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Regulation Outlook

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Executive summary

Special mention should be made of the reform package of the financial sector published by the European Commission (EC) during the last quarter of 2016, which aims to introduce into EU law, among other requirements, several internationally agreed standards which are elements of the Basel III agenda. Furthermore, the EC endorsed IFRS 9 into the EU as adopted by the IASB.

Global publications

- The BCBS published a **consultation document** and a **discussion paper** on the **regulatory treatment of accounting provisions for capital purposes**. The consultation document sets out a proposal to retain, for an interim period, the current regulatory treatment; whereas the discussion paper provides several options for the long-term treatment of provisions under the new expected credit losses (ECL) standards.
- The FSB issued the **2016 list of global systemically important banks** (G-SIBs) and the **2016 list of global systemically important insurers**.
- With regard to the Total Loss-Absorbing Capacity requirement (TLAC), the BCBS published the **final standard on the regulatory capital treatment of investments in TLAC**; whereas the FSB launched a **public consultation** proposing a set of high-level principles on the **internal TLAC of G-SIBs**.

European publications

- Special mention should be made of the **reform package of the financial system** by the EC, proposing to the Parliament and the Council that several internationally agreed standards issued by the BCBS and the FSB are introduced into EU law, among other requirements. Thus, the EC proposes to transpose the TLAC (amending the MREL), a binding Leverage Ratio (LR), the Net Stable Funding Ratio (NSFR), the new requirements for market risk, etc. This reform would entail the amendment of relevant legislative acts (e.g. CRR, CRD IV, BRRD, etc.).
- The EC **endorsed IFRS 9 into the EU** as adopted by the IASB in 2014, applying from 2018. Further, the EBA published **Final ITS** amending the ITS on supervisory reporting with regard to **FINREP**, with the aim of aligning the reporting framework with the new IFRS 9 requirements.
- The EBA published **RTS on the assessment methodology of Internal Models Approach (IMA) for market risk** to be used by competent authorities (CAs); and launched a **public consultation** on the **estimation of credit risk parameters for IRB** (PD and LGD).

European publications (continuation)

- The EBA published **Guidelines (GL)** specifying the information that CAs should collect on **ICAAP and ILAAP under the SREP**.
- The EBA also launched a **consultation paper of GL on internal governance**, which aims to update GL 44.
- The EBA published **consultation GL** regarding the **information and communication technology (ICT) risk** under SREP.
- Finally, the EBA published the **results of the 2016 EU-wide transparency exercise**.
- The ECB published its **2017 supervisory priorities**: business models and profitability drivers; credit risk, with a focus on non-performing loans and concentrations; and risk management, including RDA&RR, ICAAP and ILAAP, internal models, and outsourcing.
- The ECB published **several draft guidance**, such as a guide on **leveraged transactions**.

Local publications

- The Bank of Spain published the **updated list of institutions that are considered G-SIIs and O-SIIs in 2017**, specifying their relevant **capital buffers**.
- In USA, the Fed published the final rule under which G-SIBs will be required to meet a new **long-term debt (LTD) requirement** and the **TLAC**.
- Further, the Fed, the OCC and the FDIC issued a joint proposal regarding **enhanced cyber risk management standards** for large and interconnected entities under their supervision and those entities' service providers.
- The Bank of England (BoE) published the **results of the 2016 stress test of the UK banking system**. These results were assessed against the BoE's hurdle rate framework, comprising elements expressed both in terms of risk-weighted capital and leverage ratios.

Regulatory projections

The BCBS has postponed the finalisation of the review of the Basel III framework, initially scheduled for January 2017, without specifying when it will be accomplished. In the EU, the Parliament (EP) and the Council will continue to deliberate on the reform package proposed by the EC. In Spain, the BdE is expected to publish a Proyecto de Circular to adapt the allowance standards to the expected loss model introduced by IFRS 9.

Regulatory projections

1. Next quarter

- **(Global) To be determined**: the BCBS is expected to finalise the review of the Basel III framework by publishing standards on the revised standardised approach for credit risk, on the review of the IRB approach, on the review of the standardised approach and the basic approach for CVA, on the new approach for operational risk (SMA), on the capital floor based on the standardised methods (which would replace the Basel I floor), and on the LR (which may include a G-SIB surcharge).
- **(Europe) To be determined**: the EP and the Council are expected to approve the reform package of the financial system, amending several legislative acts (CRR, CRD IV, BRRD, etc.).
- **(Spain) To be determined**: the Bank of Spain is expected to publish a Proyecto de Circular to adapt the allowance standards to the expected loss model that will be introduced by IFRS 9.
- **(Europe) January 2017**: the EBA GL on information on ICAAP and ILAAP under the SREP will be applicable.
- **(Europe) January 2017**: the EBA GL on limits on exposures to shadow banking entities will be applicable.
- **(Europe) March 2017**: the EBA is expected to publish a consultation paper of draft RTS on the specification of the nature, severity and duration of an economic downturn, in the context of the IRB approach.
- **(UK) March 2017**: the BoE will publish the scenarios for the 2017 stress test.

2. Next year

- **(Europe) April 2017**: the EBA will update the list of other systemically important institutions (O-SIIs).
- **(Europe) June 2017**: the EBA GL on disclosure of the Liquidity Coverage Ratio (LCR) will be applicable.
- **(Europe) June 2017**: the 4th Directive on anti-money laundering (AML) shall be implemented by Member States.
- **(Europe) June 2017**: the EBA is expected to publish GL on the assessment of the ICT risk.
- **(Europe) June 2017**: the CAs are expected to apply the EBA revised GL on internal governance.
- **(Global) November 2017**: the FSB will update the list of G-SIBs.
- **(Global) December 2017**: some of the Pillar 3 disclosure requirements issued by the BCBS will be applicable.
- **(Europe) December 2017**: the EBA GL on Pillar 3 disclosure requirements will be applicable.
- **(UK) December 2017**: the BoE will publish the results of the 2017 stress test.

3. More than a year

- **(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 PSD2 shall be implemented by Member States.
- **(Europe) January 2018**: the Regulation on key information documents for package retail and insurance-based investment products (PRIIPs) will be applicable.
- **(USA) January 2018**: the NSFR will be applicable in USA.
- **(Europe) May 2018**: the General Data Protection Regulation will be applicable.
- **(Europe) September 2018**: institutions are expected to start reporting under AnaCredit.
- **(Global) December 2018**: the revised standards on IRRBB will be applicable.
- **(Global) January 2019**: the revised market risk framework (FRTB) will be applicable.
- **(Global) January 2019**: G-SIBs not headquartered in an emerging market economy will be required to comply with a minimum TLAC requirement of 16% of risk-weighted assets and 6% of the LR exposure.
- **(USA) January 2019**: the new requirements on LTD and TLAC will be applicable.
- **(UK) January 2019**: the ring-fencing rules will be implemented.
- **(Europe) December 2020**: according to the EBA's timeline, the effective implementation of the amendments to the IRB approach should finalise (e.g. definition of default, estimation of IRB parameters, etc.).

Publications of this quarter

Summary of outstanding publications of this quarter.

Topic	Title	Date	Page
	Basel Committee on Banking Supervision		
Regulatory treatment of accounting provisions	• Consultative document on regulatory treatment of accounting provisions – interim approach and transitional arrangements • Discussion paper on regulatory treatment of accounting provisions	13/10/2016	10
Regulatory treatment of TLAC holdings	• Final Standard on TLAC holdings – Amendments to the Basel III standards on the definition of capital	14/10/2016	12
	Financial Stability Board		
List of G-SIBs	• 2016 list of global systemically important banks (G-SIBs) • 2016 list of global systemically important insurers (G-SIIs) • Information on global systemically important banks (published by the BCBS)	21/11/2016	13
Internal TLAC	• Consultative document on Guiding Principles on the internal TLAC of G-SIBs • Consultative document on Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution	19/12/2016	14
	European Commission		
Reform package of the financial sector	• Proposal for a Directive amending the CRD IV • Proposal for a Regulation amending the CRR and EMIR • Proposal for a Directive amending the BRRD on loss- absorbing and recapitalisation capacity of credit institutions and investment firms • Proposal for a Directive amending the BRRD as regards the ranking of unsecured debt instruments in insolvency hierarchy • Proposal for a Regulation amending the SRMR	24/11/2016	16
IFRS 9	• Regulation (EU) 2016/2067, amending Regulation (EC) No 1126/2008 and adopting certain international accounting standards as regards IFRS 9.	30/11/2016	18

13/10/2016

- **Consultative document on regulatory treatment of accounting provisions – interim approach and transitional arrangements.**
- **Discussion paper on regulatory treatment of accounting provisions.**

1. Context

Both the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) adopted provisioning standards that require the use of expected credit losses (ECL) models rather than incurred loss models. In this regard, the BCBS is supportive of the ECL approaches, but nevertheless needs to consider the implications for regulatory capital of these approaches.

In this context, the BCBS has published a **consultative document** that sets out a proposal to retain, for an interim period, the current regulatory treatment of provisions under the standardised (SA) and the internal ratings-based (IRB), and consults on whether any transitional arrangement may be necessary to allow banks time to adjust to the new ECL accounting standards; and a **discussion paper** on the policy options for the long-term regulatory treatment of provisions under the new ECL standards.

2. Main points

Consultative document on regulatory treatment of accounting provisions - interim approach and transitional arrangements

Proposal for an interim period. The BCBS is proposing to retain the current regulatory treatment of accounting provisions.

The current regulatory treatment is as follows:

Standardized Approach (SA): banks are permitted to include general provisions (GP) in Tier 2 capital up to a limit of 1.25% of credit RWAs (specific provisions do not qualify for inclusion in Tier 2 capital). Exposures are net of SP and gross of GP.

IRB approach: any shortfall between total eligible provisions (as defined in Basel II) and the regulatory expected loss (EL) is fully deducted from CET1, whereas any excess is added to Tier 2 capital, up to a limit of 0.6% of credit RWAs. Neither SP nor GP are deducted from EAD.

An important issue is to define which portions of provisions should be regarded as SP and GP for regulatory purposes. In this regard, the BCBS is proposing that jurisdictions would extend their existing approaches to categorising provisions as GP or SP to provisions measured under the applicable ECL accounting model.

Possible transitional arrangements. The BCBS has identified a number of reasons why it may be appropriate to introduce a transitional arrangement for the impact of ECL accounting on regulatory capital. Regarding these transitional arrangements:

Some issues that would need to be considered include the following: what capital metrics should be referenced (e.g. CET1), the period to be allowed for transition (the BCBS is considering a period from 3 to 5 years), etc.

The BCBS provides three approaches that are examples of how a transitional arrangement might be structured (the BCBS's current preference is for Approach 1):

Approach 1: Day 1 impact on CET1 capital spread over a specified number of years (an explanation of the mechanics of this arrangement is given in the document).

Approach 2: CET1 capital adjustment linked to Day 1 proportionate increase in provisions.

Approach 3: phased prudential recognition of IFRS 9 Stage 1 and 2 provisions.

Discussion paper on regulatory treatment of accounting provisions

Policy options for the longer-term regulatory treatment of provisions. The BCBS is considering the following preliminary approaches (although the BCBS is open to comments and proposals other than these raised in the discussion paper):

To retain the current regulatory treatment of provisions (as explained above), including the distinction between GP and SP, as a permanent approach.

To introduce a universally applicable and binding definition of GP and SP, while retaining the current regulatory treatment based on the GP/SP distinction.

- To <u>change the current regulatory treatment under the SA</u>, removing the GP/SP distinction and introducing a regulatory expected loss (EL). The BCBS specifies, among others, that:
  - All accounting provisions would be treated in the same way, aligning with the IRB approaches.
  - Standardised regulatory EL would be introduced under the SA, serving as the minimum amount of credit losses that regulators would require banks to cover in the form of CET1 reduction under the Pillar 1 capital requirements.
  - The BCBS would provide standardised regulatory EL rates (for each risk weight in each exposure class) and banks would multiply these figures with relevant exposure values.
  - If capital requirements increase significantly, compared with the revised SA, the BCBS would assess to what extent adjustments may be necessary.

3. Next steps

- Comments on the proposals should submitted by **13 January 2017**.

14/10/2016
Final Standard on TLAC holdings – Amendments to the Basel III standards on the definition of capital.

1. Context

In November 2015, the FSB published an international standard for Global Systemically Important Banks (G-SIBs) on loss-absorbing and recapitalisation capacity in resolution, which includes a minimum requirement for Total Loss-Absorbing Capacity (TLAC).

At the same time, the BCBS consulted on its proposed deduction treatment for banks' investments in TLAC issued by other G-SIBs, and also on its proposals on the extent to which instruments ranking pari passu with TLAC should be subject to the same deduction treatment.

In this context, the BCBS has published the **final standard on the regulatory capital treatment of banks' investments in TLAC and pari passu instruments**. This standard aims to reduce the risk of contagion within the financial system should a G-SIB enter resolution.

2. Main points

- Tier 2 deduction approach. **Internationally active banks** (both G-SIBs and non-G-SIBs) must deduct their TLAC holdings that do not otherwise qualify as regulatory capital from their own **Tier 2 capital**, taking into consideration the following:
    - Under Basel III, if the investing bank does not own more than 10% of the common shares of the issuer, then capital holdings are deducted only to the extent that they exceed a **threshold** (10% of the investing bank's common equity). The BCBS has **extended this treatment to TLAC holdings**. Thus, TLAC holdings may be included within the threshold and the deduction should be applied as follows:
        - In the case of capital instruments, to the same component of capital for which the capital would qualify if it was issued by the bank itself (e.g. AT1 instruments, to AT1).
        - In the case of holdings of other TLAC instruments, to Tier 2 capital.
    - The BCBS has introduced an **additional threshold** that may be used for non-regulatory capital TLAC holdings only, and which is equivalent to **5% of the investing bank's common equity**. In this regard:
        - This threshold only applies where the investing bank does not own more than 10% of the common shares of the issuer (otherwise, TLAC holdings must be fully deducted from Tier 2 capital).
        - Where the investing bank is a G-SIB, the additional threshold may be used only for TLAC holdings in the trading book that are sold within 30 business days.
    - **Reciprocal cross-holdings** of TLAC between G-SIBs must be **fully deducted** from Tier 2 capital.
    - A **G-SIB's holdings of its own non-regulatory-capital TLAC** must be **deducted** from its own TLAC resources.
- Definition of TLAC holdings. To better meet the objective of limiting contagion, the BCBS has defined TLAC holdings more broadly than those instruments that are actively being recognised by the issuing G-SIB as TLAC. Thus, for the purpose of calculating regulatory capital requirements, the definition of relevant TLAC holdings:
    - **Includes** all direct, indirect and synthetic **holdings of external TLAC**.
    - **Includes all instruments ranking pari passu** with subordinated forms of TLAC.
    - **Excludes** all holdings of instruments or other claims listed in the "**Excluded Liabilities**" section of the FSB TLAC Term Sheet.
- Other TLAC-related changes to Basel III. It is specified that any CET1 capital that is being used to meet the TLAC requirement cannot be used to meet the regulatory capital buffers, which is consistent with the FSB TLAC Term Sheet.

