduct a standardised impact assessment where:
    - It should **analyse whether there is evidence** of elevated realised LGDs, decreased annual recoveries, decreased number of cures or prolonged time in default caused by the downturn period under consideration.
    - It should then **calibrate the downturn LGD** for the downturn period under consideration in a way that it is **coherent** with the results obtained from the impact assessment (i.e. to model appropriately the loss components materially affected by the downturn period under consideration).
  - Type 2: downturn LGD calibration based on estimated impact using historical loss data. Where loss data are not available to base the downturn LGD calibration on an observed impact for a considered downturn period, the downturn LGD should be calibrated using:
    - A **haircut approach**.
    - A **extrapolation approach**.
    - A **combination of the two previous approaches**, which may be used for the downturn calibration of intermediate risk parameters (such as recovery rates or cure rates) and risk drivers.
  - Type 3: free modelling flexibility with minimum fixed add-on. Where sufficient data are not available to quantify downturn LGDs for the downturn period under consideration based on observed or estimated impact using the type 1 and 2 approaches, the institution should estimate the downturn LGDs and fulfil a minimum level of minimum margin of conservatism (MoC). Under this preferred modelling approach, it is required that the final downturn LGD estimates plus an appropriate MoC be higher than the corresponding long-run-average LGDs plus 15 percentage points (capped at a final downturn LGD estimate level of 105%).
- **Reference value**. These GL introduce how to calculate the reference value that acts as a non-binding challenger to the final downturn LGD estimation and as a guide to the regulatory expectation as regards to the level of quantification. This means that the reference value acts as a challenger to the whole downturn LGD estimation, including the proper identification of the downturn periods pursuant to the RTS on economic downturn.

3. Next steps

- These Final GL apply from **1 January 2021**.

20/03/2019
2018 List of O-SIIs in the EU.

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 **2018 annual 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 following criteria provided in the EBA Guidelines: 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 **202 institutions as O-SIIs** in the EU, based on 2018 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 list 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.
- Higher capital requirements will become applicable once relevant authorities decide to set institution-specific buffer requirements as a consequence of this O-SII identification.

EUROPEAN CENTRAL BANK
EUROSYSTEM

04/02/2019
Final results of the SSM-wide stress test 2018.

1. Context

Under the CRD IV, the ECB is required to carry out annual supervisory stress tests. In this regard, the ECB announced in January 2018 that it would conduct such an exercise for the banks under its direct supervision, which would consider the EBA's 2018 stress test methodology, templates and scenarios. This exercise is conducted as part of its annual Supervisory Review and Evaluation Process (SREP).

In this context, the ECB has published the **Final results of the SSM-wide stress test 2018**, which will feed into the SSM SREP. In particular, this exercise is set out with the aim to assess the resilience of financial institutions to adverse market developments; contribute to the overall SREP to assure institutions' capital and liquidity adequacy, as well as sound risk coverage and internal processes; and to ensure consistent treatment of all SSM significant institutions (SIs).

As in previous exercises, this stress test was not a "pass or fail" exercise. However, it helps the supervisor to determine Pillar 2 capital in its annual SREP.

2. Main points

- **Scope**. 87 banks, including 33 euro banks (EBA banks) that were part of the EU-wide stress test carried out by the EBA in 2018, and 54 SIs which are directly supervised by the ECB but were not part of the EBA stress test (SREP banks). This sample of banks represents around a 79% of banking assets in the euro area.
- **Reference date**. The data presented in this exercise is as of 31 December 2017.
- **Main results**.
    - Banks directly supervised by ECB have become more resilient to financial shocks over the past two years.
    - The adverse scenario results in a total system-wide CET1 depletion of 4.0 p.p. on a fully loaded basis, reducing the system-wide CET1 capital ratio from 14.1% year-end 2017 to 10.1% in 2020 (which is higher than the 8.8% CET1 after stress test of the 2016 exercise) including a 0.3 p.p. impact from the first time application of IFRS 9. In this regard, it should be highlighted that:
        - Despite a more severe adverse scenario, the **54 SREP banks** still had an average final CET1 of **11.8% at the end of the test**, compared to 8.5% in the stress test 2016. The CET1 ratio depletion of an **aggregate 5.1 p.p.** in the adverse scenario was also smaller than the 6.2 p.p. two years ago.
        - **EBA banks exhibit lower depletion in CET1 ratio** than SREP banks (3.8 p.p. against 5.1 p.p.), mainly driven by higher income generation from net interest income (NII) and from client revenues from market operations under the adverse scenario.
        - **Key drivers of the results under the adverse macroeconomic scenario** are credit impairments, a funding spread shock partly offset by a positive effect from higher long-term interest rates; a significant stress to net fee and commission Income, and the impact of market price and liquidity shocks on fair value portfolios.
- **Other results**.
    - Emerging market economies show higher net interest margins under the adverse scenario, counter-balancing otherwise higher credit losses in these countries.
    - Credit losses are mostly explained by the macroeconomic scenario. NPL stocks play a less prominent role in the 2018 exercise compared to 2016 due to improved balance sheets.
    - The adverse full revaluation impact in market risk is concentrated among 6 G-SIBs, which can however largely compensate these losses with high client revenues.
    - Conduct risk losses from known cases play a less prominent role compared to 2016, as many legacy cases have been settled since, and are concentrated among the G-SIBs.
    - Adjustments to dividends, AT1 coupons and variable compensation reduce the overall impact under the adverse scenario by approximately 40 bps.

EUROPEAN CENTRAL BANK
EUROSYSTEM

07/02/2018
Sensitivity analysis of liquidity risk - 2019 stress test.

