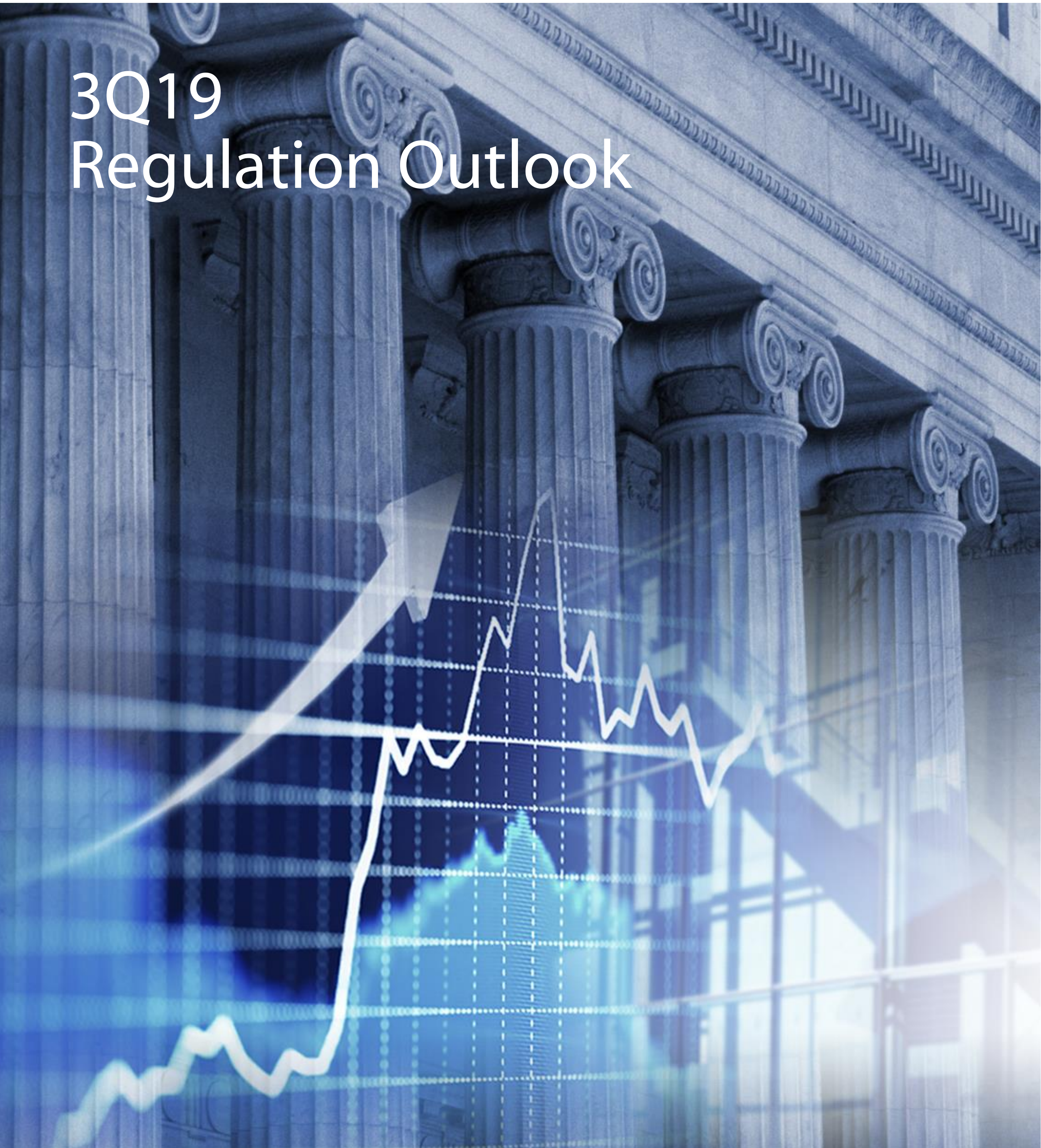
3Q19
Regulation Outlook



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Executive summary

In the third quarter of 2019, the publication of the ECB Guide to internal models on the risk-type-specific issues stands out. Further, the EBA published three CPs on RTS on the new internal model approach (IMA) under the FRTB and the IFRS 9 benchmarking exercise. In Spain, the Bank of Spain issued Draft Circular amending Circular 4/2017, that adapt the rules and annexes which set out the confidential statements that credit institutions should submit to the European Regulation formats.

European publications

- At European level, the ECB published the **Guide to internal models**, which updates the risk-type-specific chapters of the Guide to the TRIM. In particular, this Guide covers credit, market and counterparty credit risks and aims at ensuring a common and consistent approach to the most relevant aspects of the applicable regulations on internal models for banks supervised by the ECB.
- Moreover, the ECB published a **Communication on supervisory coverage expectations for NPEs** in order to introduce some adjustments to its supervisory expectations for prudential provisioning for new NPEs, specified in the Addendum to the ECB Guide on internal models, that will enhance the consistency and simplicity of the overall approach to NPEs.
- The EBA published three **Consultation Paper (CPs) on RTS on the new internal model approach (IMA) under the FRTB** in order to specify essential aspects of this method and contribute to a smooth and harmonised implementation of the FRTB in the EU. In particular, these documents are the CP RTS on liquidity horizons, the CP RTS on back-testing and profit and loss attribution (PLA) requirements and the CP RTS on criteria to assess the modellability of risk factors under the IMA.
- Regarding Basel III and IFRS 9, the EBA published a **new Basel III implementation assessment**, which includes a quantitative impact study (QIS), and a comprehensive set of policy recommendations in the area of credit and operational risk, output floor and securities financing transactions (SFTs); as well as an **IFRS 9 benchmarking exercise** on a sample of institutions aimed at analysing the different modelling practices followed by institutions and how IFRS 9 implementation impacts the amount of expected credit losses (ECL) in terms of own funds and regulatory ratios.
- The ESMA published the **Final Guidelines (GL) on liquidity stress test in Alternative Investment Funds (AIFs) and Undertakings for the Collective Investment in Transferable Securities (UCITS)**, applied to managers, depositaries and national competent authorities (NCAs).

