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# Regulation Outlook

3Q16

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# Executive summary

**During this quarter, the EBA published the results of the 2016 EU-wide stress test, as well as an information update on how these results inform the SREP. Moreover, the EBA also released several technical standards related to credit risk. Further, the ECB launched a public consultation on guidance to banks on non-performing loans (NPLs). In USA, the Fed proposed to modify its capital plan and stress testing rules.**

## Global publications

- The BCBS published the results of its latest **Basel III monitoring report**. In parallel with this report, the EBA conducted its tenth **report of the CRD IV-CRR/Basel III** on the European banking system. Both exercises allowed gathering aggregate results on capital ratios, leverage ratio (LR), liquidity coverage ratio (LCR) and net stable funding ratio (NSFR).

## European publications

- The EBA published the **results of the 2016 EU-wide stress test**, including aggregate results and granular data for each bank. In this regard, the EBA assessed the potential impact of the adverse scenario on CET1 ratio, LR, net interest income and net total cumulative loss of institutions.
- Before the publication of the stress test results, the EBA released a **document specifying how these results inform the SREP**. Among other aspects, the EBA specifies that competent authorities (CA) may set **capital guidance** above the level of binding capital to cover potential shortfalls in own funds based on the outcomes.
- The EBA also published several technical standards related to credit risk. In particular, the EBA issued consultative guidelines on **credit risk management practices and accounting for expected credit losses**, RTS on the **assessment methodology for the IRB Approach**, guidelines on the **application of the definition of default** and RTS on the **materiality threshold**.

## European publications (continuation)

- Moreover, the EBA published an **interim report on the implementation and design of the MREL**. This document includes recommendations addressed to the European Commission in relation to the legislative proposal that will bring forward implementing TLAC in the EU and reviewing MREL.
- Further, the EBA released guidelines on **remuneration of sales staff**.
- The ECB launched a **public consultation on guidance to banks on NPLs** with the objective of developing a consistent supervisory approach regarding the identification, measurement, management and write-off of NPLs.

## Local publications

- The Bank of Spain approved the **Circular 6/2016**, which specifies the content and format of the “**Información Financiera-PYME**” document and develops the **risk rating methodology and template-model** that must be included in this document.
- In USA, the Fed launched a **public consultation on a proposed rulemaking to modify its capital plan and stress testing rules** for the 2017 cycle. The amendments would apply mainly to ‘large and noncomplex firms’, as defined by the Fed.

# Regulatory projections

***During the next quarter, the BCBS will finalise the calibration of the leverage ratio. Moreover, the BCBS is expected to publish the final standards on the revised standardized approach for credit risk and the final document on constraints to the use of the IRB approach. In Europe, the European Commission will make a proposal to review MREL and introduce TLAC in the EU. In Spain, the Circular 4/2016, which amends Annex IX, will come into force.***

## Regulatory projections

### 1. Next quarter

- **(Europe) October 2016:** the Regulation on the exercise of options and discretions concerning prudential requirements for significant credit institutions will come into force.
- **(Spain) October 2016:** the Circular 4/2016 amending both Circular 4/2004, mainly its Annex IX, and Circular 1/2013, will come into force.
- **(Spain) October 2016:** the Circular 6/2016, which specifies the content and format of the “Información Financiera-PYME” document, will come into force.
- **(Global) November 2016:** the FSB will update the list of global systemically important banks (G-SIBs).
- **(Global) December 2016:** the BCBS will finalise the calibration of the LR.
- **(Global) December 2016:** the BCBS is expected to publish the final standards on the revised standardized approach for credit risk and the final document on constraints to the use of the IRB approach.
- **(Europe) December 2016:** the European Commission will publish a legislative proposal on the review of the MREL and the implementation of the TLAC standard in the EU.
- **(Europe) December 2016:** the EIOPA will publish the EU insurance stress test results.
- **(Europe) December 2016:** the Regulation on key information documents for package retail and insurance-based investment products (PRIIPs) will be applicable.
- **(UK) December 2016:** the Bank of England will publish the results of the 2016 stress test.

### 2. Next year

- **(Europe) January 2017:** the EBA guidelines regarding limits on exposures to shadow banking entities will be applicable.
- **(Europe) April 2017:** the EBA will update the list of other systemically important institutions (O-SIIs), along with the definition of any CET1 capital buffer requirements which may need to be set.
- **(Europe) June 2017:** the EBA guidelines on the LCR disclosure will be applicable.
- **(Europe) June 2017:** the 4<sup>th</sup> Directive on anti-money laundering (AML) shall be implemented by Member States.