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 2019, which will consist of a sensitivity analysis of liquidity risk. The results of this stress test will inform the 2019 Supervisory Review and Evaluation Process (SREP) assessment of bank's risks.

In this context, the ECB has today launched a **Sensitivity analysis of liquidity risk** as its 2019 stress test which is designed to provide the ECB with sufficient information to understand how supervised banks can handle hypothetical idiosyncratic liquidity shocks.

2. Main points

- **Reasons to conduct this exercise**. Although liquidity has been abundant in the euro area in recent years, the ECB has witnessed individual cases of constrained liquidity and it needs to test whether banks are ready to handle similar situations.
- **Tasks that will be carried out by the supervisor**. The ECB will perform in-depth analyses of certain aspects of banks' liquidity management, for instance the ability to mobilise collateral and the exposure to liquidity mismatches in individual currencies.
- **Type of information to be reported by banks**.
    - Banks will report information on cash flows expected over a six-month time horizon and on their collateral position. This information is a useful complement of the regulatory liquidity indicators, i.e. the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR).
    - Banks will be able to leverage on existing reporting to comply with the above information requests. The template for the sensitivity analysis of liquidity risk is largely based on the SSM liquidity template, which is used by supervisors across the SSM for the high-frequency monitoring of the liquidity position of banks.
- **Assumptions applied in this exercise**.
    - The ECB will be testing the sensitivity of banks' liquidity position to idiosyncratic shocks (e.g. deposit outflows observed in the past for institutions, losses of liquidity related to rating downgrades or the withdrawal of committed liquidity facilities), informed by past experience.
    - The exercise will focus on banks' expected short-term cash flows to calculate the 'survival period', which is the number of days that a bank can continue to operate using available cash and collateral with no access to funding markets.
    - The ECB will not simulate the impacts of a market-wide shock on banks' funding or of significant changes in asset prices.
    - The exercise will be carried out without any reference to monetary policy decisions.
- **Implications of the quantitative results of this exercise**. These results will not affect supervisory capital or liquidity requirements in the 2019 SREP decision in a mechanical way. The results will inform the supervisor about the relative vulnerability of banks to different liquidity shocks applied in the exercise and will also identify improvements needed in banks' liquidity risk management.

3. Next steps

- This sensitivity analysis of liquidity risk is expected to run for **four months**.
- The results of this exercise will be discussed as part of the SREP supervisory dialogue between banks and Joint Supervisory Teams (JSTs) in the **summer**.

EUROPEAN CENTRAL BANK

EUROSYSTEM

15/03/2019

- **Recommendations of the working group on euro risk-free rates on the transition path from EONIA to the €STR and on a €STR-based forward-looking term structure methodology**
- **Announcement of start date for euro short-term rate (€STR)**

1. Context

In September 2017 the ECB announced that it had decided to develop a euro unsecured overnight interest rate on the basis of data already available to the Eurosystem, that will replace the current euro overnight index average (EONIA). The new euro short-term rate (€STR) will complement existing benchmark rates produced by the private sector and will serve as a backstop reference rate. Further, in June 2018 the ECB issued the final methodology for calculating the €STR.

In this context, the ECB has published **Recommendations on the transition path from EONIA to the €STR and on a €STR based forward-looking term structure methodology** to market participants. In particular, these recommendations establish that market participants should gradually replace EONIA with the €STR for all products and contracts, making the €STR their standard reference rate and making certain adjustments to their IT systems; and that the European Money Market Institute (EMMI) should modify the current EONIA methodology to become the €STR plus a spread for a limited period of time in order to give market participants sufficient time to transition to the €STR; among others.

2. Main points

- **Recommendations to the transition path from EONIA to the €STR**.
  - The ECB recommends that the EMMI, as the administrator of EONIA, takes the following steps before 1 January 2020:
    - Modify the current EONIA methodology to become the **€STR plus a spread** for a limited period to further anchor EONIA's methodology in transactions. To this end, the EMMI should consider an EONIA-€STR spread methodology based on a simple average with an observation period of at least 12 months, combined with a 15% trimming mechanism.
    - **Engage with the relevant authorities** to ensure the compliance of EONIA, under its evolved methodology, with the EU Benchmarks Regulation.
    - Consider and consult market participants on **discontinuing the publication of EONIA** under its evolved methodology, after a transition period that ensures firms can achieve transition to the €STR in a smooth manner. This transition period should last until the end of 2021, which is consistent with benchmarks transitions in other jurisdictions.
  - The ECB recommends that market participants gradually replace EONIA with the €STR as a reference rate for all products and contracts and make all adjustments necessary for using the €STR as their standard benchmark after the transition period.
  - The ECB encourages market participants to make all reasonable efforts to replace EONIA with the €STR.
- **Recommendation on a €STR-based forward-looking term structure methodology**. The ECB recommends the Overnight Index Swaps (OIS) tradable quotes-based methodology as the €STR based forward-looking term structure methodology as a fallback to Euribor-linked contracts within a reasonable time period following the launch of the daily €STR publication.

3. Next steps

- The ECB has also announced that it will start publishing the €STR as of **2 October 2019**, reflecting the trading activity of 1 October 2019.

19/02/2019
Recognition of three CCPs in the event of a no-deal Brexit.

1. Context

In December 2018, the European Securities and Markets Authority (ESMA) published a Public Statement to clarify its plans for the recognition of Central Counterparties established in the United Kingdom (UK CCPs) as Third Country CCPs (TC-CCPs) under European Markets Infrastructure Regulation (EMIR) if the four recognition conditions under Article 25 of EMIR were met. Moreover, on February 2019, ESMA and the Bank of England (BoE) announced that they had agreed Memoranda of Understanding (MoUs) for the recognition of central counterparties (CCPs) and central securities depository (CSDs) established in UK, that would take effect in case of no-deal Brexit scenario.