Local publications

- In Spain, the Bank of Spain (BdE) published a **Draft Circular amending Circular 4/2017**, addressed to credit institutions, with the aim to adapt the rules and annexes that set out the confidential statements that credit institutions should submit to the BdE in order to adequate the formats of these statements to the amendments included in the European Commission (EC) Implementing Regulation (EU) 680/2014, laying down ITS with regard to supervisory reporting of institutions, and ECB Regulation (EU) 534/2015 on reporting of supervisory financial information.
- In USA, the Fed, the FDIC, and the OCC published the **Final rule on simplifications to the Capital Rule**, which applies solely to banking organizations that are not subject to the advanced approaches capital rule (i.e. in general those firms with less than $250 billion in total consolidated assets and less than $10 billion in total foreign exposure), and simplifies the capital treatment for MSAs, temporary difference DTAs, investments in the capital instruments of unconsolidated financial institutions, and minority interest.
- Further, the Fed, the OCC, the FDIC, the SEC and the CFT published the **Final Rule on revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds,** which is intended to streamline the Volcker Rule by eliminating or modifying requirements that are not necessary to effectively implement its statute, without diminishing the safety and soundness of banking entities.
- In UK, the PRA published **a CP 21/19 on credit risk: Probability of Default and Loss Given Default estimation**, in order to update the Supervisory Statement 11/13 on Internal Rating Based (IRB) which, among others, introduces proposals on the compliance with the EBA roadmap for IRB, and the cyclicality of downturn LGD estimates; and a **Supervisory Statement (SS) 5/19 on liquidity risk management for insurers**.

Regulatory projections

At international level, the FSB will update the list of G-SIBs and the BCBS will assess the G-SIBs' progress in adopting the RDA&RR principles. At European level, the ECB will start publishing the €STR, and the EBA Final GL on disclosure of NPE and FBE will be applicable. In UK, the Bank of England (BoE) will publish the 2019 annual cyclical scenario (ACS) stress test results.

Regulatory projections

1. Next quarter

- **(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.
- **(Europe) December 2019**: the EBA GL on disclosure of NPE and FBE will be applicable.
- **(UK) December 2019**: the BoE will publish the 2019 ACS stress test results.

2. Next year

- **(Europe) January 2020**: the EU new anti-money laundering directive will enter into force (AML V).
- **(Europe) January 2020**: it is expected that the Delegated Regulation of the EC on ITS on the reporting of intra-group transactions and risk concentration for financial conglomerates will be applicable.
- **(Europe) January 2020**: the EBA 2020 EU-wide stress test will be launched.
- **(Spain) January 2020**: the Circular of the BdE addressed to SLIs on public and confidential information rules and formats will enter into force.
- **(USA) January 2020**: the Final Rule to simplify and tailor compliance requirements relating to the Volcker Rule will be effective.
- **(Europe) March 2020**: the EBA Final RTS on the IMA under the FRTB will be published.
- **USA) April 2020**: the Fed, OCC and the FDIC Final Rule on simplifications to the Capital Rule will be effective.
- **(Europe) July 2020**: the results of the EBA 2020 EU-wide stress test results will be published.
- **(Europe) September 2020**: the ESMA Final GL on liquidity stress testing in UCITS and AIFs will apply.

3. More than a year

- **(Global) December 2020**: the BCBS GL on step-in risk will be applicable.
- **(Europe) December 2020**: the ECB Regulation (EU) 2018/1845 on the materiality threshold for credit obligations past due will be applicable.
- **(Spain) December 2020**: the BdE Circular on the materiality threshold for credit obligations past due will be applicable.
- **(Europe) January 2021**: the EBA GL on the new definition of default 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.
- **(Europe) June 2021**: the CRR II of the EP and the Council will be applicable with certain exceptions.
- **(Europe) July 2021**: the amendments introduced by the CRR II which have an impact on the ECB Guide on internal models will apply.
- **(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.
- **(Europe) January 2022**: the EBA GL on IRB parameters estimation will be applicable.
- **(Europe) January 2022**: the EBA final RTS on an economic downturn as well as the GL for the estimation of LGD appropriate for an economic downturn will be applicable.
- **(Europe) January 2022**: the EBA GL on credit risk mitigation (CRM) for institutions applying the advanced internal rating-based (A-IRB) approach will be applicable.
- **(Global) January 2022**: most of the new disclosure requirements of the BCBS Pillar III updated framework will have to be implemented.
- **(UK) January 2022**: the PRA will require firms to comply with an end-state MREL.
- **(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

Topic	Title	Date	Page
	European Central Bank		
Internal models	• Guide to internal models – Risk-type-specific chapters	09/07/2019	8
NPEs	• Communication on supervisory coverage expectations for NPEs	06/09/2019	10
	European Banking Authority		
Market risk	• Consultation Paper on RTS on liquidity horizons for the Internal Model Approach (IMA) under points (a) to (d) of article 325bd(7) of the CRR II • Consultation Paper on RTS on back-testing requirements under article 325bf(9) and profit and loss attribution requirements under article 325bg(4) of the CRR II • Consultation Paper on RTS on criteria assessing the modellability of risk factors under the Internal Model Approach (IMA) under article 325be(3) of the CRR II • Roadmap for the new market and counterparty credit risk approaches	01/07/2019	11
Basel III	• Basel III implementation assessment	03/07/2019	13
IFRS 9	• Roadmap for IFRS 9 deliverables	25/07/2019	15
	European Securities and Markets Authority		
Liquidity stress testing	• Final Guidelines on liquidity stress testing in UCITS and AIFs	10/09/2019	16
	Bank of Spain		
IFRS 17	• Proyecto de Circular, entidades de crédito, que modifica la Circular 4/2017, a entidades de crédito, sobre normas de información financiera pública y reservada, y modelos de estados financieros • Anejo	26/07/2019	18
	Federal Reserve / Federal Deposit Insurance Corporation / Office of the Comptroller of the Currency		
Capital rule	• Final rule on simplifications to the Capital Rule	10/07/2019	19
	Federal Reserve / Federal Deposit Insurance Corporation / Office of the Comptroller of the Currency / Securities Exchange Commission / Commodity Futures Trading Commission		
Volcker Rule	• Final Rule on revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds	12/09/2019	20
	Prudential Regulation Authority		
Credit risk	• Consultation Paper 21/19 on credit risk: Probability of Default and Loss Given Default estimation	20/09/2019	21
Liquidity Risk management	• Supervisory Statement 5/19 on liquidity risk management for insurers	25/09/2019	22

09/07/2019
Guide to internal models – Risk-type-specific chapters.

1. Context

In February 2017, the ECB issued a Guide to the Targeted Review of Internal Models (TRIM) addressed to the management of significant institutions, which sets out its view on the appropriate supervisory practices and spells out how the ECB intends to interpret the relevant EU law on internal models and on general model governance topics. The Guide to the TRIM covers four main chapters: general topics, credit risk, market risk, and counterparty credit risk. In November 2018 the ECB published a Guide to internal models (general aspects), which covers the update of the first chapter of the Guide to the TRIM.

In this context, following the consultation launched in September 2018, the ECB has published the Guide to internal models, which updates the risk-type-specific chapters of the Guide to the TRIM. In particular, this Guide covers credit risk, market risk and counterparty credit risk and aims at ensuring a common and consistent approach to the most relevant aspects of the applicable regulations on internal models for banks directly supervised by the ECB.

In this updated version of the ECB Guide to internal models the section on data quality, which was included in the general topics chapter, has now been moved to the credit risk chapter, and the credit risk chapter has been modified and completed. Further, the content of several sections on market and counterparty credit risks have been clarified and completed.