3. Next steps

- These requirements will take effect at the same time as the minimum TLAC requirements for each G-SIB. Thus, they will take effect on **1 January 2019** for investments in most G-SIBs, but later for those whose headquarters are in emerging market economies.

21/11/2016

- **2016 list of global systemically important banks (G-SIBs).**
- **2016 list of global systemically important insurers (G-SIIs).**
- **Information on global systemically important banks.**

1. Context

In November 2011 the FSB published an integrated set of policy measures to address the systemic and moral hazard risks associated with systemically important financial institutions (SIFIs). In that publication, the FSB identified an initial group of global systemically important banks (G-SIBs), and in July 2013 the FSB published an initial list of global systemically important insurers (G-SIIs). These lists are updated annually.

In this regard, the FSB has published the **2016 list of G-SIBs** and the **2016 list of G-SIIs**. In parallel with these publications, the BCBS has released **additional information** regarding the assessment methodology used for the purpose of the list of G-SIBs.

2. Main points

FSB - 2016 list of G-SIBs

- The 30 institutions identified as G-SIBs in 2016 remain the **same as those on the 2015 list**. Nonetheless, there are **changes in the allocation across buckets** of the institutions.
- The inclusion of a bank in the G-SIBs list means that the institution is subject to:
  - **Higher capital buffer requirements**.
  - The **Total-Loss Absorbing Capacity** (TLAC) requirements.
  - **Resolvability requirements**, which include group-wide resolution planning and regular resolvability assessments.
  - **Higher supervisory expectations** for risk management functions, data aggregation capabilities, risk governance and internal controls.

FSB - 2016 list of G-SIIs

- The 9 insurers on the 2016 G-SII list remain the **same as those on the 2015 list**.
- The inclusion of an insurer in the G-SII list means that the insurer is subject to:
  - A **Higher loss absorbency (HLA)** requirement, which is still under development.
  - **Enhanced group-wide supervision**, including for the group-wide supervisor to have direct powers over holding companies and to oversee the development and implementation of a Systemic Risk Management Plan and a Liquidity Management Plan.
  - **Resolvability requirements**, which include group-wide recovery and resolution planning and regular resolvability assessments.

BCBS - Additional information

- The BCBS has published the following information regarding the assessment methodology used for the purpose of the list of G-SIBs:
  - A **list of the banks** included in the assessment sample, and the **links to the disclosures** of those banks.
  - The **denominators** used to calculate the scores for sample banks.
  - The **cut-off score and bucket thresholds**.
  - The **reporting instructions**.

3. Next steps

- Both lists will be updated in **November 2017**.
- The assignment of G-SIBs to the buckets in the list published determines the **higher capital buffer requirements** that will apply to each G-SIB from **1 January 2018**.
- The TLAC standard will be phased-in from **1 January 2019**.
- The HLA requirement for G-SIIs, which is still under development, is scheduled to be applied starting from **January 2019** to those G-SIIs identified in November 2017.

19/12/2016

- **Consultative document on Guiding Principles on the Internal TLAC of G-SIBs.**
- **Consultative document on Guidance on Continuity of Access to Financial Market Infrastructures for a Firm in Resolution.**

1. Context

In November 2015 the FSB, in consultation with the BCBS, finalised a new standard on the adequacy of total loss-absorbing capacity for global systemically important banks (G-SIBs) in resolution ('the TLAC standard'). This standard requires a certain amount of the TLAC resources of a G-SIB ('internal TLAC') to be committed to material sub-groups that are located in host jurisdictions.

In this regard, the FSB has published a **Consultative document on the internal TLAC of G-SIBs**, which proposes a set of high-level **guiding principles** to assist home and host authorities in the implementation of internal TLAC mechanisms consistent with the TLAC standard. Some of these principles are described below.

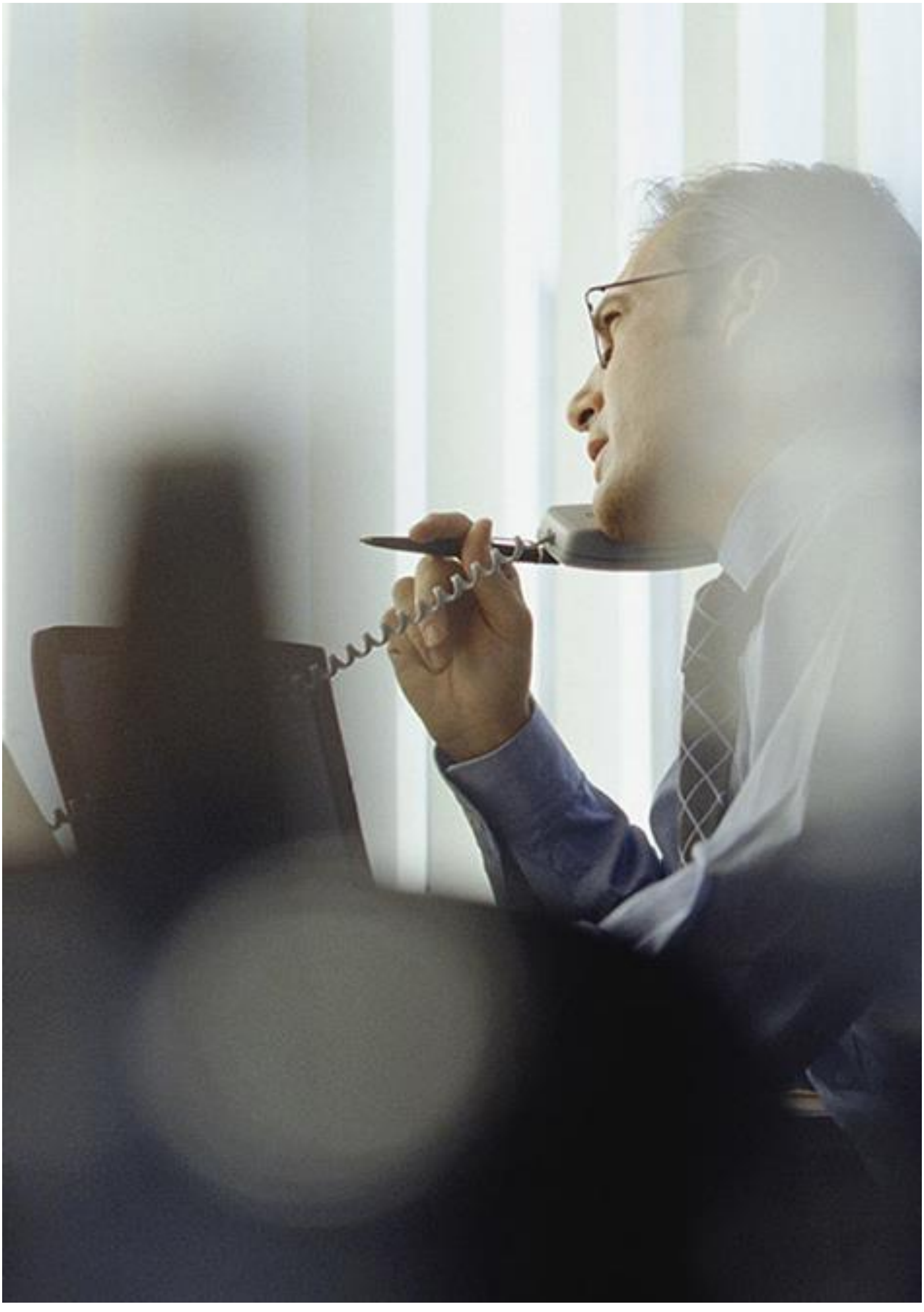
Along with this consultative document, the FSB has also published a Consultative document on Continuity of Access to Financial Market Infrastructures (FMIs) for a Firm in Resolution, setting out the arrangements required to this end. Nonetheless, this consultative document has not been analysed within this publication alert.

2. Main points

- **Material sub-group identification and composition**. Among other principles, it is proposed that:
  - Host authorities should, in consultation with the home authority and the Crisis Management Group (CMG), identify material sub-groups in their jurisdiction and determine their composition and the distribution of internal TLAC between the entities that form the material sub-group.
  - Material sub-groups should only consist of entities in more than one jurisdiction where there is a single resolution regime in those jurisdictions (or a high degree of cooperation between the host authorities).
- **Size of the internal TLAC requirement**. Among other principles, it is proposed that:
  - Host authorities retain ultimate responsibility for setting the internal TLAC requirement (between 75% and 90% of the external minimum TLAC, as set out in the TLAC standard) for the material sub-groups in their jurisdiction (but should do so in consultation with the home authority).
  - In cases where there is surplus TLAC (i.e. TLAC at the resolution entity that is not distributed to material sub-groups), home authorities should consider its characteristics to ensure that it is readily available to recapitalise any direct or indirect subsidiary.
- **Composition and issuance of internal TLAC**. Among other principles, it is proposed that:
  - Host authorities should determine the composition of internal TLAC in consultation with the home authority. They may consider the inclusion of an expectation that internal TLAC consist of debt liabilities accounting for an amount of at least 33% of the requirement.
  - The issuance of internal TLAC should credibly support the resolution strategy. If not, authorities should require G-SIBs to change their TLAC issuance strategies.
- **Features of trigger mechanisms for internal TLAC**. It is proposed that:
  - Contractual triggers for internal TLAC should specify the conditions under which a write-down and/or conversion into equity is expected to take place.
  - Authorities should consider if Point of Non-Viability (PONV) powers (i.e. ability of an authority to write down and/or convert to equity regulatory capital/other TLAC instruments when the authority determines that otherwise the relevant entity would become non-viable) should be complemented with appropriate contractual PONV triggers.
- **The process for triggering internal TLAC**. The FSB proposes principles divided into 3 stages:
  - Stage 1: home and host communication prior to triggering internal TLAC (e.g. host authorities should make home authorities aware that they are considering making a determination that the material sub-group has reached PONV).
  - Stage 2: determination to trigger internal TLAC (e.g. the decision to trigger internal TLAC should be based on the determination that the material sub-group has reached PONV).
  - Stage 3: write-down and/or conversion of internal TLAC (e.g. the host authority should determine the capital shortfall of a material sub-group that has reached PONV).

3. Next steps

- Comments to this consultative document shall be submitted by **10 February 2017**.
- The FSB will undertake a review of the technical implementation of the TLAC standard **by the end of 2019**.



24/11/2016

- **Proposal for a Directive amending the CRD IV.**
- **Proposal for a Regulation amending the CRR and EMIR.**
- **Proposal for a Directive amending the BRRD on loss-absorbing and recapitalisation capacity of credit institutions and investment firms.**
- **Proposal for a Directive amending the BRRD as regards the ranking of unsecured debt instruments in insolvency hierarchy.**
- **Proposal for a Regulation amending the SRMR.**

1. Context

In the wake of the financial crisis, the EU pursued an ambitious reform of the financial regulatory framework to bring back financial stability and market confidence, designed to comply with the internationally agreed standards. However, to tackle remaining weaknesses and implement the new regulatory developments at international level, a further review of the framework was needed.

In this context, the EC has published a **reform package of the financial system**, whereby is proposing to amend the Capital Requirement Directive (CRD IV), the Capital Requirement Regulation (CRR), the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism Regulation (SRMR), and the Regulation on EMIR. Some of the key elements of this reform are the leverage ratio (LR), the total loss absorbing capacity (TLAC) requirement, the net stable funding ratio (NSFR) and the capital requirements for market risk derived from the Fundamental Review of the Trading Book (FRTB).

2. Main points

- **Revision of MREL and implementation of TLAC**.
  - The TLAC standard is implemented by introducing a minimum Pillar 1 MREL requirement in the CRR.
    - This minimum requirement is applicable only to G-SIIs (on either an individual basis or a consolidated basis, and in certain cases it applies to non-EU G-SIIs), comprising an external MREL requirement applicable to resolution entities and an internal MREL requirement applicable to subsidiaries which are not resolution entities.
    - External MREL shall be of at least 18% of RWAs and 6.75% of the LR exposure (although transitional provisions are included).
    - In case a bank does not have sufficient amount of eligible liabilities, the shortfall is automatically filled up with CET1, which may lead to a breach of the combined capital buffer requirement, triggering a limit of discretionary payments.
  - The existing MREL requirement in the BRRD (Pillar 2 MREL requirement) is modified to be aligned with the TLAC standard (e.g. it should be expressed as a percentage of the RWAs and of the LR exposure measure).
    - All institutions have to comply with the Pillar 2 MREL requirement, which is set on a case-by-case basis.
    - Resolution authorities (RAs) should be able to require that G-SIIs comply with a supplementary Pillar 2 MREL requirement. In addition, RAs should be able to require for higher MREL in the form of MREL guidance (measures less severe than discretionary payments will be applied in case of a breach of the guidance).
- **Leverage Ratio**. The EC proposes to introduce a binding LR (Pillar 1) set at 3% of Tier 1 as a percentage of the total exposure measure, which is added to the own funds requirements in the CRR and must be met in addition to the risk-based requirements. The adjustments to the exposure measure included in the delegated act on the LR are maintained.
- **Net Stable Funding Ratio**. The EC proposes to implement the BCBS standard on NSFR, although introducing some adjustments previously recommended by the EBA. If the NSFR falls below the 100% level, the institution shall take the measures laid down in the CRR for a timely restoration.
- **Market risk (FRTB)**. The EC proposes to transpose the conclusions of the FRTB into EU law (e.g. strengthened conditions to use internal models, clarification regarding the criteria to classify the positions in the trading book or the banking book, etc.), although introducing phase-in period in which institutions shall multiply own funds requirements by a factor of 65%. Moreover, the proposal sets out two simplified approaches:
  - Small trading books, for which the thresholds increase (under 50M€ and less than 5% of the institution's total assets), and which may replace the treatment of the own funds requirements for market risk regarding the trading book by the treatment of the own funds requirements for credit risk regarding the banking book.
  - Medium-sized activities, which are subject to the market risk capital requirements (under 300M€ and less than 10% of institution's total assets) and may use the simplified standardised approach.

