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Regulation Outlook

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Executive summary

During the last quarter of 2017, the revisions to the Basel III framework published by the BCBS stand out. At European level, the EBA published Final Guidelines on PD and LGD estimation and the treatment of defaulted exposures, and the 2018 Stress Test Final Methodology. At domestic level, the Bank of Spain (BdE) published the Circular 4/2017 on rules for public and supervisory financial reporting and models of financial statements to adapt the Spanish accounting framework to IFRS 9 and IFRS 15.

Global publications

- At international level, the BCBS published **Basel III: finalising post-crisis reforms**, which reviews the standardised approach (SA) and the internal ratings-based approach (IRB) for credit risk, the credit valuation adjustment (CVA) risk framework, the operational risk framework, the leverage ratio (LR) framework and introduces output floors.
- Moreover, the BCBS published **Guidelines on the identification and management of step-in risk**.
- The FSB published two **consultative documents on principles on bail-in execution** and on **funding strategy elements of implementable** resolution plan.

European publications

- The EBA published **Final Guidelines on PD and LGD estimation and the treatment of defaulted exposures**, focusing on the definitions and modelling techniques used in the estimation of risk parameters for both non-defaulted (PD and LGD) and defaulted exposures (EL_{BE} and LGD-in defaulted) in order to align its terminology and definitions.
- Further, the EBA published the **2018 Stress Test Final Methodology**, describing how banks should calculate the stress impact of the common scenarios and also setting restrictions for bottom-up calculations.
- Regarding the revised Directive on Payment Services (PSD2), the European Commission (EC) published a **Delegated Regulation supplementing PSD2 with regard to RTS for strong customer authentication (SCA) and common and secure open standards of communication** aiming at spelling out how the SCA should be applied. In addition, the EBA published **Final RTS on central contact points** and **Final Guidelines on the security measures for operational and security risks of payment services**, which are addressed to payment services providers (PSPs).

European publications (continuation)

- The EBA published a **CP on RTS on the methods of prudential consolidation** which sets out some criteria/indicators and some conditions for the application of different methods of consolidation or the application of the equity method in certain cases.
- Finally, the EBA published a document on the **cumulative impact assessment of the Basel III reform package** which provides a summary of the results of an analysis carried out by the EBA to assess the impact of the December 2017 package of revisions on credit and operational risk approaches, as well as on the LR estimation processes.

Local publications

- In Spain, the BdE published the **Circular 4/2017 on rules for public and supervisory financial reporting and models of financial statements** aimed to adapt the accounting framework of credit institutions to IFRS 9 and IFRS 15.
- The Spanish Government published the **Proyecto de Ley Orgánica de Protección de Datos (PLOPD)**, which will adapt the Spanish legal system to the General Data Protection Regulation (GDPR).
- In USA, the Office of the Comptroller of the Currency (OCC) published the **Bulletin 2017-43 on new, modified, or expanded bank products and services** in order to adapt bank's risk management framework to new technology.
- In UK, the Bank of England (BoE) published the **results of the 2017 Stress Test of the UK banking system** that have been assessed against a biennial exploratory scenario (BES) and an annual cyclical scenario (ACS).
- Regarding the resolution framework and MREL, the BoE published an **update to the 2014 BoE's approach to resolution** and a **CP on the BoE's approach to setting MREL within groups**; whereas the Prudential Regulation Authority published a **Supervisory Statement on MREL**.

Regulatory projections

At European level, the EBA will launch the 2018 EU-wide stress test for EU banks. Further, policymakers continue to deliberate on the reform package of the financial system proposed by the EC. Regarding FinTech, the EC is expected to publish policy proposals and recommendations about their access to financial markets. In Spain, the Circular 4/2017 will apply as of 1 January 2018.

Regulatory projections

1. Next quarter

- **(Global) January 2018**: IFRS 9 will have to be implemented.
- **(Global) January 2018**: the BCBS revised IRRBB framework will come into force.
- **(Global) January 2018**: the NSFR of the BCBS and its disclosure requirements will be applicable.
- **(Global) January 2018**: the BCBS revised securitisation framework will come into force.
- **(Europe) January 2018**: Member States shall implement MiFID II and PSD2.
- **(Europe) January 2018**: the EBA will launch the 2018 EU-wide Stress Test.
- **(Europe) January 2018**: the EBA Guidelines on credit risk management practices and accounting for expected credit losses will be applicable.
- **(Europe) January 2018**: the EBA Guidelines on ICT Risk Assessment under the SREP will come into force.
- **(Europe) January 2018**: the Regulation on key information documents for package retail and insurance-based investment products (PRIIPs) will be applicable.
- **(Europe) January 2018**: the EBA Final Guidelines on the security measures for operational and security risks of payment services under the PSD2 will be applicable.
- **(Europe) January 2018**: the ESMA Guidelines on MiFID II product governance will be applicable.
- **(Spain) January 2018**: the BdE Circular 4/2017 that supersedes the Circular 4/2004 will come into force.
- **(Europe) March 2018**: the EC is expected to publish recommendations on FinTech.

2. Next year

- **(Europe) To be determined**: the European Parliament (EP) and the Council are expected to approve the reform package of the financial system proposed by the EC, amending several legislative acts (CRD IV, CRR, BRRD, SRMR and EMIR).
- **(Europe) May 2018**: the General Data Protection Regulation (GDPR) will be applicable.
- **(Spain) May 2018**: the new Ley Orgánica de Protección de Datos (LOPD) will enter into force in Spain.
- **(Europe) June 2018**: the EBA Guidelines on internal governance and the EBA and ESMA Guidelines on the assessment of suitability of the management body and key functions will be applicable.
- **(Europe) September 2018**: institutions are expected to start reporting under AnaCredit.
- **(Europe) November 2018**: the EBA will publish the 2018 EU-wide Stress Test results.
- **(Global) December 2018**: the BCBS revised standards on IRRBB will be applicable.
- **(UK) December 2018:** the BoE will publish the 2018 Stress Test results.

3. More than a year

- **(Global) January 2019**: G-SIBs not headquartered in an emerging market economy will be required to comply with a minimum TLAC requirement of 16% of risk-weighted assets and 6% of the LR exposure, in accordance with the FSB.
- **(Global) January 2019**: the large exposures framework will be applicable.
- **(Europe) January 2019**: the EBA Final Guidelines on the treatment of connected clients will come into force.
- **(USA) January 2019**: the new requirements on Long-Term Debt (LTD) and TLAC will be applicable.
- **(UK) January 2019**: the ring-fencing rules will be implemented.
- **(Global) December 2020**: the BCBS Guidelines on the identification and measurement of step-in risk will be applicable.
- **(Europe) January 2021**: the EBA Guidelines on IRB parameters estimation will be applicable.
- **(Global January 2022**: the revised SA for credit risk, the revised IRB framework, the revised CVA framework, and the revised operational risk framework published by the BCBS will be implemented. Moreover, the LR framework (using the revised exposure definition) and the G-SIB buffer will be applicable.
- **(Global) January 2022**: the revised market risk framework published in January 2016 will be applicable, as well as, the regulatory information required in this regard will be disclosed for the first time.
- **(UK) January 2022**: the PRA will require firms to comply with an end-state MREL.
- **(Global) January 2027**: the aggregate output floor will be equal to 72.5%.

Publications of this quarter

Summary of outstanding publications of this quarter

Topic	Title	Date	Page
	Basel Committee on Banking Supervision		
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Stress test timeline	• Final timeline for the 2018 EU-wide stress test	30/10/2017	24
Pillar II	• Consultation Paper on Guidelines on common procedures and methodology for SREP • Draft Revised SREP Guidelines - consolidated text • Consultation Paper on Guidelines on the management of the interest rate risk arising from non-trading activities (IRRBB) • Consultation Paper on Guidelines on institution's stress testing	02/11/2017	25

26/10/2017
Guidelines on identification and management of step-in risk.

1. Context

During the financial crisis, banks preferred to support certain shadow banking entities in financial distress, rather than allowing them to fail and facing a loss of reputation, even though they had neither ownership interests in such entities nor any contractual obligations to support them.

In this context, following the two consultation papers published in December 2015 and March 2017, the BCBS has now published **Guidelines on the identification and management of step-in risk**, which is defined as the risk that a bank decides to provide financial support to an unconsolidated entity that is facing stress, in the absence of, or in excess of, any contractual obligations to provide such support.

The BCBS also recognised the need of a tailored rather than a standardised approach. To this end, these Guidelines entail no automatic Pillar 1 capital or liquidity charge additional to the existing Basel standards. Rather, they provide banks and supervisors with a method for identifying step-in risk and with a list of possible responses.

2. Main points

- **Entities under scrutiny**. Banks should define all entities and relationships that bank should consider for evaluating potential step-in risk. To this end, the following shall be considered:
  - The scope of application of the step-in risk framework includes any unconsolidated entities, which are those out of the regulatory scope of consolidation.
  - A bank is not required to evaluate all entities with which it has a relationship, but those where it has one or more of the following relationships with and entity: i) sponsor; ii) debt or equity investor; or iii) other contractual and non-contractual involvement.
  - Banks should identify entities that are immaterial (or subject to collective rebuttals) and exclude them from the initial set of entities to be evaluated.
- **Identification of step-in risk**. Banks should assess the remaining entities against the step-in risk indicators. A non-exhaustive list of indicators is provided, including the nature and degree of the sponsorship, the degree of influence, the implicit support, etc.
- **Potential responses**. For entities where step-in risk is identified, banks should use the appropriate method to estimate the potential impact on liquidity and capital positions and determine the appropriate internal risk management action. In this regard, banks and supervisors may use some approaches, such as the inclusion of an entity in the bank's regulatory scope of consolidation, the use of a conversion factor to estimate step-in risk or the existing provisions in the liquidity standards to account for step-in risk, etc.
- **Role of banks**. For the purpose of identifying and assessing step-in risk, banks must:
  - Establish and maintain policies and procedures.
  - Regularly identify all entities giving rise to step-in risk and estimate the potential impact on liquidity and capital.
  - Regularly report the results of their self-assessment of step-in risk to their supervisor. The reporting is expected to become mandatory and to be submitted annually.
- **Role of supervisors**. Among others, supervisors should review banks' policies and procedures and also their regular step-in risk self-assessments. Supervisors should have the authority to ask banks to remedy any deficiencies in their risk management approach, considering any of the potential responses outlined above.

3. Next steps

- These Guidelines are expected to enter into force as soon as possible and no later than **2020**.

11/12/2017
Basel III: finalising post-crisis reforms.

1. Context

In December 2010, the BCBS published the Basel III framework with the aim at addressing a number of shortcomings with the pre-crisis regulatory framework and providing a regulatory foundation for a resilient banking system that supports the real economy. Since then, the BCBS has published several consultation papers focused on strengthening the current regulatory framework (e.g. by increasing the level of capital requirements, enhancing risk capture by revising areas of the risk-weighted (RWs) capital framework for market risk, counterparty credit risk, etc.).

In this context, the BCBS has now published **Basel III: finalising post-crisis reform** which includes revisions to the current Basel III framework in order to reduce excessive variability of risk-weighted assets (RWAs). In particular, these revisions to the regulatory framework will help restore credibility in the calculation of RWA by: i) enhancing the robustness and risk sensitivity of the standardised approaches for credit risk and operational risk, which will facilitate the comparability of banks' capital ratios; ii) constraining the use of internally modelled approaches; and iii) complementing the risk-weighted capital ratio with a finalised leverage ratio and a revised and robust capital floor.

2. Main points

- **Standardised approach (SA) for credit risk**. The key revisions to this SA are, among others:
  - A more granular approach has been developed for <u>unrated exposures</u> to banks and corporates, and for rated exposures in jurisdictions where the use of credit ratings is permitted.
  - For <u>exposures to banks</u>, some of the RWs for rated exposures have been recalibrated. In addition, the RW treatment for unrated exposures is more granular than the existing flat RW. A standalone treatment for covered bonds has also been introduced.
  - For <u>exposures to corporates</u>, a more granular look-up table has been developed. A specific RW applies to exposures to small and medium-sized enterprises or SMEs (i.e. a 85% will be applied for unrated exposures to corporate SMEs and a 75% for exposures to SMEs that are treated as regulatory retail SME exposures).
  - For <u>residential real estate</u> exposures, more risk-sensitive approaches have been developed, whereby RWs vary based on the LTV ratio of the mortgage (instead of the existing single RW) and in ways that better reflect differences in market structures.
  - For <u>retail exposures</u>, a more granular RW treatment applies, which distinguishes between different types of retail exposures (e.g. the regulatory retail portfolio distinguishes between revolving facilities and transactors).
  - For <u>commercial real estate exposures</u>, approaches have been developed that are more risk-sensitive than the flat RW which generally applies.
  - For <u>subordinated debt and equity exposures</u>, a more granular RW treatment applies (relative to the current flat risk weight).
  - For <u>off-balance sheet items</u>, the credit conversion factors (CCFs), which are used to determine the amount of an exposure to be risk-weighted, have been made more risk-sensitive, including the introduction of positive CCFs for unconditionally cancellable commitments (UCCs).
- **Internal ratings-based (IRB) approaches for credit risk**. In this regard, the BCBS has introduced the following revisions:
  - <u>Remove the use of the advanced IRB (A-IRB) approach for certain asset classes</u> (e.g. exposures to large and mid-sized corporates, to banks and other financial institutions). As a result, banks with supervisory approval will use the foundation IRB (F-IRB) approach. Further, all IRB approaches are being removed for exposures to equities.
  - <u>Specify the input floors</u>, by introducing minimum “floor” values for bank-estimated IRB parameters that are used as inputs to the calculation of RWA. These include PD floors for both the F-IRB and A-IRB approaches (e.g. 5bp for corporate assets), and LGD and EAD floors for the A-IRB approach (e.g. 25% unsecured LGD for corporate, and a EAD floor for corporate and retail assets, respectively).
  - <u>Additional enhancements</u>, including providing greater specification of the practices that banks may use to estimate their model parameters in the F-IRB approach (e.g. for unsecured exposures, reducing the LGD parameter from 45% to 40% for exposures to non-financial corporates).

- **Credit Valuation Adjustment (CVA) risk framework**. The revisions agreed by the BCBS includes: i) the enhancement of its risk sensitivity as the revised CVA framework takes into account the exposure component of CVA risk along with its associated hedges; ii) strengthening its robustness, by removing the internally modelled approach, and including a standardised approach and a basic approach; and iii) improvement of its consistency by establishing a standardised CVA approach based on fair value sensitivities to market risk factors and the basic approach is benchmarked to the standardised approach.
- **Operational risk framework**. In this regard, the key revisions are as follows:
  - Remove the advanced measurement approaches (AMA) and the existing three standardised approaches for calculating operational risk capital requirements.
  - Introduce a single risk-sensitive standardised approach to be used by all banks, which determines a bank's operational risk capital requirements based on two components: the business indicator component (BIC) and the internal loss multiplier (ILM).
- **Leverage ratio (LR) framework**. The BCBS has agreed to:
  - Introduce a buffer for global systemically important banks (G-SIBs), which must be met with Tier 1 capital and is set at 50% of a G-SIB's risk-weighted higher-loss absorbency requirements (e.g. a G-SIB subject to a 2% risk-weighted higher-loss absorbency requirement would be subject to a 1% leverage ratio buffer requirement).
  - Refine the LR exposure measure, by modifying the way in which derivatives are reflected in the exposure measure and updating the treatment of off-balance sheet exposures to ensure consistency with their measurement in the SA to credit risk, among others.
- **Output floor**. The BCBS has revised this floor by considering the following:
  - Under the revised output floor, banks' risk-weighted assets must be calculated as the higher of: i) total RWAs calculated using the approaches that the bank has supervisory approval to use (including both standardised and internal model-based approaches); and ii) 72.5% of the total RWAs calculated using only the standardised approaches.
  - The standardised approaches to be used when calculating the output floor are: credit risk, counterparty credit risk, CVA risk, securitisation framework, market risk and operational risk.

3. Next steps

- The implementation date of the revised SA for credit risk, the revised IRB framework, the revised CVA framework, and the revised operational risk framework will be **1 January 2022**. Further, both the implementation and regulatory reporting date for the revised market risk framework (published in January 2016) will be **1 January 2022**.
- The LR framework will be applicable by **1 January 2018** (using the existing exposure definition) and by **1 January 2022** (using the revised exposure definition). Further, the G-SIB buffer will be applicable by **1 January 2022**.
- Moreover, the transitional arrangement for **phasing in the aggregate output floor** will be: 50% (1 January 2022), 55% (1 January 2023), 60% (1 January 2024), 65% (1 January 2025), 70% (1 January 2026), and 72.5% (1 January 2027).

21/12/2017

- **Consultative Document on stress testing principles**.
- **Supervisory and bank stress testing: range of practices**.

1. Context

In May 2009, the BCBS issued Principles for sound stress testing practices and supervision setting out a comprehensive set of principles for the sound governance, design and implementation of stress testing programmes at banks, and addressing key weaknesses in such programmes that were highlighted by the financial crisis.

In this regard, the BCBS has now published a **Consultative document on stress testing principles**, relevant for both banks and authorities, which sets out nine principles to govern stress testing frameworks. Nevertheless, these principles do not constitute standards, for which the BCBS expects full implementation, but guidelines that focus on the core elements of such stress testing frameworks (e.g. objectives, governance, policies, processes, etc.).

Alongside this CP, the BCBS has also published Supervisory and bank stress testing: range of practices aiming to describe and compare supervisory and bank stress testing practices and to highlight areas of evolution.