2. Main points

- **Credit risk**. This Guide provides transparency on how the ECB understands a set of topics related to internal models used for the IRB approach, aligned with the Final Guidelines on PD and LGD estimation and the treatment of defaulted exposures (EBA/GL/2017/16) and includes references to the following aspects:
  - Data maintenance for the IRB approach, which covers IT systems (infrastructure and implementation testing); policies, roles and responsibilities in data processing and data quality management; and components of the data quality management framework.
  - Use of data, which covers the use of external data, use of external bureau scores, or the use of human judgement, among others.
  - Probability of default (PD), which covers the structure of PD-models (including risk differentiation) and PD risk quantification. Certain sections have been completed (e.g. calculation of the default rate or use of PD direct estimates), and other possible treatments have been included (e.g. PD quantification based on mapping to external grades).
  - Loss given default (LGD), which covers the concept of realised LGD, long-run LGD, downturn LGD, its structure, risk quantification, and the estimation of EL_{BE} and LGD in-default. The structure of the previous version is maintained although the most of sections have been completed.
  - Credit conversion factors (CCF), which covers the commitments, unadvised limits and scope of application of the CCFs; the realised CCFs; its structure and risk quantification. The structure and the content of this section have been revised.
  - Others aspects, such as the model-related margin of conservatism (MoC), whose framework has been adapted to the EBA Final Guidelines on PD and LGD; the review of estimates; and the calculation of maturity for non-retail exposures.
- **Market risk**. This Guide provides transparency on how the ECB understands a set of topics related to internal models used in the calculation of own funds requirements for market risk, including:
  - Scope of the internal model approach (IMA), which covers the delimitation of the regulatory trading book, treatment of banking book positions, or partial use models, among others.
  - Regulatory back-testing of value at risk (VaR) models, which covers, among others, its scope of application; historical period used to perform back-testing, definition of business days, and documentation; calculation of actual P&L; or valuation adjustments.
  - Aspects of internal validation of market risk models, which covers those aspects related to the frequency of internal validation, internal back-testing of VaR models, or the tests to be performed in internal back-testing.
  - Methodology for VaR and stressed VaR, which covers, among others, general requirements; data inputs, length of the time series used to calibrate VaR and sVaR, and quantile estimation; or data quality.
  - Methodology for incremental default and migration risk charge (IRC) models focusing on default risk, which covers aspects related to data inputs; distributions and correlation assumptions; or ratings, probabilities of default and recovery rate assumptions.
  - Risks not in the model engines (RNIME), which covers its identification, quantification, as well as its management and implementation in an institution.

2. Main points (continues)

- **Counterparty credit risk**. This Guide provides transparency on how the ECB understands a set of topics related to the principles defined for the Internal Model Method (IMM), including:
  - Trade coverage, which covers different types of treatment for IMM transactions for which the related exposure is not fully simulated, and the principles for ECB banking supervision.
  - Margin period of risk (MPOR) and cash flows, which covers the treatment of margin call and trade-related cash flows in all currencies, among other aspects.
  - Collateral modelling, which mainly covers the modelling of cash and non-cash collateral.
  - Modelling of Initial Margin (IM), which covers its implementation under the IMM.
  - Maturity, which covers the estimation of the parameter M used in the calculation of RW for counterparties.
  - Granularity, number of time steps and scenarios, which covers, the chosen time grid for the future exposure calculation and the number of scenarios generated.
  - Other aspects, such as the calibration frequency and stress calibration; validation, effective expected positive exposure (EEPE), and the alpha parameter.

3. Next steps

- This Guide is not intended to replace, overrule, or affect applicable EU and national law.
- The legal references in this Guide to the CRR provisions are references to the CRR before the amendments introduced by Regulation (EU) 2019/876 (CRR II). The amendments introduced by the CRR II which have an impact on the Guide will only apply from **July 2021**.

EUROPEAN CENTRAL BANK
EUROSYSTEM

06/09/2019
Communication on supervisory coverage expectations for NPEs.

1. Context

In March 2017, the ECB issued a Guidance to banks on non-performing loans (NPLs) which requires high NPL banks to develop their own strategies to address NPL stocks; and in March 2018, it also published an Addendum to the ECB NPL Guidance that sets out supervisory expectations for prudential provisioning for new NPEs. At the end of 2018, the EBA also issued two Guidelines (GLs) on management of NPEs and forborne exposure (FBEs) and on disclosure of NPE and FBEs. Furthermore, in April 2019 the European Parliament (EP) and the Council published the Regulation (EU) 2019/630 amending the CRR as regards minimum loss coverage for NPE, with the aim to complement the existing prudential rules in the CRR relating to own funds with provisions requiring a deduction from own funds where NPEs are not sufficiently covered by provisions or other adjustments.

In this context, the ECB has published a Communication on supervisory coverage expectations for NPEs in order to introduce some adjustments to its supervisory expectations for prudential provisioning for new NPEs, specified in the Addendum, that will enhance the consistency and simplicity of the overall approach to NPEs.

In particular, this document aims to: i) clarify aspects relating to the EBA NPE-related GL; (ii) provide further details regarding the ECB's supervisory expectations for provisioning of NPE stock, (iii) clarify the interaction between the ECB's NPE coverage expectations under Pillar 2 and the Pillar 1 prudential NPE rules, and (iv) summarise adjustments to the Pillar 2 approach in respect of supervisory expectations for prudential provisioning for new NPEs in scope of the Addendum.