### 3. More than a year




- **(Global) December 2017:** some of the new Pillar 3 disclosure requirements will be applicable.
- **(Europe) December 2017:** the EBA guidelines on disclosure requirements will be applicable.
- **(Global) January 2018:** IFRS 9 will have to be implemented.
- **(Global) January 2018:** the NSFR and its disclosure requirements will be applicable.
- **(Global) January 2018:** the revised securitisation framework will come into force.
- **(Global) January 2018:** the LR will migrate to a Pillar 1 minimum capital requirement.
- **(Europe) January 2018:** MiFID II and PSD II shall be implemented by Member States.
- **(USA) January 2018:** the NSFR will be applicable in USA.
- **(Europe) May 2018:** the General Data Protection Regulation will be applicable.
- **(Europe) September 2018:** it is expected that institutions will start reporting under AnaCredit.
- **(Global) December 2018:** the revised standards on IRRBB will be applicable.
- **(Global) January 2019:** the revised market risk framework will be applicable.
- **(Global) January 2019:** G-SIBs not headquartered in an emerging market economy will be required to comply with a minimum TLAC requirement of 16% of risk-weighted assets and 6% of the LR exposure.
- **(UK) March 2019:** the ring-fencing rules will be implemented.
- **(Europe) December 2020:** the EBA guidelines on the definition of default and the RTS on the materiality threshold will be applicable.



# Publications of this quarter

## Summary of outstanding publications of this quarter.

Topic	Title	Date	Page
 <b>Basel Committee on Banking Supervision/ European Banking Authority</b>			
<b>Monitoring Report</b>	<ul style="list-style-type: none"><li>Basel III Monitoring Report.</li><li>EBA CRD IV/CRR Monitoring exercise.</li></ul>	13/09/2016	8
 <b>European Banking Authority</b>			
<b>2016 EU-wide stress test</b>	<ul style="list-style-type: none"><li>Information update on the 2016 EU-wide stress test.</li></ul>	01/07/2016	10
<b>MREL</b>	<ul style="list-style-type: none"><li>Interim Report on the design and implementation of the MREL framework.</li></ul>	19/07/2016	11
<b>IRB Approach</b>	<ul style="list-style-type: none"><li>Final draft RTS on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB Approach.</li></ul>	21/07/2016	12
<b>Credit risk</b>	<ul style="list-style-type: none"><li>Consultation Paper on draft Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses.</li></ul>	26/07/2016	13
<b>2016 EU-wide stress test</b>	<ul style="list-style-type: none"><li>2016 EU-wide stress test results.</li></ul>	29/07/2016	14
<b>Definition of default</b>	<ul style="list-style-type: none"><li>Final Guidelines on the application of the definition of default.</li><li>Final RTS on the materiality threshold for credit obligations past due.</li><li>QIS Report on default definition.</li></ul>	28/09/2016	15
<b>Remuneration policies</b>	<ul style="list-style-type: none"><li>Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services.</li></ul>	28/09/2016	17

Topic	Title	Date	Page
 EUROPEAN CENTRAL BANK EUROSISTEMA	<b>European Central Bank</b>		
<b>Non-performing loans (NPL)</b>	<ul style="list-style-type: none"> <li>• Draft guidance to banks on non-performing loans.</li> <li>• Stocktake of national supervisory practices and legal framework related to NPLs.</li> </ul>	12/09/2016	18
 BANCO DE ESPAÑA Eurosistema	<b>Bank of Spain</b>		
<b>Información Financiera – PYME</b>	<ul style="list-style-type: none"> <li>• Circular 6/2016, de 30 de junio, del Banco de España, a las entidades de crédito y a los establecimientos financieros de crédito, por la que se determinan el contenido y el formato del documento “Información Financiera-PYME” y se especifica la metodología de calificación del riesgo previstos en la Ley 5/2015, de 27 de abril, de fomento de la financiación empresarial.</li> </ul>	11/07/2016	20
	<b>Federal Reserve</b>		
<b>Capital planning and stress testing</b>	<ul style="list-style-type: none"> <li>• Proposed rulemaking on amendments to the capital plan and stress test rules.</li> </ul>	26/09/2016	21

# Publications of this quarter

## Global publications



13/09/2016

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

### 1. Context

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

Both exercises classify banks in Group 1 (comprised of those internationally active banks with a Tier 1 capital exceeding €3billion) and Group 2 (all other banks). For the BCBS exercise a total of 228 banks participated, comprising 100 Group 1 banks and 128 Group 2 banks. In contrast, a total of 227 banks submitted data for the EBA exercise, 45 banks of them from Group 1 and 182 banks from Group 2.

### 2. Main points

- The results are based on data as of **31 December 2015**.
- The main **average results** obtained (assuming full implementation of the Basel III/CRD IV-CRR framework) were:

Organism	Group	CET1 ratio	Capital shortfall*	Shortfall reduction**	LR	LCR	NSFR
BCBS	1	11,8%	0	0%	5,6%	125,2%	113,7%
	2	13,1%	0.2bn€	0%	5,6%	148,1%	115,9%
EBA	1	12,4%	0	100%	4,7%	126,8%	105,5%
	2	13,6%	0.4bn€	-33,3%	5,6%	169,3%	112,7%

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

\*\* Shortfall reduction between June 2015 and December 2015.