In this context, the ESMA has announced that **three UK CCPs** (LCH Limited, ICE Clear Europe Limited and LME Clear Limited) **will be recognised to provide their services in the EU as third country CCPs under EMIR**, in the event of a no-deal Brexit. In particular, ESMA considers that the conditions for recognition under Article 25 of EMIR are met by the three CCPs in case of a no-deal Brexit.

2. Main points

- **Recognition of a third-country CCP**. ESMA may recognise an UK CCPs that has applied for recognition to provide certain clearing services or activities under EMIR requirements. In particular, for the recognition of the UK CCPs the following aspects should be met:
    - <u>Adoption of an equivalence decision</u>. ESMA welcomes the Commission Implementing Decision (EU) which determines for a limited period of time, that the regulatory framework applicable to central counterparties in the United Kingdom of Great Britain and Northern Ireland is equivalent, in accordance with EMIR (equivalence decision). The equivalence decision will apply for a period of 12 months starting from the date following the Brexit. Furthermore, in case of a no-deal Brexit, the equivalence decision will be extended to a two years period. The condition in the equivalence decision only concerns the exchange of information between ESMA and the BoE, which is covered by the MoU.
    - <u>CCPs should be authorised in the UK and subjected to effective supervision and enforcement</u>. The BoE is expected to provide ESMA with a letter confirming that the UK CCPs are authorised in the UK and comply with the prudential requirements applicable in the UK.
    - <u>Establishment of cooperation arrangements</u>. ESMA and the BoE has established cooperation agreements through the agreed MoUs for the recognition of CCPs established in the UK. This agreement provides ESMA with adequate tools to monitor their ongoing compliance with the recognition conditions and to assess any material risk they pose, directly or indirectly, to the EU or any of its Member States, including to their financial stability. Moreover, the BoE confirmed that it will provide information to ESMA in line with its current obligations and those set out in the equivalence decision.
    - <u>Having equivalent systems for anti-money-laundering and combating the financing of terrorism to those of the Union</u>. UK is not on the list of third-country jurisdictions which have strategic deficiencies in their anti-money laundering and countering the financing of terrorism regimes (high-risk third countries), and therefore, the ESMA has no expectation tha the UK will be added to this list upon Brexit date.

3. Next steps

- The recognition decisions would take effect on the **date following Brexit date**, under a no-deal Brexit scenario.

22/02/2019
Framework for assessing conduct risk through the product lifecycle.

1. Context

In 2017, the EIOPA committed to further strengthening its work in the area of supervisory convergence, including explicitly in the area of conduct of business. It was acknowledged that addressing conduct risk requires looking beyond the direct interaction with consumers at the point of sale (i.e. disclosures and advice). This aggregate set of risks is generally referred to as product lifecycle risks.

In this context, the EIOPA has published a **Framework for assessing conduct risk through the product lifecycle** which aims at identifying drivers of conduct risk and the implications of these in the emergence of consumer detriment. In particular, this framework provides an aid for taking stock of the issues faced by consumers and provides input to the types of risks EIOPA and national competent authorities (NCAs) should focus on.

2. Main points

- **Approach and methodology**. The analysis and description of the drivers of conduct risk is purposely high-level but aims to be comprehensive. In this regard, this framework considers a broad definition of conduct risk and it focuses on conduct risk from the perspective of retail customers. However, no country-specific conduct issues are included, though conduct risks are likely to cluster in different ways in different EU Member States.
- **Assumptions**. This framework considers the following aspects:
    - Risks are seldom <u>independent</u>.
    - These risks can be <u>highly correlated</u> and <u>interrelated</u>, making it difficult to isolate their effects or root drivers or causes.
    - There is <u>no distinction</u> between <u>insurance undertakings</u> and <u>insurance intermediaries</u> that manufacture insurance products where issues are the same.
    - There is <u>distinction</u> between <u>insurance intermediaries</u>, <u>ancillary insurance intermediaries</u> or <u>insurance undertakings</u> that carry out insurance distribution.
- **Risks addressed through the analysis**. This framework identifies four categories of risks:
    - <u>Business model and management risks</u>, that are those arising from the way undertakings structure, drive and manage their business and from relationships with other entities in the value-chain. In this regard, two types of risks can be differentiated:
        - **Business model risks**. These risks can arise from the various conceptual elements that make up the structure supporting a business, its purpose and goals and plans for achieving them. They can be addressed in areas related with the value-chain and group structures, innovation, and use of third parties-outsourcing.
        - **Business management risks**. These risks are those arising from an undertaking's culture, governance and internal structures, and system and processes. As these three elements are strongly connected, failures in one of the elements put at risk the overall capacity to identify, manage and mitigate business management risks.
    - <u>Manufacturing risks</u>, that are those arising from how products are developed by insurance undertakings prior to being marketed to whom they are targeted. The drivers of this category of conduct risk are related to: product development and design, value for money and pricing, and market targeting.
    - <u>Delivery risks</u>, that are those arising from the interaction between customers and insurance undertakings or intermediaries at the point of sale. The drivers of this category of conduct risk are related to: marketing, distribution, and sales.
    - <u>Product management risks</u>, that are those risks that customers face from the time they enter into a contract until all obligations under the contract have been satisfied. The drivers of this category of conduct risk are related to: product monitoring and review, ongoing product disclosure, claims-handling, and complaints-handling.

3. Next steps

- This framework is expected to contribute to the effective implementation of EIOPA's Conduct Supervision Strategy. This includes the development of **periodic conduct risk dashboards**.