2. Main points

- **Aspects relating to the EBA GL on NPEs**. The ECB has concluded that as the ECB Guidance on NPL is deemed to be aligned with the EBA GL on NPEs, it aims to comply with the EBA GL on NPEs. However, there are a number of considerations to take into account in this respect:
    - There are <u>no contradictions</u> in terms of substance between the EBA GL and the ECB's expectations regarding NPLs. Consequently, significant credit institutions (SIs) are expected to continue to implement the ECB NPL Guidance, and Joint Supervisory Teams (JSTs) will continue to monitor implementation.
    - The ECB intends to <u>apply the same scope</u> (i.e. an NPE strategy should be established where NPL ratios at consolidated, sub-consolidated and solo levels are equal to or greater than 5%) as indicated in the EBA GL on NPEs.
    - The <u>ECB fully supports the EBA's approach on disclosure of NPEs</u>. Accordingly, from the date of application of the EBA GL (i.e. 31 December 2019), banks are expected to follow the EBA Guidelines on disclosure of NPEs and FBEs instead of the current Annex 7 of the ECB NPL Guidance.
- **ECB's Pillar 2 approach to NPE coverage**. The ECB has announced that it is in the process of developing a framework for reporting, which will commence in 2020, using end-2019 as a reference date, and which will be developed in full coordination with the EBA. This framework will be consistent with the related Pillar 1 reporting template.
- **Supervisory expectations for the provisioning of NPE stock**. The ECB has recommended an approach for the provisioning of the NPE stock developed in two steps:
    - In a first step, banks were allocated to <u>three comparable groups</u> on the basis of their net NPL ratios as of end-2017 (i.e. banks with low, medium-high and high NPL ratios).
    - In a second step, <u>an assessment of capacity</u> regarding the potential impact was carried out for each individual bank with a horizon of end-2026.
- **Interaction between NPE coverage expectations under the ECB's Pillar 2 approach and CRR (Pillar 1) prudential NPE treatment**. Despite the differences in this regard between the ECB Addendum and the Regulation (EU) 2019/630, the ECB has concluded that the following specific adjustments are warranted:
    - <u>Adjustments to the ECB's Pillar 2 approach for new NPLs</u>. The relevant time frames for NPEs arising from loans originated before 26 April 2019 will be changed from 2/7 years to 3/7/9 years, to align these time frames with those in the Pillar 1 framework.
    - <u>Supervisory expectations for the stock of NPEs</u>. The supervisory expectations for the stock of NPEs (i.e. exposures classified as NPEs on 31 March 2018) remain unchanged. Further, those exposures classified as NPEs after 1 April 2018 but originated before 26 April 2019 will apply the Addendum to NPL Guidance (Pillar 2), whereas those exposures originated after 26 April 2019 will apply the backstop of Pillar 1.

01/07/2019

- **Consultation Paper on RTS on liquidity horizons for the Internal Model Approach (IMA) under points (a) to (d) of article 325bd(7) of the CRR II**
- **Consultation Paper on RTS on back-testing requirements under article 325bf(9) and Profit and Loss attribution requirements under article 325bg(4) of the CRR II**
- **Consultation Paper on RTS on criteria assessing the modellability of risk factors under the Internal Model Approach (IMA) under article 325be(3) of the CRR II**
- **Roadmap for the new market and counterparty credit risk approaches**

1. Context

In January 2019, the BCBS finalised and published standards on Minimum capital requirement for market risk (revised FRTB), which replaces the previous minimum capital requirements for market risk in the global regulatory framework, implemented in the EU via the CRR. Further, in June 2019 the European Parliament (EP) and the Council issued the Regulation (EU) 2019/876 (CRR II) which introduces as a first step towards the full implementation of the FRTB framework in the EU, a reporting requirement. However, key parts of the framework relating to the FRTB revisions will be implemented through a Commission Delegated Act and EBA technical standards.

In this context, the EBA has published three Consultation Paper (CPs) on RTS on the new internal model approach (IMA) under the FRTB in order to specify essential aspects of the IMA and contribute to a smooth and harmonised implementation of the FRTB in the EU. In particular, these documents are the CP on RTS on liquidity horizons, the CP on RTS on back-testing and profit and loss attribution (PLA) requirements and, the CP on RTS on criteria for assessing the modellability of risk factors under the IMA.

Along with these documents, the EBA has also published Roadmap on the new market and counterparty credit risk (CCR) approaches which provides a comprehensive overview of EBA deliverables in the area of market and CCR and outlines EBA intentions with the view of ensuring a smooth implementation of the new approaches in the EU. In particular, the roadmap reflects a prioritisation of the EBA work according to four phases, which is broadly in line with the deadlines included in the CRR II.

2. Main points

<u>CP on RTS on liquidity horizons for the IMA under points (a) to (d) of article 325bd(7) of the CRR II</u>

- **Scope**. According to the CRR II, institutions are required to map each risk factor to one of the risk factor categories and to one of the risk factor subcategories listed (e.g. most liquid currencies and domestic currency, or volatility for interest rate risk factor's category) for the purpose of identifying the relevant liquidity horizon under the IMA.
- **Content**. This CP specifies the following aspects:
    - <u>Mapping of risk factors to risk factor categories and subcategories</u>, by providing ad hoc treatments for some specific risk factors as well as a general approach for the majority of cases.
    - <u>Definition of most liquid currencies for interest rate risk</u>, by establishing that those currencies are defined considering the Triennial Central Bank Survey Over the Counter (OTC) interest rate derivatives turnover compiled by the Bank of International Settlements (BIS).
    - <u>Most liquid currency pairs for FX risk</u>, by defining them also considering the Triennial Central Bank Survey foreign exchange turnover compiled by BIS.
    - <u>Definition of a small and large capitalisation for equities</u>, by consulting on whether the definition of large capitalisation for equity risk should only rely on an absolute threshold or should be based also on the ITS specifying main indices and recognised exchanges.

2. Main points (continue)

CP on RTS on criteria assessing the modellability of risk factors under the IMA under article 325be(3) of the CRR II

- **Scope**. According to the CRR II, institutions shall assess the modellability of all the risk factors of the positions assigned to the trading desks for which they have been granted permission or are in the process of being granted such permission.
- **Content**. This CP specifies the following aspects:
  - The methodology of the modellability assessment of a risk factor by:
    - Identification at a minimum of 24 verifiable prices which are representative for the risk factor over the preceding 12-months, without any period of 90 days or longer with less than four verifiable prices which are representative for the risk factor.
    - Identification at a minimum of 100 verifiable prices which are representative for the risk factor over the preceding 12-months.
  - The requirements a price should satisfy to be verifiable and the representativeness of verifiable prices for risk factors.

3. Next steps

- Comments to these CPs shall be submitted by **4 October 2019**.
- The final RTS shall be delivered by **28 March 2020**.

03/07/2019
Basel III implementation assessment.

1. Context

In December 2017, the BCBS published the reform of 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 order to analyse the impact of such reforms, the EBA has published several documents such as the ad hoc cumulative impact assessment in December 2017, or the Monitoring Reports in October 2018 and March 2019.

In this context, the EBA has published a new Basel III implementation assessment, which includes a quantitative impact study (QIS), and a comprehensive set of policy recommendations in the area of credit and operational risk, output floor and securities financing transactions (SFTs). In particular, the Basel III reforms assessed by the EBA include the revised SA and IRB approaches for credit risk, the new SMA for operational risk, the new treatment of SFTs and the introduction of a new output floor for internal models.

However, this document does not cover the assessment of revisions to the new market risk framework (FRTB) of 2019, changes to the CVA framework, and macroeconomic impact assessment.