2. Main points

<u>Consultative document on principles on bail-in execution</u>

- **Principle 1. Stress testing frameworks should have clearly articulated and formally adopted objectives**. The BCBS establishes that these frameworks should be design to meet clear objectives that are documented and approved at the board level of the organisation, or an appropriately senior-level governance body. Further, they should be consistent with the risk management framework of the bank and its governance structure.
- **Principle 2. Stress testing frameworks should include an effective governance structure**. The BCBS sets out that the governance structure should be clear, comprehensive and documented, and should specify roles and responsibilities of senior management, oversight bodies and those responsible for the ongoing operation of the stress testing framework.
- **Principle 3. Stress testing should be used as a risk management tool and to inform business**. The BCBS establishes that stress testing should contribute to formulating and pursuing strategic and policy objectives. Further, it should be undertaken regularly and, when using its results, banks and authorities should have a clear understanding of their assumptions and limitations (e.g. scenario relevance, risk coverage, etc.)
- **Principle 4. Stress testing frameworks should capture material and relevant risks and apply stresses that are sufficiently severe**. The BCBS sets out that these frameworks should cover material and relevant risks, including a comprehensive assessment of risks, and include how the stress test scenarios, which should be sufficiently severe and varied, capture the risk.
- **Principle 5. Resources and organisational structures should be adequate to meet the objectives of the stress testing framework**. The BCBS establishes that the governance processes should ensure the adequacy of resourcing for stress testing, including ensuring that resources have the appropriate skill sets to execute the framework regarding the need for specialized staff, systems and IT infrastructure.
- **Principle 6. Stress test should be supported by accurate and sufficiently granular data and by robust IT systems**. The BCBS states that the data used should be accurate and complete, and available at a sufficiently granular level and in timely manner in order for risks to be identified and the results of the stress tests to be reliable

- **Principle 7. Models and methodologies to assess the impacts of scenarios and sensitivities should be fit for purpose**. The BCBS establishes that the models and methodologies should, among others, adequately define at the modelling stage the coverage, segmentation and granularity of the data and types of risks in line with the objectives of the stress test framework.
- **Principle 8. Stress testing models, results and frameworks should be subject to challenge and regular view**. The BCBS sets out that regular view and challenge are critical to improving the reliability of stress test results, aiding an understanding of their limitations, identifying areas where the stress testing approach should be improved and ensuring that the results are being consistent with the objectives.
- **Principle 9. Stress testing practices and findings should be communicated within and across jurisdictions**. The BCBS considers that disclosure of results of stress tests, whether by banks or authorities, can help to improve market discipline and provide confidence in the resilience of the banking sector to identified stresses.

3. Next steps

- Comments to this consultative document shall be submitted by **23 March 2018.**

21/11/2017

- **2017 list of global systemically important banks (G-SIBs)**.
- **Review of the 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 **2017 list of G-SIBs** and the **Review of the 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

<u>FSB - 2017 list of G-SIBs</u>

- The list comprises **30 banks** (the same as in the 2016 list) with one new bank, Royal Bank of Canada, being added and one bank, Groupe BPCE, being removed from the list. Moreover, 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.

<u>FSB – Review of the list of G-SIIs</u>

- The FSB, in consultation with the International Association of Insurance Supervisors (IAIS) and national authorities, has decided to **review the 2016 list of G-SIIs instead of publishing a new list for 2017**.
- Accordingly, the policy measures set out by the FSB in the 2016 list of G-SIIs will continue to apply to the firms included in this list. Nevertheless, regarding the Higher loss absorbency (HLA), the FSB established in February 2017 that the **HLA can be based on the Insurance Capital Standard (ICS)** published by the IAIS.

<u>BCBS - Additional information</u>

- 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

- 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 2019**.

30/11/2017

- **Consultative document on principles on bail-in execution**.
- **Consultative document on funding strategy elements of an implementable resolution plan**.

1. Context

In November 2011, the FSB published the Key Attributes of Effective Resolution Regimes for Financial Institutions. Since then, the resolution authorities for Global Systemically Important Banks (G-SIBs) have been working to develop firm-specific resolution strategies and plans, which involve the application of bail-in powers. Further, the FSB also published in 2016 the Guiding Principles on the temporary funding needed to support the orderly resolution of a G-SIB, which are intended to assist authorities in their resolution planning work.

In this context, the FSB has now published a **Consultative document on principles on bail-in execution**, addressed to resolution authorities, which establishes a set of principles to make the G-SIB bail-in resolution strategies operational (principles covering aspects of bail-execution such as its scope, valuation, exchange mechanisms, etc.).

Along with this document, the FSB has also published a **Consultative document on funding strategy elements of an implementable resolution plan**, addressed to resolution authorities, which sets out proposed guidance on the development of a plan for funding in resolution covering some key elements (e.g. strategy for maintaining liquidity in resolution, firm capabilities to support monitoring, reporting and estimating funding needs in resolution).

2. Main points

<u>Consultative document on principles on bail-in execution</u>

- **Principles on bail-in scope**, which provide guidance on transparency of the scope of the instruments and liabilities subject to the bail-in powers of resolution authorities; the application of discretionary exclusions from bail-in; information requirements to support the application of bail-in powers; and disclosures on the scope of bail-in to enhance transparency and market confidence.
- **Principles on valuation**, which establish a framework for the application of bail-in powers covering the timing and allocation of responsibilities between authorities for valuations; firms management information system capability; information requirements; and valuation methodologies across a resolution group.
- **Principles on exchange mechanisms**, which provide guidance to address a number of operational issues including the mechanism by which losses are absorbed; how creditors will document and track their claims; and the method to determine or adjust compensation to creditors.
- **Principles on securities law and securities exchange requirements**, which address the steps that home resolution authorities should take as part of ex ante resolution planning in order to: identify securities law and securities exchange requirements relevant to the bail-in period; and plan for the firm's compliance with the applicable disclosure requirements during such period, among others.
- **Principles on governance**, which seek to provide guidance on issues regarding the change of ownership and control of the firm following the end of the bail-in period, such as the requirements for regulatory approvals and authorisations which may differ across jurisdictions.
- **Principles on communications**, which assist authorities in the development of a coordinated strategy to manage market and creditors communications during the bail-in period.

Consultative document on funding strategy elements of an implementable resolution plan

- **Strategy for maintaining liquidity in resolution**, which should ensure that the adequate liquidity in resolution and the methodology to estimate funding needs in resolution are feasible and consistent with the overall resolution strategy for the G-SIB.
- **Firm capabilities to support monitoring**, reporting and estimating funding needs in resolution, which should include the assessment of its capabilities: i) to measure sources and positioning of liquidity and funding needs, ii) to report liquidity information at a material operating entity level on a timely basis, and iii) to identify and mobilise assets that could be used as collateral.
- **Development of the resolution funding plan by the authorities**, which should cover, among others, the interaction of measures in the resolution funding plan with measures in the firm's contingency funding and recovery plans, the authorities' approach to assessing liquidity stress in the run-up to resolution, and home authority's framework for estimating funding needs.
- **Firm assets and private sources of resolution funding**, regarding to which extent firm assets will remain available in the context of different failure scenarios, the availability, size and mobility of private sources of funding, and the actions taken by authorities to increase the willingness of private counterparties to provide funding to a G-SIB in resolution.
- **Temporary public sector backstop funding mechanisms and ordinary central bank facilities**, which should include the pre-conditions and operational procedures necessary to access any identified these temporary public funding mechanisms, the alignment of its use with the objectives of the preferred resolution strategy, etc.
- **Information sharing and coordination between authorities**, which should cover, among other aspects, whether the resolution funding plan establishes a clear allocation of responsibilities and a communication plan among the relevant home and host authorities, and whether it captures the implications of local regulatory requirements or other aspects specific to material operating entities in host jurisdictions.

3. Next steps

- Comments to both consultative documents shall be submitted by **2 February 2018**.

European Commission

28/11/2017

Delegated Regulation supplementing PSD2 with regard to RTS for strong customer authentication and common and secure open standards of communication.

1. Context

In November 2015, the European Parliament and the Council published Directive 2015/2366 on payment services in the internal market (PSD2). In this regard, a key objective of PSD2 is to increase the level of security and confidence of electronic payment by requiring payment service providers to develop strong customer authentication (SCA).

In this context, the EC has now published a **Delegated Regulation supplementing PSD2 with regard to RTS for strong customer authentication and common and secure open standards of communication** aiming at spelling out how the SCA should be applied. In particular, this document covers the following aspects: i) general provisions, ii) security measures for the application of SCA, iii) exemptions from SCA, iv) confidentiality and integrity of the payment service users' personalised security credentials, and v) common and secure open standards of communication.

2. Main points

- **General provisions**. Among other aspects, this Regulation establishes that:
  - Payment service providers should comply with certain requirements for the purpose of implementing security measures (e.g. apply the procedure of SCA).
  - The payment service providers shall have transaction monitoring mechanisms to detect unauthorised or fraudulent payment transactions, considering several risk-based factors (e.g. the amount of each payment transaction).
  - The implementation of the security measures shall be documented, periodically tested, evaluated and audited.
- **Security measures for the application of SCA**. Among others, this Regulation establishes that:
  - Where payment service providers apply SCA, the authentication shall be based on two or more elements which are categorised as knowledge (something only the user knows), possession (something only the user possesses), and inherence (something the user is) and shall result in the generation of an authentication code.
  - Payment service providers shall adopt security measures which meet that, among others, the payer is made aware of the amount of the payment transaction and of the payee, the authentication code generated is specific to the amount of the payment transaction, etc.
  - They shall adopt measures to mitigate the risk of the elements of SCA categorised as: knowledge (e.g. those to prevent the disclosure to unauthorized parties), possession (e.g. those designed to prevent replication of elements), inherence (e.g. those to avoid unauthorised use of the elements through access to the devices and the software). Further, payment service providers shall ensure that the breach of one of the elements does not compromise the reliability of the other elements (independence of elements).
- **Exemption from SCA**. This Regulation establishes that payment service providers shall be allowed not to apply SCA where, among others:
  - A payment service user is, in general, limited to accessing the balance of one or more designated payment accounts or payment transactions executed in the last 90 days through one or more designated payment accounts, without disclosure of sensitive payment data.
  - The payer initiates a contactless electronic payment transaction provided certain conditions are met (e.g. the individual amount does not exceed 50€).
  - The payer initiates an electronic payment transaction at an unattended payment terminal for the purpose of paying a transport fare or a parking fee.

- **Confidentiality and integrity of the payment service users' personalized security credentials**. This Regulation sets out that payment service providers shall ensure, among others:
    - The confidentiality and integrity of the personalised security credential of the payment service user, including authentication codes, during all phases of authentication.
    - The creation of personalised credentials is performed in a secure environment.
    - Only the payment user is associated, in a secure manner, with the personalised security credential, the authentication devices and the software.
    - The delivery of personsalised security credentials, authentication devices and software is carried out in a secure manner designed to address the risks related to their unauthorised use (i.e. due to their loss, theft or copying).
    - The renewal or re-activation of personalised security credentials, and its destruction, deactivation and revocation.
- **Common and secure open standards of communication**. Further, this Regulation establishes:
    - General requirements for communication, covering aspects regarding requirements for identification and traceability.
    - Specific requirements for the common and secure open standards of communication, such as general obligations for access interfaces, access interfaces options, etc.

3. Next steps

- This Regulation shall enter into force on the **day following** that of its publication in the Official Journal of the European Union.
- This Regulation shall apply, in general terms, **18 months after entry into force date**.

02/10/2017

- **Opinion in response to the European Commission's Call for Advice on Investment Firms**.
- **Annex to the EBA Opinion**.

1. Context

In December 2015, the EBA published a report with two recommendations for a sound prudential regime for investment firms. Following this report, the EBA received a call for advice (CfA) from the European Commission (EC) to provide further technical advice on these recommendations.

In the first part of its CfA the EC sought advice on: i) the criteria to identify the class of investment firms for which the CRD and CRR would be applicable (i.e. Class 1 investment firms, which should be those identified as G-SIIs or O-SIIs); and ii) the specific rules which should apply to them. The EBA provided its response to this part of the CfA in October 2016. The second part of the CfA sought advice regarding the new prudential regime for Class 2 and Class 3 firms.

In this context, the EBA has published an **Opinion in response to the second part of EC's CfA on investment firms**, which includes a set of recommendations regarding the criteria for identifying Class 2 and Class 3 firms, the level of initial capital requirements, the liquidity regime, remuneration requirements and corporate governance rules, etc.

2. Main points

- **General recommendations**. Among others, it is recommended to develop a single rulebook, separate from the one for credit institutions, for all MiFID investment firms not falling in Class 1.
- **Categorisation**. Among others, it is recommended to introduce a new categorisation of MiFID investment firms distinguishing between:
    - Systemic investment firms or investment firms which are exposed to the same types of risks as credit institutions (Class 1) to which the full CRD/CRR should be applied.
    - Other non-systemic investment firms (Class 2) above specific thresholds that should be subject to a more tailored prudential regime.
    - Small and non-interconnected investment firms (Class 3) providing limited services in terms of number and size to which a very simple regime should be applied.
- **Consolidated supervision**. Some recommendations are provided regarding whether requirements should be applied on a consolidated or individual basis.
- **Capital definition and composition**. It is recommended that the definition of the regulatory capital should be aligned to the one in the CRR for credit institutions; that investment firms should meet a specific composition of capital (CET1 of at least 56% of capital requirements; Additional Tier 1 eligible up to 44%; and Tier 2 capital eligible up to 25%); etc.
- **Capital requirements**. It is recommended that the new prudential regime for Class 2 and 3 investments firms should include provisions for the application of an Initial Capital Requirement (IC) for the authorisation phase (set at 750.000€, 150.000€ or 75.000€ depending on the activities of the investment firm); that investment firms should meet the Permanent Minimum Capital (PMC) requirements and the minimum level of Fixed Overheads Requirement (FOR); etc.
- **Liquidity requirements**. It is recommended that the application of the LCR should be extended to all Class 1 investment firms; that Class 2 and 3 investment firms should have internal rules to monitor, measure and manage exposures and liquidity needs and should be required to hold an amount of liquid assets equal to one third of the FOR requirements; etc.
- **Concentration risk**. It is recommended that all investment firms should be required to identify, manage and monitor any concentration risk; that Class 2 investment firms should report concentration risks to competent authorities; etc.
- **Additional requirements on an individual firm basis (Pillar 2)**. Among others, it is recommended to set out a requirement for investment firms to be responsible for assessing the adequacy of the new minimum requirements to their own risk situation and for competent authorities to undertake individual firm-specific assessments.

- **Reporting**. It is recommended that a simplified reporting framework for Class 2 and 3 investment firms should be applied, whereas Class 1 investment firms should be subject to the same reporting requirements of credit institutions; that public disclosure requirements (Pillar III) for Class 2 and 3 investment firms should be reduced to the minimum; etc.
- **Remuneration and governance**. For instance, it is recommended that the governance requirements set out in CRD should fully apply to Class 1 firms, while a lighter governance framework should be applied to Class 2 and 3 firms; that Class 3 firms should only be subject to the remuneration provisions of MiFID; etc.
- **Macro-prudential perspective**. It is recommended that the new prudential regime for investment firms should include a macroprudential perspective.

3. Next steps

- A review of the prudential framework of investment firms is under way as part of the EC 2017 work programme.

13/10/2017
Opinion on issues related to the departure of the UK from the EU.

1. Context

The UK's decision to withdraw from the EU includes the UK leaving the European Single Market. In this regard, those UK-based financial services firms which provide services in other Member States of the EU may seek to retain access to the EU market, either by using establishments that are already present in the remaining Member States (EU27) or by seeking the authorisation or approval of new establishments in the EU27.

In this context, the EBA has issued an **Opinion on issues regarding to the departure of the UK from the EU**, to provide guidance on supervisory expectations and to address regulatory and supervisory arbitrage risks. In particular, this Opinion addresses a number of relevant policy topics relating to authorisations; internal models; internal governance, outsourcing, risk transfers and 'empty shell' companies; and resolution and Deposit Guarantee Schemes (DGSs).

This not binding Opinion is addressed to competent authorities (CAs) and to the European Commission, and takes into account and complements the opinions issued by the ESMA and the EIOPA.

2. Main points

- **Authorisations**. The EBA is of the view that:
    - Existing <u>authorisation standards should not be lowered</u> and that the same procedures and standards that have always applied should continue to do so.
    - Firms seeking authorisation should undergo a <u>rigorous assessment</u> against the relevant requirements. The applications should contain sufficient information on their business structure and programme and a clear explanation of the choices taken in terms of substance of the incoming entity (no 'empty shells').
    - The <u>regulatory burden on firms should be kept</u> to a minimum through the use of existing information held by CAs, and through cooperation between authorities.
- **Internal models**. The EBA is of the opinion that:
    - The existing EU legal framework for <u>model approvals should be applied in full</u>, and, where model approvals or changes are sought, the CRR assessment process should be applied.
    - Institutions which do not yet have the relevant model permissions should apply for new <u>permissions or model extensions</u> to use the internal models in the EU27 Member States.
    - When considering applications, EU27 CAs can rely on assessments made by UK CAs where the assessment was for a <u>similar rating system</u> in the same class of exposures.
- **Internal governance, outsourcing, risk transfers and 'empty shell' companies**. The EBA considers that:
    - CAs should assess whether or not institutions have <u>sound and effective governance</u> and that the members of the management body are suitable.
    - CAs should not allow institutions to outsource activities to such an extent that they operate as <u>'empty shell' companies</u>.
    - EU27 CAs should have regard to the likelihood that after Brexit the UK will be a third country and thus <u>activities outsourced to institutions in the UK</u> prior to Brexit should be assessed with regard to the ability of the institution to adapt to this possible scenario.
    - Institutions engaging in intragroup operations to transfer risk to another entity should have adequate resources to identify and fully manage their <u>counterparty credit risk</u>.
- **Resolution and DGSs**. The EBA notes that:
    - Changes arising from Brexit should be factored into <u>resolution authorities' resolution planning</u>.
    - Institutions and authorities should consider the implications of the departure of the UK for the <u>build-up of the minimum requirement for own funds and eligible liabilities (MREL)</u>, and take steps now to mitigate relevant risks. At present, significant issuance of liabilities eligible for the MREL takes place in the UK under English law.
    - DGSs should be prepared to ensure that EU27 depositors maintain their protection after Brexit, by assessing (where relevant) the <u>equivalence of the UK's deposit protection regime</u>.

3. Next steps

- The EBA will monitor how the Opinion is applied in practice and continue to seek convergence through its tools and powers.
- The EBA may update this Opinion in future in response to changing circumstances.

13/10/2017

- **Consultation Paper on ITS on provision of information for the purpose of resolution plans**.
- **Annex I - Resolution templates**.
- **Annex II – Instructions**.

1. Context

Relevant, accurate and updated information on institutions is crucial for resolution authorities (RAs) to draw up resolution plans and substantiate their resolvability assessment and resolution strategy. In this regard, the EBA developed ITS on reporting for resolution plans in 2015, which were endorsed by the European Commission (EC) in 2016 (Regulation 2016/1066).

In this context, the EBA has published a **Consultation Paper (CP) to amend the ITS on the information which institutions must provide to RAs for the purpose of drawing up and implementing resolution plans**, which aims at achieving three objectives: i) clarifying the scope of the reporting framework; ii) specifying the minimum procedural and technical reporting requirements; and iii) updating the templates.