- **Standardised Approach for Counterparty Credit Risk (SA-CCR)**. In line with the BCBS standards, the EC proposes, among others, replacing the Mark-to-Market Method and the existing Standardised approach with the SA-CCR for calculating the exposure value of derivative positions. Moreover, a simplified standardised approach is included for those institutions with a small derivative business (under 150M€ and less than 10% of the institution's total assets).
- **Interest Rate Risk for Banking Book (IRRBB)**. The EC introduces the BCBS revised framework on IRRBB, including a common SA that institutions may use on a voluntary basis and that CAs may require to use where the internal systems are not satisfactory.
- **Large exposures**. In line with the BCBS standards, the EC proposes to: i) limit the capital that can be taken into account to calculate the large exposures limit (only Tier 1 capital); ii) introduce a lower limit of 15% for G-SIIs exposures to other G-SIIs and; iii) impose the use of the SA-CCR for determining exposures to OTC derivative transactions (even for banks using internal models).
- **Pillar 2**. The EC clarifies the conditions for the application of Pillar 2 capital add-ons, distinguishing between capital requirements, mandatory and imposed to address risks not covered by Pillar 1 and buffer capital requirements; and capital guidance, which refers to the possibility for CAs to communicate their expectations for an institution to hold capital in excess of capital requirements.
- **Intermediate EU parent undertaking**. The EC introduces a new requirement for establishing an intermediate EU parent undertaking where two or more institutions established in the EU have the same ultimate parent undertaking in a third country. This requirement only applies to groups identified as non-EU G-SIIs or that have entities on the EU with total assets of at least 30.000M€.
- **IFRS 9**. A 5 year phasing-in period is proposed to prevent sudden impact on capital ratios (i.e. institutions may add to their CET1 capital the 12-month expected credit losses and the lifetime expected losses calculated in accordance with IFRS 9 multiplied by the transitional factors).
- **Other aspects**. The proposals include other amendments in relation to Financial and Mixed Holding Companies (they are included in the scope of the prudential framework); reporting (e.g. amendments to enhance proportionality); disclosure (e.g. alignment with international standards); ranking of unsecured debt instruments in insolvency hierarchy; certain rules regarding remuneration; treatment of bank exposures to SMEs and to infrastructure projects; treatment of exposures to central counterparties (following the BCBS standard); etc.

3. Next steps

- These proposals are now submitted to the EP and the Council for their consideration and adoption.
- The proposed Regulations and Directives shall enter into force on the **twentieth day** following that of its publication in the Official Journal of the European Union. Nonetheless, different application dates are provided. For instance:
  - The LR, the NSFR, the new rules on market risk, the SA-CCR, the revised IRRBB framework, and the new large exposures regime, among others, shall apply from **2 years** after the date of entry into force of the proposed texts.
  - G-SIIs shall meet a MREL requirement of 16% of RWAs and 6% of the LR exposure measure (phase-in) by **January 2019**.
- Regarding the LR, once a final international agreement on the leverage ratio buffer for G-BIS is reached, it should be considered for inclusion in the CRR.

30/11/2016

Regulation (EU) 2016/2067, amending Regulation (EC) No 1126/2008 and adopting certain international accounting standards as regards IFRS 9.

1. Context

On 24 July 2014, the International Accounting Standards Board (IASB) published IFRS 9 Financial Instruments. The standard aims to improve the financial reporting of financial instruments by addressing concerns that arose in this area during the financial crisis. In particular, IFRS 9 responds to the G20's call to move to a more forward-looking model for the recognition of expected losses on financial assets.

In this context, the EC has published the Regulation (EU) 2016/2067, **transposing IFRS 9 into the EU framework**. This Regulation amends the Annex to Regulation (EC) 1126/2008, and as a consequence of the adoption of IFRS 9, certain international accounting standards in the EU are also amended.

2. Main points

- IFRS 9 has been **endorsed as adopted by the IASB** in 2014.
- The adoption of IFRS 9 implies, by way of consequence, **amendments** to:
    - International Accounting Standards: IAS 1, IAS 2, IAS 8, IAS 10, IAS 12, IAS 20, IAS 21, IAS 23, IAS 28, IAS 32, IAS 33, IAS 36, IAS 37, IAS 39, IFRS 1, IFRS 2, IFRS 3, IFRS 4, IFRS 5, IFRS 7 and IFRS 13.
    - Interpretations of the International Financial Reporting Interpretations Committee: IFRIC 2, IFRIC 5, IFRIC 10, IFRIC 12, IFRIC 16 and IFRIC 19.
    - Interpretation of the Standing Interpretations Committee (SIC) 27.
- Furthermore, **IFRS 9 repeals IFRIC 9**.

3. Next steps

- Each company shall apply this Regulation, at the latest, as from the commencement date of its first financial year starting on after **1 January 2018**.
- The EC intends to give an **option to the insurance sector not to apply IFRS 9 for a limited period of time**.

07/10/2016

Consultation Paper on Guidelines on ICT Risk Assessment under the Supervisory Review and Evaluation Process (SREP).

1. Context

Information and communication technology (ICT) risk is defined as the current or prospective risk of losses due to the inappropriateness or failure of the hardware and software of technical infrastructures, which can compromise the availability, integrity, accessibility and security of such infrastructures and of data.

In view of the increasing importance and complexity of ICT risk within the banking industry and in individual institutions, the EBA has published a **Consultation Paper on Guidelines (GL) on the assessment of the ICT risk under the Supervisory Review and Evaluation Process (SREP)**. These GL are addressed to competent authorities (CAs) and are intended to promote common procedures and methodologies for the assessment of the ICT risk under the SREP.

The GL are divided into the following three parts: i) general provisions; ii) assessment of governance and strategy on ICT; and iii) assessment of ICT risks exposures and controls.

2. Main points

- **General provisions**.
  - Level of application: CAs should apply these GL to all institutions in line with the level of application as set out in the SREP GL. However, CAs should apply them in a manner proportionate to the size, structure and operational environment of institutions.
  - Use of findings and scoring:
    - The assessment of governance and strategy on ICT feeds into the assessment of internal governance and institution-wide controls under the SREP, and also informs the business model assessment under SREP.
    - The assessment of ICT risks exposures and controls informs the operational risk score under the SREP.
- **Assessment of governance and strategy on ICT**. CAs should assess:
  - ICT strategy: whether the institution has an ICT strategy that is adequately governed (i.e. adequate oversight from the management body), is consistent with the institution's business strategy, and supports the institution's business model.
  - Overall internal governance: whether the overall internal governance arrangements are adequate in relation to the ICT systems (e.g. the institution has a robust organizational structure with clear responsibilities, including among others the management body and its committees, and that the key responsible persons for ICT such as the Chief Information Officer have adequate access to the management body).
  - ICT risk in the institution's risk management framework: whether the risk management and internal control framework adequately safeguards the ICT systems (i.e. the risk appetite and the ICAAP cover the ICT risks, and the ICT risks are within the scope of the risk management and internal control frameworks).
- **Assessment of ICT risks exposures and controls**. It focuses on two areas:
  - Identification of material ICT risks. CAs should identify the significant ICT risks to which the institution is or might be exposed. In this regard, CAs should:
    - Review the institution's ICT risk profile, considering several aspects (e.g. whether the institution is implementing material changes to its ICT systems, or has outsourced them, etc.).
    - Review the critical ICT systems and services, taking into consideration that they should fulfill at least one of the conditions specified in the GL (e.g. they support the core business operations and distribution channels, etc.).
    - Identify the material ICT risks that can have a significant prudential impact on the critical ICT systems and services. CAs should then map material ICT risks into one of the ICT risk categories (e.g. ICT security risk, ICT change risk, etc.).
  - Assessment of the controls to mitigate material ICT risks. For the identified material ICT risks, CAs should review the following aspects: i) ICT risk management policy, processes and risk tolerance thresholds; ii) organizational management and oversight frameworks; iii) internal audit coverage and findings; and iv) ICT risk controls that are specific for the identified material ICT risk.

3. Next steps

- Comments to this consultative document shall be submitted by **6 January 2017**.

25/10/2016
Report on the review of the large exposures regime.

1. Context

As part of the review of the CRR, the European Commission (EC) is considering whether to implement the BCBS standards on large exposures in the EU framework, and also reviewing the exemptions to the rules on large exposures. In this regard, in April 2016, the EC sent a Call for Advice (CfA) to the EBA seeking its assistance.

In response to the CfA, the EBA has published a **Report on the review of the large exposures framework** laid down in the CRR, which includes recommendations intended to simplify and harmonise the regime. The report is divided into three different sections: i) alignment with the BCBS large exposures framework; ii) discretionary exemptions to the large exposures regime; and iii) additional aspects.

2. Main points

- **Alignment with the BCBS large exposures framework**. The EBA provides the following recommendations:
  - Strengthening the large exposures capital base by considering only Tier 1 capital, instead of including a proportion of Tier 2 capital (as currently allowed).
  - Reducing the large exposures limit for exposures from Global Systemically Important Institutions (G-SIIs) to other G-SIIs to 15% of Tier 1 capital. The EBA would amend the ITS on supervisory reporting and clarify for which counterparties this limit should apply.
  - Maintaining the existing framework with regard to exposures to funds, securitisations and other transactions with underlying assets. However, regarding the treatment of institutions' exposures to 'shadow banking entities', the EBA suggests that a report on the effectiveness of the existing guidelines should be provided so that a higher degree of harmonization could be achieved.
  - Considering the extension of the new standardised approach for measuring counterparty credit risk exposures (SA-CCR) to the large exposures framework (and the consequent exclusion of the use of internal models to calculate the exposure value of OTC derivatives) only after the full implementation of the SA-CCR in the CRR.
- **Discretionary exemptions to the large exposures regime**. The EBA suggests keeping two of the exemptions identified in the CfA and deleting three. In particular, the EBA recommends that:
  - The following exemptions should be kept: i) exposures within cooperative networks; and ii) interbank exposures incurred to promote specific sectors of the economy under some form of government oversight.
  - The following exemptions should be deleted: i) overnight interbank exposures in minor trading currencies; ii) guarantees on mortgage loans financed by issuing mortgage bonds; and iii) exposures to recognised exchanges.
- **Additional aspects**. The EBA provides views on other aspects of the large exposures framework, which require further work. In particular, the EBA refers to:
  - Alignment with other features of the BCBS framework (e.g. with regard to the treatment of credit risk mitigation techniques).
  - Issues where there is a need for clarification in the CRR (e.g. the treatment of breaches to the large exposures limits could be further developed and harmonised).
  - Errors, inconsistencies and fundamental issues identified in the Q&As, submitted by stakeholders.

3. Next steps

- This report will support the Commission in its review of the large exposures framework as part of the overall CRR review.

25/10/2016

- **Consultation Paper on ITS on procedures and templates for the identification and transmission of information by resolution authorities to the EBA on MREL under the BRRD.**
- **Annex to the Consultation Paper on ITS on MREL reporting by Resolution Authorities (Annex I and Annex II).**

1. Context

Under the BRRD, resolution authorities (RAs), after consulting the relevant competent authorities (CAs), shall ensure that institutions meet at all times a minimum requirement for own funds and liabilities eligible for bail-in (MREL). This minimum requirement is to be set on a firm-by-firm basis, based on criteria laid down in the BRRD and further specified in the RTS on MREL.

In this regard, the EBA has published a **Consultation Paper on draft ITS on MREL reporting by RAs**, which set the procedures they should use when informing the EBA of the MREL that have been set for each institution under their jurisdiction. Along with the draft ITS, the EBA has published an **Annex** which contains the templates to be used by RAs.

These ITS only cover the reporting of MREL requirements by RAs to the EBA. Thus, **reporting by institutions** to RAs or CAs is **outside of the scope** of this consultation.

2. Main points

- **Information included in the standard forms and templates**.
  - The RA, in coordination with the CA, shall transmit to the EBA for each reporting period the relevant information for each institution for which it has set a MREL, contained in the template of Annex I. Among others, this template covers the following elements:
    - Total liabilities and own funds.
    - Total risk exposure amount.
    - Leverage ratio denominator.
    - The amount necessary to ensure loss absorption determined by the RA.
    - The amount of MREL needed to recapitalize the institution under resolution through execution of the resolution strategy considering the amount necessary to sustain market confidence.
    - Where appropriate, adjustments applied to reflect liabilities excluded from bail-in, size, systemic risk, etc.
    - The final MREL requirement applied and any transitional arrangements.
  - Regarding those institutions for which the recapitalization amount is zero, the RA may transmit to the EBA the information detailed in the template contained in Annex II (simplified reporting template) instead of Annex I.
  - In respect of groups, the group-level RA shall inform the EBA of the consolidated MREL and any MREL set on an individual basis for the parent entity and subsidiaries through a joint decision of the resolution college.
- **Reporting periods and submissions dates**.
  - RAs shall inform the EBA without undue delay after the decision establishing the MREL is taken or updated, and update this information at least annually thereafter.
  - In any case the information shall be transmitted to the EBA relating to the MREL that applied on 1 April of each year and this should be submitted to the EBA by 1 May.

3. Next steps

- Comments to this consultative document shall be submitted by **21 November 2016**.

31/10/2016
Consultation Paper Draft Guidelines on internal governance

1. Context

According to the CRD IV, the EBA is mandated to further harmonise institutions' internal governance arrangements, processes and mechanisms within the EU. In this regard, in September 2011, the EBA published its Guidelines on internal governance (GL 44) with the objective of enhancing and consolidating supervisory expectations and improving the internal governance framework.

In this context, the EBA has published a **Consultation Paper on draft Guidelines on internal governance** that updates GL 44 and puts more emphasis on the duties and responsibilities of the management body in its supervisory function in risk oversight. In particular, this document specifies the role of the management body regarding internal governance; the internal governance policy, risk culture and business conduct; the principle of proportionality; the internal control framework; and the principle of transparency.

2. Main points

- **Role of the management body regarding internal governance**. These GL improve the corporate governance arrangements of the institutions and specify:
  - The management body's duties and responsibilities that include, among others, the approval and oversight of the implementation of the overall business strategy and overall risk strategy.
  - The role of the chair of the management body that should lead the management body and be responsible for its effective overall functioning.
  - The supervisor function of the management body which involves, among others, monitoring and challenging the strategy of the institution, management actions and decision, and performing the role independently from the management body.
  - The management function of the management body which involves, among others, to be responsible for the implementation of the strategies set by the management body and discuss regularly their implementation and appropriateness.
  - The role of the Committees (i.e. setting up, composition, processes, etc.).
    - All significant institutions (at individual, parent company and group level) must establish a **risk and a nomination committee** and should set other specialised (e.g. Committee on ethics, conduct and compliance).
    - Not significant institutions may also consider setting up such committees.
  - The organisational framework and its structure that should ensure the independence of the internal control functions and that the management body have the appropriate financial and human resources as well as powers to effectively perform their role.
- **Internal governance policy, risk culture and business conduct**. In this regard, the GL specify certain aspects regarding:
  - The internal governance policy (at individual and group level) which should be a clear organisational and operational structure with well-defined, transparent and consistent lines of responsibility.
  - The business conduct framework that should be focused on the establishment of a risk culture, a code of conduct and the management of conflicts of interest.
  - The mechanisms to report breaches of regulatory requirements (e.g. a dedicated whistleblowing unit, internal alert procedures, etc.).
  - The outsourcing policy which should be regularly reviewed and should consider the impact of outsourcing on an institution's business and the risks it faces (such as operational, reputational and concentration risk).
- **Principle of proportionality**. As established in these GL, institutions should take into account their size (in terms of total assets), internal organization, nature, scale and complexity of their activities when developing and implementing internal governance arrangements.