# Publications of this quarter

## European publications



01/07/2016

### Information update on the 2016 EU-wide stress test.

#### 1. Context

The objective of the 2016 EU-wide stress test is to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks and the EU banking system to shocks. In particular, this exercise is designed to inform the Supervisory Review and Evaluation Process (SREP) that competent authorities (CAs) will carry out in 2016.

In this context, the EBA has published **additional information on how the results of the EU-wide stress test will inform the SREP**. The objective of this update is on the employment of capital guidance to cover potential shortfalls in own funds based on the outcomes of supervisory stress tests.

This capital guidance does not constitute any form of minimum capital requirement although it should be set above the level of binding capital (minimum and additional) and the combined buffer requirements. Institutions are expected to incorporate it on their risk management frameworks and CAs monitor its fulfillment.

#### 2. Main points

- The 2016 EU-wide stress test **does not contain a pass fail threshold** and is instead designed to be used as a crucial input into the SREP process in 2016.
- The quantitative results of the EU-wide stress test should be used to assess whether the quantity and composition of available own funds would allow under the assumed scenarios an institution to meet the **total SREP capital requirement (TSCR)** and the impact on the **Overall Capital Requirements (OCR)**. The incorporation of these quantitative results into SREP assessments will involve that:
  - The CAs will discuss the quantitative impact of the stress test with the institution and the management actions that may offset some of the impact of the adverse scenario.
  - The CAs will assess the net impact of the stress test on the institution's forward looking capital plans and its capacity to meet applicable own funds requirements (e.g. TSCR).
  - If CAs identify capital shortfalls leading to potential breaches of applicable own funds requirements revealed by the stress tests, they can employ the capital guidance to address their concerns.
  - Some changes may be requested to the institutions' capital plan, such as restrictions on dividends, among others.
  - Additional supervisory monitoring metrics in the form of capital guidance may be included above the combined buffer requirement, taking into account all available capital. When this capital guidance is provided, it will not be included in calculations of the Maximum Distributable Amount (MDA), but CAs would expect banks to meet that guidance unless explicitly agreed.
- The CAs will **monitor the capital guidance** and the way it is integrated into institutions' risk management and capital planning processes.
  - If the qualitative outcomes of the stress test (e.g. deficiencies in risk management and controls, hidden concentrations, etc.) have not been previously factored in the SREP assessment, CAs should revise the conclusions of the main SREP elements.
  - If the quantitative outcomes suggest that there is imminent risk of the institution not being able to meet its TSCR, CAs may consider updating the SREP assessment and reviewing the TSCR.

#### 3. Next steps

- The results of the stress test will be published on **29 July 2016**.



19/07/2016

## Interim Report on the design and implementation of the MREL framework.

### 1. Context

In May 2016, the European Commission (EC) endorsed a Delegated Regulation specifying the criteria relating to the methodology for setting the minimum requirement for own funds and eligible liabilities (MREL). In this regard, the MREL requirement has been set for each bank by the relevant resolution authorities and ensures that sufficient capital and debt instruments are available to absorb the losses of a failing institution and to recapitalise its critical functions.

Following the Bank Recovery and Resolution Directive's (BRRD) mandate, the EBA has published a consultative **interim report on the implementation and design of the MREL** that includes a quantitative assessment on the situation of banks operating in the EU in relation to the MREL requirement as well as a number of provisional recommendations with the objective of providing timely input for a EC's legislative proposal on the implementation of the FSB's total loss absorbing capacity (TLAC) standard in the EU and the review of the MREL.

### 2. Main points

- **Quantitative assessment** of a wide sample of banks (114 banks covering approximately 70% of total EU banking assets): based on the current minimum MREL eligibility criteria, the current average MREL is 13% of total liabilities and own funds (TLOF) or 34% of risk weighted assets (RWAs).
- **Provisional recommendations** relating to the MREL framework:
  - **Reference base for MREL requirement.** It is proposed to change the reference base from TLOF to RWAs and this new reference base should be complemented with a leverage ratio exposure backstop in parallel with the phase-in of the leverage ratio requirement within the capital framework.
  - **Relationship with regulatory requirements.** Banks should prevent CET1 instruments from counting both towards capital buffers and MREL, while considering the implications on maximum distributable amounts (MDA) restrictions on voluntary distributions and the supervisory review and evaluation process (SREP).
  - **Breach on MREL.** Resolution authorities' powers to address breaches of MREL should be strengthened by requiring an accelerated procedure that should allow resolution authorities to act on the basis of a previous assessment of resolvability and to shorten the timeline currently foreseen by the BRRD (4 months).
  - **Adequacy and calibration.** In calibrating MREL, specific business models may be worth considering to the extent that they lead to differences in resolution strategies. Calibration should in all cases be closely linked to and justified by the institution-specific resolution strategy.
  - **Eligibility.** It is recommended to introduce mandatory subordination of MREL eligible liabilities for improving resolvability and contribute to clarity for investors. Subordination requirements should focus on establishing to which other liabilities MREL qualifying liabilities need to be subordinated, rather than specifying the legal form of that subordination (contractual, statutory or structural).
  - **Third country recognition.** Some reduction of the burden of compliance with third country recognition requirements is necessary. This could be achieved by streamlining the requirement to include international recognition clauses in contracts giving rise to bail-inable liabilities.