In conducting this review, the EBA has taken into account the need for proportionality. The envisaged revised ITS are without prejudice to the right of RAs to set simplified obligations for banks whose failure would have a limited impact on financial markets, on other institutions and on funding conditions.

2. Main points

- **Scope**. The revised ITS establish a minimum set of information items to be reported by all credit institutions, as well as investment firms and other entities included in the scope of the BRRD. Moreover, these ITS recognise the possibility of RAs to request additional information or to collect the information set out in the ITS with a higher frequency or at more levels that set out in the ITS.
- **Procedural requirements**.
    - Request for information. Information in the templates which is already available to supervisory authorities must be shared with the RAs. Were the information is not already available, the RA will directly request it to the institution. In this regard:
        - By default a request for information will cover all the information items included in the templates annexed to the ITS.
        - Where a request extends to additional information, the RA will set the applicable timeframe, format, scope and level.
    - Frequency. Templates must be collected on annual basis.
    - Level and scope of reporting. Requirements on level and scope are inherently linked to the rationale of each template, which are underpinned by certain principles (e.g. templates with general information on banking groups should at least be collected at parent level for the entire group).
    - Reporting format and data point model. The EBA will develop in parallel with these ITS a single data point model (DPM) and XBRL taxonomies based on the DPM database.
- **Requirements on minimum content and revised templates**. Three main blocks of templates have been identified.
    - General information on banking group. It enables RAs to map a group and locate its various entities, and to identify the main distribution of assets and RWAs, consolidation perimeters, and the main contact points. Within this block, certain amendments have been introduced (e.g. information on ownership has been simplified, information on contact details has been deleted).
    - Quantitative information on on- and off-balancesheet items. This information will be used for a wide range of purposes such as setting and monitoring MREL. Within this block, certain amendments have been introduced (e.g. the central template 'Liability structure' has been restructured; a new 'intragroup financial interconnections' template and a new template on deposit protection have been added).
    - Critical functions. This block relates to identifying critical functions, mapping them across group entities and identifying which core business lines, services, financial market infrastructures and information support them. Within this block, certain amendments have been introduced (e.g. a new 'criticality assessment' template has been added).

3. Next steps

- Comments to this consultation shall be submitted by **11 December 2017**.
- The EBA intends to disclose the data point model and taxonomies at the same time as delivering these draft ITS to the EC, which is expected in the **1Q18**.
- The new framework is expected to be operational in **2019** when RAs will collect information as of 31 December 2018.

30/10/2017
Final timeline for the 2018 EU-wide stress test.

1. Context

In summer 2017, the EBA decided to extend overall timeline for the stress test to take into account the challenges that the implementation of IFRS 9 poses regarding the availability of starting point data in early 2018.

In this regard, the EBA has now announced the **Final timeline of the 2018 EU-wide stress** test which mainly covers the key milestones agreed by the EBA Board of Supervisors for the 2018 stress test.

2. Main points

- The EBA has established the following **key milestones for the 2018 stress test**:
    - Launch of the exercise in January 2018.
    - First submission of results to the EBA in early June 2018.
    - Second submission to the EBA in mid-July 2018.
    - Final submission to the EBA in late October 2018.
    - Publication of results by 2 November 2018.
- Further, the EBA in cooperation with competent authorities is now in the process of finalising the **methodology and templates** with the objective of sharing them with participating banks ahead of the launch.

3. Next steps

- The EBA will publish the final methodology in **November 2017**.
- The final templates and further guidance to participating banks will be published by the **end of the year**.
- The macroeconomic scenario will be published with the launch of the exercise in **January 2018**.

02/11/2017

- **Consultation Paper on Guidelines on common procedures and methodology for SREP**.
- **Draft Revised SREP Guidelines - consolidated text**.
- **Consultation Paper on Guidelines on the management of the interest rate risk arising from non-trading activities (IRRBB)**.
- **Consultation Paper on Guidelines on institution's stress testing**.

1. Context

In April 2017, the EBA published its Pillar 2 Roadmap aiming to enhance institutions' risk management and supervisory convergence in the supervisory review and examination process (SREP). Following the global regulatory developments, as well as the EBA's supervisory assessments, specific changes are now needed to reinforce the framework as set in the Roadmap.

In this context, the EBA has published **three Consultation Papers (CPs) on Guidelines (GL) regarding**: i) **common procedures and methodology for SREP**, ii) **the management of interest rate risk arising from non-trading activities** (IRRBB), and iii) **institution's stress testing**. These CPs aim to update the existing regulation on these aspects, i.e. the EBA GL on SREP published in 2014, the EBA GL on the management of the IRRBB published in 2015, and the Committee of European Banking Supervisors GL on stress testing (CEBS GL 32) published in 2010, respectively.

2. Main points

CP GL on common procedures and methodology for SREP

- Despite the overall SREP framework and GL remain intact, this CP covers **several elements of the EU SREP framework that have been updated** to reflect the ongoing policy initiatives related to Pillar 2/SREP, which include amongst other things:
  - The introduction of Pillar 2 Capital Guidance (P2G).
  - The integration of supervisory stress testing requirements and supervisory assessment of banks' stress testing from the EBA CP GL on stress testing and supervisory stress testing.
  - Clarification of certain aspects regarding the scoring framework (e.g. definitions, measures set out from the SREP scoring framework).
  - Further details on the articulation of own funds requirements regarding Total SREP Capital Requirements (TSCR) and Overall Capital Requirements (OCR).
- Moreover, this CP has also been updated with **assessments of internal governance** based on the recently revised EBA GL on internal governance, published in September 2017.

CP GL on the management of the interest rate risk arising from non-trading activities (IRRBB)

- This CP sets out **supervisory expectations** on the management of IRRBB considering the development introduced in the BCBS Standard on IRRBB.
- In particular, this CP covers several aspects regarding, among others:
  - General provisions. The scope of the current GL has been expanded covering credit spread risk from non-trading book activities (CSRBB), providing a definition of CSRBB and a high level expectation for institutions to identify CSRBB exposures and ensure it is adequately measured, monitored and controlled.
  - Capital identification, calculation and allocation. Despite the existing expectations on internal capital allocation have been retained, more detailed guidance is provided regarding the capital adequacy assessments of IRRBB.
  - Governance. New guidance is provided on the appropriate assessment of new products and activities, delegation and monitoring and management of IRRBB, risk appetite, etc.
  - Measurement. The existing guidelines have been retained although some additional expectations originating in the BCBS Standard have been added (e.g. provision on currency specific shocks for material currencies).
  - Supervisory outlier test. A set of principles that institutions should use when calculating this test is provided (e.g. all interest rate sensitive instruments not deducted from own funds should be included).

CP GL on institution's stress testing

- This CP aims at achieving **convergence of practices** followed by institutions for stress testing across the EU by providing detailed guidance to be complied with by institutions when designing and conducting a stress testing programme/framework.
- In particular, this CP focuses on the following aspects:
    - Stress testing governance structures and their use including the application of the GL on internal governance of stress testing.
    - Data infrastructure, including data aggregation capabilities and reporting practices.
    - Stress testing scope and coverage.
    - Possible methodologies including importance of undertaking both simple and complex scenarios.
    - Range of, non-exhaustive, individual risk categories in relation to stress testing in order to enhance risk management and capital planning and liquidity processes.
    - Application of stress testing programmes, including interaction with recovery and resolution plans, the use of stress test to assess viability of the capital plan, etc.

3. Next steps

- Comments to these three CPs shall be submitted by **31 January 2018**.
- These three GL are expected to be implemented by **1 January 2019** for the 2019 cycle of SREP, in accordance with the Pillar 2 Roadmap.
- The GL on SREP will amend, where relevant, and supplement the existing EBA GL on SREP.
- The GL on IRRBB will repeal the EBA GL on management of IRRBB.
- The GL on institution's stress testing will repeal and replace CEBS GL on institutions' stress testing.

10/11/2017

- **Consultation Paper on RTS on the methods of prudential consolidation under the CRR**.
- **Opinion of the EBA on matters relating to other financial intermediaries and regulatory perimeter issues**.
- **EBA Report on other financial intermediaries and regulatory perimeter issues**.

1. Context

According to the CRR, for prudential consolidation purposes, institutions shall fully consolidate all institutions and financial institutions that qualify as their subsidiaries or, where relevant, the subsidiaries of their parent financial holding company or parent mixed financial holding company. However, under certain circumstances, it is allow the application of a different method of consolidation (other than full consolidation).

In this context, the EBA has published a **Consultation Paper on RTS on the methods of prudential consolidation** which sets out some criteria/indicators and some conditions for the application of different methods of consolidation (e.g. full consolidation, proportional consolidation, aggregation method) or the application of the equity method in certain cases.

The scope of the prudential consolidation framework includes institutions (i.e. credit institutions and investment firms), financial institutions and, when consolidated supervision is required under the CRD IV, ancillary services undertakings. In this regard, the EBA has published an Opinion and a Report on the prudential treatment of other financial intermediaries (OFIs) and regulatory perimeter issues, highlighting the diversity in terms of application of the definition of financial institution and ancillary services undertakings, which currently exists.

2. Main points

- **Permission for proportional consolidation of subsidiaries**. The competent authority's (CA) permission to apply proportional consolidation may be granted to a parent undertaking in proportion to the share of the capital it holds in a subsidiary, and where all the following conditions are met:
    - A contract limiting the liability of the shareholders or member in respect of the subsidiary shall be established under certain conditions (e.g. the limitation of the liabilities of the parties shall be defined as a percentage of the total shareholding).
    - The parent undertaking shall inform the CA at least 3 months in advance of any changes in the above-mentioned contract. The termination of the contract shall result in the full consolidation of the subsidiary.
    - The parent undertaking shall demonstrate that the solvency of the other shareholders or members of the subsidiary at individual and consolidated levels, where appropriate, is satisfactory and can be reasonably expected to remain so.
- **Use of the aggregation method**. The use of this method is allowed for undertakings managed on a unified basis pursuant to a contract, memorandum or articles of association; or undertakings' whose administrative, management or supervisory bodies consist in the majority of the same persons in office.
- **Proportional consolidation of undertakings with limited liability**. CAs shall require institutions to proportionately consolidate undertakings according to the share of capital held on these undertakings, if their participations fulfil certain conditions (e.g. the institution manages them together with one or more participating undertakings sharing the control, the decision on the undertaking's relevant activities requires the unanimous consent of the parties sharing control).
- **Treatment of other participations or capital ties (including equity method)**. CAs shall determine the consolidation method on a case-by-case basis. In this regard, the EBA establishes that:
    - The equity method would generally be applied and, in particular, when CA considers that the concerned undertaking does not need to be included in supervision on a consolidated basis.
    - Despite the above, CAs may require institutions to consider other measures (e.g. to apply proportional or full consolidation, to assess the appropriate prudential treatment of participations or capital ties in an undertaking).
- **Consolidation of undertakings where there is significant influence over another undertaking without holding any participation or other capital ties**. In this case, CAs may require full consolidation where, as a consequence of organisational and financial relationships, the institution is exposed in substance to the majority of the risks and/ or of the benefits arising from the activities of the undertaking.
- **Consolidation of undertakings where two or more or financial institutions are placed under single management**. In this case, the consolidating entity and the method of prudential consolidation are determined according to the Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings.

3. Next steps

- Comments to this CPs shall be submitted by **9 February 2018**.

15/11/2017

- **Report on the results from the 2017 market risk benchmarking exercise**.
- **Report on the results from the 2017 low default portfolios (LDP) credit risk benchmarking**.

1. Context

Under the CRD IV, competent authorities (CAs) shall carry out supervisory benchmarking studies of internal approaches for calculating own funds requirements. Moreover, the EBA is mandated to produce a report to assist the CAs in the assessment of the quality of the internal approaches.

In this regard, the EBA has published two reports on the consistency of RWAs: a **Report on the results from the 2017 market risk benchmarking exercise as well as a Report on the results from the 2017 low default portfolios (LDP) credit risk benchmarking**. In particular, the objective of the market risk report is to assess the level of variability observed in risk-weighted exposure amounts for market risk (MRWA) produced by banks' internal models whereas the LDP report provides an overview of risk weight (RW) variability and its drivers.

2. Main points

Report on the results from the 2017 market risk benchmarking exercise

- **Sample**. 51 banks from 12 jurisdictions that submitted data for 34 market portfolios in all asset classes (e.g. equity, interest rates) and 3 correlation trading portfolios.
- **Main findings**.
    - Interest rates portfolios exhibit a lower level of dispersion than other asset classes due to the use of more consistent practices and more homogeneous assumptions across the banks for modelling interest rate risk.
    - Significant dispersion in the initial market valuation (IMV) is observed stemming from different interpretations and heterogeneous market practices adopted by the firms.
    - Across all asset classes, the overall variability for value at risk (VaR) is lower than that observed for stressed VaR (24% and 30%, respectively). More complex measures such as incremental risk charge (IRC) and all price risk (APR) show a much higher level of dispersion (47% and 48%, respectively).
    - A lack of consistent practice among banks for modelling some of the risk factors was found (e.g. basis risk between a credit default swap and its equivalent bond).
    - The dispersion of empirical estimates of expected shortfall (proposed in the FRTB) at a 97,5% confidence level across risk factors is lower than that found for VaR and P&L VaR.
- **Dispersion in capital outcome**. The average variability across the sample, measured by the inter-quantile dispersion statistic (IQD) coefficient, is around 26% (considered significant by the EBA).
- **CAs' assessments based on supervisory benchmarks**. Some areas require follow-up actions (e.g. reviewing the banks' internal VaR and IRC models, alongside the Targeted Review of Internal Models or TRIM in-depth assessment; a supervisory extra charge) on the part of specific institutions whose internal models were flagged as outliers in this benchmarking exercise.

Report results from the 2017 LDP Credit Risk benchmarking

- **Sample**. 118 banks from 17 jurisdictions that submitted data on large corporate, sovereign and institutions portfolios (collectively referred to as LDP). In this report two indicators are used to summarise the results, the RW and the global charge or GC (i.e. considering expected and unexpected losses for IRB exposures).
- **Main findings**
    - The EAD-weighted average RW increased if compared with previous exercises (on average to 28%) ranging from 8% to 125%.
    - The weighted average GC increased if compared with previous exercises (on average to 36%) ranging from 8% to 147%.
    - Around 61% of GC variability observed could be explained by differences in: i) the share of the defaulted assets, ii) the geography and associated macroeconomic conditions, and iii) the portfolio mix effect. The remaining 39% may be due to differences in bank-specific factors, such as risk management practices.
    - The benchmark median RW is 48% for large corporate portfolios, 22% for institutions and 11% for sovereign.
    - PD for institutions portfolios show a reduction in interquartile range from 0.13% to 0.07% (in 2015 and in this exercise, respectively). For the sovereign portfolios, a significant decrease in the interquartile range for the LGD could be observed, from 23% to 15%.
- **Impact analysis using benchmarking parameters**. The report shows that if banks' parameters were replaced by benchmarking parameters, RW would increase by 7.9 percentage points.
- **CAs' assessments based on supervisory benchmarks**. Some areas require follow-up actions on the part of specific institutions whose internal models were flagged as outliers in this benchmarking exercise. Regarding the level of priority for the assessments, the large corporate and institutions portfolios are the most important exposures for possible supervisory actions.

16/11/2017
Final Guidelines on connected clients.

1. Context

In December 2009, the Committee of European Banking Supervisors (CEBS) published Guidelines on the implementation of the revised large exposures regime, in order to ensure an harmonised application of the revised large exposures regime regarding the definition of connected clients.

In this context, following the consultation launched in July 2016, the EBA has published **Final Guidelines (GL) on the treatment of connected clients**, which replace the CEBS Guidelines, aiming at supporting institutions in identifying all possible connections among their clients, in particular when control relationships or economic dependency should lead to the grouping of clients because they constitute a single risk.

These GL focus exclusively on the issue of connected clients as defined in the CRR, and apply to all areas of the CRR where the concept of 'group of connected client' is used (i.e. large exposures regime, the categorisation of clients in the retail exposure class for the purposes of credit risk, the development and application of rating systems, and SME supporting factor), including the EBA technical standards and the EBA guidelines that refer to that concept.

2. Main points

- **Groups of connected clients based on control**. The GL establishes that:
  - Institutions are required to assume that <u>two or more clients constitute a single risk</u> when there is a control relationship between them. In exceptional cases, institutions could justify that no single risk exists despite the existence of a control relationship among clients, if they document the relevant circumstances under this case.
  - Institutions should apply the <u>concept of control</u> as defined in the CRR in relation to depending clients that prepare the consolidate financial statements in conformity with the national rules transposing Directive 2013/34/EU on the annual financial statements, with the international accounting standards, or with the accounting rules of a third country.
  - They should <u>group two or more clients on account of a control's relationship</u>, even where:
    - These clients are not included in the same consolidated financial statements because exemptions apply to them under the relevant accounting rules (e.g. small groups).
    - The exposures to these clients are exempted from the application of the large exposures limit under the CRR or the exemptions set out in their national rules.
- **Alternative approach for exposures to central governments**. The GL establishes that:
  - Institutions may assess the existence of a group of connected clients <u>separately for each of the persons directly controlled</u> by or directly interconnected with the central government (alternative approach). A <u>partial application</u> of the alternative approach is allowed (i.e. assessing separately the natural or legal persons directly controlled with the central government).
  - Where the entities directly controlled by or directly interconnected with the central government are economically dependent on each other, they should form <u>separate groups of connected clients</u> (excluding the central government).
- **Establishing interconnectedness based on economic dependency**. In this regard, the GL sets out that, among others:
  - When assessing economic dependency, institutions should consider the <u>specific circumstances of each case</u>, in particular whether the financial difficulties or the failure of a client would lead to funding or repayment difficulties for another client (e.g. where a client has fully or partly guaranteed the exposure of another client).
  - Where an institution's client is <u>economically dependent on more than one client</u>, which are not dependent on each other, the institution should include the latter clients in separate groups of connected clients (together with the dependent client).
  - Institutions should form a group of connected clients where <u>two or more of their clients are economically dependent on an entity</u>, even if this entity is not a client of the institution.
  - Regarding <u>economic dependency through a main source of funding</u>, institutions should consider situations where the funding problems of one client are likely to spread to another. To this end, they should assess any contagion risk that could emerge from: i) use of one funding entity; ii) use of similar structures; or iii) reliance on commitments from one source (e.g. guarantees).