04/03/2019
Real Decreto 102/2019, por el que se crea la Autoridad Macroprudencial Consejo de Estabilidad Financiera, se establece su régimen jurídico y se desarrollan determinados aspectos relativos a las herramientas macroprudenciales.

1. Context

Since 2009, several international and European institutions such as the FSB, IMF, or the European Systemic Risk Board (ESRB), have issued recommendations on the introduction of macroprudential measures in order to address potential vulnerabilities of the financial system. Further, in December 2018 the Government issued the Royal Decree-law 22/2018, on macroprudential measures, with the aim to assign the Bank of Spain (BdE), the National Securities Market Commission (CNMV), and the Directorate General for Insurance and Pension Funds (DGSFP), the needed macroprudential tools to prevent and mitigate systemic risks.

In this context, the Spanish Government has published the **Royal Decree 102/2019, that sets out the Macroprudential Authority on the Financial Stability Council (AMCESFI), establishes its legal regime, and develops certain aspects regarding macroprudential tools**. In particular, this authority replaces the Financial Stability Committee (CESFI) created in 2006, and this Royal Decree sets out the structure, legal regime, functions and powers of the AMCESFI.

Moreover, with the establishment of the AMCESFI and the provision of new tools to sectoral supervisors through the Royal Decree-law 22/2018, the institutional reform of the macroprudential supervisory system is finalised.

2. Main points

- **Legal status and objectives of the AMCESFI**. This authority is set out as a collegial institution attached to the Ministry of Economics and Business, and aims to prevent and mitigate the systemic risk for the financial stability.
- **Structure and functioning of the AMCESFI**.
  - Composition. This institution is composed by a Council, a Technical Committee as a support institution and those sub-committees that the Council would agree to set out. These bodies are comprised by representatives from the Ministry of Economics and Business, the BdE, and the CNMV, although it is possible to invite other public institutions (e.g. FROB or CNMC).
  - Functions. The AMCESFI is responsible for analysing the potential drivers of the systemic risk; issuing opinions, alerts regarding any aspect that could impact the financial stability as well as recommendations to sectoral supervisors on the adoption of specific measures. The recipients of such AMCESFI's recommendations should explain how they will comply with them or justify properly the reasons why they considered unnecessary or inappropriate to follow them.
- **Macroprudential tools and communication procedures to the AMCESFI**.
  - Macroprudential tools. The BdE, the CNMV and the DGDFP could adopt macroprudential tools to prevent systemic risks according to the relevant sectoral regulation. Among such tools, they could establish countercyclical capital buffers, limits to the sectoral concentration of risks and to the granting of loans according to the value of the collateral or the debt's capacity of firms and individuals; or the implementation of higher risk weights for real estate exposures.
  - Communication to the AMCESFI. Despite the fact that sectoral supervisors are responsible for the management of macroprudential tools, according to its scope of application and expert knowledge, these supervisors should notify in advance the AMCESFI its intention to turn on, reset or disable any of these tools.
- **Cooperation and coordination among authorities**. The obligation to cooperate with the macroprudential authorities of other Member States, and with the relevant European institutions is regulated in this Royal Decree.
- **Accountability**. The AMCESFI should develop an annual public report which will address the main sources of systemic risk identified, as well as the opinions, alerts and recommendations issued. Furthermore, following the publication of this report, the AMCESFI should appear before the Committee of Economics and Business of the Congreso de los Diputados in order to communicate the systemic risk drivers addressed and the actions to be taken by the AMCESFI.

3. Next steps

- This Royal Decree entered into force by **3th March 2019** (i.e. the day following that of its publication in the Official Journal).

20/03/2019
Proyecto de Real Decreto de desarrollo de la Ley reguladora de los contratos de crédito inmobiliario.

1. Context

The Directive 2014/17/UE on credit agreements for consumers relating to residential immovable property, lays down a common framework of the Member States concerning agreements covering credit for consumers secured by a mortgage or otherwise relating to residential immovable property. This Directive has recently been partially transposed by Law 5/2019 regulating real estate credit agreements, which covers, among other aspects, the rules for protecting the borrower regarding the trading of real estate loans, and the rules on conduct to be observed by real estate credit intermediaries, their representatives and real estate creditors.

In this context, the Spanish Government has published a **Draft Royal Decree to develop the Law 5/2019 regulating real estate credit agreements**, with the aim to complete the transposition of the Directive 2014/17/UE, as well as to develop several aspects needed to ensure the borrowers' rights in Law 5/2019. In particular, this Draft Royal Decree covers the following aspects: i) general provisions; ii) advisory service; iii) creditor's obligations; and iv) telematic resources for the documentation submission to the notary by creditors, credit intermediary or its relevant representative.

2. Main points

- **General provisions**. This Draft Royal Decree shall apply to the activities carried out in relation to real estate loan agreements granted by natural or legal persons who performs such activity in a professional manner (including intermediation) when the borrower or the guarantor is a natural person, and the purpose of such contract is to grant:
    - Loans with mortgage collateral or other security right in a property for residential use.
    - Loans whose objective is to acquire or preserve property rights in land or in an existing or projected building, provided that the borrower or the guarantor is a consumer.
- **Advisory service**. This Draft Royal Decree establishes that the advisory service will constitute a separate and different activity from granting and intermediation of real estate loans, which will be subject of a specific agreement. Moreover, in relation to independent advisory services, it is determined that those providing these types of services must take into account a sufficiently large number of loan agreements available on the market, and they must not receive remuneration for those services from one or more creditors if the number of creditors they take into account does not represent a majority of the market.
- **Creditor's obligations**. This Draft Royal Decree covers the requirements for the registration in the corresponding register of real estate creditors and the information that must be provided to the borrower during the agreement, regulating both formal aspects (i.e. clarity and accuracy) and material aspects (e.g. information on commissions and accrued expenses and interest rates effectively applied during the previous year).
- **Telematic resources for the documentation submission to the notary**. This Draft Royal Decree establishes the technical principles and requirements that are required to telematics resources (e.g. they must enable permanent access and allow download or extraction of documentation, and must have authentication mechanisms to ensure the exclusivity of its use and the identity of the user), and the procedure for the submission to the notary the needed documentation to comply with the principle of material transparency (i.e. general, precontractual and personalised information) by the creditor, the credit intermediary or its relevant representative.