### 3. Next steps

- Comments to this interim report shall be submitted by **30 August 2016**.
- The EBA will provide the final report to the EC by **31 October 2016**.
- The EC has committed to bringing forward a combined legislative proposal reviewing MREL as well as implementing the FSB's TLAC standard in the EU, by **the end of 2016**.

21/07/2016

## Final draft RTS on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB Approach.

### 1. Context

The CRR contains specific mandates for the EBA to develop draft RTS to specify the assessment methodology competent authorities shall follow in assessing the compliance of an institution with the requirements to use the IRB Approach.

In this context, the EBA has published **the final RTS on assessment methodology for IRB** with the aim of harmonising its implementation across all Member States in the EU. In particular, this document rectifies the issues identified in this regard in the EBA Report on the comparability of the IRB models and provide enhanced clarity on various aspects of the IRB Approach application.

### 2. Main points

- The final **standards** should be considered by competent authorities when:
  - Assessing the institution's compliance with minimum IRB requirements defined in the CRR when the institution applies to:
    - Initially use the IRB Approach.
    - Use the IRB approach for certain types of exposures in accordance with the sequential implementation plan.
    - Implement material changes to the IRB approach.
    - Return to the use of less sophisticated approaches.
  - Assessing the institution's compliance with minimum IRB requirements on an ongoing basis following the regular review of the IRB Approach and review of changes that require notifications from the institution.
- These RTS provide a **mapping** of the minimum IRB requirements into fourteen chapters, which each starts with a brief description of the assessment criteria to be used by competent authorities as regards (i) verification requests and (ii) methods to be used by competent authorities in this context.
- The RTS clarify, among others, the following aspects:
  - The level of independence of the validation function from the credit risk control unit (CRCU) is based on the proportionality principle, therefore the separation requirements are stricter for G-SIIs.
  - Own-LGD estimates should be calculated as the average based on the number of defaults, i.e. default-weighted average.
  - The calculation of the difference between expected loss amounts and credit risk adjustments, additional value adjustments and other own funds reductions should be performed on an aggregate level separately for the portfolio of defaulted exposures and the portfolio of exposures that are not in default.

### 3. Next steps

- These RTS will apply **20 days** after their publication in the Official Journal of the European Union (OJEU).



26/07/2016

## Consultation Paper on draft Guidelines on credit institutions' credit risk management practices and accounting for expected credit losses.

### 1. Context

In December 2015, the BCBS issued supervisory guidance on credit risk and accounting for expected credit losses (ECL) which sets out supervisory expectations for credit institutions related to sound credit risk practices associated with implementing and applying an ECL accounting model.

Building on the BCBS guidance, the EBA has now published a **consultation on draft Guidelines on credit institution's credit risk management practices and accounting for ECL** with the aim of harmonizing the criteria established by the BCBS and ensuring consistent interpretations and practices according to IFRS 9. In particular, this consultative document is structured around four main sections: general considerations; principles on credit risk management and accounting for ECL; specific guidance to credit institutions reporting under IFRS; and supervisory evaluation of credit risk practices, accounting for ECL and capital adequacy.