- **Relation between interconnectedness through control and interconnectedness through economic dependency**. The GL establishes that:
  - Institutions should assess whether the identified groups of connected clients need to be (partially) connected themselves via economic dependency. In this case, all entities for which a chain of contagion exists need to be grouped into one group of connected clients.
  - In their assessment, institutions should consider each case separately (i.e. identify the possible chain of contagion or domino effect, based on the individual circumstances).
- **Control and management procedures for identifying connected clients**. The GL establishes that, among others, institutions should have a thorough knowledge of their clients and their clients' relationships and should identify and document all control relationships and economic dependencies.

3. Next steps

- These GL will apply from **1 January 2019**.
- The CEBS GLs will be repealed with effect from **1 January 2019**.

20/11/2017
Final Methodological Note of the EU-wide Stress Test 2018.

1. Context

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

In this regard, the EBA has published the **2018 EU-wide stress test final methodology**, describing how banks should calculate the stress impact of the common scenarios. The **list of institutions** participating in the exercise is also included.

This final methodology can be seen as a continuation of the 2016 stress test's approach, taking into account the adjustments after the IFRS 9 implementation and 2016 lessons learnt.

2. Main points

- **Sample of bank**s:
    - 49 EU banks will participate in the exercise (51 EU banks participated in 2016), covering broadly 70% of the banking sector in the euro area, each non-euro area EU Member State and Norway.
    - To be included in the sample, banks have to hold a minimum of €30 billion in assets. Nonetheless, CAs could request to include additional institutions in their jurisdiction provided that they have a minimum of €100 billion in assets.
    - The scope of consolidation is the perimeter of the banking group defined by the CRD IV / CRR.
- **Reference date**: the exercise is carried out on the basis of year-end 2017 figures. Nevertheless, for banks commencing to report under IFRS 9 in the first quarter of 2018, the 2018 EU-wide stress test considers the impact of the introduction of IFRS 9 in starting point data as well as in the projections of banks. To this end, banks shall recognise the effect of the introduction in capital as of 1 January 2018.
- **Macroeconomic scenarios**: the stress test includes a baseline scenario and an adverse scenario, which cover the period 2018-2020.
- o The exercise is conducted on the assumption of static balance sheet, which applies for both the baseline and the adverse scenario.
- **Risk coverage**:
    - Banks are required to stress test the following common set of risks:
        - Credit risk, including securitisation.
        - Market risk, counterparty credit risk (CCR) and credit valuation adjustment (CVA).
        - Operational risk, including conduct risk.
    - Banks are also requested to project the effect of the scenarios on net interest income (NII) and to stress P&L and capital items not covered by other risk types.
    - The risks arising from sovereign exposures are covered in credit risk and in market risk, depending on their accounting treatment.
- **Results**:
    - The impact of the EU-wide stress test will be reported in terms of CET1. In addition, the Tier 1 capital ratio and total capital ratio, as well as a leverage ratio, will be reported for every year of the exercise.
    - Like in the 2016 stress test, no hurdle rates or capital thresholds are defined for the purpose of the exercise. CAs will apply stress test results as an input to the SREP.
- **Process**: it involves close cooperation between the EBA, the CAs and the ECB, as well as the European Systemic Risk Board (ESRB).
    - The adverse macroeconomic scenario and any risk type specific shocks linked to it will be developed by the ESRB and the ECB.
    - The ECB will supply the baseline macroeconomic scenario.
    - The CAs are responsible for the quality assurance process.

3. Next steps

- To give banks sufficient time to prepare for the 2018 exercise, the methodology is published well ahead of the formal launch, which will include relevant macroeconomic scenarios.
- According to the EBA final timeline of the 2018 EU-wide stress test, the final templates and further guidance to participating banks will be published by the **end of the year**, and the exercise will be launched in **January 2018**.

21/11/2017
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, following the consultation launched in November 2016, the EBA has **published Final Guidelines (GL) on PD and LGD estimation and the treatment of defaulted exposures** 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 GL apply to all models for which an institution received permission to use under the IRB approach and 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 aspects regarding segmentation principles, aimed to provide guidance on the highest level of rating system design; data requirements, including clarifications regarding accuracy, completeness, and appropriateness; use of human judgement in estimation of risk parameters; and treatment of deficiencies and margin of conservatism (MoC), addressing the identified deficiencies via appropriate adjustments and MoC.
- **PD estimation**. The GL provide detailed guidance on the following aspects:
    - General requirements, which clarify that each natural/legal person that has exposures within the scope of the IRB Approach should be rated including where there is unfunded credit protection.
    - Model development, which include clarifications regarding the risk drivers and rating criteria (e.g. they should not be based only on statistical analysis), treatment of ratings of third parties in the estimates of the PD of an obligor, and rating philosophy in order to increase institutions awareness and understanding of the relationship between the definition of risk drivers, the number of grades, etc.
    - PD calibration, which specifies several aspects regarding: i) data requirements for observed default rates calculation, in order to identify the relevant type of exposures covered by the rating system in; ii) calculation of the one-year default rates, which obligors should consider for the purpose of calculating this default rate; iii) calculation of the observed average default rate, in which institutions should justify their approach; iv) long-run average default rate, which 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); and v) calibration to the long-run average default rate, which is performed on a calibration sample that should be comparable to the current portfolio in terms of obligor and transaction characteristics, but should reflect at the same time the likely range of variability of default rates.
- **LGD estimation**. The GL provide detailed guidance on the following aspects:
    - General requirements, which includes clarifications regarding LGD estimation methodologies (e.g. LGD estimates based on the institutions' own loss and recovery experience is the main methodology that should be used by institutions), data requirements (e.g. they should be properly recorded and stored), and recoveries from collateral (e.g. they should be treated regardless of the form of the realisation of the collateral).
    - Model development in LGD estimation, which includes clarifications on risk drivers (e.g. factors related to transactions and obligors, to institutions), eligibility of collaterals (e.g. institutions may consider any type of eligible collateral according to the CRR), and inclusion of collaterals (e.g. institutions should avoid bias in the LGD estimates).
    - LGD calibration, which specifies several aspects regarding: i) calculation of economic loss and realised LGD, in particular on the treatment of fees, interest and additional drawings after default, discounting rate, and costs; ii) long-run average LGD, in particular on the historical observation period, calculation, treatment of incomplete recovery processes and treatment of cases with no loss or positive outcome; and iii) calibration of the estimates to long-run average LGD that may be performed either on a portfolio level or on a grade or pool level, depending on the chosen estimation methodology.

- **Estimation of risk parameters for defaulted exposures**. The GL cover the following aspects specific to ELBE and LGD in-default:
  - General requirements, which include clarifications regarding estimation methodologies (e.g. institutions should use the same estimation methods used for estimating LGD for non-defaulted exposures), reference dates (e.g. institutions should set them according to the recovery pattern observed on a specific type of exposures), and data requirements (e.g. the scope of data necessary should include the information obtained during the recovery process).
  - Model development, which includes clarifications on the types of potential risk drivers should be taken into account in estimating ELBE and LGD in-default on top of those used for non-defaulted exposures.
  - Calibration, which specifies several aspects regarding: i) calculation of realised LGD and long-run average LGD for defaulted exposures, specifying that the reference date should be determined according to the recovery patterns rather than at the date of default; ii) specific requirements for ELBE estimation, in particular regarding the current economic circumstances and exposure status and the relations of ELBE with specific credit risk adjustments; and iii) specific requirements for LGD in-default estimation, including downturn conditions and adequate MoC.
- **Other aspects**. These GL provide also guidance on the application of risk parameters (conservatism; human judgement in their application; use of internal rating and defaults and loss estimates; and calculation of IRB shortfall or excess) and on the review of estimates.

3. Next steps

- These GL apply from **1 January 2021**, but earlier implementation is encouraged.
- Institutions should engage with their competent authorities at an early stage in order to determine an adequate implementation plan, including the timeline for the supervisory assessment and approval of material model changes, where necessary.

27/11/2017

- **Risk Assessment of the European Banking system**.
- **2017 EU-wide transparency exercise**.

1. Context

The EBA has published its **tenth Risk Assessment Report (RAR)**, which describes the main developments and trends that have affected the EU banking sector since the end of 2016 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 2017 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 this exercise includes 132 banks at the highest level of consolidation in the EU.

2. Main points

- **Sample of banks in the RAR**: 186 banks from 29 European Economic Area countries (151 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 2017.
- **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 (RAQ) for banks and market analysts, and micro-prudential qualitative and supervisory college information.
- **Results of the RAR**: the EU banking sector has shown further resilience amidst a benign macroeconomic and financial environment, with an additional strengthening of the capital position and a slight improvement of profitability and asset quality.
    - Capital position. The strengthening of solvency has continued, albeit at a slower pace. The aggregate CET1 capital ratio is 14.3% (14.0% fully loaded). The Tier 1 capital ratio and the total capital ratio reached 15.7% and 18.6%, respectively.
    - RoE. The aggregate weighted average RoE is 7.0%, up by 130 bps with respect to June 2016. The increase in profitability has been driven by several different trends: a decrease of impairments, an increase of fees and commissions and an increase of trading profits. Nevertheless, EU banks have continued to face high levels of NPLs which still hamper profitability in some countries along with cost efficiency issues in a competitive environment due to the decrease registered in June 2016.
    - NPL ratio. The aggregate NPL ratio decreased from 5.4% to 4.5% between June 2016 and June 2017. However, around one third of EU jurisdictions have NPL ratios above 10% and the level of NPLs still remains at a very high historical level (893 billion €).
    - Coverage ratio of NPL. This ratio increases to 45.0%, compared to 43.9% in June 2016.
    - ICT risks. EU banks have started to adapt their business models to ensure sustainable profitability due to the heightened competition from new financial technology players (FinTech). Further, this situation is accompanied by a number of new pockets of risk (cyber and data security). In this regard, the risks that cyberattacks are posing and their volume and sophistication are moreover unabatedly high.

CET1 ratio (transitional)	CET1 ratio (fully loaded)	RoE	NPL ratio	Coverage ratio of NPL	Leverage ratio (fully phased-in)
14.3%	14.0%	7.0%	4.5%	45.0%	5.1%

Reference date as of June 2017

12/12/2017

Cumulative impact assessment of the Basel reform package.

1. Context

In December 2017, the BCBS published the final set of revisions to the Basel III framework addressing undue variability in risk-weighted assets (RWAs) calculations and amending, among others, the standardised approach (SA) for credit risk and credit valuation adjustment (CVA), which becomes more risk-sensitive, and the introduction of a leverage ratio (LR) surcharge requirement for global systemically important banks (G-SIBs).

In this context, the EBA has published a document on the **cumulative impact assessment of the Basel reform package** which provides a summary of the results of an analysis carried out by the EBA to assess the impact of the December 2017 package of revisions on the EU banking system.

This impact assessment relies on December 2015 data from 88 European institutions from 17 EU Member States of which 36 are Group 1 institutions (G-SIIs and large institutions) and 52 are Group 2 institutions (the rest), and covers the results regarding: i) change in total minimum required capital (MRC) Tier 1 as percentage of baseline MRC, ii) regulatory capital ratios, leverage ratios and capital shortfalls, and iii) percentage of banks constrained by different metrics of capital requirement in the revised framework.

2. Main points

- **Change in total MRC T1 as percentage of baseline (December 2015) MRC (in %)**. The impact assessment show that:
    - For the entire EU sample the increase in total Tier 1 MRC is 12.9% in weighted average terms.
    - EU G-SIIs are the most impacted with a +15.2% weighted average increase in Tier 1 MRC.
    - The aggregate output floor is the strongest driver of the MRC increase, whereas the revisions to the credit risk and operational risk frameworks have a more moderate impact.

	Total		Breakdown by driver				
			Credit risk		Operational risk	Output floor	Leverage ratio
	All factors	of which risk-based	IRB	SA			
All banks	12.9	14.5	4.3	1.0	2.5	6.6	-1.6
Group 1	14.1	15.6	4.5	1.5	2.7	6.9	-1.6
G-SIIs	15.2	14.1	5.1	1.6	2.9	4.5	1.1
Group 2	3.9	5.3	2.7	-2.4	0.8	4.2	-1.3

- **Regulatory capital ratios, leverage ratios and capital shortfalls**. The impact assessment show that:
    - The reform has a limited aggregate impact on these ratios. In this regard, the CET1 ratio, calculated according to revised standards, is 0.6 p.p. lower than the baseline for the overall sample, and the total capital shortfall amounts to €39.7 billion.
    - The leverage ratio is estimated to remain almost stable for all bank categories.

	No. of banks	Risk-weighted CET1 capital ratio (%)			Tier 1 leverage ratio (%)			Capital shortfalls (€ billions)		
		Current (Dec 2015)	Revised	Difference	Current (Dec 2015)	Revised	Tier 1 surplus (€ billions)	CET1	Tier 1 combined	Total capital
All banks	88	12.3	11.6	-0.6	4.8	4.8	1.3	17.5	34.4	39.7
Group 1	36	12.2	11.5	-0,7	4.7	4.8	1.2	16.4	32.0	36.7
G-SIIs	12	11.7	10.9	-0.8	4.5	4.5	0.7	16.4	30.0	36.7
Group 2	52	12.5	12.6	0.2	5.3	5.3	2.3	1.1	2.4	3.0

- **Percentage of banks constrained by different metrics of capital requirement in the revised framework**. Additionally, the EBA states that the impact assessment show that:
    - 58% of the institutions in the sample would remain constrained by the RWAs-based metric of capital. In this regard, the percentage of institutions constrained by the RWAs metric of capital decreases within Group 1, whereas it increases within Group 2.
    - 20.5% of the institutions would be constrained by the output floor.
    - 21.6% of the institutions would be constrained by the leverage ratio.

12/12/2017
Final RTS on central contact points under the PSD2.

1. Context

According to the revised Payment Services Directive (PSD2), Member States have the option to require payment institutions that have their head office in another Member State (MS) and that operate through agents in the host MS territory under the right of establishment to establish a central contact point in the host MS's territory.

In this regard, the EBA has published **Final RTS on central contact points under the PSD2** which specify the criteria to be applied when determining, in accordance with the principle of proportionality, the circumstances when the appointment of a central contact point is appropriate, and the functions of those contact points under the PSD2.

These RTS applies mutatis mutandis to electronic money institutions providing payment services referred to in host Member States by engaging agents under the right of establishment and subject to the conditions laid down in PSD2.

2. Main points

- **Criteria for the appointment of a central contact point**. The RTS sets out that it is appropriate to require payment institutions to appoint a central contact point in the territory of the host MS where any one or more of the following criteria is met:
    - The total number of agents through which a payment institution provides any payment services in a host MS under the right of establishment is equal to or exceeds 10 agents.
    - The total value of payment transactions carried out by a payment institution in the host MS in the last financial year, including the value of payment transactions initiated when providing payment initiation services, exceeds 3 million € and the payment institution has engaged at least 2 of its agents under the right of establishment.
    - The total volume of payment transactions carried out by a payment institution in the host MS in the last financial year, including the volume of payment transactions initiated when providing payment initiation services, exceeds 100.000 transactions and the payment institution has engaged at least 2 of its agents under the right of establishment.
- **Functions of the central contact point**. The RTS establishes that a central contact point that is appointed pursuant to the PSD2 shall carry out each of the following functions:
    - It shall serve as single provider and single point of collection of the reporting obligations of the appointing payment institution towards the competent authorities (CAs) of the host MS, in relation to payment services provided in the host MS through agents under the right of establishment.
    - It shall serve as single point of contact of the appointing payment institution in communications with the CAs of the home and host Member States, in relation to the payment services provided in the host MS through agents under the right of establishment, including by providing CAs with documents and information on request.
    - It shall facilitate the on-site inspections by CAs of the agents of the appointing payment institution operating in the host MS under the right of establishment and the implementation of any supervisory measures adopted by the CAs of the home or host Member States.

3. Next steps

- These RTS shall enter into force on the **twentieth day after** their publication in the Official Journal of the European Union (OJEU).

13/12/2017

Final Guidelines on the security measures for operational and security risks of payment services under PSD2.

1. Context

In November 2015, the European Parliament and the Council published the revised Payment Services Directive (PSD2) contributing to an integrated payment market across the EU, promoting equal conditions for competition, and mitigating the increased security risks arising from electronic payments.

In this regard, the EBA has published **Final Guidelines (GL) on the security measures for operational and security risks of payment services under PSD2**, which set out the requirements that payment services providers (PSPs) should implement in order to mitigate operational an security risks derived from the provision of payment services.

In particular, this document includes guidelines addressed to PSPs on the following aspects: i) general principle, ii) governance, iii) risk assessment, iv) protection, v) detection, vi) business continuity, vii) testing of security measures, viii) situational awareness and continuous learning, and ix) payment service user relationship management.

2. Main points

- **General principle**. All PSPs should comply with all the provisions set out in these GL proportionately to their size, nature, scope, complexity and riskiness of the services they provide.
- **Governance**. PSPs should, among others:
  - Establish an effective operational and security risk management framework (approved and reviewed at least once a year by the management body), focusing on security measures to mitigate operational and security risks.
  - Establish three effective lines of defence, or an equivalent internal risk management and control model, to identify and manage such risks.
  - Ensure the effectiveness of the security measures when operational functions of payment services, including IT systems, are outsourced.
- **Risk assessment**. Regarding functions, processes and assets, PSPs should among others:
  - Identify, establish and regularly update an inventory of their business functions, key roles and supporting processes, as well as an inventory of the information assets.
  - Classify the identified business functions, supporting processes and information assets.
  - Ensure that they continuously monitor threats and vulnerabilities and regularly review the risk scenarios, as well as determine whether and to what extent changes are necessary to the existing measures, the technologies used and on the procedures or payment services offered.
- **Protection**. PSPs should establish and implement, among others, preventive security measures against identified operational and security risks, ensuring an adequate level of security. In particular, PSPs should, among others:
  - Ensure the data and systems integrity and confidentiality (i.e. the collection, routing, processing, storing and/or archiving and visualization of sensitive payment data is adequate, the software used is up to date and the security patches are deployed).
  - Have appropriate physical security measures.
  - Establish strong controls over privileged system access by limiting and supervising staff with elevated system access entitlements.
- **Detection**. PSPs should, among others:
  - Establish and implement processes and capabilities to continuously monitor functions, processes and assets in order to detect anomalous activities.
  - Ensure consistent and integrated monitoring of operational or security incidents, as well as establish a procedure for reporting such incidents.