3. Next steps

- Comments to this Draft Royal Decree shall be submitted by **27 March 2019**.

28/03/2019

Consulta pública previa sobre el Proyecto de Circular, dirigido a EFC, sobre normas de información financiera pública y reservada y modelos de estados financieros.

1. Context

Since the 1 January 2014, the specialised lending institutions (SLIs) applies a transitional regime on financial information as set out under the second transitional provision of the Royal Decree-Law 14/2013 on urgent measures for the adaptation of Spanish law to EU legislation on the supervision and solvency of financial institutions. Further, in December 2017 the BdE published the Circular 4/2017 on public and confidential financial information rules and formats, which included consistent criteria with the European IFRS accounting framework.

In this context, the BdE has launched a **Public consultation prior to the preparation of the Draft Circular, addressed to SLIs, on public and confidential financial information rules and formats**, with the aim to keep the convergence of the Spanish accounting standards of supervised institutions to the IFRS framework. In particular, the new Circular will establish general requirements for submitting financial information of the SLIs as well as a reference to the Circular 4/2017 regarding the rules on recognition, valuation, submission and disclosure of information.

2. Main points

- **Objective of this rule**. The Draft Circular aims to ensure that SLIs apply the same accounting criteria as credit institutions, which are consistent with the IFRS accounting framework and with the Commercial Code. Given the nature, scale and complexity of SLIs' activities compared to credit institutions, the SLIs will apply a simplified requirements' regime for models on public and confidential financial statements.
- **Issues identified**. Through the Draft Circular addressed to SLIs, the BdE aims to continue with the strategy that expects to adapt the national accounting regime of the supervised institutions with the most advanced accounting principles included in IFRS. In particular, the IFRS 9 criteria on financial instruments which consider the expected loss approach for estimating allowances for credit risk, will be included in the accounting standards for SLIs.
- **Regulatory measures**. The approval of a new Circular is required to finalise the transitional regime established in the Royal Decree-Law 14/2013, and to provide the accounting standards and models for public and confidential financial statements of SLIs.

3. Próximos pasos

- Comments to this previous consultation shall be submitted by **10 April 2019**.
- The new Circular will apply by **1 January 2020**.

28/02/2019
Guía Técnica 1/2019 sobre Comisiones de nombramientos y retribuciones (CNR).

1. Context

The selection, nomination and remuneration system applied to Board members and senior executive members are key aspects of good governance framework of listed companies. In December 2014, the Ley 31/2014, which amended the Spanish Corporation Law (LSC), required listed companies and other firms issuing securities admitted to trading on secondary regulated markets, to have in place a Nomination and Remuneration Committee (CNR).

In this context, following the consultation launched in November 2018, the CNMV has published the **Technical Guide 1/2019 on Nomination and Remuneration Committees (CNR)**, in order to foster a proper functioning of CNR within the firms. In particular, this document covers a set of principles, good practices and standards on how these committees can improve the performance of their function.

2. Main points

- **Basic principles**. This Technical Guide covers a set of performance's principles, that CNR should consider when carrying out their functions:
  - Independency and scepticism.
  - Constructive dialogue between their members.
  - Internal dialogue with the Board's Chairman, chief executive, or the coordinating Board's member as well as, when relevant, with any executive member.
  - Sufficient capacity of analysis, and the possibility to appeal to experts.
- **Good practices**. This Technical Guide sets out good practices aimed at strengthening the independency of the CNR and fostering its proper functioning in the selection, assessment and design of remuneration policy of the Board's members; and which cover, among other aspects:
  - **Single committee or two individual committees**. It is advised that listed companies, depending on their complexity, should consider to separate committees, and in those cases, to have in place coordination mechanisms between both committees.
  - **External advisors**. If services provided by external advisors are requested, it is recommended that those external advisors may carry out different tasks regarding the selection, evaluation and remuneration policy.
  - **Composition**. Criteria on diversity, knowledge and training are defined. Further, it is considered that proprietary Board's members could be part of the CNR, although it is advised that they should not have full control or significant influence, and they should comply with the requirements required to independent Board's member (except the requirements of bearing no relation with a significant shareholder).
  - **Functioning**. It is advised that the CNR should meet with sufficient frequency, at least three times a year.
  - **Evaluation and selection of Board's members**. It is detailed those analyses that the CNR should carry out regarding the current and future composition of the Board (e.g. analysis of Board members' competences, knowledge and experience). Moreover, it is recommended that they should elaborate a competence matrix that will define the skills and knowledges that a candidate to the Board should have.
  - **Proposal of independent Board's members**. The outsourcing of searching tasks, or the adoption of greater caution when the candidate is proposed by a significant shareholder, or proprietary or executive Board's members, are considered good practices, among others.
  - **Information about the proposals of other Board's members, senior executives members and the secretary of the Board**. It is recommended that the CNR decides on which candidates meet the requirements considered in the competency matrix .
  - **Succession of the Board's Chairman, chief executive and senior executives**. It is recommended to involve the coordinating Board's member, as well as the Board's Chairman and chief executive in these tasks; and to develop a succession plan that should be regularly reviewed.
  - **Policy and determination of remuneration and contractual conditions of Board's members and senior management**. It is recommended that the policy should be clear, accurate, verifiable and based on objective criteria, and it also should be consistent with the specific circumstances and the institution's strategy. Regarding contractual conditions, the CNR should demonstrate that they are consistent with current remuneration policies.
  - **Information to other institution's committees and its shareholders**. It is provided details on a set of issues (e.g. on the regulation of the CNR, or its composition, functions and tasks) which should be included in the performance's report drawn up annually by the CNR.
  - **Reasons of board members' resignations**. It is recommended that the CNR should evaluate, where relevant, the information covered in the document summited by the resigned Board's member to the Board and, when the Board considers that this information is not sufficient, to establish a dialogue with such Board's member to find out the reasons for his/her resignation, and to disclose the reasons behind his/her decision.