- **Internal control framework**. These GL provide more guidance on how internal control functions are organised and how internal controls are implemented. They also specify:
  - The <u>risk management framework</u> which should encompass all relevant risks with appropriate consideration of both, financial and non-financial risks, including credit, market, liquidity, concentration, operational, information technology, reputational, legal, conduct, compliance and strategic risks.
  - The institution's well documented <u>new product approval policy (NPAP)</u> which should address the development of new markets, products and services and significant changes to existing ones.
  - The <u>internal control functions</u>, and in particular the risk management function (its role in risk strategy and decisions, in material changes in the institution's risk profile, in identifying and measuring risks and, in unapproved exposures), the compliance function and the internal audit function.
  - The establishment of a sound <u>Business Continuity Management</u> to ensure the institution's ability to operate on an on-going basis and limit losses in the event of severe business disruption.
- **Principle of transparency**. According to these GL, the management body should <u>inform and update the relevant staff</u> about the institution's strategies and policies in a clear and consistent way, at least to the level needed to carry out their particular duties.

3. Next steps

- Comments to this consultative document shall be submitted by **28 January 2017**.
- Competent Authorities across the EU will be expected to implement these GL by **mid-2017**. The existing Guidelines on internal governance (GL 44) will be repealed when the revised Guidelines enter into force.

03/11/2016
Final Guidelines on ICAAP and ILAAP information collected for SREP purposes.

1. Context

Competent authorities (CAs) review institutions' internal capital adequacy assessment process (ICAAP) and internal liquidity adequacy assessment process (ILAAP) as part of the supervisory review and evaluation process (SREP) performed in accordance with the CRD IV and in accordance with the EBA SREP Guidelines.

In this regard, the EBA has issued **Final Guidelines** to facilitate the consistent approach to the assessment of institutions' ICAAP and ILAAP under the SREP. In particular, the Guidelines specify what **information** regarding ICAAP and ILAAP CAs should collect from the institutions, and also set **general criteria** for CAs to organise collection of ICAAP and ILAAP information from institutions and use such information for the purposes of their assessments of other SREP elements.

2. Main points

- **Information regarding ICAAP and ILAAP that CAs should collect from institutions**.
  - Reader's manual. Overarching document which is prepared to facilitate the assessment of ICAAP and ILAAP documents and provides an overview of the ICAAP and ILAAP-related documents submitted to the CAs and their status (e.g. new, changed, etc.).
  - Common information to ICAAP and ILAAP. Information on business model and strategy; risk governance and management framework; stress testing framework and programme; and risk data, aggregation and IT systems.
  - ICAAP specific information. Information regarding the overall ICAAP framework; risk measurement, assessment and aggregation; internal capital and capital allocation; capital planning; stress testing in ICAAP; and supporting documentation.
  - ILAAP specific information. Information on the liquidity and funding risk management framework; funding strategy; strategy regarding liquidity buffers and collateral management; cost benefit allocation mechanism; intraday liquidity risk management; liquidity stress testing; liquidity contingency plan; and supporting documentation.
  - Conclusions on ICAAP and ILAAP and quality assurance information. For instance, the findings of the internal capital and liquidity adequacy assessments and their impact on the risk and overall management of an institution; an adequate explanation of how institutions ensure that the ICAAP and ILAAP frameworks and models used provide reliable results; results of the internal validations/reviews of ICAAP and ILAAP methodologies and calculation outcomes performed by independent validation function; etc.
- **General criteria for CAs to organise collection of ICAAP and ILAAP information**. The frequency, reference and remittance dates, and scope for ICAAP and ILAAP information should be determined in relation to the SREP categorisation of institutions, minimum supervisory engagement model and supervisory examination programmes.
  - CAs would be expected to receive from Category 1 institutions (i.e. global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) and, as appropriate, other institutions determined by CAs) all information specified in these Guidelines annually by a single set date as a comprehensive package.
  - Non-Category 1 institutions may have different scope, format, frequencies, remittance and reference dates regarding information, which will be determined by the CAs for each category of institutions, or individual institutions.

3. Next steps

- These Guidelines will apply from **1 January 2017**.
- Based on their implementation, CAs will determine the scope and set the remittance dates for the first submission of information in accordance with the provisions of these Guidelines.

07/11/2016

Report in response of the EC's CfA on standardised approach for counterparty credit risk and own funds requirements for market risk.

1. Context

In April 2016, the EBA received two calls for advice (CfAs) to assist the European Commission (EC) in the adoption into EU legislation of two new international frameworks proposed by the BCBS: i) a new standardised approach for counterparty credit risk (SA-CCR); and ii) a new market risk framework, based on the so-called Fundamental Review of the Trading Book (FRTB).

In response to these CfAs, the EBA has published a **Report to the EC on the SA-CCR and own funds requirements for market risk**. This report analyses the envisaged impact of these two frameworks, and issues **recommendations** regarding their implementation which are addressed to the EC.

In particular, this report includes 5 policy recommendations on the following aspects: i) threshold for small trading book (TB) business; ii) threshold for small derivative business; iii) consideration of additional proportionality solutions; iv) higher reliance on delegated legislation in the implementation of the SA-CCR and the FRTB frameworks; and v) COREP proportionality monitoring.

2. Main points

- **Threshold for small TB business**. The EBA recommends keeping a threshold below which institutions are able to use the non-trading book approach for the computation of capital requirements. Regarding this threshold, the EBA suggests, among others, the following aspects:
  - It should be applicable in the case of <u>position risk</u> only.
  - It should be defined in terms of the <u>sum of the absolute market value of long and short positions in equity and debt instruments</u> included in the <u>TB</u>.
  - With regard to the level of the threshold, it should be set at <u>50M€</u>.
- **Threshold for small derivative business**. The EBA recommends introducing a threshold below which institutions are allowed to use a simple approach for the computation of CCR capital requirements, which could include the use of the current original exposure (OEM) or mark to market (MtM) method, subject to appropriate recalibration. In particular, it suggests that:
  - The threshold should be defined in terms of the <u>sum of the absolute market value of long and short positions in derivative instruments</u> included in both its <u>TB and non-TB</u>.
  - With regard to the level of the threshold, it could be established at <u>20M€</u>.
- **Consideration of additional proportionality solutions**. The EBA recommends considering the definition of higher thresholds below which SAs that are simpler than the ones developed in Basel could be applied for smaller banks not included in the scope of the Basel standards:
  - For market risk, the <u>current SA</u> (subject to appropriate recalibration) could be kept for institutions that fall between the threshold of 50M€ of recommendation i) and the higher threshold to be defined.
  - For CCR, either a <u>simplified version of SA-CCR</u> or the <u>current MtM method</u> (subject to appropriate recalibration) could be kept for institutions that fall between the threshold of 20M€ of recommendation ii) and the higher threshold to be defined.
- **Higher reliance on delegated legislation in the implementation of the SA-CCR and the FRTB frameworks**. The EBA recommends that large technical parts of these international standards should be implemented using <u>delegated acts or RTS mandates</u>.
- **COREP proportionality monitoring**. The EBA recommends the inclusion into COREP of the following (a deadline of 2 years should be set):
  - <u>CCR COREP templates</u> giving an overview of the CCR of institutions (e.g. exposures to central counterparties, methods used to compute CCR exposures and corresponding RWAs, etc.).
  - <u>COREP cells/templates</u> providing details on the computation of the different proportionality thresholds included in legislation and links with corresponding accounting categories.

3. Next steps

- According to the BCBS's implementation calendar, the SA-CCR will become effective on **1 January 2017**.
- According to the implementation calendar included in the FRTB text, the **new market risk framework** should be implemented in jurisdictions' legal frameworks by **January 2019**, and firms are expected to **report under the new standards by the end of the year**.

15/11/2016

- **Consultation Paper on Draft ITS amending Implementing Regulation (EU) No 680/2014 with regard to operational risk and sovereign exposures.**
- **Annex I – Templates for reporting on own funds and own funds requirements (changes showing).**
- **Annex II – Instructions for reporting on own funds and own funds requirements.**

1. Context

The CRR mandates the EBA to develop uniform reporting requirements, which are included in Regulation 680/2014. In this regard, the data on sovereign exposures currently collected suffers from several shortcomings which required additional ad-hoc data collections from several competent authorities (CAs); and improvements are also necessary to the reported information on operational risk (OpRisk) to allow supervisors to monitor the losses due to OpRisk events.

In this context, the EBA has published a **Consultation Paper on ITS amending Regulation 680/2014 with regard to sovereign exposures and OpRisk**. In particular, these ITS proposes new requirements as regards the reporting of information on sovereign exposures, and changed requirements as regards the reporting of OpRisk information.

2. Main points

- **New requirements regarding sovereign exposures**. This proposal covers the following aspects:
  - Templates. The existing reporting requirements should be supplemented with **two new templates** that shall be reported with a **semi-annual frequency**:
    - **C 33.01**, which provides a breakdown of sovereign exposures by residence of the obligor, accounting portfolio and regulatory treatment.
    - **C 33.02**, which provides breakdown of sovereign exposures by residence of the obligor and accounting portfolio and maturity.
  - Scope (definition of sovereign). All exposures to 'General governments' are to be reported in the new templates, which includes central, state or regional and local governments.
  - Proportionality. Institutions that have sovereign exposures of at least **1% of total 'debts securities and loans receivables'** are requested to report the information as specified in templates C 33.01 and C 33.02. Among these institutions:
    - Those that hold non-domestic sovereign exposures of 10% or more compared to total sovereign exposures shall report a **full country breakdown**.
    - Those that do not meet the above-mentioned threshold shall report the information for **exposures aggregated** at total level and domestic level.
- **Changed requirements regarding OpRisk**. The EBA proposes the following changes:
  - Redefine scope of institutions subject to obligation to report OpRisk loss data. The EBA proposes to limit the exceptions from reporting the full sheet C 17.00. Thus, institutions using the Basic Indicator Approach (BIA) and the Standardised Approach (TSA) shall report this information when they meet at least one of the criteria specified (e.g. total value of the asset exceeds €30 billion).
  - Separate loss impacts in current reporting period relating to events from previous reporting periods. A few changes are proposed to template C 17.01 (e.g. new rows) to distinguish between loss impacts from current events and those relating to older events.
  - Collect detailed information on the largest losses from the last year. The EBA proposes to introduce a new template (C 17.02), which aims at collecting detailed information on the largest OpRisk loss incidents in the last year.

3. Next steps

- Comments to this consultative document shall be submitted by **7 January 2017**.
- The envisaged date for finalisation of the draft ITS is **March/April 2017**, with the application of the revised reporting requirements in **March 2018**.

16/11/2016
Consultation Paper on Guidelines on PD estimation, LGD estimation and the treatment of defaulted exposures.

1. Context

In February 2016, the EBA published a Report on the regulatory review of the IRB Approach, outlining the initiatives that has undertaken to reduce the unjustified variability in the outcomes of internal models while preserving the risk sensitivity of capital requirements.

In this regard, the EBA has published a **Consultation Paper on Guidelines (GL) on PD and LGD estimation and on the treatment of defaulted assets**, which are focused on the definitions and modelling techniques used in the estimation of risk parameters for both non-defaulted (PD and LGD) and defaulted exposures (best estimate of expected loss (ELbe) and LGD-in defaulted).

These draft GL aims at aligning the terminology and definitions, and provide clarification on the application of certain regulatory requirements that were until now interpreted in various ways.

2. Main points

- **General estimation requirements**. These GL cover policy proposals regarding <u>segmentation principles</u>, aimed to provide guidance on the highest level of rating system design; <u>data requirements</u>, including clarifications regarding accuracy, completeness, etc.; <u>human judgement</u> in model development; and <u>margin of conservatism</u> (MoC), including principles to be followed regarding its identification, quantification, reporting and documentation.
- **PD estimation**. The GL provide detailed guidance on the following aspects:
    - <u>General requirements</u>, such as the requirement that each natural/legal person that has exposures within the scope of the IRB Approach should be rated, clarification on the updates of rating relevant information, etc.
    - <u>Data requirements</u> for the purpose of default rate calculation and for the reference data set for model development.
    - <u>Observed default rates</u>, in particular regarding the calculation of a one-year default (the GL clarify it for a number of specific situations) and the method chosen for averaging over a series of one-year default rates (e.g. the GL require institutions to justify their approach).
    - <u>Long-run average default rate</u>, clarifying among others that it should be calculated as the average of observed one-year default rates if the historical observation period is representative of their variability (i.e. it contains a downturn period).
    - <u>PD estimation methodologies</u>, including particular policies for the use of third-party ratings, the design of grades and pools and for the process of assigning PD estimates to grades and pools.
- **LGD estimation**. The GL provide detailed guidance on the following aspects:
    - <u>General requirements</u>, which clarify, among others, that institutions should not use methodologies that are based only on external data when estimating LGD.
    - <u>Data requirements</u> on the reference data set and the representativeness of data (e.g. use of appropriate points in time).
    - <u>Calculation of economic loss and realised LGD</u>, in particular on the treatment of unpaid late fees, interest and additional drawings after default, discounting rate, and costs.
    - <u>Long-run average LGD</u>, including clarifications regarding the historical observation period, calculation, treatment of incomplete recovery processes, etc.
    - <u>LGD estimation methodologies and risk drivers</u>, specifying principles that should be adhered to regardless of the methodology.

- **Estimation of risk parameters for defaulted exposures**. The GL cover the following aspects:
    - General requirements (specific to ELbe and LGD in-default) that specify that the same methods used for estimating LGD on non-defaulted exposures should be used and provide guidance only on those specific aspects where different treatment for defaulted assets loss rate estimation is justified.
    - Data requirements (specific to ELbe and LGD in-default), which specify that the scope of data necessary includes also the information obtained during the recovery process.
    - Reference dates, specifying, among others, that institutions should set them according to the recovery pattern observed on a specific type of exposures.
    - Calculation of realised LGD and long-run average LGD for defaulted exposures specifying that the former should be performed at each relevant reference date, and clarifying the treatment of incomplete recovery processes for the latter.
    - Risk drivers, specifying the type of drivers that institutions should take into account (e.g. type of product, type of collateral, geographical location of the collateral, etc.).
    - Specific requirements for ELbe estimation, in particular regarding the current economic circumstances and the relations of ELbe with specific credit risk adjustments.
    - Specific requirements for LGD in-default estimation, including downturn conditions and appropriate MoC.
- **Other aspects**. These GL provide also guidance on the application of risk parameters (conservatism and human judgement in their application); re-development, re-estimation and re-calibration of internal models; and calculation of shortfall or excess of provisions against EL for IRB portfolios.