- **Business continuity**. PSPs should establish sound business continuity management to maximise their ability to provide payment services on an on-going basis. In this regard, PSPs should among others:
  - Consider a scenario-based continuity planning.
  - Test their business continuity plans and update them at least annually.
  - Ensure that, in the event of a disruption or emergency, they have effective crisis communication measures.
- **Testing of security measures**. PSPs should, among others, establish a testing framework that validates the robustness and effectiveness of the security measures and ensure this framework is adapted to consider new threats and vulnerabilities, identified through risk-monitoring activities.

Situational awareness and continuous learning. PSPs should, among others:
  - Establish and implement processes and organisational structures to identify and monitor security and operational threats that could materially affect their ability to provide payment services.
  - Establish a training programme for all staff to ensure that they are trained to perform their duties consistent with the relevant security policies and procedures, as well as periodic security awareness programmes in order to educate their personnel and to address information security related risks.
- **Payment service user relationship management**. PSPs should, among others, establish and implement processes to enhance payment service users awareness of security risks linked to the payment services, as well as risk-mitigating actions, by providing assistance and guidance.

3. Next steps

- These GL apply from **13 January 2018**.

15/12/2017
Final NPL transaction templates.

1. Context

On March 2017, the European Commission asked the EBA to develop data templates to reduce information asymmetries between potential buyers and sellers of Non-Performing Loans (NPL) and, thus, contribute to the development of a functioning secondary market in the EU. Also, the EU Council mandated the EBA to issue templates for banks, specifying detailed information required from banks on their credit exposures in the banking book.

In this regard, the EBA has published **Final NPL transaction templates**, which provide a common EU data set for the screening, financial due diligence and valuation during NPL transactions. In particular, these templates aim at enhancing standardisation of NPL-related data and at reducing current information asymmetries of NPLs portfolios.

The EBA NPL templates are not a supervisory reporting requirement. They are designed in a way that they can act as a market standard, used by banks on a voluntary basis for NPL transactions, and to form the foundation for NPL secondary markets initiatives. Furthermore, the use of these templates does not discharge contracting parties from any legal, accounting, supervisory, etc.

2. Main points

- These templates to allow banks to supply **comparable** and **standardised data on NPLs** to meet the need of investors and other stakeholders.
- The EBA NPL transaction templates provide **data loan by loan**, i.e. at the most granular level, including information on counterparties related to the loan and the collateral provided; and are built on existing reporting, which should reduce implementation costs for banks.
- In particular, these **templates** cover the following aspects: i) a cover note, ii) instructions, iii) data dictionary, iv) residential real estate loans, v) commercial real estate loans, vi) small and medium enterprises / corporate loans, vii) unsecured retail loans, viii) auto loans, ix) leasing / asset backed finance (ABS), x) specialised loans, xi) validations rules, and xii) portfolio screening.

20/12/2017
Ad hoc cumulative impact assessment of the Basel reform package.

1. Context

In December 2017, the BCBS published the final set of revisions to the Basel III framework addressing undue variability in risk-weighted assets (RWAs) calculations and amending, among others, the standardised approach (SA) for credit risk and credit valuation adjustment (CVA), which becomes more risk-sensitive, and the introduction of a leverage ratio (LR) surcharge requirement for global systemically important banks (G-SIBs).

In this context, following up the EBA cumulative impact assessment published on 7 December 2017, the EBA has now published its **full impact assessment of the Basel reform package** which provides a summary of the results of an analysis carried out by the EBA to assess the impact of the December 2017 package of revisions on the EU banking system. In particular, this exercise now reflects all the revisions to the credit and operational risk approaches, as well as to the process for the estimation of the LR.

This impact assessment relies on December 2015 data from 88 European institutions from 17 EU Member States of which 36 are Group 1 institutions (G-SIIs and large institutions) and 52 are Group 2 institutions (the rest), and covers the results regarding: i) change in total minimum required capital (MRC) Tier 1 as percentage of baseline MRC, ii) regulatory capital ratios, leverage ratios and capital shortfalls, iii) percentage of banks constrained by different metrics of capital requirement in the revised framework, iv) distribution of changes in T1 MRC assigned to credit risk only (SA and IRB approaches), v) distribution of changes in T1 MRC assigned to operational risk only; and vi) distribution of changes in T1 MRC assigned to LR requirements only.

2. Main points

- **Change in total MRC T1 as percentage of baseline (December 2015) MRC (in %)**. The impact assessment show that:
    - For the entire EU sample the increase in total Tier 1 MRC is 12.9% in weighted average terms.
    - EU G-SIIs are the most impacted with a +15.2% weighted average increase in Tier 1 MRC.
    - The aggregate output floor is the strongest driver of the MRC increase, whereas the revisions to the credit risk and operational risk frameworks have a more moderate impact.

	Total		Breakdown by driver				
			Credit risk		Operational risk	Output floor	Leverage ratio
	All factors	of which risk-based	IRB	SA			
All banks	12.9	14.5	4.3	1.0	2.5	6.6	-1.6
Group 1	14.1	15.6	4.5	1.5	2.7	6.9	-1.6
G-SIIs	15.2	14.1	5.1	1.6	2.9	4.5	1.1
Group 2	3.9	5.3	2.7	-2.4	0.8	4.2	-1.3

- **Regulatory capital ratios, leverage ratios and capital shortfalls**. The impact assessment show that:
    - The reform has a limited aggregate impact on these ratios. In this regard, the CET1 ratio, calculated according to revised standards, is 0.6 p.p. lower than the baseline for the overall sample, and the total capital shortfall amounts to €39.7 billion.
    - The leverage ratio is estimated to remain almost stable for all bank categories.

	No. of banks	Risk-weighted CET1 capital ratio (%)			Tier 1 leverage ratio (%)			Capital shortfalls (€ billions)		
		Current (Dec 2015)	Revised (2022)	Revised (2027)	Current (Dec 2015)	Revised (from 2022)	Tier 1 surplus (€ billions)	CET1	Tier 1 combined	Total capital
All banks	88	12.3	11.6	10.9	4.8	4.8	1.3	17.5	34.4	39.7
Group 1	36	12.2	11.5	10.8	4.7	4.8	1.2	16.4	32.0	36.7
G-SIIs	12	11.7	10.9	10.5	4.5	4.5	0.7	16.4	30.0	36.7
Group 2	52	12.5	12.6	12.0	5.3	5.3	2.3	1.1	2.4	3.0

- **Percentage of banks constrained by different metrics of capital requirement in the revised framework**. The impact assessment shows that:
    - 58% of the institutions in the sample would remain constrained by the RWAs-based metric of capital. In this regard, the percentage of institutions constrained by the RWAs metric of capital decreases within Group 1, whereas it increases within Group 2.
    - 20.5% of the institutions would be constrained by the output floor.
    - 21.6% of the institutions would be constrained by the leverage ratio.

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- **Distribution of changes in T1 MRC assigned to credit risk only (SA and IRB approaches)**. The impact assessment shows that:
    - On average, the impact on T1 MRC of both IRB and SA approach portfolios are approximately the same, 3.25% and 3.26%, respectively.
    - Despite the great variability in the distribution of changes in T1 MRC in both approaches, it is broader under the IRB approach.

	Distribution of changes in T1 MRC assigned to the IRB approach only			
	All banks	Group 1	Of which: G-SIIs	Group 2
Weighted average	3.25%	3.32%	4.43%	2.28%

	Distribution of changes in T1 MRC assigned to the SA only			
	All banks	Group 1	Of which: G-SIIs	Group 2
Weighted average	3.26%	5.33%	5.74%	-5.20%

- **Distribution of changes in T1 MRC assigned to operational risk only**. The impact assessment shows that:
    - The revisions to the operational risk framework generate an aggregate increase of operational risk MRC of approximately 26.0% for Group 1 and 24.5% for G-SIIs, while the increase for Group 2 is 15.6%.
    - The result show that, on average, the revisions of the operational risk framework affect banks migrating from AMA approach more than banks currently using other approaches.

	All banks	Banks migrating from AMA	Banks migrating from other approaches
All banks	25.0%	28.5%	21.4%
Group 1	26.0%	28.7%	22.7%
G-SIIs	24.5%	27.7%	20.3%
Group 2	15.6%	19.0%	15.1%

- **Distribution of changes in T1 MRC assigned to LR requirements only**. The impact assessment shows that the standalone changes in LR MRC for Group 1 banks are on average 16.7%, while there is no change in Group 2 banks.

	Distribution of changes in T1 MRC assigned to LR requirements only, including revisions of the definition of exposure measure and 50% of the G-SII surcharge ratio of the risk-based requirements			
	All banks	Group 1	Of which: G-SIIs	Group 2
Weighted average	14.8%	16.7%	25.6%	0.0%

3. Next steps

- The EBA will conduct additional impact assessment exercises relating to the impact of final Basel reforms in order to include the remaining reforms for which there were no available data as of December 2015 and use more recent data to better estimate the current impact, among others.

21/12/2017

Final Recommendations on outsourcing to cloud service providers.

1. Context

Although general outsourcing guidelines have been in place since 2006 in the form of the Committee of European Banking Supervisors (CEBS) Guidelines on outsourcing, the growing importance of cloud services as a driver of innovation and the increasing interest for the use of cloud outsourcing solutions within the banking industry have prompted the EBA to develop recommendations on this regard.

In this context, the EBA has published **Final Recommendations on outsourcing to cloud service providers**, addressed to credit institutions, investment firms and competent authorities (CAs), which clarify the EU-wide supervisory expectations if institutions intend to adopt cloud computing.

In particular, these Recommendations address eight key areas: i) materiality assessment, ii) duty to adequately inform supervisors, iii) access and audit rights, iv) right of access (in particular), v) security of data and systems, vi) the location of data and data processing, vii) chain outsourcing, and viii) contingency plans and exit strategies.

2. Main points

- **Materiality assessment**. Outsourcing institutions should, prior to any outsourcing of their activities, assess which activities should be considered as material by taking into account, among others, the criticality and inherent risk profile of the activities to be outsourced and the potential impact that a confidentiality breach or failure of data integrity could have on the institution and its customers.
- **Duty to adequately inform supervisors**. Outsourcing institutions should adequately inform the CAs of material activities to be outsourced to cloud service providers (e.g. by providing to the CAs the name of the cloud service provider), and should maintain an updated register of information on all its material and non-material activities outsourced to cloud service providers at institution and group level.
- **Access and audit rights**. Outsourcing institutions should further ensure that they have in place an agreement in writing with the cloud service provider whereby the latter undertakes the obligation:
    - To provide to the institution, to any third party appointed by the institution and to the institution's statutory auditor full access to its business premises, including the full range of devices, systems, networks and data used for providing the services outsourced (right of access).
    - To confer to the institution, to any third party appointed by the institution and to the institution's statutory auditor, unrestricted rights of inspection and auditing related to the outsourced services (right of audit).
- **Right of access (in particular)**. The above-mentioned agreement should include the following provisions: i) the party intending to exercise its right of access should before a planned onsite visit provide notice in a reasonable time period; and ii) the cloud service provider is required to fully cooperate with CAs, institution and its auditor.
- **Security of data and systems**. The outsourcing contract should oblige the outsourcing service provider to protect the confidentiality of the information transmitted by the financial institution. Moreover, institutions should implement arrangements to ensure the continuity of services provided by outsourcing service providers, and the respective needs of outsourcing institutions with respect to quality and performance should feed into written outsourcing contracts and service level agreements.
- **Location of data and data processing**. The outsourcing institution should adopt a risk-based approach to data and data processing location considerations when outsourcing to a cloud environment. The assessment should address the potential risk impacts (e.g. legal risks and compliance), considerations on political and security stability of the relevant jurisdiction, etc.
- **Chain outsourcing**. The outsourcing institution should agree to chain outsourcing only if the subcontractor will also fully comply with the obligations existing between the outsourcing institution and the outsourcing service provider.
- **Contingency plans and exit strategies**. The outsourcing institution should plan and implement arrangements to maintain the continuity of its business in the event that the provision of services by an outsourcing service provider fails or deteriorates to an unacceptable degree. These arrangements should include contingency planning and a clearly defined exit strategy.

3. Next steps

- These Recommendations apply from **1 July 2018**.

08/11/2017
Consultation Paper on second set of advice to the European Commission on specific items in the Solvency II Delegated Regulation.

1. Context

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

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

2. Main points

- **Recalibration of standard parameters of premium and reserve risks**. The EIOPA recommends new calibrations for the premium (e.g. 6.4% for assistance, 6.0% for health medical expense) and reserve risks (e.g. 22.0% for assistance, 6.6% for health medical expense).
- **Volume measure for premium risk**. The EIOPA suggests that the definition of the volume measure for premium risk should be reassessed for continued appropriateness, as the standard parameters for non-life premium and reserve risk, and for medical expense risk should be calibrated.
- **Recalibration of mortality and longevity risks**. The EIOPA advices to maintain the 20% stress for longevity, to increase the mortality stress factor for mortality risk to 25%, and not to improve the granularity of the mortality and longevity stresses.
- **Man-made catastrophe risk**. The EIOPA provides advice regarding the fire risk sub-module, marine risk sub-module, motor vehicle liability risk sub-module, and reinsurance basis risk sub-module.
- **Natural catastrophe risk**. The EIOPA considers that, among others, mapping non-allocated exposure to the zone with the highest zonal weight is the most appropriate simplification option.
- **Interest rate risk**. The EIOPA deems the current relative approach inappropriate to measure interest rate risk in a low yield environment with negative interest rates. Thus, the EIOPA advises to adjust the current interest rate risk module according to either Proposal A (minimum shock approach with a static floor) or Proposal B (combined approach).
- **Market risk concentration**. The EIOPA states that it will consider whether it is necessary to provide clarifications on the application of any of the current legal provisions. Further, the EIOPA will also further analyse whether it should recommend maintaining the current treatment of 'mixed' exposures in the Delegated Regulation or should suggest a change.
- **Unrated debt**. The EIOPA provides criteria (e.g. on transparency, adverse selection) applicable to bonds and loans for which no credit assessment by a nominated External Credit Assessment Institution (ECAI) is available, in order to identify certain instruments, which would then be allowed to receive the calibration associated with credit quality step 2.
- **Unlisted equity**. The EIOPA provides criteria (e.g. on underlying investment, diversification, transparency) applicable to portfolios of equity from the European Economic Area (EEA) which are not listed, in order to identify those instruments which could benefit from the same risk factor as listed equity.
- **Simplification of the look-through approach**. The EIOPA proposes to, among others, 'carve-out' from the 20% limit for assets corresponding to unit/index linked products (e.g. insurance products without significant guarantees), and to impose an additional qualitative condition for the application of a simplified look-through.
- **Risk margin**. The EIOPA recommends that the currently applicable cost of capital (CoC) rate of 6% should not be changed.
- **Capital instruments only eligible as tier 1 up to 20% of total tier 1**. The EIOPA advises to retain the 20% limit, or if this limit is not kept, to strengthen the quality of hybrid T1 instruments (e.g. by requiring that the first call date of restricted tier 1 instruments is extended to 10 years after issuance).
- **Other elements revised**. The EIOPA also includes recommendations on the following aspects: health catastrophe risk, currency risk at group level, strategic equity investments, simplification of the counterparty default risk, treatment of exposures to CCPs and changes resulting from EMIR, look-through approach at group level, loss-absorbing capacity of deferred taxes, comparison of own funds in insurance and banking sectors, and impact assessment.

3. Next steps

- Comments to this CP shall be submitted by **5 January 2018**.
- The EIOPA will send its final advice on the areas covered by this CP to the EC by the end of **February 2018**.

12/12/2017

Final RTS on the measures credit institutions and financial institutions shall take to mitigate the risk of money laundering and terrorist financing where a third country's law does not permit the application of group-wide policies and procedures.

1. Context

According to the Anti-Money Laundering and Countering the Financing of Terrorism Directive (4th AML/CFT Directive), credit and financial institutions have to put in place AML/CFT policies and procedures to mitigate and manage effectively the money laundering and terrorist financing (ML/TF) risks. Where an obliged entity is part of a group, these policies and procedures have to be applied at group-level.

In this context, following the consultation launched in June and July 2017, the ESAs have published **Final RTS on the measures credit institutions and financial institutions shall take to mitigate the risk of ML/TF where a third country's law does not permit the application of group-wide policies**, aiming to foster a consistent and more harmonised approach to identifying and managing the ML/TF risk to which those credit and financial institutions are exposed.

In particular, these RTS set out minimum actions that should be taken by credit and financial institutions in such circumstances and will contribute to creating a level playing field across the Union's financial sector.

2. Main points

- **General provisions**. The RTS establish that for each third country, credit institutions and financial institutions shall at least:
    - Assess the resultant ML/TF risk to their group and keep it up to date in order to be able to share it with their competent authority (CA).
    - Ensure the ML/TF risk is reflected appropriately in their group-wide AML/CFT policies and procedures.
    - Obtain senior management approval at group-level for the ML/TF risk assessment and for the group-wide AML/CFT policies and procedures.
    - Provide targeted training to relevant staff members in the third country to enable them to identify ML/TF risk indicators.
- **Minimum action**. The RTS provide actions where the third country's law prohibits or restricts the application of AML/CFT policies and procedures. In this regard, it is established that:
    - Credit institutions and financial institutions shall: i) inform the CA of the home Member State no later than 28 calendar days the name of the third country concerned and how the third country's law restricts the application of these policies; ii) ensure that their branches established in the third country determine whether consent from their customers can be used to legally overcome such restrictions; and iii) ensure that these branches require their customers to give consent to overcome the above mentioned restrictions.
    - These minimum actions shall be applied regarding third country's law prohibitions or restrictions on:
        - Individual ML/TF risk assessments due to restrictions on access to relevant customer information.
        - Customer data sharing and processing for AML/CFT purposes.
        - Disclosure of information related to suspicious transactions, such as the sharing of certain information with other entities in the group.
        - Transfer of customer data to Member States for the purpose of AML/CFT supervision.
        - Record keeping measures.
- **Additional measures**. The RTS recommend that, in cases where consent is not feasible, credit institutions and financial institutions shall, among other, ensure that their branches or majority-owned subsidiaries established in the third country restrict the nature and type of financial products to those that present a low ML/TF risk, and carry out enhanced reviews or independent audits that satisfy that the branch or majority-owned subsidiary effectively identifies, assesses and manages the ML/TF risks.