06/03/2019

- **Stress testing the UK banking system: Key elements of the 2019 stress annual cyclical scenario**
- **Stress testing the UK banking system: 2019 stress guidance for banks and building societies**
- **Variable paths for the 2019 stress test**
- **Traded risk scenario for the 2019 stress test**

1. Context

The BoE's concurrent stress-testing framework was established following a Recommendation on stress testing from the Financial Policy Committee (FPC) published in March 2013, with the aim at providing forward-looking, quantitative assessment of the capital adequacy of the UK banking system as a whole, and individual institutions within it. In 2019, the BoE will launch two stress tests, including a first test that assess the impact of the annual cyclical scenario (ACS), and a second test which will assess the impact of the biennial exploratory scenario (BES). This second test is scheduled to be launched in October 2019.

In this context, the BoE has published a document on **key elements of the 2019 UK stress test scenarios** which provides details on the 2019 baseline scenario and ACS. Moreover, the BoE has also released a **Guidance for participating banks** for conducting their own analysis for the 2019 stress test.

Along with these two documents, the BoE has also published two additional documents covering the variable paths, as well as the traded risk scenario for the 2019 stress test.

2. Main points

Stress testing the UK banking system: key elements of the 2019 UK stress test scenarios

- **2019 baseline scenario**. Under the 2019 UK stress test, this scenario provides base macroeconomic projections for UK (e.g. annual real GDP growth is projected to fall to 1.3% in 2019 before rising to 1.5% in 2020; and the UK unemployment rate remains around 4%, ending the scenario at 3.8% in 2023).
- **2019 ACS**. This scenario is used to help determine the appropriate level of capital banks should have and to test the resilience of the UK banking system to deep simultaneous recessions in the UK and global economies.
    - Three types of severe stress (as in previous exercise), which are assumed to be synchronized, are included: a macroeconomic stress, a traded risk stress, and a misconduct costs stress.
    - Underlying domestic vulnerabilities are broadly unchanged over the past year (e.g. UK GDP falls by 4.7%, unemployment rises peaking at 9.2%, UK residential property price falls by 33%).
    - The stressed outcome for the global economy reflects that a high level of whole-economy debt could point to a more difficult recovery from a stress (e.g. world GDP falls by 4.0%, Chinese GDP falls by 1.2%).
    - The Bank Rate rises to 4% due to the sharp increase in inflation that results from the depreciation in sterling (i.e. £0.91 against the US dollar).
    - The hurdle rates framework for the 2019 ACS is broadly similar to that used in the 2018 test, comprising elements expressed both in terms of risk-weighted CET1 capital ratio and Tier1 leverage ratio (i.e. a 3.25%). The CET1 hurdle rate against which participating banks will be assessed will be comprised of:
        - Each bank's minimum **CET1 capital requirements** (i.e. 4.5% RWAs and any uplift to that minimum requirement set by the Prudential Regulation Authority).
        - Any **systemically buffers** that a G-SIB or D-SIB is required to hold, including the systemic risk buffer (SRB).

Stress testing the UK banking system: 2019 guidance for participating banks and building societies

- **Participating banks**. The 2019 stress test will cover seven major UK banks and building societies (same group of banks that participated in 2018): Barclays, HSBC, Lloyds Banking Group, Nationwide, The Royal Bank of Scotland Group, Santander UK Holdings plc 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.
- **Time horizon and reference date**. The 2019 ACS will cover a five-year horizon with the 31 December 2018 as the reference date. Banks are expected to submit projections as at 31 December for each subsequent year end.

2. Main points (continues)

- **Guidance on modelling risks and income**. This document provides guidance on the following aspects: balance sheet modelling, credit risk and IFRS 9, general credit risk, traded risk, structured finance, interest income and interest expense, other income and costs, operational risks and misconduct costs, pension risk, UK impact, and structural foreign exchange (SFX) risk.
- **Management actions and mandatory distribution restrictions**. Banks should consider what realistic strategic and business-as-usual management actions could be taken in response to the stress scenario; and should submit a description of all material business-as-usual actions.
- **Qualitative review**. In 2019, the BoE will undertake a qualitative review of the effectiveness of the banks' stress-testing framework against the BCBS stress testing principles.

3. Next steps

- The projections data requested should be submitted by participating banks and building societies to the BoE by **14 June 2019**.
- The results of the 2019 ACS will be published in **2019 Q4**.
- Information on the content of the 2019 BES will be published later in **2019**.

10/01/2018

Proposed rule on amendments to the company-run and supervisory stress test rules.

1. Context

In May 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) was enacted in order to introduce amendments to the Dodd-Frank Act as well as to other rules published by the Fed, the FDIC and the OCC. In particular, Section 401 of EGRRCPA amended certain aspects of the stress testing requirements applicable to state member banks set out in the Dodd-Frank Act.