2. Main points

- **Sample of banks**. 189 EU banks at highest level of consolidation participate in the cumulative analysis, representing approximately 85% of total assets of EU domestic banking group and stand-alone banks.
- **Reference date**. This assessment is carried out using data as of June 2018.
- **Assumptions**. The results of the QIS considered the following conservative assumptions that are applied to the assessment:
  - Banks' balance sheets were assumed to be static.
  - Given uncertainty over the impact, institutions likely to be conservative in QIS reporting.
  - The analysis assumed that current EU-specific choices and exemptions were discontinued and the impact, therefore, fully reflected the existing global standards.
  - This assessment included the impact of Pillar 2 and macroprudential requirements, which in the analysis were assumed to be static.
  - Due to the late finalisation of the market risk part of the Basel reform (FRTB) in January 2019, the impact was computed using the calibration of the 2016 market risk regime. The incorporation of the 2019 FRTB reform would lower the impact.
- **Main results**.
  - The impact in terms of minimum capital requirements (MRC) varies across banks and the average results are affected by very large banks.
  - The weighted average increase in MRC is 24.4% for the entire sample under conservative assumptions. However, the assessment shows that:
    - For half of the banks in the sample, the impact is less than 10.6%.
    - For small banks, the MRC increase is limited to 5.5%.
    - For around a quarter of the banks in the sample, MRC decreases.
  - The total capital shortfall is about 135 bn€, almost entirely in large banks, and this shortfall would be reduced to 58.7 bn€ if banks were to retain profits (based on 2014-18 data) throughout the transition period.
  - The main drivers of such impact are:
    - For large banks: output floor, CVA and operational risk.
    - For small banks: SA for credit risk.
- **Policy recommendations**.
  - Credit risk. The EBA provides recommendations on the SA (e.g. the implementation of enhanced due diligence requirements, or the implementation of the RW treatment for equity-like instruments), IRB (e.g. clarification of the treatment of sovereign exposures where A-IRB modelling is allowed, or deletion of the possibility to use 180 days past due), and common issues (e.g. alignment of SME definition across SA and IRB).
  - Operational risk. The EBA recommends, among others, that in the adoption of the BCBS SA, the discretion to set internal loss multiplier (ILM) equal to 1 is not applied; or that competent authorities should retain the discretion to grant permission to the relevant G-SIBs (bucket 1) under their supervision to use a bank's specific ILM.
  - Output floor. The EBA recommends, among others, to implement the output floor in the EU in a Basel compliant manner and calibrated at 72.5% of the total RWA computed under the standardised approaches.
  - SFTs. The EBA supports the introduction in the EU of the Basel III reforms affecting the calculation of exposure values of counterparty credit risk exposures stemming from SFTs with the exception of the introduction of the minimum haircut floors framework for SFTs.

3. Next steps

- The EBA will deliver its advice (including this QIS and recommendations) to the European Commission around **end July 2019**.

25/07/2019
Roadmap for IFRS 9 deliverables.

1. Context

In January 2018 the international accounting standard IFRS 9 entered into force and introduced changes in credit loss provisioning by moving from an incurred loss model (under IAS 39) to an expected credit loss (ECL). In order to analyse the impact of such standard, the EBA before the first application of IFRS 9, published two pre-implementation impact assessments (IA) in November 2016 and July 2017. Further, in December 2018, it also published a Report on first observation on the impact and implementation of IFRS 9 by EU institutions.

In this context, the EBA has now published a **Roadmap on IFRS 9 deliverables** providing a comprehensive overview of planned monitoring activities on IFRS 9 implementation. In particular, this roadmap includes the different phases of the EBA's work from qualitative and quantitative perspectives which will take place in the coming months and years.

Along with this document, the EBA has launched an **IFRS 9 benchmarking exercise** on a sample of institutions aimed at analysing the different modelling practices followed by institutions and how IFRS 9 implementation impacts the amount of expected credit losses (ECL) in terms of own funds and regulatory ratios.

2. Main points

- **Overview of planned monitoring activities on IFRS 9 implementation**. This roadmap covers the following information:
  - Scope and content. The IFRS 9 deliverables are organised around quantitative and qualitative monitoring. In particular, this roadmap aims to clarify further the next steps with regard to the quantitative monitoring.
  - Quantitative monitoring. Several deliverables are expected to be published in three phases:
    - **Phase 1**: it includes deliverables on different areas (e.g. use of selected IFRS 9 indicators on the basis of regulatory reporting FINREP/COREP for all banks, or testing of selected IFRS 9 parameters and ad hoc data collection for common counterparties for IRB banks, and qualitative questionnaire on modelling for IRB and SA banks). The expected timeline covers present-end 2020.
    - **Phase 2**: it includes a deliverable on the Integration of the SA/smaller institutions into the quantitative part of the benchmarking exercise. The expected timeline is not before 2021.
    - **Phase 3**: it includes a deliverable on the extension of the ITS on benchmarking to high default portfolios (HDPs) for IFRS 9 purposes. The expected timeline is not before 2021.
  - Qualitative monitoring. These deliverables are expected to be published in two phases:
    - **Phase 1**: it includes two deliverables on the monitoring of IFRS 9 implementation by EU institutions (i.e. three reports on pre-implementation preparation and expected impact which were already delivered), and on the ongoing monitoring of IFRS 9 transitional provisions (started and ongoing).
    - **Phase 2**: it includes two deliverables on the monitoring of IFRS 9 implementation by EU institutions (medium-/long-term impact) which is expected by 3Q/4Q 2020 and a follow-up on the EBA Guidelines (GL) on ECL and GL for communication between supervisors and auditors in the context of IFRS 9 which is expected not before 2020.
- **Launch of the IFRS 9 benchmarking exercise**.
  - Objective. This exercise aims to understand to what extent the use of different methodologies, models, inputs and scenarios could lead to material inconsistencies in ECL outcomes, affecting own funds and regulatory ratios.
  - Qualitative aspects of the exercise. This part implies the collect qualitative information on the practices followed by institutions with regard to modelling (e.g. determining a significant increase in credit risk, or use of scenarios) and relies on the responses to a detailed questionnaire provided to institutions.
  - Quantitative aspects of the exercise. Many aspects of this part of the exercise will follow the instructions set out in the most recent ITS on benchmarking. Among others, the EBA will collect data at counterparty level (a 'common sample') from a given list of counterparties defined by the EBA for low default portfolios (LDPs), some additional IFRS 9 parameters (e.g. PD under IFRS 9 by counterparty and by economic scenario), as well as data on HDPs.

10/09/2019
Final Guidelines on liquidity stress testing in UCITS and AIFs.

1. Context

In April 2018, the European Systemic Risk Board (ESRB) published a set of recommendations to address liquidity and leverage risk in investment funds, which requires the ESMA to develop guidance on the practice to be followed by managers for the stress testing of liquidity risk for individual Alternative Investment Funds (AIFs) and Undertakings for the Collective Investment in Transferable Securities (UCITS), in order to promote supervisory convergence.

In this context, following the consultation launched in February 2019, the ESMA has published the F**inal Guidelines (GL) on liquidity stress testing in UCITS and AIFs**, applied to managers, depositaries and national competent authorities (NCAs), that will establish consistent, efficient and effective supervisory practices; increase the standard, consistency and, in some cases, frequency of liquidity stress test (LST) already undertaken; as well as promote convergent supervision of LST by NCAs.