3. Next steps

- The RTS shall enter into force on the **twentieth day after** their publication in the Official Journal of the European Union (OJEU).
- The ESAs will submit these RTS to the European Commission for approval.

EUROPEAN CENTRAL BANK
EUROSYSTEM

05/10/2017
Public Consultation on the draft Addendum to the ECB Guidance to banks on non-performing loans (NPL): Prudential provisioning backstop for non-performing exposures.

1. Context

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

In this context, the ECB has launched a **consultation on the draft addendum to its guidance to banks on NPL**, specifying quantitative supervisory expectations concerning the minimum levels of prudential provisions expected for non-performing exposures (NPEs). These expectations should be seen as prudential provisioning backstops aimed at a prudent treatment of NPEs and therefore avoiding the excessive build-up of non-covered aged NPEs on banks' balance sheets in the future.

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

2. Main points

- **Scope**. This addendum applies to all significant banks directly supervised by the ECB and, although it is non-binding, banks are expected to explain any deviations and report on the compliance with the prudential provisioning backstop.
- **Definitions**. This addendum sets out, among others, some definitions to be considered:
  - New NPEs: all those exposures that are reclassified from performing to non-performing after 1 January 2018 irrespective of their classification at any moment prior to that date.
  - NPE vintage: amount of days from when an exposure was classified as non-performing to the relevant reporting or reference date, regardless of the trigger of the NPE classification. The vintage count for 'unlikely to pay' and 'past due' exposures is the same; and for exposures moving from 'unlikely to pay' to 'past due', the counting continues and is not reset.
  - Secured and unsecured parts of NPEs. The addendum distinguishes between fully unsecured NPEs (if they do not benefit from the credit risk protections, which should be assessed with the unsecured backstop); fully secured NPEs (if the credit risk protection exceeds the current drawn and potential undrawn credit facilities of the debtor, which should be assessed with the secured backstop); and partially secured exposures (if the value of eligible credit risk protection does not exceed the current drawn and potential undrawn credit facilities).
- **Prudential provisioning backstops**.
  - Functioning. In order to fulfil the full prudential provisioning backstop, the sum of the following items forms the bank's supply:
    - All accounting provisions under the applicable accounting standard including potential newly booked provisions.
    - Expected loss shortfalls for the respective exposures in default.
    - CET 1 deductions from own funds under the bank's own initiative.
  - Application. If the applicable accounting treatment does not fulfil the prudential provisioning backstop, banks should adjust their CET 1 capital on their own initiative.
  - Categories. There are two types of backstops: i) unsecured, that apply to fully unsecured NPEs and to the unsecured balance of partially secured NPEs; and ii) secured, that apply to fully secured exposures and the secured balance of partially secured exposures.
  - Calibration. The application of the backstops should be implemented in a gradual way by banks from the moment of NPE classification until the moment when 100% prudential provisioning is expected (two and seven years for unsecured and secured backstops, respectively).
- **Related supervisory reporting and public disclosure**.
  - All banks should report to their respective Joint Supervisory Teams (JSTs) at least on an annual basis the coverage levels by NPE vintage, regarding to the newly classified NPEs after 1 January 2018. Deviations from the backstops are possible if a bank can demonstrate that, among others, its application is not reasonable.
  - A public disclosure of NPE coverage by vintage is an important tool for banks to convey their credit risk profiles comprehensively to market participants.

3. Next steps

- Comments to this draft addendum should be submitted by **8 December 2017**.
- This addendum will be applicable as of its **date of publication**.
- The backstops are applicable at a minimum to new NPEs classified as such from **January 2018** onward.

EUROPEAN CENTRAL BANK

EUROSYSTEM

10/10/2017
Sensitivity analysis of IRRBB – Final results.

1. Context

Under the CRD IV, the ECB is required to organise annual supervisory stress tests. In this regard, the ECB announced in February that it would conduct such an exercise for the banks under its direct supervision in 2017, which consisted of a sensitivity analysis of the banking book, with a focus on interest rate changes. This exercised was conducted as part of its annual Supervisory Review and Evaluation Process (SREP).

In this context, the ECB has published now the **final results** of this supervisory exercise. Findings show that, on average, banks are equipped to cope with changes in the interest rate environment.

The ECB conducted this sensitivity analysis based on year-end 2016 data from 111 significant institutions.

2. Main points

- **Results**. The interest rate risk in the banking book (IRRBB) is measured through two metrics:
  - Regarding the Net Interest Income (NII), the ECB finds that it would decrease over the next 3 years in the end-2016 interest rate environment and under most interest rates shocks, but it would progressively recover if interest rate (IR) were to rise.
  - As for the Economic Value of Equity (EVE), the ECB finds that:
    - Impact on EVE is rather limited on average.
    - An increase in IR would negatively affect EVE (e.g. -2.7% CET1 impact under the parallel up shock).
    - Positions are heterogeneous at bank-level.
  - Thus, an interest rate increase would be beneficial for NII, but have a negative EVE impact for most banks. In particular:
    - NII would increase for 76% of banks.
    - EVE would decrease for 77% of banks.
- **IRRBB management**. Information collected allows the ECB to gain substantial insights into how banks manage the IRRBB, and in particular regarding the following aspects:
  - Customer behavior risk inherent to the recourse to ALM models. The ECB finds that:
    - The behavior of banks' customers can significantly differ from the contractual features of the underlying contract.
    - Banks use behavioral models to better measure and manage their IRRBB. In this regard, Non-Maturing Deposits (NMDs) are the most relevant model, as 87 banks out of 111 use them; whereas loan prepayments are the second most relevant model, used by 61 banks.
    - Deposit models are particularly important, as deposits are the main funding source of euro area banks.
  - IR derivatives. The ECB finds that:
    - Interest rate derivatives are a widely used risk management tool, used by 97 out of 111 banks.
    - Banks also use IR derivatives to reach a target IR profile or even to position themselves in a certain way. In this regard, supervisors shall assess consistency with banks' risk appetite framework and adequacy of risk governance.
- **Integration into SREP**. The results have contributed to the overall SREP in several ways:
  - The quantitative impact of interest rate risk on EVE was used to adjust up or down the level of 2016 Pillar 2 Guidance (+25 / -25 bps range).
  - The qualitative information (data availability, timeliness, quality) as well as the quantitative impact of interest rate risk on NII, were used to enrich the Pillar 2 Requirement and qualitative measures.

3. Next steps

- Follow-up activities will be led by individual Joint Supervisory Teams (JSTs) in the **coming months**, focusing on modelling of depositor behavior, use of interest rate derivatives, and consistency of IRRBB positions and practices with risk appetite/governance frameworks.
- Moreover, follow-up will focus on institutions for which the exercise revealed potential vulnerabilities.

13/11/2017

- **Opinion on amendments to the Union framework for capital requirements of credit institutions and investment firms**.
- **Opinion on revisions to the Union crisis management framework**.

1. Context

In November 2016, the European Commission (EC) issued a proposal on a reform package of the financial system, 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.

In this context, the ECB has now published an **Opinion on amendments to the Union framework for capital requirements of credit institutions and investment firms** and an **Opinion on revisions to the Union crisis management framework** aiming to set out its general overview regarding the EC's reform package of the financial system.

In particular, the Opinion on capital requirements covers two main aspects: i) changes to the existing Union regulatory and supervisory framework, and ii) implementation of internationally agreed supervisory standards; whereas the Opinion on the crisis management framework covers aspects on TLAC, MREL, etc.

2. Main points

<u>Opinion on amendments to the Union framework for capital requirements</u>

- **Changes to the existing Union regulatory and supervisory framework**. The ECB has addressed the following issues:
  - <u>Pillar 2 refinements</u>. Among others, the ECB is of the view that the Pillar 2 current framework is adequate and that the single market will continue to benefit in terms of convergence from the existing tools, possibly supplemented by making further use of EBA peer reviews.
  - <u>Implementation of IFRS 9</u>. The ECB recommends, among others, that the period for the transitional measures for IFRS 9 should start on 1 January 2018 with a linear phasing-in, and to only apply the phase-in to the initial CET1 reduction on this date (static approach).
  - <u>Additional deductions and adjustments to CET 1 capital</u>. The ECB considers that the EC's clarification regarding the confirmation that competent authorities are allowed to require a credit institution to apply specific adjustments to own funds where the accounting treatment by the credit institution is considered not to be prudent from a supervisory perspective should be included directly in the text of the CRD.
  - <u>Intermediate EU parent undertaking</u>. The ECB welcomes the requirement to establish intermediate EU parent undertakings for third-country banking groups with two or more institutions established in the Union. Nevertheless, it states out that certain aspects require further clarifications (e.g. if the requirements apply also to branches).
  - <u>Automatic restrictions on distributions</u>. Among others, the ECB agrees with the EC's clarification on the capital stack regarding the maximum distributable amount (MDA) although it proposes several recommendations (e.g. all interim/year-end profits not already included in CET1 capital, should be included in the MDA).
  - <u>Credit and counterparty credit risk</u>. The ECB recommends, among others, to request the EBA to develop RTS with specific assessment criteria for the Internal Model Method (IMM) and for the advanced credit valuation adjustment (A-CVA) method.
  - <u>Own funds requirements for exposures to central counterparties (CCPs)</u>. The ECB suggests establishing a shorter maximum exemption period for exposures to third country CCPs (i.e. from the maximum exemption period of five years already considered).
  - <u>Other issues</u>. The ECB also makes recommendations regarding the interaction of micro and macroprudential powers, cross-border waiver for prudential requirements, proportionality in reporting, treatment of financial holding companies and mixed financial holding companies, supervision of large cross-border investment firms, national powers, fit and proper assessment and key function holders, exchange of information, enforcement and sanctions regime, and options and discretions.
- **Implementation of internationally agreed supervisory standards**. In this regard, the ECB has addressed the following issues:
  - <u>Leverage ratio (LR)</u>. Among others, the ECB supports the introduction of a LR requirement in the Union law and its calibration at 3%, which is in line with the BCBS standards and EBA recommendations.
  - <u>Net stable funding ratio (NSFR)</u>. The ECB proposes, among others, to apply the BCBS standards regarding the treatment of Level 1 high quality liquid assets (i.e. to apply a 0% required stable funding factor instead of a 5%) and of future funding risk in derivative contracts.
  - <u>Fundamental review of the trading book (FRTB)</u>. The ECB welcomes the proposal for the implementation in Union law of the BCBS standard on market risk (FRTB) and recommends to consider the outcome of ongoing international discussions for its implementation.

Opinion on revisions to the Union crisis management framework

- **Total loss-absorbing capacity (TLAC)**. The ECB welcomes the proposed amending Regulations and Directive, which aim to implement the TLAC standard of the FSB for global systemically important institutions (G-SIIs) established in the Union.
- **Minimum requirement for own funds and eligible liabilities (MREL)**. The ECB addresses two issues:
  - Amendments to MREL. Among others, the ECB recommends that the proposed amendments to the BRRD and SRMR clarify that resolution authorities have the task of monitoring the levels of available MREL eligible instruments and the MREL ratio itself, taking account of all the calculations on deductions.
  - Transitional arrangements for MREL. The ECB proposes, among others, the introduction of an adequate transition period across credit institutions (no shorter than the period applicable to G-SIIs set out in the TLAC term sheet), as well as of new eligibility criteria for MREL eligible instruments which align them with the TLAC eligible instruments.
- **Early intervention measures**. The ECB recommends removing from the BRRD the early intervention measures (e.g. resolution) that are already available in the CRD, and the Single Supervisory Mechanism Regulation (SSMR) and amending the SRMR aiming to facilitate consistent application of ECB's early intervention powers.
- **Pre-resolution moratorium tool**. Among others, the ECB suggests introducing a procedure for the allocation of responsibility for a moratorium to either the competent or the resolution authority, depending on whether the moratorium is imposed before or after the 'failing or likely to fail' determination.
- **'Failing or likely to fail' assessment of less significant credit institutions under responsibility of the Single Resolution Board (SBR)**. The ECB recommends to extend the proposed amendments to the SRMR to provide explicitly that the respective national authority is responsible for this assessment.

EUROPEAN CENTRAL BANK
EUROSYSTEM

28/11/2017

- **SSM thematic review on IFRS 9. Assessment of institutions' preparedness for the implementation of IFRS 9**.

1. Context

As part of its supervisory priorities for 2016 and 2017 within the Single Supervisory Mechanism (SSM) framework, the ECB decided to conduct a thematic review on IFRS 9 for significant institutions (SIs) and for less significant institutions (LSIs), on the basis of the information made available by the SIs during the first quarter of 2017 and the results based on the assessment performed on 77 LSIs.

In this context, the ECB has published the results of the **SSM thematic review on IFRS 9** aiming to assess to what extent SIs and LSIs are prepared for the introduction of IFRS 9, to assess its potential impact on provisioning and to promote consistent application of the new standard. In particular, this report presents the first quantitative and qualitative results of the thematic review on IFRS 9 for these institutions.

2. Main points

- **Quantitative results**. The average estimated quantitative impact for the significant supervised institutions covered by the thematic review is broadly in line with the results of the EBA second impact assessment of IFRS 9 published in July 2017. Thus, the average fully loaded negative impact on CET 1 is:
  - 40 bps, considering only the better prepared institutions from the SI sample.
  - 59 bps, considering only those LSIs from the sample that are at an advanced level of preparedness.
- **Qualitative results**. The thematic review focuses on the following nine areas identified by the supervisors as highly relevant in terms of the proper implementation of IFRS 9:
  - Governance, processes, systems and disclosures. Most project plans were deemed largely adequate, as they involved all levels of management and all relevant organisational units (in particular risk, finance, business, IT and audit). However, rigorous governance and internal controls processes for assessing external vendors (i.e. of models, data and scenarios) are expected to be in place, especially for small institutions.
  - Assessment of business models for the classification of financial instruments. The vast majority of SIs have developed draft policies and put adequate procedures to assess their business models, although in some cases these draft policies appear to be rather vague. In this regard, most institutions still have to work on this.
  - Classification and measurement: solely payments of principal and interest (SPPI) test. Most of the SIs have standardised processes in place on this matter, although some institutions lack a clear definition of the benchmark test needed to assess whether financial instruments with a modified time value of money meet the SPPI criterion.
  - Impairment: definition of default for IFRS 9 purposes. Institutions are aligning the accounting and regulatory definitions of default. In this regard, the ECB recommends, among others, to use the EBA non-performing exposure definition for internal risk management and public financial reporting purposes.
  - Impairment: significant increase in credit Risk (SICR) assessment. A majority of institutions focus their assessments on quantitative indicators (e.g. the relative change in the PD). In this regard, the ECB recommends to use other backstop indicators such as the inclusion of exposures in the watch list, the application of forbearance measures, etc. Further, it is recommended that the use of the 'low credit risk' exemption should be well documented and justified.
  - Impairment: incorporation of forward-looking information (FLI) in the expected credit losses (ECL) impairment model. The majority of institutions will incorporate FLI in this type of models (applying a three-year period). In this regard, the ECB recommends to improve the governance aspect related to FLI and to apply a sufficient level of caution regarding the determination of collateral valuation, among others.
  - Impairment: validation and back-testing. Almost all institutions have room for improvement. To this end, all institutions that demonstrated weaknesses in this regard are strongly encouraged to assign sufficiently skilled staff to this area, and to elaborate comprehensive documentation on the model validation framework and process.

- Impairment: calculation of lifetime ECL. The majority of the institutions have not yet transposed the EBA Guidelines on ECL. In this regard, Institutions are expected to ensure that the differences between the IRB models and IFRS 9 model requirements are properly addressed through the necessary adjustments.
- Impairment: additional considerations for portfolios under the standardised approach (SA). Institutions with supervisory-approved IRB models are generally well equipped in terms of expertise and modelling skills. Nevertheless, for institutions applying only the SA (primarily the LSIs) the main challenge in the implementation of IFRS 9 lies in the development of the ECL framework.

3. Next steps

- Those SIs that were not fully prepared for the assessment will be assessed by the Joint Supervisory Teams (JSTs) by **30 November 2017**.
- Findings and remedial actions will be communicated to the institutions and the JSTs will follow up on outstanding issues **throughout 2018**.

EUROPEAN CENTRAL BANK
EUROSYSTEM

18/12/2017

- **SSM supervisory priorities for 2018**.

1. Context

The ECB has published its **2018 priorities for supervising significant banks** in the euro area, which warrants a continuation of the high-level priority areas from 2017, albeit with amendments. They build on an assessment of the key risks faced by supervised banks (e.g. the protracted low interest rate environment, large stocks of non-performing loans, etc.), taking into account the relevant developments in the economic, regulatory and supervisory environment.

In particular, the ECB specifies that the **four areas** that will guide banking supervision are: i) business models and profitability drivers; ii) credit risk; iii) risk management, and iv) activities comprising multiple risk dimensions. 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. Thus, activities will focus on examining <u>the evolution of banks' profitability</u> and on assessing <u>interest rate risk implications</u>.
- **Credit risk**. The ECB will continue to supervise in 2018:
    - <u>Non-performing loans (NPL)</u>. Subsequent to the publication of the NPL guidance, the supervisory dialogue with banks will continue with a strong focus on examining NPL strategies and improving the timeliness of NPL provisioning and write-offs. In addition, the support to Joint Supervisory Teams (JSTs) in follow-up actions and the supervisory dialogues with respect to banks' non-performing exposures will continue.
    - <u>Exposure concentrations & collateral management and valuation</u>. The supervisory approach combining off-site and on-site elements that has been effectively adopted in the context of shipping portfolios envisaged to be rolled out over time to other asset classes (e.g. real state). Moreover, supervisory attention will focus on banks' collateral management and valuation practices.
- **Risk management**. The ECB will carry out as part of day-to-day supervision numerous activities, including the monitoring of complex financial instruments like level 2 and level 3 assets. Moreover, it will give special attention to the following initiatives:
    - <u>Targeted review of internal models (TRIM)</u>. Activities in 2018 will align closely with the progress made in 2017, with on-site inspections at banks continuing for credit, market and counterparty credit risk. The outcome of the revision regarding the Guide for the TRIM, i.e. the ECB Guide to internal models, will be issued for public consultation and different parts of the Guide will be consulted separately as they become available.
    - <u>ICAAP and ILAAP</u>. The ECB has refined and enriched its supervisory guidance on ICAAP and ILAAP and will finalise it in 2018, after a public consultation to be launched early in the year. In addition, work aiming at improving the transparency around the risk-by-risk composition of the Pillar II requirements will also be performed
    - <u>Preparedness for IFRS 9 and other regulatory changes</u>. The ECB will follow up with banks on their preparedness for, and implementation of, the relevant changes (e.g. IFRS 9). Further regulatory changes in relation to which banks' preparedness will be monitored include the net stable funding ratio (NSFR), the leverage ratio, and the minimum requirements for own funds and eligible liabilities (MREL).
- **Multiple risk dimensions**. Supervisory activities planned for 2018 to address multiple risk dimensions include:
    - <u>Stress testing</u>. The next supervisory stress tests for significant institutions will be conducted in 2018. There will be two complementary exercises: a sample of large significant institutions will participate in the EU-wide stress test coordinated by the EBA; the ECB will conduct an additional stress test for the remaining significant institutions not participating in the EU-wide stress test.
    - <u>Brexit preparations</u>. The ECB, together with the national competent authorities, will continue to assess banks' plans to relocate activities from the UK to the euro area, including applications for the granting of banking licences, and special attention will be paid to compliance with the agreed policy stances, especially to avoid the establishment of empty shell institutions in SSM countries.