In this context, the Fed has published a **Proposed rule on amendments to the company-run and supervisory stress test rules** that introduce changes to these rules regarding the minimum asset threshold for state member banks, the frequency of stress testing for these banks, the removal of adverse scenarios for state member banks, the removal of adverse scenario for all other stress testing requirements, the review of stress testing processes by board of director, and the review of the scope of applicability of the company-run stress testing requirements for certain savings and loan holding companies.

2. Main points

- **Minimum asset threshold for state member banks**. This Proposed rule amends the Dodd-Frank Act by raising the minimum asset threshold for state member banks required to conduct company-run stress tests from $10 billion to $250 billion. Therefore, only state member banks with total consolidated assets greater than $250 billion would be required to conduct stress tests.
- **Frequency of stress testing for state member banks**. This Proposed rule changes the required frequency to conduct stress test from annual to periodic. In particular, it sets out the following:
    - State member banks with assets greater than $250 billion generally would no longer be required conduct stress tests annually, rather they would be required to conduct stress tests once every other year. Those banks would be required to conduct stress tests in the same even numbered year (i.e. the reporting years for these state member banks would be synchronized).
    - State member banks that are subsidiaries of U.S. global systemically important bank holding companies or bank holding companies that have $700 billion or more in total assets or cross-jurisdictional activity of $75 billion or more would be required to conduct a stress test on an annual basis.
- **Removal of adverse scenario for state member banks**. This Proposed rule removes the adverse stress-testing scenario in the company-run stress test, reducing the number of required scenarios from three to two (i.e. only the baseline and the severely adverse scenario). Because the baseline and severely adverse scenarios are designed to cover the full range of expected and stressful conditions, the adverse stress-testing scenario has provided limited incremental information to the Fed and market participants, and therefore is proposed to remove it.
- **Removal of adverse scenario for all other stress testing requirements**. This Proposed rule removes the adverse scenario from the stress testing requirements applicable to bank holding companies, U.S. intermediate holding companies of foreign banking organizations, and any nonbank financial company supervised by the Fed, consistent with the reasons set forth above.
- **Review of stress testing processes by board of director**. This Proposed rule amends the frequency of reviewing the stress testing processes by the board of directors, or a committee thereof of a state member bank from annual to no less than each year a stress test is conducted in order to make review by the board of directors consistent with the supervised firm's stress testing cycle.
- **Review of the scope of applicability of the company-run stress testing requirements for certain savings and loan holding companies**. This Proposed rule revises the applicability of the company-run stress testing requirements in order to include all savings and loan holding companies that meet the thresholds for either a Category II (e.g. if the banking organization has $700 billion or more in average total consolidated assets) or a Category III (e.g. if the banking organization has $250 billion or more in average total consolidated assets) banking organization of Regulation LL on prudential standards.

3. Next steps

- Comments to this Proposed rule should be submitted by **19 February 2019**.

06/02/2019

- **2019 Supervisory Scenarios for Annual Stress Tests Required under the Dodd-Frank Act Stress Testing Rules and the Capital Plan Rule**
- **Amendments to Policy Statement on the Scenario Design Framework for Stress Testing**
- **Enhanced Disclosure of the Models Used in the Fed's Supervisory Stress Test**
- **Stress Testing Policy Statement**

1. Context

The Fed conducts supervisory stress tests to help ensure that large bank holding companies operating in the US will be able to lend to households and businesses even in a severe recession. The tests are known as the Dodd-Frank Act stress test (DFAST) and the Comprehensive Capital Analysis and Review (CCAR).

The DFAST is a forward-looking assessment of capital adequacy that uses standard assumptions across all firms, whereas the CCAR evaluates the capital planning practices and capital adequacy using the capital distribution actions (e.g. dividend payments) planned by the firms.

In this regard, the Fed has published the **2019 CCAR and DFAST scenarios** to be used by banks and supervisors. Further, the Fed has also published a set of changes that will increase the transparency of its stress testing program for the US largest and most complex banks and will improve public understanding of the program while maintaining its ability to independently test large banks' resilience.

2. Main points

2019 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 1Q19 and extend through 1Q22.
  - Each scenario includes 28 variables (e.g. GDP, stock market prices, and interest rates, etc.), as in the 2018 exercise.
  - Along with the variables, a narrative description of the scenarios that also highlights changes from last year.
- **Supervisory scenarios**.
  - Baseline scenario. It features a moderate economic expansion in the U.S. (e.g. real GDP grows on average between 2% and 2.25% over the scenario period, the unemployment rate falls below to about 3.5% during 2019 and then increases to about 4% in the first half of 2021, etc.), and an expansion in international economic activity.
  - Adverse scenario. It is characterized by a recession in the U.S. (e.g. GDP falls to -4.0% in 2Q19, the unemployment rate peaks at 7% in the 3Q20, 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 period of heightened stress in commercial real estate markets and corporate debt markets. In particular, the U.S. real GDP falls about 8% from its pre-recession peak, reaching a trough in the 3Q20, unemployment rate climbs to a peak of 10% in the 3Q20, etc.
- **Global market shock component**.
  - This component is a set of hypothetical shocks to a large set of risk factors, such as asset prices, interest rates, and spreads, reflecting general market distress and heightened uncertainty.
  - It applies to firms that are subject to the supervisory stress test and that has aggregate trading assets and liabilities of $50 billion or more, or aggregate trading assets and liabilities equal to 10% more of total consolidated assets, and is not a large and noncomplex firm under the Fed's capital plan rule.
- **Counterparty default component**.
  - This component involves the instantaneous and unexpected default of the firm's largest counterparty.
  - Firms with substantial trading or custodial operations will be required to incorporate a counterparty default scenario component into their supervisory adverse and severely adverse stress scenarios for CCAR 2019.