2. Main points

- **Guidelines applicable to managers**. These GL cover the following aspects:
    - Design of the LST models. In building LST models managers should determine, among others, the risk factors that may impact the fund's liquidity, the types of scenarios to use and their severity, or different outputs and indicators to be monitored based on the results of the LST.
    - Understanding liquidity risks. A manager should have a strong understanding of the liquidity risks arising from the assets and liabilities of the fund's balance sheet, and its overall liquidity profile, in order to employ LST that is appropriate for the fund it manages.
    - Governance principles. LST should be properly integrated and embedded into the fund's risk management framework supporting liquidity management. It should be subject to appropriate governance and oversight, including appropriate reporting and escalation procedures.
    - LST Policy. The stress testing should be documented in an LST policy within the UCITS and AIF Risk Management Process (RMP), which should require the manager to periodically review and adapt, if necessary, the LST as appropriate. This policy should include, among others, a clear definition of the role of senior management in the process, its internal ownership and which management functions are responsible for its performance, or its interaction with other liquidity risk management procedures.
    - Frequency. The LST should be carried out at least annually and, where appropriate, employed at all stages in a fund's lifecycle.
    - Scenarios. The LST should employ hypothetical and historical scenarios and, where appropriate, reverse stress testing. LST should not overly rely on historical data, particularly as future stresses may differ from previous ones.
    - Other aspects, regarding the use of LST outcomes, adapting the LST to each fund, data availability, product development, stress testing fund assets and liabilities to determine the effect on fund liquidity, LST on other types of liabilities, funds investing in less liquid assets, combined asset and liability LST, and aggregating LST across funds.
- **Guidelines applicable to depositaries**. These GL set out that a depositary should set up appropriate verification procedures to check that the manager of a fund has in place documented procedures for its LST programme.
- **Interaction with NCAs**. These GL establish that NCAs may at their discretion request submission of a manager's LST to help demonstrate that a fund will be likely to comply with applicable rules, including regarding the ability of the fund to meet redemption requests in normal and stressed conditions. Further, NCAs may at their discretion request managers to notify them of other information relating to the LST, including liquidity stress test models and their results.

3. Next steps

- These Final GL apply from **30 September 2020**.

24/07/2019

- **Proyecto de Circular, entidades de crédito, que modifica la Circular 4/2017, a entidades de crédito, sobre normas de información financiera pública y reservada, y modelos de estados financieros**
- **Anejo**

1. Context

In December 2017, the BdE published the Circular 4/2017 on public and confidential financial information standards and formats, that supersedes the Circular 4/2004 aimed to adapt the current accounting framework of the Spanish credit institutions to IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from Contracts with Customers) that modify the accounting criteria of financial instruments and revenue, respectively.

In this context, the BdE has published a **Draft Circular amending Circular 4/2017**, addressed to credit institutions, with the aim to adapt the rules and annexes that set out the confidential statements that credit institutions should submit to the BdE in order to adequate the formats of these statements to the amendments included in the European Commission (EC) Implementing Regulation (EU) 680/2014, laying down ITS with regard to supervisory reporting of institutions, and ECB Regulation (EU) 534/2015 on reporting of supervisory financial information.

2. Main points

- **Objective**. This Draft Circular aims to: i) incorporate the latest developments in International Financial Reporting Standards into the accounting and reporting criteria; ii) simplify some information requirements of institutions; iii) collect data to verify compliance with national standards and statistical data; and iv) introduce clarifications and corrections addressed since the entry into force of the Circular 4/2017.
- **Main amendments**. This Draft Circular introduces amendments on:
  - Rule 4 (Other individual public financial information) and Rule 5 (Other consolidated public financial information) to enable the disclosure of public financial statements by both associations of credit institutions and the BdE.
  - Rule 22 (Recognition, classification and assessment of financial instruments), rule 44 (Business combinations) and annex 9 (Credit risk analysis and hedging) to incorporate the latest developments in the International Financial Reporting Standards adopted by the EU into the accounting and reporting criteria.
  - Standard 67 (Individual confidential statements) and annex 4 (Individual confidential statements) to adapt the financial statements FI 1 to FI 45 used to, among other purposes, collect the common financial information that supervised credit institutions have to submit to the ECB through national authorities, to the amendments introduced to Implementing Regulation (UE) nº 680/2014, and to Regulation (EU) nº 534/2015.
  - Annex 4, where the statement FI 143 on financing to construction and real estate development (business in Spain) is amended; and a new statement FI 152 on loans to households for the purchase of residential property through real estate mortgages (businesses in Spain) is introduced in order to meet the Recommendation of the European Systemic Risk Board (ESRB) regarding the removal of gaps on real state data (e.g. including information on the current loan-to-value ratio (LTV-C) or the loan-to-income at origination ratio (LTI-O), among others). Further, the statement FI 160 on mortgage activity (businesses in Spain) is removed and additional information on leased assets is added to statements FI 100-14 (Breakdown of tangible assets) and FI 150-3 (Breakdown of depreciation of tangible assets) of Annex 4.
  - Rule 67 to simplify some information requirements for institutions. In particular, those branches in Spain of foreign credit institutions whose headquarters is in a member state of the European Economic Area and that have decided to apply the credit risk valuation and coverage criteria used by their headquarters and have informed the BoE accordingly, are exempted from submitting the statement FI 131 (Credit risk coverage).
  - Rule 68 (Confidential consolidated statements) to reduce the reporting requirements of consolidated groups of credit institutions regarding their subsidiaries and joint business that are part of the consolidated group for prudential purposes by amending the frequency of the statement FC 201-1 (Balance sheet) and the statement FC 201-2 (Profit and Loss account) from quarterly to semi-annually; by removing the statement FC 201-3; and by reducing the requirements set out in FC 201-2. Moreover, the statement FC 203 is introduced to require, on annual basis, information on the number of employees of dependent financial institutions and joint businesses.
  - Rule 66 (Sectorisation of personal balances by holders) to clarify and introduce the relevant corrections to the notes to some financial statements defined in Annexes 4, 6 (Statements on statistical requirements of the Economic and Monetary Union) and 7 (Sectorisation schemes).

3. Next steps

- Comments to this Draft Circular shall be submitted by **10 September 2019**.
- The Final Circular will enter into force on **1 January 2020**. However, the first statements to be submitted to the BdE according to the models introduced or amended by the Final Circular will be those corresponding to 30 June 2020.

10/07/2019
Final rule on simplifications to the Capital Rule.

1. Context

In October 2013, the Fed and the OCC issued the Capital Rule in order to address weaknesses that became apparent during the financial crisis of 2007-08; strengthen the capital rule's requirements and improve risk sensitivity by providing two methodologies for determining RWAs, such as the standardized approach and the advanced approach. Further, in March 2017 these agencies issued a Joint Report which intended to simplify, for non-advanced approaches banking organizations the current regulatory capital treatment for concentrations of mortgage servicing assets (MSAs), certain deferred tax assets (DTAs), investments in the capital instruments of unconsolidated financial institutions, and the calculation for the amount of minority interest includable in regulatory capital.