3. Next steps

- Comments to this consultative document shall be submitted by **10 February 2017**.
- The proposed deadline for **implementation is end-2020**, as already specified by the EBA.

23/11/2016

Final draft RTS on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use internal models for market risk and assessment of significant share.

1. Context

The CRR contains specific mandates for the EBA to develop RTS to specify the conditions under which competent authorities (CAs) assess the significance of positions included in the scope of market risk internal models, as well as the methodology that CAs shall apply to assess compliance of an institution with the requirements to use an Internal Model Approach (IMA) for market risk.

In this regard, the EBA has published the **Final RTS** on the assessment of significant share and on the assessment methodology, being mindful of the Fundamental Review of the Trading Book (FRTB) that the BCBS published in January 2016. In particular, these RTS introduce some elements that go in the direction of the Basel review, which can be implemented within the CRR current legal setting.

2. Main points

- **Assessment of significant share of positions**. Permission by CAs for the use of internal models shall be required for each risk category (general risk of equity instruments, specific risk of equity instruments, general risk of debt instruments, specific risk of debt instruments, foreign-exchange risk and commodities risk) and shall be granted only if the internal model covers a significant share of the positions of a certain risk category.
  - <u>Identification of risk categories and legal scope</u>. The assessment of the significance of positions has to be conducted for the particular combination of legal entity/ies and risk category/ies, without considering any roll-out plans or materiality limits for the risk categories or institutions that remain outside the scope of the model.
  - <u>Methodology applied</u>. When assessing the significance of positions, due to differences in the nature of general and specific risks, it is proposed to use two different treatments. The assessment of general risk has to be based on the own fund requirements stemming from changes in broad market movements, unrelated to any specific attributes of individual securities, while the assessment of specific risk shall be based on the net position in each individual security, in order to reflect the idiosyncratic risk.
  - <u>Initial and regular assessment of significance</u>. As part of the annual internal validation, the risk control unit shall assess the materiality of the positions excluded from the internal model by using two simple metrics: the proportion of the P&L and the proportion of the own funds requirements stemming from the positions included in the scope of the model compared with the total by risk category.
  - <u>Minimum model stability period prior to authorization</u>. At the moment when the model application is submitted, the market risk internal model shall have been working for at least 1 year in a stable way (not subject to material changes).
  - <u>Calculation of thresholds for positions excluded</u>. Two calculations are required:
    - When submitting a model application, banks shall comply with a threshold of 10% for the positions they intend to include in the internal model.
    - If CAs have excluded some positions from the scope, banks shall meet a threshold of 40%.
- **Assessment methodology of market risk internal models**.
  - <u>Common governance framework</u>. The RTS include minimum standards on model governance, independence, resources and validation in a single governance section that covers the following elements: segregation and independence of the risk unit; variable remuneration of the risk unit/internal audit personnel; outsourcing; initial and regular internal validation; completeness of the internal validation; independence of the internal validation; new product approval policy; internal reports and structure of committees; internal limits and limit breach approval process; and stress testing programme.
  - <u>VaR and SVaR</u>. The RTS include requirements on calculation at consolidated level; backtesting; treatment of 'event risk'; treatment of own creditworthiness, etc.
  - <u>IRC model</u>. The RTS include requirements regarding some elements used in this model such as the selection of ratings, PDs and LGDs, transition matrices or liquidity horizons. Governance requirements are also introduced for the inclusion of equity positions in IRC and it is required that PDs used for modelling purposes shall be higher than zero (without providing an explicit floor value).
  - <u>Internal model for the correlation trading portfolio</u>. The RTS establish governance requirements for the inclusion of positions and appropriate segregation of instruments included in the correlation trading portfolio, including an explicit requirement to assess and monitor regularly the existence of a liquid two-way market.

3. Next steps

- These RTS shall enter into force on the **twentieth day** following that of its publication in the Official Journal of the European Union.

01/12/2016

- **Final draft ITS Commission Implementing Regulation (EU) 680/2014 on supervisory reporting of institutions with regard to FINREP following the changes in IFRS 9.**
- **Annex I (FINREP Annex III – IFRS templates).**
- **Annex II (FINREP Annex IV – nGAAP templates).**
- **Annex III rev1 (FINREP Annex V – Instructions).**

1. Context

In July 2014, the International Accounting Standards Board (IASB) issued 'IFRS 9 – Financial Instruments' which supersedes IAS 39.

In this regard, following the recent endorsement of IFRS 9 into EU law, the EBA has published the **Final ITS amending the ITS on supervisory reporting with regard to FINREP**, with the aim of aligning the reporting framework with the new IFRS 9 requirements.

Moreover, as certain parts of FINREP templates are to be reported indistinctively by institutions using IFRS and by institutions under national Generally Accepted Accounting Principles (GAAP), and it is necessary to ensure that information remains consistent, the ITS also requires an update of the GAAP templates.

2. Main points

Changes to FINREP IFRS templates

- **Classification and measurement**. The main changes throughout the FINREP templates are:
  - Deletion of the Held to Maturity accounting portfolio which no longer exist in IFRS 9.
  - Replacement of the 'Available for sale (AFS)' accounting portfolio by the 'Fair value through Other Comprehensive Income (FVOCI)' accounting portfolio.
  - Replacement of the 'Loans and Receivables' accounting portfolio by the 'Amortised cost' accounting portfolio.
- **Impairment**. The FINREP templates with a focus on impairment have been modified to accommodate the changes introduced by IFRS 9. Some of the amendments are the following:
  - Each template breaks assets down between the different stages and their associated allowance where relevant.
  - Some templates convey information on the classification and impairment status of exposures for which exemptions and rebuttable presumptions are used in IFRS 9.
  - Assets subject to specific impairment rules are separately identified when needed for supervisory purposes.
  - Information on write-offs are included in three specific templates.
  - The impact of modifications of assets is now separately identified both in terms of P&L in and in terms of amount of allowance.
- **Hedge accounting**. The following amendments have been introduced:
  - Extra rows have been added in existing templates to reflect the changes in the accounting for qualifying hedges.
  - Moreover, the revision of FINREP introduces two new templates:
    - A template to report information on non-derivative hedging instruments in cash-flow hedges and fair value hedges.
    - A template on hedged item in fair value hedges and on the impact on fair value hedges in the reporting period in review.

Changes to FINREP GAAP templates

- **Consequential changes**. The ITS introduce changes that are implemented to keep the information reported aligned between both IFRS and GAAP reporters (e.g. accumulated changes in fair value due to credit risk for trading assets are no longer required, new rows are inserted for the breakdown of hedging instruments by types of hedges, regulatory concepts implemented for FINREP purposes have been updated for national GAAP reporters, etc.).
- **Broader changes**. The ITS introduce changes to fix specific reporting issues that have arisen with the current Annex IV (e.g. new rows and columns have been added regarding held for trading assets under IFRS and trading assets under GAAP, reporting of market values of derivatives, etc.).

Other changes that apply to both IFRS and GAAP templates

- **Other changes**. The ITS introduce changes that apply to both IFRS and GAAP templates regarding the concept of gross carrying amount of financial assets; the reporting of non-performing exposures and forbearance, the reporting of mortgage loans, etc.

3. Next steps

- The ITS will be **submitted to the European Commission** (EC) for endorsement.
- The ITS apply, depending on the accounting year, from the **first date where IFRS 9** as endorsed by the EU **becomes applicable** (1 January 2018). Thus, for an institution with an accounting year of January / December the application date will be 1 January 2018, with a first reference date of 31 March 2018.

05/12/2016

- **Risk Assessment of the European Banking system.**
- **2016 EU- wide transparency exercise.**

1. Context

The EBA has published its **ninth Risk Assessment Report (RAR)**, which describes the main developments and trends that have affected the EU banking sector since the end of 2015 and provides an outlook on the main micro-prudential risks and vulnerabilities looking ahead.

In particular, the RAR includes aggregate results on capital position, return on equity (RoE), non-performing loans (NPL) ratio, and coverage ratio of NPLs. Moreover, the RAR also addresses other aspects such as information and communication technology related (ICT) risks.

Moreover, the RAR is complemented with the **EBA's EU-wide 2016 transparency exercise**. Unlike the stress tests, transparency exercises are disclosure exercises where only bank-by-bank data are published and no shocks are applied to the actual data. The sample in the this exercise includes 131 banks at the highest level of consolidation in the EU.

2. Main points

- **Sample of banks in the RAR**: 198 banks from 29 European Economic Area countries (157 banks at the highest EU level of consolidation). Based on total assets, this sample covers about 85% of the EU banking sector.
- **Reference date of the RAR**: the data presented in the RAR is as of June 2016.
- **Data for the RAR**: the RAR is based on qualitative and quantitative information collected by the EBA from the supervisory reporting, its Risk Assessment Questionnaire for banks and market analysts, and micro-prudential qualitative and supervisory college information.
- **Results of the RAR**: the EU banking sector continues to struggle with high levels of NPLs and low profitability, notwithstanding the steady strengthening of the capital base.
    - Capital position. The strengthening of solvency has continued. The aggregate CET1 capital ratio is 13.6% (13.2% fully loaded). The Tier 1 capital ratio and the total capital ratio reached 14.8% and 17.8%, respectively.
    - RoE. The aggregate weighted average RoE is 5.7%, down by more than 100 bp compared to June 2015. The decline in profitability was driven by a drop of total operating income by 8.8 %. Moreover, the RoE remain below banks' cost of equity (CoE).
    - NPL ratio. It improved to 5.4%, compared to 5.7% at the end of 2015. Nonetheless, even if there are signs of potential improvements, asset quality is still subdued compared to historical figures and other regions.
    - Coverage ratio of NPL. It increases marginally to 43.8%, compared to 43.7% in December 2015.
    - ICT risks. The rising digitalisation of distribution channels and 'always-on' expectations of customers is putting pressure on systems to adapt; and cyberattacks are on the rise. In this context, supervisors are focusing on ICT-related risks including measures to fix rigid and outdated legacy IT systems, IT resilience and governance and outsourcing. The entry of financial technology (FinTech) competitors is also seen as a challenge and opportunity.

CET1 ratio (transitional)	RoE	NPL ratio	Coverage ratio of NPL
13,6%	5,7%	5,4%	43,8%

Reference date as of June 2016

3. Next steps

- The EBA decides on a yearly basis whether or not to conduct a stress test exercise. On those years where a stress test exercise is not conducted, a transparency exercise is carried out.

15/12/2016
Final Report on the implementation and design of the MREL framework.

1. Context

In November 2016, the European Commission (EC) brought forward proposals that, among others, aim to incorporate TLAC into the EU legal framework and to improve the existing minimum requirement for own funds and eligible liabilities (MREL) framework. The proposals entail amendments to various pieces of EU legislation that will be discussed by the European Parliament (EP) and Council with a view to their adoption.

In this context, the EBA has published the **Final Report on the implementation and design of the MREL** addressed to the EC, including a number of recommendations to reinforce the MREL framework and integrate the international standards on TLAC in the EU's MREL. These recommendations are analysed below.

Moreover, this report provides a quantitative analysis of the MREL stack and funding needs of 133 banking groups, and an analysis of the potential macroeconomic impact of the introduction of MREL. In this regard, the EBA estimates that the financing needs to comply with an assumption-based MREL requirement in the steady phase would range between €186bn and €276bn. Further, the net macro-economic impact of introducing MREL would be positive and range between 17 and 91 basis points of GDP.

2. Main points

- The EBA makes, among others, the following **recommendations**:
    - **Reference base for MREL requirement (denominator)**. It should be changed from total liabilities and own funds (TLOF) to RWAs. This should be complemented with a leverage ratio exposure backstop, in parallel with its phase-in within the capital framework.
    - **MREL stacking order**. Banks in the EU should not be able to use the same CET1 capital to meet MREL and to meet regulatory capital buffers.
    - **Interaction between MREL and the maximum distributable amount (MDA) framework**. It is recommended to introduce a suspension ('grace period') in the automatic triggering of distribution restrictions under the MDA framework where the breach relates to a failure to roll over or issue sufficient MREL-eligible debt.
    - **Breach of MREL**. It should be treated as seriously as a breach of capital requirements. Thus, the EBA recommends, among others, that powers of resolution authorities (RAs) should be enhanced to respond to a breach, including an expedited impediment removal process and the power to require an institution to draw up an MREL restoration plan.
    - **Redemption and maturity management**. It is recommended to introduce an approval requirement for any redemption by an institution of an MREL-eligible instrument where that redemption would bring the institution into breach of its MREL requirement or the combined buffer requirement (CBR). Moreover, the legislative framework should contain a requirement for RAs to monitor the maturity profile of the MREL-eligible instruments.
    - **Cross-holdings of MREL**. Exposures to MREL instruments issued by credit institutions should be deducted from MREL on a like-for-like basis above the double threshold (in line with the proposal by the BCBS for the TLAC holdings).
    - **Subordination**. The report recommends requiring globally systemically important banks (G-SIBs) to meet their MREL with subordinated instruments at least to a level of 14.5% of RWAs in line with the TLAC term sheet; and requiring other systemically important institutions (O-SIIs) to meet a subordination requirement of 13.5% of RWAs.
    - **Third-country recognition requirements**. Some reduction of the burden of compliance with these requirements should be introduced, which could be done by narrowing the scope of the requirement while maintaining the effectiveness of contractual recognition for MREL liabilities.
    - **Adequacy and calibration**. The calibration of MREL should, in all cases, be closely linked to and justified by the institution's resolution strategy. Business models may be worth considering to the extent that they translate into differences in resolution strategies.
    - **Intragroup issues**. The MREL framework should provide for the identification of resolution entities and the allocation of internally issued, subordinated MREL at the non-resolution-entity level.
    - **Reporting**. The BRRD should provide for an explicit obligation for credit institutions to regularly report their level and composition of MREL instruments to RAs.
    - **Disclosure**. Credit institutions in the EU should be required to disclose the quantum and composition of their MREL-eligible liabilities and the MREL required by the RAs.

3. Next steps

- The EP and Council will deliberate on the financial sector reform package in the coming months.
- The EBA intends to continue to analyse the implementation of MREL and TLAC in the EU.

15/12/2016
Final Guidelines on disclosure requirements under Part Eight of the CRR.

1. Context

In January 2015, the BCBS released a **revised Pillar 3 framework** (RPF), whose first application is set for 2016 year-end disclosures.

The incorporation of the RPF into the EU law would require an update of the disclosure requirements laid down in the CRR. In the meantime, EU institutions are facing stronger market pressure to provide disclosures in line with the BCBS RPF, which might force them to provide a double set of disclosures in these areas of misalignment between the CRR and the RPF.