### 2. Main points

- **General considerations:**
  - Credit institutions should comply with these guidelines considering the principle of proportionality (i.e. appropriate to their size, internal organization and the nature, scope and complexity of their activities), materiality (i.e. it should not be only assessed on the basis of the potential impact on the profit or loss statement) and symmetry (i.e. timely recognition of credit deterioration and allowance without delay).
  - These guidelines do not set out any additional requirements regarding the determination of expected loss for regulatory capital purposes. Rather these guidelines should be read as the supervisory approach to support the appropriate application of IFRS 9.
- **Principles on credit risk management practices and accounting for expected credit losses:** eight principles have been established regarding the following aspects:
  - Management body and senior management responsibilities, e.g. senior management should be responsible for implementing the credit risk strategy approved by the management body and developing the policies and processes.
  - Sound ECL methodologies, e.g. adoption and documentation of sound methodologies for assessing and measuring credit risk on all lending exposures.
  - Credit risk rating and grouping, e.g. establishment of a credit risk rating process to appropriately group lending exposures on the basis of shared credit risk characteristics.
  - Adequacy of the allowance, e.g. determination of an aggregate amount of allowances which should be adequate and consistent with the objectives of the applicable accounting framework.
  - ECL model validation, e.g. definition of policies and procedures to validate models used to assess and measure expected credit losses.
  - Use of experienced credit judgement in the assessment and measurement of ECL, especially in the consideration of forward-looking information.
  - Common processes, systems, tools and data, e.g. establishment of a credit risk assessment process that provides a strong basis for common systems, tools and data to assess credit risk, and account for ECL.
  - Disclosure, e.g. promotion of transparency and comparability through public disclosures.
- **Specific guidance to credit institutions reporting under IFRS.**
  - Some considerations have been provided on three aspects of the ECL requirements regarding the impairment sections of IFRS 9: (i) the loss allowance at an amount equal to 12-month ECL; (ii) the assessment of significant increases in credit risk; and (iii) the use of practical expedients.
- **Supervisory evaluation of credit risk practices, accounting for expected credit losses and capital adequacy:**
  - Periodic evaluation of the effectiveness of a credit institution's credit risk practices.
  - Assessment of the methods employed by a credit institution to determine allowances and their measurement of ECL under the applicable accounting framework.
  - Consideration of a credit institution's credit risk practices when assessing a credit institution's capital adequacy.

### 3. Next steps

- Comments to this consultative document shall be submitted by **26 October 2016**.
- These guidelines should be implemented by **1 January 2018**.



29/07/2016

## 2016 EU-wide stress test results.

### 1. Context

The objective of the 2016 EU-wide stress test is to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks and the EU banking system to shocks. In particular, this exercise is designed to inform the Supervisory Review and Evaluation Process (SREP) that competent authorities (CAs) will carry out in 2016.

In this context, the EBA has published the **aggregate results of the 2016 EU-wide stress test and granular data for each bank**. In particular, this document assesses the results relative to the potential impact on CET1 phase-in and fully loaded capital ratio, leverage ratio, net interest income (NII) as well as net total cumulative loss, for both base and adverse scenarios.

### 2. Main points

- **Sample of banks:** 51 EU banks have participated in 2016 (124 EU banks participated in 2014), covering around 70% of the national banking sector in the EU.
- **Results:**
  - Transitional CET1 capital ratio: the EU banking sector registered 1,238 bn€ of CET1 or a weighted average CET1 capital ratio of 13.2 % as of end-2015. The impact of the adverse scenario is -269 bn€ or -380bps, bringing the aggregate ratio to 9.4% at the end of 2018.
    - Impact of credit risk: aggregate cumulative credit losses over the three years of the exercise in the adverse scenario are 349 bn€ (-370bps impact on the CET1 capital ratio).
    - Impact of market risk: aggregate cumulative market risk losses over the three years of the exercise in the adverse scenario across all portfolios including counterparty credit risk (CRR) account for 98 bn€ (-100bps impact on the CET1 capital ratio).
    - Impact of operational risk: aggregate cumulative operational risk losses over the three years of the exercise in the adverse scenario are 105 bn€, including conduct risk losses of 71 bn€ (-110 bps impact on the CET1 capital ratio).
  - Fully load CET1 capital ratio: the aggregate impact on a fully loaded basis is lower, from 12.6% in 2015 to 9.2% in 2018.
  - Transitional leverage ratio: the aggregate ratio decreases from 5.2% at the end of 2015 to 4.2% at the end of 2018.
  - Net interest income: aggregate NII in the sample falls by 68 bn€ or 20%, from 335 bn€ at the end of 2015 to 267 bn€ at the end of 2018.
  - Net total cumulative loss: the aggregate loss over the three years is 90 bn€, excluding €91bn of market risk losses directly recognised in capital.

### 3. Next steps

- The stress test will be an important input into the SREP in 2016. However, the focus in **2016** will be on setting **Pillar 2 Guidance** to banks to maintain capital that can support the process of repair and lending into the real economy.





28/09/2016

- **Final Guidelines on the application of the definition of default.**
- **Final RTS on the materiality threshold for credit obligations past due.**
- **QIS Report on default definition.**

## 1. Context

The CRR establishes the definition of default of an obligor that is used for the purpose of the IRB Approach and for the Standardised Approach for credit risk. However, in the absence of specific rules in this regard, the EBA has identified differing practices used by institutions when applying the definition of default.

In this context, the EBA has published **Final Guidelines (GL) specifying the application of the definition of default**, which clarify aspects such as the days past due criterion, the indications of unlikelihood to pay, etc.; and **Final RTS on the materiality threshold of past due credit obligations**, which specify the conditions for setting the materiality threshold for credit obligations. Both the Guidelines and the final draft RTS will harmonise the definition of default across the EU.

Along with the GL and the RTS, the EBA has published the **results of a Quantitative Impact Study (QIS)** aimed at assessing the impact on the regulatory capital requirements of selected policy options to harmonise the definition of default.