In this context, the Fed, the FDIC, and the OCC (the agencies) have published the **Final rule on simplifications to the Capital Rule**, which applies solely to banking organizations that are not subject to the advanced approaches capital rule (i.e. in general those firms with less than $250 billion in total consolidated assets and less than $10 billion in total foreign exposure), and simplifies the capital treatment for MSAs, temporary difference DTAs, investments in the capital instruments of unconsolidated financial institutions, and minority interest.

2. Main points

- **Scope**. This final rule aims to simplify the capital rule and reducing regulatory burden for non-advanced approaches banking organizations.
- **Overview of the simplifications**. This final rule covers the following aspects:
  - <u>Non-advanced approaches banking organizations</u>, should not apply:
    - The 10% CET1 deduction threshold, which applies individually to holdings of MSAs, temporary difference DTAs, and significant investments in the capital of unconsolidated financial institutions in the form of common stock.
    - The 15% CET1 deduction threshold, which applies to the aggregate amount of such items.
    - The 10% threshold for non-significant investments, which applies to holdings of regulatory capital of unconsolidated financial institutions.
    - The deduction treatment for significant investments in the capital of unconsolidated financial institutions that are not in the form of common stock.
  - These banking organizations should not apply distinct treatments to significant and to non-significant investments in the capital of unconsolidated financial institutions, and therefore the treatment should be based on the <u>type of instrument underlying the investment</u>.
  - Further, non-advanced approaches banking organizations should deduct from CET1 any amount of MSAs, temporary difference DTAs, and investments in the capital of unconsolidated financial institutions that individually <u>exceed 25% of CET1 of the banking organization</u>. For those MSAs or temporary difference DTAs not deducted from capital, a 250% RW should be applied; and for investments in the capital of unconsolidated financial institutions, a banking organization should risk weight each exposure not deducted according to the RW applicable to the exposure category of the investment.
  - A <u>simpler methodology</u> for non-advanced approaches banking organizations to calculate <u>minority interest limitations</u> is introduced by basing such limitations on the parent banking organization's capital levels rather than on the amount of capital its subsidiaries would need to meet the minimum capital requirements on their own.
  - <u>Certain technical changes</u> to the capital rule are considered, including some changes to the advanced approaches, to clarify certain provisions, updated cross-references, and correct minor errors.

3. Next steps

- This final rule will be effective as of **April 1, 2020** for the amendments to simplify capital rules.

12/09/2019

Final Rule on revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds.

1. Context

On 21 July 2010, the Dodd-Frank Act was enacted and in 2014 the Section 619 of the Dodd-Frank Act added a new section 13 to the Bank Holding Company Act of 1956 (BHC Act), also known as the Volcker Rule, that generally prohibits any banking entity from engaging in proprietary trading or from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a hedge fund or private equity fund (covered fund), subject to certain exemptions.

In this context, following the proposed rulemaking published in July 2018, the Fed, the OCC, the FDIC, the SEC and the CFT (the agencies) have published the **Final Rule on revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds**, which is intended to streamline the Volcker Rule by eliminating or modifying requirements that are not necessary to effectively implement its statute, without diminishing the safety and soundness of banking entities.

2. Main points

- **Rule for tailoring the compliance requirements based on the size of a firm's trading assets and liabilities**. The agencies aim to further reduce compliance obligations for small and mid-sized firms that do not have large trading operations and therefore reduce costs and uncertainty faced by smaller and mid-size firms in complying with the Volcker Rule, relative to their amount of trading activity, subject to certain requirements. In this regard, the final rule establishes that compliance categories will be based only on trading assets and liabilities of U.S. operations instead of global ones as proposed, and it distinguishes between:
    - Entities with <u>significant</u> trading assets and liabilities: equal to or exceeding $20 billion.
    - Entities with <u>moderate</u> trading assets and liabilities: less than $20 billion.
    - Entities with <u>limited</u> trading assets and liabilities: less than $1 billion.
- **Rule for limiting the impact of the Volcker Rule on the foreign activity of FBOs**. The agencies have eliminated: i) the requirement that no financing for the banking entity's purchase or sale be provided, directly or indirectly, by any branch or affiliate that is located in the United States or organized under the laws of the United States or of any state, ii) the restrictions on a foreign banking organization's (FBO) ability to enter into transactions with U.S. counterparty, iii) the requirement that FBO personnel who arrange, negotiate, or execute a transaction outside the United States (TOTUS) be located outside the United States, but the condition that relevant personnel that makes decision to purchase or sell as principal is not located in the United States is retained; and iv) the accounting prong, returning to a short-term intent prong.
- **Rule for providing more clarity by revising the definition of trading account in the Volcker Rule**. The agencies aim to rely on commonly used accounting definitions and therefore, they have revised them to streamline and clarify for all banking entities certain definitions and requirements related to the proprietary trading prohibition and limitations on covered fund activities and investments (e.g. trading desk, proprietary trading).
- **Rule for revising the exemptions from the prohibitions for underwriting and market making-related activities, risk-mitigating hedging, and trading by FBOs solely outside the United States (SOTUS)**. The agencies have reviewed the exemptions for underwriting and market making-related activities by requiring to maintain and make available upon request records of any such breaches or increases. Further, entities are required to follow certain internal escalation and approval procedures in order to remain qualified for the presumption of compliance. Moreover, the agencies have modified the SOTUS funds exception by eliminated restrictions on financing from U.S. branches or affiliates.
- **Rule for simplifying the trading activity information that banking entities are required to provide to the agencies**. The agencies have reduced metrics reporting, recordkeeping, and compliance program requirements for all banking entities and expanded tailoring to make the scale of compliance activity required by the Volcker Rule commensurate with a banking entity's size and level of trading activity. However, different from the proposed rulemaking, the final rule only applies the CEO attestation requirement to firms with significant trading assets and liabilities.

3. Next steps

- The final amendments will be effective on **January 1, 2020**. In order to give banking entities a sufficient amount of time to comply with the changes adopted, banking entities will not be required to comply with the final amendments until **January 1, 2021**.
- Furthermore, the agencies intend to issue an additional proposed rulemaking that would propose additional, specific changes to the restrictions on covered fund investments and activities and other issues related to the treatment of investment funds.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

20/09/2019
Consultation Paper 21/19 on credit risk: Probability of Default and Loss Given Default estimation.

1. Context

In February 2016, the EBA published a roadmap of regulatory products aiming at reducing unwarranted variability in the risk-weighted assets (RWAs) calculated using banks' IRB models. According to this roadmap, the EBA issued Guidelines (GL) on PD estimation, LGD estimation and the treatment of defaulted exposures in November 2017; Final RTS on the specification of the nature, severity and duration of an economic downturn in accordance the CRR in November 2018; and Final GL for the estimation of LGD appropriate for an economic downturn in March 2019.