In this context, the EBA has published **Final Guidelines (GL) on disclosure requirements**. These GL, while not changing the requirements of the CRR, provide further guidance to institutions in complying with both the CRR and the RPF requirements. In particular, they cover the entire content of the RPF, with the exception of securitisation requirements, which are currently under discussions at EU level, and other disclosure requirements for which there are already EBA technical standards (e.g. own funds and leverage ratio).

2. Main points

- **Scope**. These GL apply to Global and Other Systemically Important Institution (G-SIIs and O-SIIs). Moreover, competent authorities may require institutions that are neither G-SII nor O-SII to them.
- **Formats and disclosures**. The GL contain Tables for qualitative and quantitative information; and Templates for quantitative information. Templates come with a flexible or a fixed format (e.g. information on capital requirements and RWAs), while Tables come with a flexible format.
- **Disclosure requirements**. The GL contain the following requirements (in certain cases some adjustments have been made to the RPF tables and templates):
  - General requirements on disclosures: the GL implement the RPF principles (related to clarity, consistency over time, comparability, etc.), and include provisions regarding the disclosure of non-material, proprietary or confidential information, the location of disclosures, etc.
  - Capital requirements: information on capital requirements and RWA for all the risks (template OV1) and for equity exposures under the IRB approach (template CR10), and disclosures on non-deducted insurance participations (template INS1, not contemplated in the RPF framework).
  - Risk management: disclosures on risk management (table OVA), credit risk (table CRA), counterparty credit risk (table CCRA) and market risk (table MRA).
  - Scope of application: disclosures on the difference in the scope of consolidation (template LI1), measurement of exposure (template LI2), additional information on these issues (table LIA), and information on the consolidation method applied for each entity within the scope of consolidation (template LI3, not contemplated in the RPF framework).
  - Credit risk and credit risk mitigation: general information (tables CRB and CRC, and templates CR1, CR2 and CR3), disclosures on the standardised approach (table CRD and templates CR4 and CR5), and disclosures on the IRB approach (table CRE and templates CR6, CR7, CR8 and CR9).
  - Counterparty credit risk (CCR): among others, disclosures on breakdown of CCR by exposure computation method (template CCR1), breakdown of the CVA charge (template CCR2), etc.
  - Market risk: qualitative disclosures (table MRB) and quantitative disclosures (templates MR1, MR2, MR3 and MR4).
- **Timing and frequency of disclosures**. The GL adopt the same frequency framework as the RPF:
  - Tables are to be disclosed annually.
  - Templates are to be disclosed semi-annually, except in the following cases:
    - Templates on linkages between the accounting and regulatory scopes of consolidation and the accounting and regulatory exposure values, as well as on the backtesting of PD under the IRB approach, are to be disclosed annually.
    - A limited set of templates with a fixed format and focused on RWA variations and capital requirements are to be disclosed quarterly.

3. Next steps

- These GL apply from **31 December 2017**. However, G-SIIs are encouraged to comply with a subset of those Guidelines as soon as 31 December 2016.

19/12/2016

- **EBA Qualitative survey on IRB models.**
- **Instructions for the EBA qualitative survey on IRB models (Dec 2016).**

1. Context

In November 2016, the EBA published a consultation paper on Guidelines (GLs) on PD, LGD and defaulted assets. These GL are part of the broader review of the internal ratings-based (IRB) approach that is carried out by the EBA to reduce the unjustified variability in the outcomes of internal models.

In this context, the EBA has launched a **Qualitative survey on IRB models**, in order to assess the impact of these GL in terms of expected amount and severity of model changes. In particular, this survey contains detailed questions about banks' modelling practices for estimating PD, LGD, LGD-in default and expected loss best estimate (ELbe).

2. Main points

- **Scope**. This qualitative survey is only addressed to institutions that use the IRB approach for credit risk. In any case, it will be carried out on a voluntary basis.
- **Selection of models to complete the survey**.
    - Institutions are requested to complete these questionnaires for at least 3 PD models and 3 LGD models, covering the highest share of exposure values. Institutions should also take into account which models cover the largest share of obligors and which models reflect the current modelling practices.
    - Institutions are requested to use the definition of PD model and LGD model as proposed in the GLs.
    - Institutions should take into account the level of governance of the models (central model or local model) when deciding which model to select in accordance with certain criteria (e.g. only local models should be selected by subsidiaries).
- **Questionnaire template**. The responses should be submitted using 3 different sheets:
    - Sheet A (general information). It contains general questions regarding the number of PD and LGD models used within an entity, general features of these models, etc.
        - **Scope**: sheet A should be completed once, by all institutions.
        - **Reference date**: as of 30 June 2016.
    - Sheet B (info on PD model). It contains detailed questions about the development, calibration and application of individual PD models selected by institutions.
        - **Scope**: sheet B should be completed by all institutions for at least 3 PD models (unless less than 3 PD models are used within the institution).
        - **Reference date**: the most up-to-date information about the approved model.
    - Sheet C (info on LGD model). It contains detailed questions about the estimation and application of individual LGD models selected by institutions.
        - **Scope**: sheet C should be completed by those institutions applying the A-IRB approach or the IRB approach for the retail exposure class, for at least 3 LGD models (unless less than 3 PD models are used within the institution).
        - **Reference date**: the most up-to-date information about the approved model.

3. Next steps

- Institutions are invited to submit their responses to this survey to relevant competent authorities by **27January 2017**.
- Institutions may be contacted by the EBA in order to clarify potential issues or concerns related to the quality of provided information from **6 February 2017** onwards.
- The EBA expects to publish the consultation paper of the draft RTS on the specification of the nature, severity and duration of an economic downturn in the **first quarter of 2017**.

22/12/2016
Decision by the EBA Board of Supervisors regarding and EU-wide stress test in 2017.

1. Context

The EBA is required, in cooperation with the European Systemic Risk Board (ESRB), to initiate and coordinate EU-wide stress tests. In this regard, the EBA shall, at least annually, consider whether it is appropriate to carry out EU-wide stress tests.

In this context, the EBA has published a **decision to carry out its next EU-wide stress test in 2018**, in line with its previous decision to aim for a biennial exercise. Furthermore, the EBA has decided to perform its regular annual transparency exercise in 2017.

2. Main points

- The EBA has decided not to conduct an EU-wide stress test in 2017 but to start preparations for the **next stress test in 2018**.
    - The decision to run the next EU-wide stress test in 2018 was driven by an acknowledgement of the ongoing progress that EU-banks are making in strengthening their capital positions.
- The EBA will perform its regular annual **transparency exercise in 2017** which will be carried out similar to the one in 2016.

3. Next steps

- The EBA will start immediately to prepare the methodology for the 2018 stress test exercise, which will also include an assessment of the impact of IFRS 9.

02/11/2016

- **Consultation paper on the assessment of the suitability of members of the management body and key function holders under the CRD IV and MiFID II.**
- **Annex I – Template for the assessment of collective suitability.**

1. Context

The EBA and the ESMA have published a **Consultation Paper on Guidelines (GL) on the assessment of the suitability of the members of the management body and key function holders**, in accordance with the requirements introduced under the CRD IV and MiFID II. The existing EBA GL on the assessment of the suitability of the management body, published in November 2012, will be repealed after the entry into force of these GL.

Along with these GL, the EBA and the ESMA have published a **template** ('suitability matrix') which institutions may use to self-assess periodically the collective suitability of the members of the management body.

2. Main points

- **Scope of suitability assessments**. Among others, the GL specify that institutions should ensure that members of the management body, individually and collectively, are suitable at all times (according to the notions specified below). This assessment should be carried out on an ongoing basis an in certain situations (e.g. when material changes to the composition of the management body occur).
- **Notions of suitability**. In particular, institutions should assess the following aspects, for which the GL provide common criteria:
  - <u>Sufficient time commitment of a member</u>. Institutions should consider aspects such as the number of directorships in financial and non-financial companies, the member's geographical presence and the travel time required for the role, etc.
    - Significant institutions must comply with the limitation of directorships set out in the CRD IV. The GL specify how to calculate the number of directorships.
  - <u>Adequate knowledge, skills and experience</u>. This assessment should consider, among others, the knowledge and skills attained through education and training, the practical and professional experience gained in previous positions, etc. Consideration should be given to experience relating to financial markets, regulatory framework, risk management, etc.
  - <u>Reputation, honesty and integrity</u>. Institutions should consider factors such as the convictions or ongoing prosecutions of a criminal offence (e.g. fraud, tax offences, etc.), financial and business performance of entities owned or directed by the member, etc.
  - <u>Independence of mind</u>. Some situations that can create conflicts of interests should be considered (e.g. relationships with the owners of qualifying holdings in the institution).
  - <u>Collective suitability criteria</u>. Among other aspects, the GL specify that members of the management body should collectively be able to take appropriate decisions considering the business model, risk appetite, strategy and markets; there should be a sufficient number of members with knowledge in each area; etc.
- **Other relevant notions**. The GL also specify certain aspects regarding:
  - <u>Human and financial resources for training</u>. Institutions should have in place policies for the induction and training of members of the management body, a process to identify the areas in which training is required, and an evaluation process to review the effectiveness.
  - <u>Diversity policy</u>. It should at least refer to educational and professional background, gender, age and for institutions that are active internationally geographical provenance.
  - <u>Suitability policy and governance arrangements</u>. The GL specify that institutions should implement a suitability policy aligned with the institution's overall corporate governance framework, corporate culture and risk appetite; and include some requirements regarding governance (e.g. adequate number of members of the management body).
- **Assessment of suitability by competent authorities (CAs)**. The GL specify, among others, that CAs are required to assess all members of the management body, and for significant institutions also the heads of internal control functions and the CFO (when they are not part of the management body).

3. Next steps

- Comments to this consultative document shall be submitted by **28 January 2017**.

04/11/2016

- **Draft Guideline on the exercise of options and discretions available in Union law by NCAs in relation to less significant institutions.**
- **Draft Recommendation on common specifications for the exercise of some options and discretions available in Union law by NCAs in relation to less significant institutions.**

1. Context

As the competent authority, the ECB has exercised a number of options and discretions (O&Ds) available in Union law for significant institutions (SIs). To this end, the ECB published during 2016 several documents (among others, Regulation 2016/445 and a Guide on the exercise of O&Ds).

Although national competent authorities (NCAs) are primarily responsible for exercising the relevant O&Ds in relation to less significant institutions (LSIs), the ECB's overarching oversight role within the SSM enables it to promote the consistent exercise of O&Ds in relation to both SIs and LSIs.

In this context, the ECB has launched a **public consultation** on a **Guideline** and a **Recommendation** concerning the exercise of O&Ds for LSIs. On the one hand, the Guideline (legally binding act once approved), lays out how NCAs should exercise 7 O&Ds of general application for LSIs; on the other hand, the Recommendation (a non-legally binding act) aims to harmonise 43 O&Ds that are not of general application but are assessed on a case-by-case basis for each institution.

2. Main points

<u>Guideline on the exercise of O&Ds by NCAs in relation to LSIs</u>.

- The O&Ds specified below should be **exercised by NCAs** in the supervision of LSIs **in the same way** as specified in Regulation 2016/445.
  - <u>Own funds</u>. The option with regard to risk weighting and prohibition of qualifying holdings outside the financial sector (i.e. the risk weight of 1250 % shall be applied).
  - <u>Capital requirements</u>.
    The option with regard to the default of an obligor (i.e. the past due criterion of 90 days shall be applied).
    The option with regard to hedging sets (i.e. the mark-to-market method shall be used).
  - <u>Large exposures</u>. The option with regard to exemptions to the limits to large exposures (i.e. certain exposures shall be exempted).
  - <u>Liquidity</u>. The option with regard to outflows from stable retail deposits (i.e. institutions shall multiply by 3% the amount of stable retail deposits covered by a deposit guarantee scheme).
  - <u>Transitional provisions of the CRR</u>.
    - The option with regard to the exemption from deduction of equity holdings in insurance companies from CET1 items (i.e. during the period from 1 January 2016 to 31 December 2018, credit institutions shall be permitted not to deduct them provided that some conditions are met).
    - The option with regard to the applicable percentages for deduction from CET1 of significant investments in financial sector entities and deferred tax assets that rely on future profitability (i.e. 60% until December 2016, 80% from January 2017 to December 2017, and 100% from January 2018).

<u>Recommendation on common specifications for the exercise of some O&Ds in relation to LSIs</u>.

- The ECB has identified **43 O&Ds** among those included in the above-mentioned ECB Guide which would be appropriate to exercise in an **identical manner** in relation to **SIs and LSIs**, in accordance with the ECB Guide (those included in the Annex of this Recommendation).
- Further, the ECB has identified **8 O&Ds** for whose exercise it recommends a **specific approach** in relation to LSIs (e.g. liquidity waivers at cross border level, exposures in the form of covered bonds, treatment of exposures to central counterparties, etc.).

3. Next steps

- Comments to these consultation documents shall be submitted by **5 January 2017**.
- Once approved, the NCAs shall comply with the Guideline from **1 January 2018**, except for the liquidity option which they shall comply with from **1 January 2019**.

EUROPEAN CENTRAL BANK
EUROSYSTEM

15/11/2016
Draft guide to fit and proper assessments.

1. Context

Since November 2014 the ECB has been responsible for taking decisions on the appointment of all members of the management bodies of the significant credit institutions under its direct supervision.

In this regard, the ECB has launched a **public consultation** on a **Draft guide to fit and proper assessments of members of the management bodies** of significant credit institutions, with the objective of explaining in greater detail the policies, practices and processes applied by the ECB when assessing the suitability. This draft guide builds on the EBA's draft guidelines published for consultation in October.

This draft guide is **not a legally binding document** and cannot in any way substitute the relevant legal requirements stemming either from applicable EU law or applicable national law.

2. Main points

- **Principles**. The ECB follows 6 principles when performing fit and proper assessments: i) primary responsibility of supervised entities when selecting individuals for the management body; ii) role of the ECB as a gatekeeper; iii) harmonisation; iv) proportionality and case-by-case assessment; v) due process and fairness; and vi) interaction with ongoing supervision.
- **Assessment criteria**. The fitness and propriety of members of the management body is assessed against 5 criteria (in line with the above-mentioned EBA's Guidelines):
    - Experience. It is assessed against presumptions based on thresholds (e.g. for CEO, 10 years of recent practical experience). If the thresholds are not met, the appointee can still be considered suitable if the entity can justify, which is analysed by conducting a full detailed assessment.
    - Reputation. An appointee is considered to be of good repute if there is no evidence to suggest otherwise (presumption of innocence). Nonetheless, the fact that an individual being prosecuted is relevant to propriety. In this regard, the supervisor must always be informed about legal proceedings.
    - Conflicts of interest and independence of mind. The supervisor assesses the materiality of the risk posed by the conflict of interest. In this regard, the Guide includes a list of situations in which there is presumption that a material conflict of interest exists (e.g. the appointee has a close personal relationship with a Board member).
    - Time commitment. The entity should provide a minimum set of information (e.g. specification of the time commitment required for the role), and in certain cases additional information may be required. Regarding counting of directorships, the ECB takes a restrictive approach.
    - Collective suitability. The supervised entity should provide certain information (e.g. a description of the composition of the management body, a statement on how the appointee will to its collective suitability needs, etc.).
- **Interviews**. Interviews are one of the tools used in the information gathering phase. In this regard:
    - Interviews are mandatory in the case of new appointments for CEO and Chairman positions at stand-alone banks and the top banks of groups, and in all other cases interviews may be used on a discretionary basis.
    - An informative interview covers all elements of suitability and if there are still concerns after this interview, a second specific interview focusing on the facts that gave rise to the concerns may be conducted.
- **Assessment process**. A fit and proper assessment can be triggered by: i) a change in the management body owing to a new appointment, a change of role or a renewal (e.g. when a non-executive member is appointed as executive director); ii) new facts (e.g. report of a breach, facts alleged in newspapers, etc.); iii) a licensing or qualifying holding procedure.
- **Decision**. After every assessment a formal ECB decision is taken, and an appointee is either considered fit and proper or not. The ECB has the power to include recommendations, conditions or obligations in positive decisions.
- **Removal of members from the management body**. The ECB has the power to remove at any time members of a significant supervised entity who do not fulfil the requirements.