## 2. Main points

### Final Guidelines on the application of the definition of default

- **Past due criterion.** The GL clarify, among others, aspects with regard to:
  - Counting of days past due: in the case the credit arrangements allow the client to change the schedule, suspend or postpone the payments, the changed, suspended or postponed instalments should not be considered past due.
  - Exposures to central governments, local authorities and public sector entities: in many cases the repayment is dependent on the completion of certain administrative procedures. It has been specified that if the delay in payments results only from these procedures, default may not be recognized until any material credit obligation of such obligors is 180 days past due.
  - Materiality threshold: it has been specified that institutions may use lower thresholds than those specified by competent authorities (CAs), as additional indications of unlikelihood to pay.
- **Indications of unlikelihood to pay.** The GL provide clarification regarding the application of each indication of unlikelihood to pay, such as bankruptcy or distressed restructuring, among others.
- **Application of the definition of default in external data.** The GL specify that the requirements on external data apply only to institutions that use the IRB approach and use such data for estimating risk parameters.
- **Criteria for the return to a non-defaulted status.** The probation period and the minimum conditions for reclassification to a non-defaulted status have been specified, including a specific probation period and specific conditions applying to loans under distressed restructuring (e.g. payments have been made regularly according to the schedule, there are no past due credit obligations, etc.).
- **Consistency of the application of the definition of default.** It has been clarified that in some situations institutions may use different definitions of default for certain types of exposures (e.g. different geographical locations), although the differences have to be justified.
- **Application of the definition of default for retail exposures.** The GL clarify aspects with regard to the level of application of the definition of default (e.g. it may be applied at level of an individual credit facility); the pulling effect (e.g. institutions may define a threshold in terms of a percentage of the total credit obligations of an obligor as an additional indication of unlikelihood to pay); and the materiality threshold for joint exposures (i.e. exposures to a group of individual obligors).
- **Documentation and internal governance.** The GL specify that the documentation related to the application of the definition of default should include a description of the operationalization of all indications of default; and requirements with regard to internal governance have been clarified for institutions that use the IRB Approach (e.g. definition of default approved by the management body, or by a committee designated by it, and by senior management).

### Final RTS on the materiality threshold for credit obligations past due

- CAs are required to set a materiality threshold that is composed of both:
  - **An absolute threshold**, which refers to the sum of all past due amounts related to the credit obligations of the borrower towards the institution, the parent undertaking or any of its subsidiaries.
    - For retail exposures, the absolute threshold cannot be higher than 100€.
    - For non-retail exposures, the absolute threshold cannot be higher than 500€.
  - **A relative threshold**, which is defined as a percentage of a credit obligation past due in relation to the total on-balance-sheet exposures to the obligor excluding equity exposures.
    - For both retail and non-retail exposures, the relative threshold should be set at the level of 1%. Nonetheless, if a CA considers that this level does not reflect a reasonable level of risk it may set a relative threshold at a different level, which in any case must be lower than or equal to 2.5%.
- In the case where **both of those limits** are **breached** for 90 consecutive days (or 180 days if the CA has decided to replace it in accordance with the CRR) a **default** would be considered to have occurred.
- In the course of setting the threshold, CAs shall take into account the **risk characteristics** of retail and non-retail exposures.

### **3. Next steps**

- The implementation of the Guidelines and of the RTS is expected **at the latest by end-2020**.
- In the case of IRB banks, the implementation should be based on individual plans agreed between institutions and their CAs.



28/09/2016

## Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services.

### 1. Context

Developments in recent years, both at a European and international level, have shown significant cases of misconduct and mis-selling by staff in financial institutions, with poor remuneration policies and practices having been identified as a key underlying driver.

In this regard, the EBA has published **final Guidelines (GL) on remuneration of sales staff**. In particular, these GL specify requirements for the design and implementation of remuneration policies and practices, in relation to the offering or provision of retail banking products and services to consumers by institutions, with a view to protecting consumers.

The GL apply to remuneration paid to staff employed by credit institutions, creditors, credit intermediaries, payment institutions and electronic money institutions, when providing deposits, payment accounts, payment services, electronic money, residential mortgages, and other forms of credit to consumers. Moreover, competent authorities (CAs) may extend the scope applying the GL also in relation to persons other than consumers (e.g. SMEs).