In this context, the PRA has published a **Consultation Paper (CP) 21/19 on credit risk: Probability of Default and Loss Given Default estimation**, in order to update the Supervisory Statement 11/13 on Internal Rating Based (IRB) by implementing these three EBA's regulatory. In particular, this CP introduces proposals for the following areas: i) compliance with the EBA roadmap for IRB, ii) cyclicality of downturn LGD estimates, iii) discount rate, iv) use of a component-based modelling approach for downturn LGD, v) identification of an economic downturn, vi) LGD exposure level floor for residential mortgages, vii) treatment of defaulted exposures, and viii) rating and calibration philosophy for non-mortgage exposure classes.

2. Main points

- **Compliance with the EBA roadmap for IRB**. This CP proposes to amend the SS11/13 by align it to the EBA roadmap and therefore to comply with: i) Final RTS on the specification of the assessment methodology for competent authorities (CAs) regarding compliance of an institution with the requirements to use the IRB approach, ii) RTS for the materiality threshold for credit obligations past due, iii) GL on the application of the definition of default, iv) RTS on economic downturn, v) GL on downturn LGD, and vi) GL on PD and LGD.
- **Cyclicality of downturn LGD estimates**. This CP proposes to amend SS11/13 in order to clarify that for UK residential mortgages, probability of possession given default (PPGD) models must appropriately reflect downturn conditions (i.e. firms should estimate PPGD consistent with property values at least 25% below their peak and at least 5% below their current value).
- **Discount rate**. This CP proposes to update:
    - Discount rate used when estimating LGD. Firms should use a discount rate of Sterling Overnight Index Average (SONIA) at the moment of default plus 5%.
    - Discount of defaulted exposures that return to non-defaulted status. Firms should only include accrued interest up to the moment of cure when calculating the artificial cash flow.
    - Discount of cash flows from realising security. The amount of recoveries that can be recognised as a cash flow and discounted should not be higher than the amount of recoveries the firm is contractually entitled to retain for the exposure.
- **Use of a component-based modelling approach for downturn LGD**. This CP proposes three approaches regarding the downturn LGD estimation: i) a downturn LGD estimation based on observed impact, ii) downturn LGD estimation based on estimated impact, and iii) downturn estimation where observed or estimated impact is not available.
- **Identification of an economic downturn**. This CP sets out that firms should continue to use economic conditions equivalent to those observed in the UK during the early 1990s in order to calibrate long-run average PD for UK residential mortgages.
- **LGD exposure level floor for residential mortgages**. This CP proposes to set an expectation that the exposure-level LGD floor should not be less than 5% for residential mortgages.
- **Treatment of defaulted exposures**. This CP proposes to delete its existing expectations for the treatment of defaulted exposures, and firms should follow the approach in the EBA roadmap.
- **Rating and calibration philosophy for non-mortgage exposure classes**. This CP establishes that firms' PD models should move away from cyclical point in time (PiT) models or non-cyclical through the cycle (TtC) approaches and fall within a spectrum between these two approaches.

3. Next steps

- Comments to this CP shall be submitted by **18 December 2019**.
- The PRA proposes to update the implementation deadlines published in the PS7/19 on the definition of default in light of the EBA's Progress Report on the IRB Roadmap.

25/09/2019
Supervisory Statement 5/19 on liquidity risk management for insurers.

1. Context

In November 2009, the European Parliament and the Council published Solvency II, which lays down rules concerning the taking-up and pursuit of self-employed activities of direct insurance and reinsurance, the supervision of insurance and reinsurance groups, and the reorganisation and winding-up of direct insurance undertakings. Regarding this Directive, the PRA has issued several documents on insurance supervision, corporate governance or the own risk and solvency assessment (ORSA), among others.

In this context, the PRA has published a **Supervisory Statement (SS) 5/19 on liquidity risk management for insurers**, which sets out the PRA's expectations concerning: i) the development and maintenance of proper policies, systems, controls and processes; ii) the identification of material liquidity risk drivers; iii) the design and undertaking of forward looking scenario analysis and stress testing programmes; iv) considerations for the inclusion of highly liquid assets in the liquidity buffer; v) the use of quantitative metrics and tools for measuring and monitoring liquidity risk drivers; and vi) effective contingency planning.

This SS is addressed to all UK firms and groups that fall within the scope of the Solvency II Directive, to the Society of Lloyd's and its managing agents, and to non-Directive insurers (collectively referred to as 'insurers').

2. Main points

- **Liquidity Risk management framework**. The PRA establishes that an insurer is required to have a risk appetite or tolerance for risk, a process to identify, measure and monitor risk and appropriate systems to convey information to management or the board. In particular, the following elements are, among others, fundamental components of an insurer's liquidity risk management framework: a defined liquidity risk appetite that is owned and approved by the board; a liquidity risk management strategy and documented liquidity risk policies and processes consistent with its stated liquidity risk appetite; and proper IT systems and reporting procedures.
- **Sources of liquidity risk**. This SS establishes that the insurers must understand the sources of liquidity risk it faces and to consider its relevance, including the implications of these risks on its liquidity position under both normal and stressed conditions. Furthermore, material sources of liquidity may include the following risks: i) liability-side; ii) asset-side; iii) concentration; iv) off-balance sheet; v) funding; vi) cross-currency; vii) intra-day; and viii) franchise.
- **Stress testing**. The PRA expects insurers to consider varying degrees of stressed conditions in a range of stress scenarios, where in the case of a group, an insurer is expected to define separate stress scenarios on a group basis in order to encompass group-specific risks; and the impact of chosen market stresses on the appropriateness of its assumptions. In addition, when designing scenarios, insurers should also consider the appropriateness of their calibration, considering past liquidity events and other relevant data or experience.
- **Liquidity buffers**. This SS establishes that an insurer should be able to monetize the assets in its liquidity buffer to meet its excess cash flow needs in the chosen time horizon without directly conflicting with any existing business or risk management strategies.
- **Risk monitoring and reporting**. The PRA establishes that as part of its risk management framework, insurers may define its own risk metrics for its day-to-day operations, reflecting its own circumstances and risk profiles, maintaining minimum governance standards when defining these metrics. Moreover, the PRA expects regular reports on liquidity to be provided to senior management and any risk committee of the board addressing the insurer's compliance with its risk management strategy and policies, as well as alert management when the insurer approaches its liquidity risk appetite or risk limits.
- **Liquidity contingency planning**. The PRA expects insurers to develop a liquidity contingency plan to maintain a clear process and plan for recognising and addressing a liquidity stress. In particular, this plan should set a framework with a high degree of flexibility so that an insurer can respond quickly to a variety of liquidity stresses which disrupt its ability to fund some or all of its activities in a timely manner and at a reasonable cost.

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