3. Next steps

- Comments to this consultative document shall be submitted by **20 January 2017**.

EUROPEAN CENTRAL BANK
EUROSYSTEM

25/11/2016
Consultation paper on Draft Guidance on leveraged transactions.

1. Context

The prolonged period of low interest rates and the ensuing search for yield strategies have warranted specific monitoring of credit quality by the ECB in general and of leveraged finance exposures in particular. Recent research suggests that globally leveraged finance markets have experienced a strong recovery since the crisis, and the ECB considers that closer supervisory scrutiny of leveraged transactions is needed.

In this regard, the ECB has launched a **public consultation** on a **Draft Guidance on leveraged transactions** that summarises key supervisory expectations concerning these transactions, and the ongoing monitoring of both syndication risk and the fundamental credit quality of leveraged exposures.

This guidance applies to all **significant credit institutions** supervised by the ECB, although its implementation should be consistent with the size and risk profile of institutions' leveraged transactions.

2. Main points

- **Definition of leveraged transactions**. Institutions should have in place, as part of their internal policies, a <u>unique definition</u> which would encompass all business units and geographical areas, and that should be regularly reviewed by an independent audit department.
    - Institutions are expected to consider as a leveraged transaction any transaction that meets <u>at least one</u> of the following conditions:
        - All types of loan or credit exposure where the borrower's post-financing level of leverage exceeds a Total Debt to EBITDA ratio of 4.0 times.
        - All types of loan or credit exposures where the borrower is owned by one or more financial sponsors.
    - Certain transactions are <u>not expected to be covered by the definition</u> (e.g. loans with natural persons, commercial real estate financing, project finance loans).
- **Risk appetite and governance**. As part of their internal risk appetite framework, institutions should define their <u>appetite and strategy</u> for leveraged transactions. To this end, <u>senior management</u> is expected to define, review and endorse at least annually the budget and limits allocated to leveraged transactions. Moreover, institutions are expected to have a <u>sound governance structure</u> for leveraged transactions, enabling senior management to have a comprehensive oversight.
- **Underwriting and syndication**. Institutions should define their <u>appetite</u> for underwriting and syndicating, setting limits and sub-limits. The ECB specifies some expectations that <u>internal standards and monitoring functions</u> should consider (e.g. each transaction posing an underwriting/syndication risk requires prior approval, institutions are expected to define acceptable leverage levels, institutions should identify transactions subject to failed syndications).
- **Policies and procedures for new deal approval, and monitoring and managing of longer-term leveraged transaction holdings**. The ECB specifies the following aspects:
    - Institutions should have a <u>credit approval process</u> for all leveraged transactions. Further, <u>due diligence</u> requirements (e.g. assessment of the industry sector, critical review of the business plan of the corporate borrower, etc.) should be triggered in certain cases (e.g. new transactions, renewal, refinancing, etc.).
    - Institutions should ensure <u>regular monitoring</u> of the portfolio, encompassing all relevant risks for leveraged transactions held for the longer term.
        - The long-term risk positions ('hold book') should be reviewed once a year.
        - Deteriorated exposures should be reviewed more frequently. In this regard, the ECB provides a list of signs of impairment or default in which institutions are expected to, among other things, run an impairment test.
    - The monitoring of exposures should be complemented by a <u>stress-testing framework</u>.
- **Secondary market activities on leveraged transactions**. Institutions' <u>compliance and risk management functions</u> should put in place and regularly review policies and procedures to ensure proper <u>adherence of secondary market transactions</u> with regulations on market conduct (e.g. Chinese walls, treatment of privileged information).

- **Reporting requirements and IT systems**. Regular comprehensive reports should be sent to the management of each institution, including information about both its underwriting book and its hold book. These reports should cover, among others, key markets trends, all leveraged transactions across the various business units and geographies, the positioning of a institution with regard to internal limits and the outcome of the stress scenarios, etc. Management information systems (MIS) should be sufficiently granular and sound enough to enable management to identify, aggregate and monitor leveraged transactions.

3. Next steps

- Comments to this consultative document shall be submitted by **27 January 2017**.
- **18 months following the publication** of this guidance an internal audit report should be drawn up and submitted to the joint supervisory team, detailing which of the expectations expressed in this guidance have been implemented by the credit institutions.

EUROPEAN CENTRAL BANK
EUROSYSTEM

16/12/2016
SSM supervisory priorities for 2017.

1. Context

The ECB has published its **2017 priorities for supervising significant banks** in the euro area. They build on an assessment of the key risks faced by supervised banks (e.g. the low/negative interest rate environment, high levels of non-performing loans, etc.), taking into account the latest developments in the economic, regulatory and supervisory environment.

In particular, the ECB specifies that the **three areas** that will guide banking supervision are: i) business models and profitability drivers; ii) credit risk, with a focus on non-performing loans (NPLs) and concentrations; and iii) risk management. For each of the priorities, a number of supervisory initiatives will be carried out.

2. Main points

- **Business models and profitability drivers**. European banking supervision will continue to drive forward its thematic review of banks' business models and profitability drivers.
    - A further point of supervisory attention will be the possible repercussions of the UK's referendum on EU membership for supervised banks and their business models.
    - In addition, European banking supervision will explore potential risks for business models emanating from the emergence of FinTech and non-bank competition.
- **Credit risk, with a focus on NPLs and concentrations**. European banking supervision will continue to support Joint Supervisory Teams (JSTs) in follow-up actions and supervisory dialogues with respect to the NPL guidance and the assessment of banks' NPLs.
    - In the light of the upcoming introduction of IFRS 9, the thematic review of the potential impact of IFRS 9 on banks and their degree of preparation will be intensified.
    - Moreover, to investigate excessive concentrations of credit risk in certain asset classes (e.g. shipping loans) European banking supervision intends to use a new approach combining both on-site and off-site elements.
- **Risk management**. European banking supervision will:
    - Finalise its ongoing thematic review of banks' compliance with principles for effective risk data aggregation and risk reporting (RDA&RR), and JSTs will follow up with institutions, as appropriate.
    - Roll out its multi-year targeted review of internal models (TRIM). On-site inspections will be launched in connection with this review.
    - Promote the continuous improvement of banks' ICAAPs and ILAAPs.
    - Initiate a thematic review to take stock of banks' outsourced activities and scrutinise how they are managing the associated risks (including IT risks).

EUROPEAN CENTRAL BANK
EUROSYSTEM

20/12/2016
Consultation on Guide on materiality assessment for IMM and A-CVA model extensions and changes.

1. Context

The CRR requires model approval for material model extensions and changes to credit, operational and market risk internal models. In this regard, RTS have been adopted for the materiality assessment of model extensions and changes to the IRB approach, the AMA and the IMA.

For counterparty credit risk (CCR) for both the internal model method (IMM) and the advanced method for credit valuation adjustment risk (A-CVA), the adoption of similar RTS is not mandated by the current text of the CRR. Nonetheless, it should be noted that the EBA may regulate this field by adopting guidelines.

In this context, the ECB has launched a **public consultation on the Guide on materiality assessment (EGMA) of IMM and A-CVA**, which indicates how the ECB intends to interpret the existing legal framework. The EGMA provides assistance to significant institutions in their self-assessment of the materiality of changes and extensions to IMM and A-CVA models under the applicable legal framework, although is not intended to have legal effect.

2. Main points

- **Overview**. Within the EGMA, the materiality of extensions and changes is subject to:
    - A self-assessment, which is the first step and can lead to two classifications:
        - Not material extensions and changes, which are notified to the ECB and implemented.
        - Extensions and changes that need to be investigated.
    - The extension and changes categorised as needing to be investigated are subject to an ECB internal model investigation, which classifies them as material or not material. When the extension or change is material, the institution receives a decision from the ECB.
- **IMM Approach. Extensions and changes that need to be investigated**. They are submitted to the ECB in order to investigate materiality if they fulfil any of the following conditions:
    - They fall under any of the extensions described in Annex I, Part I, section 1 (e.g. exposures of an additional type of transaction, new legal agreement types with regard to netting and margining if they require new or other modelling, etc.); or
    - They fall under any changes described in Annex I, Part II, section 1 (e.g. significant changes in the way the model captures the effect of existing margining agreements); or
    - They result in a change (calculated as specified in the Guide):
        - In absolute value of 1% or more, computed for the 1st business day of the testing of the impact, in the overall risk-weighted exposure amounts; and
        - In absolute value of 5% or more in the overall risk-weighted exposure amounts.
- **IMM Approach. Extensions and changes considered not material**. They are notified to the ECB at least 2 weeks before their implementation if they are described in Annex I, Part II, Section 2. All other extensions and changes are notified after their implementation on at least an annual basis.
- **A-CVA approach. Changes that need to be investigated**. They are submitted to the ECB in order to investigate materiality if they fulfil the following conditions:
    - Where the bank was granted permission to set M equal to 1, they affect the modelling of CVA risk for counterparties in a significant way as regards this permission; and either
    - They fall under any of the changes described in Annex II, section 1 (e.g. changes in the methodology used to determine the proxy spreads); or
    - They result in a change (calculated as specified in the Guide):
        - In absolute value of 1% or more, computed for the 1st business day of the testing of the impact of the change, in one of the relevant risk numbers referred to in the CRR (non-stressed or stressed VaR); and either
        - Of 5% or more in the full CVA capital charge; or
        - Of 10% or more in at least one of the relevant risk numbers referred to in the CRR (non-stressed or stressed VaR).

- **A-CVA approach. Changes considered not material**. Changes that do not meet the above-mentioned conditions are classified as not material and are notified 2 weeks before their planned implementation or on at least an annual basis (depending on the type of change).
- **A-CVA approach. Exceptions**. For all A-CVA extensions and for A-CVA changes that coincide with an IMA model change, the EGMA refers to the RTS on IMA; and for A-CVA changes that coincide with an IMM model change, the EGMA refers to the IMM part of the EGMA.
- **Documentation**. For extensions/changes that need to be investigated, institutions are expected to submit certain documentation (e.g. description of the extension or change, the implementation date, relevant technical documents – pricing, netting and margining, backtesting, etc.-).

3. Next steps

- Comments to the EGMA shall be submitted to the ECB by **14 February 2017**.

BANCO DE ESPAÑA
Eurosistema

08/11/2016
2017 Updated list of systemically important institutions and their capital buffers.

1. Context

According to the Ley 10/2014 that transposes the CRD IV into the Spanish law, the Bank of Spain (BdE) should identify those credit institutions authorized in Spain that are global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs).

In this regard, the BdE has published the **updated list of institutions that are considered G-SIIs and O-SIIs in 2017**, specifying their relevant **capital buffers**.

2. Main points

- List of G-SIIs in 2017 and their applicable buffers.
  - **Santander** has been classified in sub-category 1 of **G-SIIs** and will be subject to an additional CET1 requirement equal to 1% of its total risk exposure on a consolidated basis. Nevertheless, the **buffer applicable in 2017 will be 0.5%** in accordance with the transitional provisions of Law 10/2014, which establishes a gradual implementation period.
- List of O-SIIs in 2017 and their applicable buffers.
  - **BBVA**, **Caixabank**, **Bankia**, **Sabadell** and **Popular** have been identified as **O-SIIs**.
  - Regarding the additional CET1 requirement, the applicable buffers in 2017 will be the following (already applying the transitional regime):
    - **0.375%** for BBVA.
    - **0.125%** for Caixabank, Bankia, Sabadell and Popular.
  - **Santander** has been also identified as O-SII. In these cases, only the higher of the two capital buffers will apply, and since the two are identical, the buffer required in 2017 will be 0.50%.

3. Next steps

- The designation as G-SIIs or O-SIIs is reviewed **annually**.

20/10/2016

Advance notice of proposed rulemaking on Enhanced Cyber Risk Management Standards.

1. Context

As technology dependence in the financial sector continues to grow, so do opportunities for high-impact technology failures and cyber-attacks. Moreover, due to the interconnectedness of the U.S. financial system, a cyber incident or failure at one interconnected entity may not only impact the safety and soundness of the entity, but also other financial entities with potentially systemic consequences.

In this regard, the Fed, the OCC and the FDIC (hereinafter 'the agencies') are inviting comment on an advance notice of proposed rulemaking (**ANPR**) regarding **enhanced cyber risk management standards** for large and interconnected entities under their supervision and those entities' service providers.

2. Main points

- **Scope of application**. The agencies are considering applying the enhanced standards to certain entities (e.g. U.S. bank holding companies) with total consolidated assets of $50 billion or more on an enterprise-wide basis, and also to services provided by third parties to these entities.
- **Two-tiered approach**. The agencies are considering establishing a two-tiered approach, with the enhanced standards applying to all systems of entities under the scope, and an additional higher set of expectations applying to those systems of entities that are critical to the financial sector.
- **Enhanced cyber risk management standards**. They would be organized into five categories:
    - Cyber risk governance. Agencies are considering requirements such as:
        - Developing a written, board-approved, enterprise-wide cyber risk management strategy (incorporated into the overall business strategy and risk management).
        - Establishing cyber risk tolerances consistent with the risk appetite and strategy.
        - Ensuring that the board oversees and holds senior management accountable for implementing the entity's cyber risk management framework.
    - Cyber risk management. The standards would require entities to integrate cyber risk management into the responsibilities of at least three independent functions:
        - Business units, which would among others assess on an ongoing basis the cyber risks associated with their activities.
        - Independent risk management function, which would among others identify, measure, and monitor cyber risk; and report to the CRO and the board regarding the implementation of the cyber risk management framework.
        - Audit function, which would assess whether the cyber risk management framework complies with applicable laws; and incorporate an assessment of cyber risk management into the overall audit plan.
    - Internal dependency management. Entities would be required to integrate an internal dependency management strategy into the overall strategic risk management plan; maintain a listing of all internal assets and business functions; and apply appropriate controls to address the inherent cyber risk of their assets.
    - External dependency management. Entities would be required to integrate an external dependency management strategy into the overall strategic risk management plan; maintain a listing of all external dependencies and business functions; and apply appropriate controls to reduce the cyber risk of external dependencies.
    - Incident response, cyber resilience, and situational awareness. Entities would be required to be capable of operating critical business functions in the face of cyber-attacks, establish enterprise-wide cyber resilience and incident response programs, etc.
- **Standards for sector-critical systems**. The agencies are considering the following requirements:
    - Minimizing the residual cyber risk (i.e. remaining cyber risk after mitigating controls have been taken into consideration) of sector-critical systems by implementing the most effective, commercially available controls.
    - Establishing a recovery time objective (RTO) of 2 hours.
    - Measuring quantitatively the ability to reduce the aggregate residual cyber risk of the sector-critical systems and the ability to reduce such risk to a minimal level.