### 2. Main points

- **Design of remuneration policies and practices.** Among other aspects, the GL specify that:
  - Institutions should design and implement remuneration policies and practices that take into account the rights and interests of consumers.
  - The human resources function of institutions should participate in the design of the remuneration policies and practices. In addition, the risk management and compliance functions should provide effective input.
  - Institutions should consider both qualitative and quantitative criteria for determining the level of variable remuneration.
  - Institutions should ensure that the ratio between the fixed and variable components of the remuneration is appropriately balanced.
- **Documentation, notification and accessibility.** The GL include the following aspects:
  - Institutions should document remuneration policies and practices, keep them for audit purposes for at least 5 years, and make them available to CAs upon request.
  - Relevant persons (i.e. any natural person working for an institution and directly offering or providing banking products or services to consumers, or working for an institution and managing sales staff) should be clearly informed in a simple and transparent manner of the remuneration policies and practices that are applicable to them, before being allowed to offer banking products or services to consumers.
  - The remuneration policies and practices should be easily accessible to all relevant persons of the institution.
- **Approval.** The GL specify the following aspects:
  - The management body approves and retains ultimate responsibility for the institution's remuneration policies and practices.
  - The management body should seek advice from the remuneration committee.
  - The compliance function should confirm that policies and practices comply with the GL.
- **Monitoring.** The GL specify that:
  - Institutions should review, at least annually, their remuneration policies and practices. Where the review reveals that an institution's policies and practices do not operate as intended, the institution should amend them.
  - Institutions should establish effective controls to check that the remuneration policies and practices are being adhered to.

### 3. Next steps

- The Guidelines apply from **13 January 2018**.



12/09/2016

- **Draft guidance to banks on non-performing loans**
- **Stocktake of national supervisory practices and legal framework related to NPLs**

## 1. Context

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

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

Moreover, a stocktake of national practices on NPLs has also been made available along with the guidance.

## Main points

- **Level of application:** the guidance is applicable to all significant institutions supervised directly under ECB banking supervision, including their international subsidiaries. The guidance is non-binding, although deviations should be explained upon supervisory request.
- **Scope:** the guidance addresses all non-performing exposures (NPEs) following the EBA definition, as well as foreclosed assets and performing exposures with an elevated risk of turning non-performing.
- **Recommendations and best practices:**
  - **NPL strategy.** To develop, implement and embed a fit strategy banks should:
    - Assess and review their operating environment (e.g. internal capabilities, external conditions, capital implications, etc.).
    - Develop the NPL strategy, including targets in terms of development of operational capabilities (qualitative) and projected NPL reductions (quantitative) over the short, medium and long-term time horizons.
    - Implement operational plans (including investments, staffing, etc.).
    - Fully embed NPL strategy into the management processes of the bank (e.g. NPL strategy aligned with and integrated into the ICAAP).
    - Provide an annual summary of NPL strategy and targets to the ECB.
  - **Governance and operations.** To address NPL issues in an efficient way:
    - The management body should annually approve the NPL strategy and the operational plan, oversee the implementation of the NPL strategy, etc.
    - Banks should establish: (i) separate and dedicated NPL workouts units; (ii) a control framework that clearly assign roles across all three lines of defence; (iii) a monitoring framework by setting key performance indicators (KPIs) to measure progress on NPL; and (iv) an early warning process (i.e. adequate internal procedures and reporting to identify and non-performing clients at a very early stage).
  - **Forbearance.** Guidance is provided regarding viability of forbearance solutions; forbearance processes (e.g. using standardized forbearance products); and supervisory reporting and public disclosure (e.g. disclosing credit quality of forborne exposures). This guidance is not related to forbearance classification.
  - **NPL recognition.** Banks should, among others:
    - Implement the EBA's definition of NPE.
    - Align regulatory and accounting definitions.
    - Use the EBA ITS on supervisory reporting for NPEs and forbearance.

- NPL impairment measurement and write-offs. A set of best practices on NPL impairment recognition that banks should apply are provided, with regard to individual and collective estimations of provisions (e.g. defining criteria for exposures requiring individual assessment of provisions); furthers aspects to provisioning and write-off (e.g. fostering timely provisioning and write-off through internal policies); and documentation, reporting and disclosure (e.g. keeping sufficient level of documentation detailing provisioning methodology and parameters). These best practices are consistent with the Guidance on accounting for expected credit losses published by the BCBS.
- Collateral valuation of immovable property. Guidance is provided regarding governance, procedures and controls (e.g. independent control process for appointment of appraisers, for back-testing of valuations, etc.); frequency and methodology of valuations (e.g. updating valuations for all NPL collateral at least annually); valuation of foreclosed assets (e.g. banks should apply IFRS 5); and disclosure (e.g. disclosure of NPL collateral and foreclosed assets separately).

### 3. Next steps

- Comments to this guidance shall be submitted by **15 November 2016**.

# Publications of this quarter

## Local publications

11/07/2016

**Circular 6/2016, de 30 de junio, del Banco de España, a las entidades de crédito y a los establecimientos financieros de crédito, por la que se determinan el contenido y el formato del documento “Información Financiera-PYME” y se especifica la metodología de calificación del riesgo previstos en la Ley 5/2015, de 27 de abril, de fomento de la financiación empresarial.**

### 1. Context

In April 2015, the Ley 5/2015 de fomento de la financiación empresarial was approved with the objective of improving and encouraging funding of SMEs. The regulation states that institutions must notify with three months' notice their decision to cancel or significantly reduce financing to their SME customers and self-employed workers. Institutions must also deliver the “Información Financiera-PYME” document to their customers, which contains information on the financial condition, payment history and risk rating of the borrower.