2. Main points (continues)

Amendments to Policy Statement on the Scenario Design Framework for Stress Testing / Enhanced Disclosure of the Models Used in the Fed's Supervisory Stress Test / Stress Testing Policy Statement

- **Amendments to Policy Statement on the scenario design framework for stress testing**. The Fed provides changes to its framework for the design of the annual hypothetical economic scenarios that will provide more information on the hypothetical path of the unemployment rate and will introduce a quantitative guide for the hypothetical path of house prices, among other changes.
- **Enhanced disclosure of the models used in the Fed's supervisory stress test**. The Fed provides significantly more information about the stress testing models used in the CCAR. This information will include:
  - Ranges of loss rates, estimated using the Fed's models, for actual loans held by CCAR firms.
  - Portfolios of hypothetical loans with loss rates estimated by the Fed's models.
  - More detailed descriptions of the Fed's models, such as certain equations and key variables that influence the results of the models.
- **Stress testing Policy Statement**. The Fed sets out this Policy Statement that describes the Fed's approach to model development, implementation, and validation.

3. Next steps

- Banks are required to submit their capital plans and the results of their own stress tests to the Federal Reserve by **April 5 2019**.
- The Fed will announce the results of its supervisory stress tests by **June 30, 2019**.

08/03/2019

- **Comprehensive Capital Analysis and Review 2019 Summary Instructions**
- **Final rule on amendments to the Capital Plan Rule**

1. Context

The Fed's annual Comprehensive Capital Analysis and Review (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.

In this regard, the Fed has released the **2019 CCAR Summary instructions** which provide information regarding the requirements and expectations for CCAR 2019, the stress testing and capital planning cycle. In particular, this document includes information about the Fed's qualitative and quantitative assessments of capital plans submitted by firms in connection with this year's CCAR exercise.

Along with these instructions, the Fed has also published a **Final rule on amendments to the Capital Plan Rule** in order to limit the scope of potential objections to a firm's capital plan on the basis of qualitative deficiencies in the firm's capital planning process (qualitative objection).

2. Main points

Comprehensive Capital Analysis and Review 2019 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 no longer subject to the qualitative assessment and for CCAR 2019, and certain of those firms are not subject to the quantitative assessment. For the 2019 cycle, 18 firms will be subject to the CCAR, with five of those firms subject to a possible qualitative objection.
- **Content**. Similar to previous years, the instructions for CCAR 2019 provide information regarding:
    - 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 a firm's capital plans and planned capital actions
    - Limited adjustments that a firm may make to its planned capital actions
    - Public disclosures by the Fed at the end of the CCAR exercise
- **New elements included in the CCAR 2019 instructions**. The instructions have been updated to reflect changes to certain regulatory and reporting requirements. Thus, among others aspects, the Fed have decided to remove its authority to object to capital plans on qualitative grounds for firms other than those recently subject to CCAR that continue to exhibit material deficiencies in capital planning; and to exempt certain firms with between $100 and $250 billion in assets from CCAR's quantitative assessment in 2019. Moreover, IHCs that have aggregate trading assets and liabilities of $50 billion or more, or equal to or greater than 10% of total consolidated assets become subject to the global market shock and counterparty default scenario.

2. Main points (continues)

Final rule on amendments to the Capital Plan Rule

- **Removal of the Fed's qualitative objection**. This final rule sets out that:
  - The Fed will no longer issue a qualitative objection under the capital plan rule to a firm if: i) it has been subject to a potential qualitative objection for four consecutive years; and ii) It does not receive a qualitative objection in the fourth year of that period.
  - However, if a firm does not pass the qualitative evaluation in its fourth year, it will continue to be subject to a possible qualitative objection until it passes.
- **Issuance of a public capital directive to institutions**. This final rule also establishes that, consistent with the current capital plan rule, if the Fed determines that a firm has unsafe or unsound capital planning processes or the financial condition of the firm is unsafe or unsound, it has the authority to issue publicly a capital directive, in order to reduce capital distributions, and to take other supervisory or public enforcement actions, including an action to address such unsafe or unsound practices or any other conditions or violations of law

3. Next steps

- The 2019 capital plans should be submitted to the Federal Reserve no later than **April 5, 2019**.
- The decisions for all firms participating in CCAR 2019, including the reasons for any objections to a firm's capital plan, will be published by the Fed on or before **June 30, 2019**.
- Regarding the removal of the qualitative objection, the Fed expects no longer issue a qualitative objection to any firm effective **January 1, 2021**.

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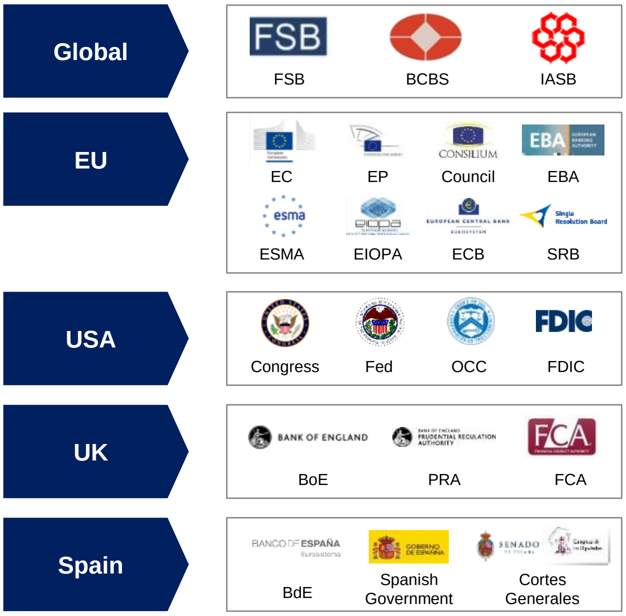

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