EUROPEAN CENTRAL BANK
EUROSYSTEM

18/12/2017
Draft Guide on assessment methodology for the IMM and A-CVA.

1. Context

The CRR requires model approval for new models of any risk type and for material model extensions and changes to credit, operational, and market risk models. In this regard, the ECB published in September 2017 a Guide on materiality assessment (EGMA) which provides the ECB's interpretation of the applicable rules for material model extensions and changes in the counterparty credit risk (CCR) area.

In this context, the ECB has launched a public consultation of its **Draft Guide on assessment methodology (EGAM) for the internal model method (IMM) and the advanced method for credit valuation adjustment (A-CVA)**, which will be applied in the context of any CCR-related internal model investigation and the ongoing monitoring of approved internal models and indicates to supervisors how the ECB intends to investigate compliance with the existing legal framework. Further, it provides optional guidance to significant institutions on the self-assessment of their IMM and A-CVA models.

In particular, this document covers aspects regarding general provisions, sequential implementation of IMM across different transaction types, organization and governance of model validation, internal governance, risk control, collateral management and audit, and IMM use test, among others.

2. Main points

- **General provisions**. The EGAM includes provisions regarding the following aspects: i) definitions, ii) scope and methods applied, iii) quality and auditability of documentation, iv) third party involvement, and v) temporary non-compliance with requirements for the IMM.
- **Sequential implementation of IMM across different transaction types**. The EGAM establishes that the ECB will verify:
  - Institution's initial IMM scope and coverage and its plan for sequential implementation.
  - That non-IMM methods under the CRR are only applied where transactions are eligible for permanent exemption from the IMM (permanent partial use).
- **Organisation and governance of model validation**. The EGAM sets out that the ECB will verify the robustness of the arrangements, mechanisms and processes for validating the exposure methodology, including the appropriateness of the personnel responsible for the performance of the validation, in particular:
  - The independence of the validation function.
  - The completeness of the validation process, also in terms of frequency.
  - The adequacy of the validation methods and procedures.
  - The soundness of the reporting process and the process for addressing the validation conclusions and recommendations.
- **Internal governance, risk control, collateral management and audit**. The EGAM indicates that the ECB, will verify its internal governance regarding:
  - The role of senior management and the management body.
  - The CCR control unit and its reporting.
  - The collateral management unit and its reporting.
  - The internal auditing process.
- **IMM use test**. The EGAM indicates that the ECB will verify that:
  - The distribution of exposures generated by the model used to calculate effective expected positive exposure (EPE) plays an essential role in the following areas: i) day-to-day CCR management, ii) the internal capital allocation process, and iii) the corporate governance functions.
  - Data and exposures considered by the institution for the calculation of own funds and those used for internal purposes are consistent and, where discrepancies exist, these are fully documented and reasonable.
  - An exposure model broadly in line with the requirements set out in the CRR has been used by the institution for at least one year before receiving the permission to use IMM.
- **Documentation and design**. The ECB will verify in particular the adequacy of:
  - The documentation on the design, operational details of and rationale for the IMM.
  - The structure and design of the risk factor dependencies within IMM for forecasting various types of market values.

- **Exposure quantification**. The EGAM establishes that the ECB, in order to assess the calculation of exposure values, will verify compliance with the requirements for:
  - The estimation of future exposure distributions based on changes in market values.
  - Exposure values for calculating the value of a netting set using transaction price routines at appropriate time grid point, exposure grid and number of scenarios.
  - Legal agreements and the exposure aggregation per netting set, as well as the subsequent calculation of the exposure value, and the maturity calculation.
  - The calculation of the IMM exposure value and maturity using current market data and a stress calibration.
  - Margined trading and for eligible collateral.
  - Transaction-specific Wrong Way Risk (WWR).
- **Validation techniques**. The EGAM sets outs that the ECB will assess the following:
  - Compliance with the requirements for back-testing.
  - Compliance with the requirements for the validation of pricing models.
  - Adequacy of any other performance assessment.
  - Compliance with the requirements for the validation processes of the exposure model.
- **Stress testing**. The EGAM sets out that the ECB, in order to assess the soundness of an institution's stress testing programme will verify in particular:
  - The adequacy of methods used in designing the stress tests.
  - The robustness of organisation of the stress-testing process.
  - The integration of the stress testing into the risk and capital management processes.
- **Data maintenance and IT processes**. The EGAM indicates that the ECB, in order to assess the compliance with the requirements on the integrity of the modelling process, will verify:
  - The quality of the transaction terms and specifications, market data and legal data, including the data quality management process.
  - The data documentation and reporting.
  - The relevant IT infrastructure.
- **Specifics for A-CVA**. The EGAM indicates that the ECB, in order to assess the calculation of the capital charge for the A-CVA, will verify the institution's compliance with:
  - The requirements set out in RTS for determining proxy spread and limited smaller portfolios for credit valuation adjustment risk (RTS on CVA).
  - The own funds requirement calculation for the A-CVA and, if applicable, the calculation of the own funds requirement for CCR using the M parameter.

3. Next steps

- Comments to this guide shall be submitted by **31 March 2018**.
- The Guide will be finalised following another consultation in **2018**.

06/11/2017
- **Proyecto de Ley de Crédito inmobiliario**.
- **Cuadro comparativo respecto de la situación actual**.

1. Context

In February 2014, the European Parliament and the Council published the Directive 2014/17/UE on credit agreements for consumers relating to residential immovable property, which stablishes a specific regime for the protection of natural persons who act as borrowers, guarantors or holders of collaterals of loans secured by residential real estate mortgages o whose aim is the acquisition of residential real estate properties.

In this context, with the aim of transpose the Directive into the Spanish legal system, the Government has approved a **Proyecto de Ley (PL) de Crédito Inmobiliario**, which aims at reducing expenses associated to amendments on mortgage contracts and strengthening transparency. In particular, this document covers aspects regarding early repayment, the conversion of loans in foreign currency, tying practices, incentives to the conversion of variable-rate mortgages into fixed-rate mortgages, transparency and early maturity.

2. Main points

- **Early repayment**. The PL establishes that, as a general rule, it will be not possible to charge commissions, unless an agreement under the following conditions is achieved:
  - For variable-rate mortgages:
    - A maximum of 0.5% of the early repayment capital, during the first three years of the contract term.
    - A maximum of 0.25% of the early repayment capital, during the first five years of the contract term.
  - For fixed-rate mortgages:
    - A maximum of 4% of the early repayment capital, during the first ten years.
    - A maximum of 3%, afterwards.
- **Conversion of loans in foreign currency**. In this regard, the PL establishes that: i) the consumers could request at any time the conversion, in euros or in the currency in which they earn the majority of its income, of the loan in a foreign currency; and ii) it will be possible to determine contractually other exchange risk hedge system for borrowers that are not considered consumers.
- **Tying practices**. The PL prohibits the tying practices (i.e. those that force the consumer to accept a range of financial products as a condition to obtain the mortgage), although the Bank of Spain has the power to authorise exceptions through Circulares. Regarding combined practices, the lending credit institution is required to offer two budgets: one including products that are commercialised along with the loan (e.g. insurance products) and other without them.
- **Incentives to convert variable-rate mortgages into fixed-rate mortgages**. The PL encourages this conversion, facilitating the novation agreement of the loan and the subrogation of the creditor through fixing a minor commission payable in cases of early repayment. In particular:
  - The PL sets a maximum commission payable of 0.25% of the early repayment capital if the early repayment takes place during the first three years of the contract; or 0% afterwards.
  - The fees of notaries and real estate registrars are reduced.
- **Formal and material transparency**. In this regard, the PL includes the following: i) an information sheet with particularly sensitive unfair terms; ii) a period of seven days in which the borrower should go to the notary in order to receive free advice; and iii) a forced control set by notaries and real estate registrars that will avoid the inclusion of unfair terms as considered by law courts. Further, the Government could approve a common type of contract, easy to understand, that contractual parties could adopt.
- **Early maturity**. The PL establishes that the early maturity statement will depend on the number of instalments due and non-satisfied, as well as on the stage where the default occurs. Thus, the early maturity will take place:
  - If there are past-due monthly payments higher than the 2% of capital granted or nine monthly payments, during the first half of the loan's life.
  - If the default is equivalent to monthly payments that are higher than the 4% of capital granted or twelve monthly payments, during the second half of the loan's life.

3. Next steps

- The PL will be submitted to the Congreso de los Diputados to launch the parliamentary procedure.

13/11/2017
Proyecto de Ley Orgánica de Protección de Datos.

1. Context

In April 2016, the European Parliament and the Council adopted the Regulation (EU) 2016/679 (GDPR), related to the protection of natural persons with regard to the processing of personal data and on the free movement of such data, which will be applicable as of 25 May 2018.

In this regard, after the publication of the Anteproyecto de Ley (APLOPD) in June 2017, the Government has approved the referral to the Cortes Generales of the **Proyecto de Ley Orgánica de Protección de Datos,** which will repeal the current LOPD and will adapt the Spanish legal system to the GDPR, introducing amendments and enhancements in the regulatory framework of this fundamental right.

In particular, this Proyecto de Ley covers certain amendments to the regime of consent and to the processing as well as the introduction of new figures and procedures.

2. Main points

- **Child and deceased persons**.
  - The age of consent for the data processing is reduced to 13 years old.
  - The treatment of personal data of deceased persons will be considered based on the request of their legal successors.
  - The tacit consent is excluded and replaced by an explicit consent from the affected subject, and the duty of confidentiality is explicitly regulated.
  - The controller's responsibility of the processing is excluded if he/she has adopted all reasonable measures for rectification or erasure, in case of inaccuracy of the personal data obtained directly.
- **Rights of natural persons**.
  - The principle of transparency with regard to the right of affected subjects to be informed about the processing of their personal data is adopted.
  - The rights of access, rectification, erasure (right to be forgotten), restriction of processing, and data portability are also incorporated.
- **Discriminatory cases**.
  - The prohibition of storing data of special protection such as ideology, trade union membership, religion, sexual orientation, racial or ethnic origin and beliefs, is maintained. In these cases, the consent of the affected subject is not enough to make the processing feasible.
  - The credit information systems are specifically regulated, as well as other topics regarding video surveillance, exclusion advertising systems (i.e. Robinson lists), etc.
- **Other amendments**.
  - The figure of the data protection officer, natural or legal person whose appointment has to be reported to the competent authority (CA) is reinforced. This CA will keep a relationship with the Agencia Española de Protección de Datos (AEPD).
  - The existence of self-regulatory mechanisms is promoted, both in the public and private sectors, and a locking obligation that guarantees that the data are available to certain authorities (e.g. courts) is introduced.

3. Next steps

- Once the new Ley Orgánica is approved, it will enter into force by **25 May 2018** and will repeal the current LOPD. Current LOPD will govern the procedures started before this date.

04/12/2017
Anteproyecto de Ley del Mercado de Valores y de los Instrumentos Financieros.

1. Context

In June 2014, the European Parliament and the Council published the Directive 2014/65/EU on markets in financial instruments (MiFID II), which introduced, among others, product governance requirements to ensure that firms which manufacture and distribute financial instruments act in the clients' best interests during all the stages of the life-cycle of products or services. This Directive will be applicable by 3 January 2018.

In this regard, the Spanish Government has published the **Anteproyecto de Ley (APL) del Mercado de Valores y de los Instrumentos Financieros** with the aim at adapting the Spanish legal system to MiFID II, in order to ensure high levels of investor protection in financial products, especially retailers, and increase the security and efficiency, proper functioning and stability of the stock markets in Europe.

In particular, this APL includes aspects related to commissions, structured deposits, products governance, high-frequency algorithmic trading (i.e. those where a computer algorithm automatically determines if the order is going to be executed or not; the moment; price; amount; how the order will be managed after its presentation, etc., with limited or without human intervention), financing SMEs and organised trading facility, among others.

2. Main points

- **Commissions**. In this regard, the APL established that:
    - It is prohibited to charge commissions, retrocessions or any other type of incentives when independent financial advice or portfolios management services are provided.
    - If other investment services are provided, it is necessary to increase the quality of the advice and to ensure that the institutions are acting honestly, fairly and professionally in accordance with the best interest of the client (e.g. by including in the products' offer other products from third party competitors).
    - Likewise, in the regulatory development of the Law it will be determined that at least a 25% of the total products regarding the same category from third parties must be offered to consider that there is an increase in the quality of the service.
- **Structured deposits**. The APL covers that the sale of structured deposits should comply with, among others, good governance and suitability assessment standards. To this end, according to MiFID II, credit institutions should follow rules on an entity's good governance, measures of internal organisation, measures to avoid conflicts of interest, duties on records regarding recording and conduct standards (i.e. on customer classification, product governance, assessment of suitability and appropriateness, remunerations and orders' management) when commercialising or providing advice on structured deposits.
- **Products governance**. The APL establishes that investment firms that design financial instruments for commercialising them to customers should:
    - Implement a prior approval process of each instrument, for which the Board of Directors is responsible, to identify the final customers' market to whom the instrument will be addressed.
    - Keep a record of the actions their perform with clients and of the markets in which they operate.
- **High-frequency algorithmic trading**. The APL establishes that institutions which perform high frequency algorithmic trading should establish risk controls and communicate the algorithm used and the market in which they will address it to their supervisor.
- **Financing SMEs**. The APL covers enhancements of its functioning standards regarding the relevant requirements and obligations. Thus, the managers of a multilateral trading system may request their registration as a SME growth markets if, at least 50% of the issuers whose financial instruments are admitted to trading on the multilateral trading system are SMEs.
- **Organised trading facility**. The APL establishes a new type of trading center called organised trading facility. This facility is an multilateral system in which several interests of buying and selling bonds and obligations, securitisations, emission rights or derivatives of multiple third parties interact to give rise to contracts.

3. Next steps

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

BANCO DE ESPAÑA
Eurosistema

15/11/2017
Proyecto de Guía de los Procesos de Autoevaluación del Capital (PAC) y de la Liquidez (PAL) de las Entidades de Crédito.

1. Context

In June 2008, the BdE published the Guía del Proceso de Autoevaluación del Capital (Guía PAC). Likewise, the EBA issued in November 2016 Guidelines on ICAAP and ILAAP information collected for Supervisory Review and Evaluation Process (SREP) purposes.

In this context, the BdE has published a **Proyecto de Guía de los Procesos de Autoevaluación del Capital (PAC) y de la Liquidez (PAL)** aiming at updating the 2008 Guía PAC and adapting it to the EBA Guidelines. In particular, the Proyecto de Guía aims to support institutions in the application of these self-assessments processes where both quantitative (e.g. risk measurement, liquidity level), and qualitative aspects (e.g. Internal corporate governance, risk identification) will be included in an annual new report of capital and liquidity self-assessment (IACL) that will collect information regarding both processes.

The most relevant amendments that this Proyecto de Guía sets out are: an update of structural interest rate risk valuation, the introduction of the risk appetite framework, the development of PAL, and the recommendation of including an internal audit report on the revision of the design and consistency of both processes.

2. Main points

- **Scope**. This Proyecto de Guía is addressed to less important credit institutions established in Spain, and to groups or subgroups subject to consolidation with a Spanish parent undertaking.
- **Annual report of capital and liquidity self-assessment (IACL)**. This report should be known and approved by the Board of Directors; and, in order to set out the PAC and PAL, should be structured according to the following sections:
    - Summary and conclusions that should provide a brief overview of the PAC and PAL on their scope (e.g. individual institution, consolidated group), significant amendments (e.g. on risk management and control framework, business model), responsible departments, etc.; as well as the most relevant conclusions (brief summary of each remaining aspect).
    - Business model and mid-term strategy that should include a summary of the business model identifying the main business lines, markets, jurisdictions and products of the institution or consolidated group. Further, it should resume the mid-term strategy (3 years minimum), the planning approved by the Board of Directors and, if any, significant amendments.
    - Governance framework. Risk management and control that should provide an explanatory summary of the internal governance's qualitative items (description, rationale, and assessment of the institution's governance), risk management and control (principles, specific aspects on each risk, and global risk management assessment) and internal audit (duties on risk review and assessment).
    - Risk appetite framework (RAF) that should consider all material risks for the institution, and which should be aligned to the institution's strategy. Further, it is recommended, among others, to include a description of the policies, processes, risk appetite's controls and reporting and monitoring systems, as well as of the risk appetite statement (RAS), and to establish risk limits.
    - Risk profile that should identify all relevant risk for the institution (material and non-material) and will include a brief assessment of the exposure to such risks (inherent risk) based on quantitative data (if possible), and on the quality of such exposures. For submitting the risk level, institutions will use the rating scale set out in EBA GL on SREP.
    - Stress testing framework and planning that should cover a description of the institution's general planning on stress testing, including types of tests, frequency, models and assumptions, among others. Furthermore, it should include information regarding changes of capital and liquidity on adverse scenarios.
    - Information on risk data, aggregation and Information Technology (IT) systems that should describe the data management framework and its defined strategies (i.e. flow of data, structures, applied validations and IT systems).

- Capital self-assessment that should include information on: i) institution's available capital (regulatory and internal), ii) risk measurement and quantification of capital necessary to cover them, iii) aggregation of capital needs and reconciliation adjustments, and iv) capital planning.
- Liquidity self-assessment that should provide information on: i) management of liquidity and funding risks, ii) funding strategy, iii) strategy on liquidity buffers and management of collaterals, iv) cost and benefit allocation mechanism, v) management of intraday liquidity risk, and vi) liquidity contingency plan.
- Future action programme that should include a summary of the main deficiencies and weaknesses addressed and, where relevant, that should provide a plan to amend them, including changes to the risk profile or enhancements to internal governance, among others.