In this context, the Bank of Spain (BdE) has published the Circular 6/2016 which specifies the content and format of the “**Información Financiera-PYME**” document and develops the **risk rating methodology and template-model** that must be included in this document. The BdE has also published three annexes that include the template-model document, instructions for developing the credit history section as well as data on the relative position of the borrower within its sector.

### 2. Main points

- **Scope:** credit institutions and specialised credit institutions based in Spain, as well as the activities performed in Spain by credit institutions based in other countries.
- **Content of the “Información Financiera-PYME” document:**
  - Data submissions to the Central de Información de Riesgos (CIR) of the Bank of Spain. It will include the last four monthly data submissions of the borrowers and those corresponding to the end of each quarter of the last five previous years to the notification or request date.
  - Data provided by the institution to companies providing information services on creditworthiness and credit. It will include the reported data on the borrowers that are still recorded in the correspondent registers of such companies at the notification or request date.
  - Credit history. It will contain the credit history of the previous 5 years to the notification or request date and it will cover: a list of historical and current loans, and the amounts pending of repayment; a chronological list of unpaid obligations with their details; a statement on the current situation of default; a list of bankruptcy proceedings, refinancing agreements, etc.; and a list of insurance contracts linked to the financial flow.
  - Statement on the movements during the past year within the financial flow contracts of the borrower.
  - Borrower's risk rating. Institutions must incorporate the borrower's risk rating calculated through the application of the provided methodology described below.
- **Risk rating methodology.** The borrower's risk rating will be low risk, medium-low risk, medium-high risk, high risk and not available depending on the following variables:
  - Financial condition of the borrower: assessed through the analysis of its financial statements. In the case of SMEs, entities shall use, in general terms, the latest financial statements deposited in the Registro Mercantil.
  - Qualitative variables: analysis of the number of years during which the borrower's has been a customer of the institution, years during which the business has been operating, and the economic sector where it operates.
  - Behavioral variables: assessment of the evolution of the borrower's behavior and analysis of overdue positions, frequency and recurrence of defaults, uncovered positions and positions exceeding the credit limit, and variables obtained from the CIR of the Bank of Spain.

### 3. Next steps

- This Circular shall enter into force **3 months** after its publication in the Boletín Oficial del Estado.
- Until there are 5 years of available data submissions to the CIR, the data submissions included in the document "information financial-SME" will be those beginning from 30 June 2015, inclusive, and will be provided according to this Circular.





26/09/2016

## Proposed rulemaking on amendments to the capital plan and stress test rules.

### 1. Context

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

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

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

### 2. Main points

- **Definition of 'large and noncomplex firm'**. A BHC or U.S. IHC with total consolidated assets of \$50 billion or greater but less than \$250 billion, on-balance sheet foreign exposure of less than \$10 billion, and nonbank assets of less than \$75 billion.
- **Amendments applying to large and noncomplex firms**. The proposal would:
  - Remove the qualitative assessment of CCAR for these firms. Instead, the qualitative assessment would be conducted outside of CCAR through the supervisory review process. These firms would remain subject to a quantitative assessment in CCAR.
  - Modify certain regulatory reporting requirements to collect less detailed information on these firm's stress test results and raise materiality threshold for reporting on specific portfolios.
  - Amend the Parent Company Only Financial Statements for Large Holding Companies (FR Y-9LP) to include a new line item for purposes of identifying the large and noncomplex firms.
- **General amendments applying to firms with more than \$50 billion in total consolidated assets**. The proposal would:
  - Simplify the timing of the initial applicability of the capital plan and stress test rules. In particular, the cutoff date for the capital plan rule would be moved to September 30, instead of December 31 (a firm that crosses the \$50 bn asset threshold in the fourth quarter would not have to submit a capital plan until April 5 of the second year after it crosses the threshold).
  - Revise the amount of capital that any firm subject to the quantitative requirements of CCAR can distribute to shareholders outside of an approved capital plan without seeking prior approval from the Fed ('de minimis exception'). In particular, it would:
    - Decrease the 'de minimis exception' amount from 1% of the firm's tier 1 capital to 0.25%.
    - Establish a blackout period (i.e. the second quarter of the year), during which firms would not be able to submit a notice to use the 'de minimis exception'.
  - Regarding the trading and counterparty component of the stress test, extend the range of dates from which the Fed may select the as-of date for the global market shock from October 1 of the calendar year preceding the year of the stress test cycle to March 1 of the calendar year of the stress test cycle.

### 3. Next steps

- Comments to this proposed rule shall be submitted by **25 November 2016**.
- The proposed amendments would take effect for the **2017 CCAR**, once the final rule has been published.

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