3. Next steps

- Comments shall be submitted by **January 17, 2017**.
- The agencies will again invite public comment on a detailed proposal before adopting any final rule.

20/12/2016
Final rule on LCR disclosure requirements.

1. Context

In September 2014, the US agencies (Fed, OCC and FDIC) adopted the LCR Rule to implement a quantitative liquidity requirement, the **liquidity coverage ratio** (LCR), for certain companies. The LCR requires a covered company to maintain an amount of high-quality liquid assets (HQLA) that is no less than 100% of total net cash outflows over a prospective 30 calendar-day period of stress. The LCR rule includes also a modified LCR requirement for certain smaller, less complex banking organizations.

In this context, the Fed has adopted a **final rule** to implement **public disclosure requirements regarding the LCR**. Under this rule, a covered company will be required to publicly disclose on a quarterly basis quantitative information about its LCR calculation, as well as a discussion of the factors that have a significant effect on its LCR.

2. Main points

- **Scope**. The final rule applies to those companies subject to the LCR Rule:
  - All bank holding companies and certain savings and loan holding companies that have $50 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure.
  - Nonbank financial companies to which the Fed has applied the LCR Rule.
- **Quantitative information**. Companies are required to disclose in a standardized tabular format both the average unweighted and the average weighted amounts of:
  - Eligible HQLA and each of its components (i.e. level 1, 2A and 2B liquid assets).
  - Cash Outflows (e.g. deposit outflow from retail customers and counterparties, unsecured wholesale funding outflow, etc.).
  - Cash Inflows (e.g. secured lending and asset exchange cash inflow, retail cash inflow, unsecured wholesale cash inflow, etc.).
  - HQLA Amount, Total Net Cash Outflow Amount excluding the Maturity Mismatch Add-on, Maturity Mismatch Add-on, Total Net Cash Outflow Amount, and LCR. However, modified LCR holding companies are not required to calculate the maturity mismatch add-on.
- **Qualitative information**. Companies are required to provide a discussion of certain features that have a significant effect on their LCR. A company's discussion may include aspects such as the main drivers of the LCR results, changes in the LCR results over time and their causes, etc.
- **Frequency**. Companies are required to provide quarterly public disclosures.
- **Amendment**. There is an amendment to the LCR Rule to provide holding companies that become subject to the modified LCR Rule after the rule's effective date with a full year to come into compliance with the modified LCR.

3. Next steps

- Companies that have $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody and that are subject to a transition period in the LCR Rule will be required to comply with the disclosure requirements beginning on **April 1, 2017**.
- Other covered companies that are subject to another transition period in the LCR Rule will be required to comply with the disclosure requirements beginning on **April 1, 2018**.
- The rule will require holding companies subject to the modified LCR to comply with the disclosure requirements beginning on **October 1, 2018**.

16/12/2016

Final rule on LTD and TLAC requirements.

1. Context

The Fed has published a final rule to improve the resiliency and resolvability of global systemically important banks (G-SIBs) and thereby reduce threats to financial stability. Under this final rule, covered banks will be required to meet a new **long-term debt (LTD) requirement** and a new **total loss-absorbing capacity (TLAC) requirement**.

In particular, this final rule applies to U.S. top-tier Bank Holding Companies (BHCs) identified as global systemically important BHCs under the GSIB surcharge rule ('covered BHCs'); as well as to the top-tier U.S. Intermediate Holding Companies (IHCs) of global systemically important Foreign Banking Organizations ('covered IHCs').

2. Main points

Requirements for a covered BHC

- **External LTD requirement**.
  - Eligibility. Debt that is issued directly by the covered BHC, unsecured, 'plain vanilla', governed by U.S. law, and that is due to be paid after one year or more (for eligible external LTD that is due to be paid between one and two years, there is a haircut of 50%).
  - Minimum level of external LTD. The greater of: i) 6% plus the G-SIB surcharge of RWAs (RWA component); and ii) 4.5% of leverage exposure (leverage component).
- **External TLAC requirement**.
  - Eligibility. Tier 1 regulatory capital issued directly by the BHC and the amount of eligible external LTD.
  - Minimum level of external TLAC. The greater of: i) 18% of the RWAs; and ii) 7.5% of the leverage exposure.
  - Buffers. External TLAC buffers will be applied to BHCs, the breach of which would result in limitations on capital distributions and discretionary bonus payments:
    - Buffer to the RWA component: equal to the sum of 2.5% plus the G-SIB surcharge applicable under method 1 of the G-SIB surcharge rule plus any applicable countercyclical capital buffer.
    - Buffer to the leverage component: 2% of leverage exposure.
- **Other aspects**. To mitigate the impact, a grandfather for certain outstanding LTD of covered BHCs issued prior to 31 December 2016 is provided, to count towards the LTD and TLAC requirements.

Requirements for a covered IHC

- **Distinction between a resolution and a non-resolution IHC**. The minimum amount of TLAC and LTD, and whether the eligible LTD may be issued externally, depends on whether the IHC is a:
  - Resolution covered IHC, which is expected to enter resolution in multiple-point-of-entry (MPOE) resolution strategy. Resolution ICHs will have the option to issue capital and LTD externally.
  - Non-resolution covered IHC, which is expected to continue to operate outside of resolution proceedings while the foreign parent entity is resolved under a single-point-of-entry (SPOE) resolution strategy. Non-resolution IHCs are required to issue internal TLAC and LTD to a foreign parent or to a wholly owned foreign subsidiary of the foreign parent.
- **LTD requirement**.
  - Minimum level of LTD. The greater of: i) 6% of RWAs; ii) 2.5% of the leverage exposure (if applicable); and iii) 3.5% of average consolidated assets.
- **TLAC requirement**.
  - Minimum level of TLAC. IHCs will be required to maintain the following levels of TLAC:
    - Resolution IHCs, the greater of: i) 18% of RWAs; ii) 6.75% of the leverage exposure (if applicable); and iii) 9% of average consolidated assets.
    - Non-resolution IHCs, the greater of: i) 16% of RWAs; ii) 6% of the leverage exposure (if applicable); and iii) 8% of average consolidated assets.
  - Buffer. An internal TLAC buffer to the RWA component, equal to 2.5% plus any applicable countercyclical capital buffer will be applied to all covered IHCs, which must be satisfied with CET1 capital. A breach of this buffer would result in limits on capital distributions and discretionary bonus payments.

3. Next steps

- The Fed requires covered BHCs and IHCs to achieve compliance with the rule as of **1 January 2019**, although **phase-in provisions** are included.

BANK OF ENGLAND

30/11/2016
Stress testing the UK banking system: 2016 results.

1. Context

In March 2016, the BoE launched the 2016 stress test of the UK banking system, which covered 7 major UK banks accounting for around 80% of PRA-regulated banks' lending to the UK real economy. The test, which is the first conducted under the BoE's new approach to stress testing, examined the resilience of the system to a more severe stress than in 2014 and 2015.

In this regard, the BoE has published the **results of the 2016 stress test of the UK banking system**. Performance in the test was assessed against the BoE's hurdle rate framework, comprising elements expressed both in terms of risk-weighted capital and leverage ratios.

On the one hand, the risk-weighted capital ratio hurdle rate has two elements: i) a hurdle rate, equal to the sum of the minimum standard for CET1 (4.5%) and any Pillar 2A CET1 uplift set by the PRA; and ii) a CET1 'systemic reference point', which adds the phase-in G-SIB capital buffer to the hurdle rate. On the other hand, the Tier 1 leverage hurdle rate is 3%, while a bank's systemic reference point also includes its G-SIB additional leverage ratio buffer.

2. Main points

- **Impact of the stress scenario on the banking system**. The BoE judged that the banking system is, in aggregate, capitalised to support the real economy in a stress scenario.
  - The stress scenario is estimated to lead to losses of £44 billion over the first 2 years of the stress (around 5 times the net losses incurred by the same banks as a group over 08–09).
  - The stress scenario would reduce the aggregate CET1 capital ratio from 12.6% at the end of 2015 to a low point of 8.8% in 2017, after factoring in the impact of management actions and the conversion of Additional Tier 1 (AT1) instruments into CET1 capital.
    - The low-point CET1 capital ratio is well above the 6.5% weighted average hurdle rate and 7.3% weighted average systemic reference point.
    - Moreover, the low-point CET1 capital is also well above the 7.6% low point seen in the 2015 and 2014 tests.
  - The aggregate Tier 1 leverage ratio falls from 4.9% at the end of 2015 to a low point of 3.9% in 2017.
- **Impact of the stress scenario across banks**. The impact differs substantially across banks. In general, the stress has the greatest impact on those banks with significant international and corporate exposures.
  - For HSBC, Lloyds Banking Group, Nationwide Building Society and Santander UK, the test did not reveal capital inadequacies.
  - RBS did not meet its CET1 capital or Tier 1 leverage hurdle rates before AT1 conversion. After AT1 conversion, RBS did not meet its CET1 systemic reference point or Tier 1 leverage ratio hurdle rate.
    - RBS has already updated its capital plan to incorporate further capital strengthening actions and its revised plan has been accepted by the PRA.
    - The PRA will continue to monitor RBS's progress against its revised capital plan.
  - Barclays did not meet its CET1 systemic reference point before AT1 conversion. Nonetheless, in light of the steps that Barclays had already announced to strengthen its capital position, the PRA did not require Barclays to submit a revised capital plan.
  - Standard Chartered met all of its hurdle rates and systemic reference points, although it did not meet its Tier 1 minimum capital requirement (including Pillar 2A). Nonetheless, in light of the steps that Standard Chartered is already taking to strengthen its capital position, the PRA did not require Standard Chartered to submit a revised capital plan.
- **Qualitative review**. As in previous stress tests, the BoE also undertook a qualitative review of banks' stress-testing capabilities. The PRA judged that banks in aggregate have made progress during the stress test, but the rate of improvement has been slower and more uneven than expected. This qualitative review will be considered in the BoE's broader assessment of banks' risk management and governance arrangements.

3. Next steps

- The **2017 stress test** will for the first time include a **second 'exploratory' scenario** in addition to the regular 'cyclical' scenario. In this regard:
  - The BoE will publish the quantitative data associated with these scenarios, along with an explanatory 'Key Elements' document, around the end of 2017 Q1.
  - The BoE intends to publish the results of the 2017 exercise in 2017 Q4.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

28/11/2016
Consultation paper on the implementation of MiFID II: Part 2.

1. Context

Following the financial crisis, the European Commission reviewed the MiFID I framework and concluded that it should be updated in order to, among other aspects, strengthen investor protection. As a result of this review, the EU adopted a new legislative package in June 2014, including a directive revising and expanding the existing framework: MiFID II.

In this regard, the PRA has published a **Consultation Paper (CP) on the implementation of MiFID II**, setting out its proposals for rules to transpose parts of MiFID II in the UK. This is the second PRA consultation on implementing MiFID II, and follows CP9/16, which consulted on implementation of the MiFID II passporting regime and algorithmic trading.

2. Main points

- **Scope**. The PRA proposes to amend its rules by extending the substantive requirements of the Delegated Regulation of the European Commission on organisational requirements and operating conditions to apply across all businesses and firms within the scope of the rules.
- **Management body**. The PRA proposes to introduce rules to require firms to implement those management body requirements under MiFID II not previously included in the PRA rules. Among other aspects, the PRA specifies that:
    - A firm must ensure that the management body monitors and periodically assesses the adequacy and implementation of the strategic objectives in the provision of its regulated activities, the adequacy of the policies relating to the provision of services to clients, etc.
    - The management body defines, approves and oversees the organisation of the firm for the provision of regulated activities (e.g. skills, knowledge and expertise required by personnel; the resources; etc.); a remuneration policy of persons involved in the provision of services to clients; etc.
    - A firm must ensure that the members of the management body have adequate access to information that are needed to oversee and monitor management decision-making.
- **Organisational requirements**. The PRA proposes to introduce rules to require firms to implement those organisational requirements under MiFID II not previously included in the PRA rules. The organisational requirements in MiFID II are related to the operation of the compliance function, outsourcing, and record-keeping.
- **Other aspects**. The proposal includes other amendments, such as the following:
    - Removal from the PRA Rulebook of provisions that are superseded by provisions in the above-mentioned Delegated Regulation as they are directly applicable.
    - Consequential changes to PRA Rulebook notes and supervisory statements to update references from MiFID to MIFID II.

3. Next steps

- Comments to this CP shall be submitted by **27 February 2017**.
- The expected implementation date for the proposals in this CP is **1 January 2018**.

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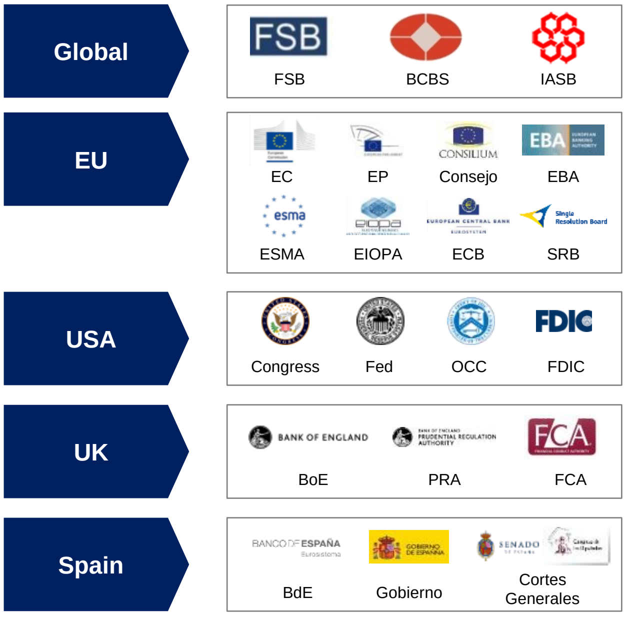

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