3. Next steps

- Comments to this Proyecto de Guía must be submitted by **1 December 2017**.
- Once approved, the Guía will affect the IACL Report with reference date to **31 December 2017**, which institutions must prepare and submit by **30 April 2018**.

BANCO DE ESPAÑA
Eurosistema

07/12/2017
Circular 4/2017 a entidades de crédito, sobre normas de información financiera pública y reservada, y modelos de estados financieros.

1. Context

IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from Contracts with Customers) were adopted in the EU in 2016. These standards will be applicable to banking groups for preparing their consolidated annual accounts for the financial years starting from 1 January 2018.

In this regard, following the Draft circular published in June 2017, the BdE has published the **Circular 4/2017 on public and confidential financial information standards and formats**, that supersedes Circular 4/2004, aimed to adapt the current accounting framework of the Spanish credit institutions to these accounting standards that modify the criteria for recognising financial instruments and revenues, respectively.

Among the amendments introduced by this Circular and stemming from IFRS 9, special mention should be made of the following: i) amendments to the classification of financial assets for valuation purposes; ii) changes regarding impairment of financial assets, introducing a framework based on expected credit losses rather than on incurred losses; and iii) treatment of accounting hedges.

As for IFRS 15, the Circular aims at introducing the new treatment of revenue recognition.

2. Main points

- **Classification of financial assets for valuation purposes**.
    - The classification of debt instruments depends on their contractual characteristics and on the business model used by the institution to manage them, which will determine that these instruments are valued at: i) amortised cost, ii) fair value accounting for changes in other comprehensive income; or iii) fair value through results.
    - Equity instruments should be measured at fair value through results, unless the institution chooses to account for changes in their value in other result.
    - All other financial assets should be measured at fair value, accounting for changes in results.
- **Impairment of financial assets**.
    - The Circular introduces the concept of expected credit loss (ECL):
        - Standard exposures: the ECL will be calculated based on the default events that may occur over a 12-month period from the date of reference.
        - Standard exposures under special monitoring and doubtful exposures: the ECL will be calculated based on the default events that may occur over the lifetime of the financial asset or that have occurred, respectively. The recognition of interests for doubtful exposures will be calculated using the carrying amount (i.e. net of impairment allowance).
    - For estimating allowances for credit risk, credit institutions should follow Anejo 9. Overall, the amendments introduced by the Circular 4/2016 are kept, and additionally the Circular introduces certain enhancements such as the following:
        - Certain additional indicators are introduced for the purpose of determining whether a significant increase in credit risk has occurred or not.
        - The Circular specifies that total allowances shall be the sum of allowances attributable to insolvency plus those attributable to country risk.
        - A requirement is introduced for having a record book of all valuations, including complete individual valuations for effective collaterals and foreclosed real estate assets.
        - The Circular sets out the option of using the estimated probability of default of an specific transaction, or a group of transactions with similar risk, to incorporate the risk of default to individual estimation of transaction hedges under special monitoring.
    - Amendments to a financial asset, or exchanging financial assets, without meeting the requirements for its withdrawal, will have an impact on profits account, registering the difference between the carrying amounts of the asset.
    - For all other assets, including goodwill, impairment is deemed to exist when the carrying amount of the assets is higher than the recoverable amount.

- **Accounting hedges**.
  - The effective quantitative tests are removed, and instead monitoring and adjusting the coverage ratio is required.
  - Credit institutions will decide on a voluntary basis whether they keep the existing rules on accounting hedges or follow the new rules.
- **Changes introduced by IFRS 15**. The Circular introduces a new model for revenue recognition, which involves identification of the obligations of contracts, determination of their price, allocation of the price to the identified obligations, and revenues recognition as the institution complies with its obligations.
- **Financial statements**. All these amendments involve changes in the confidential and public financial statements. To ease the burden for credit institutions, the formats have been fully aligned with the European reporting models (i.e. Commission Implementing Regulation 2017/1443, amending Implementing Regulation 680/2014; and ECB Regulation 2017/1538, amending Regulation 2015/534, on reporting of supervisory financial information).

3. Next steps

- The Circular will enter into force by **1 January 2018**. The first confidential and public statements to be submitted to the BdE following the format, design, frequency and reference period of this Circular will refer to 31 January 2018.

23/10/2017
Bulletin 2017-43 on New, Modified, or Expanded Bank Products and Services.

1. Context

In May 2004, the OCC published Bulletin 2004-20 on Risk Management of New, Expanded, or Modified Bank Products and Services assessing bank's on risk management practices when engaging in new activities.

In this context, the **OCC has published Bulletin 2017-43 on New, Modified, or Expanded Bank Products and Services** (e.g. those offered for the first time, as well as offerings that the bank will offer again) which replaces Bulletin 2004-20 in order to adapt bank's risk management framework to new technology (e.g. artificial intelligence, machine learning). In particular, this document sets out a description of the bank's Risk Management system and Risk Management Principles that guides bank management and boards of directors to understand the impact of new activities on banks' financial performance, strategic planning process, risk profiles, etc.

This Bulletin applies to all **OCC-supervised banks** (i.e. U.S. national banks, federal savings associations, and federal branches and agencies of foreign banks).

2. Main points

- **Risk Management**. Banks should establish appropriate risk management processes for new activity development and effectively measure, monitor, and control the risks associated with new activities (e.g. strategic, reputation, credit, operational risks), addressing the costs associated with control functions, including management information systems (MIS), training, audit, and compliance programs.
- **Risk Management Principles**. Banks should design an effective risk management system that identifies, measures, monitors, reports, and controls risks when developing and implementing new activities. This system should be based on the following principles:
    - Due diligence and approvals. Management and the board should conduct due diligence to fully understand the risks and benefits before implementing. Due diligence should include, among others, identifying the customer demand, assessing how the new activity affects the bank's current and projected capital position, etc.
    - Policies. procedures and controls. Management should provide guidance on risk management of new activities establishing policies and procedures that outline the processes, roles and responsibilities, and any standards required to ensure implementation of an adequate system. In addition, the management should expand existing policies to address new activities, develop and deploy MIS as necessary to monitor adherence to established objectives, etc.
    - Change management. Management should have effective change management processes to manage and control the implementation of new or modified operational processes, as well as the addition of new technologies into the bank's existing technology architecture. These processes should include reviews of business units (e.g. finance, treasury), proper testing of new or modified operational systems, etc.
    - Performance and monitoring. Management should have appropriate systems, including MIS, to assess whether the activities meet operational and strategic expectations and legal requirements and are within the bank's risk appetite. These systems should, among others, include limits on the size of risk exposure that the management and the board is willing to accept with the addition of new activities, identify specific objectives and criteria to evaluate whether the new activities are successful, etc.
    - Third-Party relationship risk management. Management should implement effective and commensurate risk management processes when the bank engages in new activities through third-party relationships (i.e. any business arrangement between the bank and another entity, by contract or otherwise).

03/10/2017

- **The BoE's approach to resolution**.
- **Consultation Paper on the BoE's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) within groups, and further issues**.

1. Context

In February 2009, the Parliament of the UK approved the Banking Act which sets out the objectives that the BoE must pursue when it carries out the resolution of a bank. In this regard, the BoE published a document on its approach to resolution in October 2014, which describes the framework to resolve failing banks, building societies and some types of investment firms. Further, the BoE published a Statement of Policy (SoP) on the minimum requirements for own funds and eligible liabilities (MREL) in November 2016.

In this context, the BoE has now published an **update to the 2014 BoE's approach to resolution**, which explains the key features of the UK resolution regime and how the BoE would be likely to implement a resolution. This document is structured into three parts: i) framework for resolution; ii) how to conduct a resolution; and iii) resolution planning (this is a new part, not included in the 2014 document).

Along with this document, the BoE has also published a **Consultation Paper (CP) on the BoE's approach to setting MREL within groups**, which addresses some elements of Internal MREL, and also proposes amendments to the SOP to address operational continuity requirements and the setting of External MREL for multiple point of entry (MPE) groups.

2. Main points

<u>The BoE's approach to resolution</u>

- **Framework for resolution**. The BoE specifies which are the objectives of the resolution regime; its key features; its scope (which now includes central counterparties but not insurance companies), the main strategies it has developed to deal with failing banks; and the arrangements for safeguarding the rights of depositors, clients, counterparties and creditors.
- **How to conduct a resolution**. The BoE explains how is likely to conduct a resolution and to implement resolution strategies (bail-in, partial transfer of business, and insolvency).
- **Resolution planning**. The BoE explains how it prepares resolution and which are its resolution responsibilities. In this regard, the BoE should among others:
    - Identify a <u>preferred resolution strategy</u> and develop a <u>resolution plan</u> for every firm or group in the UK.
    - Provide the HM Treasury with an <u>assessment of potential risks to public funds</u> where the resolution plan involves the use of resolution powers.
    - Develop <u>policies</u> to address any significant barriers to the implementation of resolution strategies and plans.

<u>CP on the BoE's approach to setting a minimum requirement for own funds and eligible liabilities (MREL) within groups, and further issues</u>

- **Scope**.
    - Internal MREL is intended to cover <u>UK-headquartered banking groups</u> as well as <u>UK subsidiaries of overseas banking groups</u> (it does not apply to resolution entities).
    - The BoE proposes to set Internal MREL above capital requirements for a 'material subsidiary' of a group where either: i) there is a UK resolution entity which is or will become subject to an <u>External MREL above its capital requirements</u>; or ii) in the case of UK subsidiaries of overseas groups, the subsidiary delivers <u>critical functions</u> in the UK.
    - Whether or not a subsidiary in the UK is '<u>material</u>' is a decision that the BoE will take on a case-by-case basis (although it expects that a subsidiary will be material if it meets at least one of the criteria set in the TLAC standard).
- **Calibration**. In line with the TLAC standard of the FSB, the BoE expects that Internal MREL for a material subsidiary will be scaled in the range of <u>75% to 90% of the full amount of External MREL</u>.
- **Internal MREL instrument eligibility**.
    - The BoE proposes that all the <u>eligibility criteria that apply to External MREL</u> apply equally to Internal MREL (e.g. minimum effective remaining maturity of one year).
    - In addition to these eligibility criteria, Internal MREL eligible liabilities will be subject to some <u>additional requirements</u> (e.g. subordination).

- **Transitional arrangements for Internal MREL**. The BoE proposes that the transition period to meet Internal MREL should be the same as for External MREL. Thus:
  - Interim Internal MRELs will apply from 1 January 2019 for material subsidiaries of G-SIBs and from 1 January 2020 for other firms.
  - End-state Internal MRELs will apply from 1 January 2022.
- **Loss-absorbing capacity for operational continuity**. The BoE proposes that critical service providers supporting delivery of the group's critical functions must maintain resources equivalent to at least 25% of the annual operating costs of providing services.
- **External MREL for banking groups with MPE resolution strategies**.
  - External MREL for MPE resolution entities: the BoE expects that each resolution entity will be set an External MREL or an equivalent requirement if applicable in non-EU jurisdictions. Moreover, it will set MREL for any UK resolution entity.
  - Group consolidated MREL for MPE groups: the BoE expects to set a consolidated External MREL that the group as a whole must meet, where it is the home authority for the ultimate parent company of a MPE banking group.
- **Other issues regarding the BoE's policy approach to MREL**. The BoE also includes provisions regarding additional policy areas related to MREL (e.g. restrictions on bank's ability to hold each other's MREL, disclosure of MREL resources by firms, etc.).
- **Impact assessment**. An updated impact assessment of the MREL framework is provided, considering the cost and benefits of MREL to banking groups and to the economy as a whole.

3. Next steps

- Comments to the CP should be submitted by **2 January 2018**.

BANK OF ENGLAND

29/11/2017

- **Stress testing the UK banking system: 2017 results**.

1. Context

In March 2017, the BoE launched the 2017 stress test of the UK banking system, which covered seven major UK banks accounting for around 80% of PRA-regulated banks' lending to the UK real economy. The 2017 stress test includes for the first time a biennial exploratory scenario (BES) alongside the annual cyclical scenario (ACS).

In this regard, the BoE has published the **results of the 2017 stress test of the UK banking system** that have been assessed against these two scenarios. The ACS scenario is more severe than the global financial crisis (UK GDP falls by 4.7%, UK residential property prices fall by 33%, UK bank rate rises and peaks at 4%, etc.) whereas the BES scenario examines major UK banks' long‑term strategic responses to an extended low growth, low interest rate environment with increasing competitive pressures in retail banking enabled in part by an increase in the use of financial technology (FinTech).

2. Main points

- **Aggregate results of the 2017 ACS scenario**. The BoE establishes that, for the first time since the BoE launched its stress tests in 2014, no bank needs to strengthen its capital position as a result of the stress test.
    - This scenario is estimated to lead to losses of around £50 billion in the first two years of the stress. However, banks can now absorb these losses within the buffers of capital banks have on top of their minimum requirements.
    - Even after the severe losses in this scenario, the participating banks would be able to continue to supply the credit the real economy could demand even in a very severe stress, as they would have in aggregate in 2018:
        - A Tier 1 leverage ratio of 4.3%.
        - A CET1 capital ratio of 8.3%.
        - A Tier 1 capital ratio of 10.3%.
    - Regarding buffers, the Financial Policy Committee (FPC) has increased the system-wide UK countercyclical capital buffer rate, which applies to all banks, from 0.5% to 1%, whereas the capital buffers for individual banks ('PRA buffers') will be set in light of the stress-test results. However, these buffers will not require banks to strengthen their capital positions.
    - The qualitative review on the bank's stress testing capabilities shows banks have difficulties to assess the impact of the stress on net interest income (NII) and traded risk.
- **Individual results of the 2017 ACS scenario**. The results differ substantially across banks (due to differences between banks' business models, the types of risk exposed to, etc.) although no bank was required to take action to improve its capital position as a result of the stress test
    - Royal Bank of Scotland (RBS) and Barclays have significantly improved their capital positions since the end of 2016, registering a CET1 capital ratio at 15.5% and at 13.1% in 2017 Q3, respectively.
    - Further, the BoE has provided specific results in terms of the projected consolidated solvency ratios in the stress scenario for the seven participating banks (i.e. Barclays plc, HSBC Holdings plc, Lloyds Banking Group plc, Nationwide Building Society, The RBS Group plc, Santander UK Group Holdings plc, and Standard Chartered plc).
- **Results of the 2017 BES scenario**. The BoE judge that:
    - In aggregate, participating banks project that they could adapt to a low rate, low growth macroeconomic environment without major strategic change or taking on more risk.
    - Banks expect that they would generate a RoE of a little over 8% by 2023.
    - There are three important risks to the banks' projections: i) competitive pressures enabled by FinTech, in particular the emergence of Open Banking, may cause greater and faster disruption to banks' business models than banks project; ii) banks are projecting large reductions in costs and there is a risk that they will be unable to execute these plans fully while delivering a broad range of services; and iii) in an environment of low growth and low interest rates the equity risk premium may be higher than banks expect.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

05/10/2017

- **PS21/17 'UK leverage ratio: treatment of claims on central banks'**.
- **PS22/17 'Refinements to the PRA's Pillar 2A capital approach'**.
- **PS23/17 'Internal Ratings Based (IRB) approach: clarifying PRA expectations'** .

1. Context

In order to discuss the implementation of several aspects set out in the CRR within the UK regulatory framework, the PRA has published some consultation papers (CP) during 2017. In particular, the 'CP3/17 Refining the PRA's Pillar 2A capital framework' in February; the 'CP5/17 Internal Ratings Based (IRB) approach clarifying PRA expectations' in March; and the 'CP11/17 on changes to the UK leverage ratio (LR) framework relating to the treatment of claims on central banks' in June.

In this context, following these consultations, the PRA has now published three Policy Statements (PS) which provide feedback to responses and introduce minor amendments to these CPs, as well as modify accordingly the relevant Supervisory Statements: i) **'PS21/17 UK leverage ratio: treatment of claims on central banks'**; ii) **'PS22/17 Refining the PRA's Pillar 2A capital framework'**; and iii) **'PS23/17 IRB approach: clarifying PRA expectations'**.

2. Main points

<u>'PS21/17 UK leverage ratio: treatment of claims on central banks'</u>

- **Scope**. This PS is relevant to PRA-regulated banks and building societies with retail deposits equal to or greater than £50 billion on an individual or a consolidated basis.
- **Content**. In line with the CP11/17, the PRA has decided to:
  - <u>Exclude central bank claims</u> matched by deposits in the same currency and of identical or longer maturity from the <u>definition of the total leverage exposure measure</u> in the UK LR framework.
  - <u>Increase the minimum LR requirement</u> from 3% to <u>3.25%</u> of total exposures.
  - Align the UK LR <u>reporting and disclosure requirements</u> according to the above-mentioned amendments.

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<u>'PS22/17 Refinements to the PRA's Pillar 2A capital approach'</u>

- **Scope**. This PS is relevant to banks, building societies and PRA-designated investment firms.
- **Content**. In line with the CP3/17, the PRA has reviewed the following aspects:
  - <u>Adjustments to the PRA's Pillar 2A approach for firms using the standardised approach (SA) for credit risk</u>. The PRA is expected to exercise its supervisory judgement to adjust variable Pillar 2A add-ons for firms using the SA for credit risk. Its judgement would be informed, alongside other factors, by a comparison of firms' SA Pillar 1 capital charges to the upper range risk weights of the IRB benchmark.
  - <u>Revisions to the PRA's IRB benchmark used for assessing credit risk</u>. The PRA has amended the IRB benchmark for commercial real estate (CRE) exposures in order to clarify its treatment which consists on assigning CRE exposures to the risk weight category for specialised lending exposures (instead of using average IRB risk weights).
  - <u>Additional considerations the PRA will make, as part of the SREP, for SA firms using IFRS as their accounting framework</u>. The PRA has corrected an error in the IRB benchmark excluding expected losses (EL) for personal loans. In this regard, the revised IRB risk weights range from 65.9% to 89.2% with an average risk weight of 77.5%. The PRA does not expect these corrections to have any material impact on firms.

PS23/17 'Internal Ratings Based (IRB) approach: clarifying PRA expectations'

- **Scope**. This PS is relevant to banks, building societies and PRA-designated investment firms.
- **Content**. The PRA has made two clarifications which are not considered to have any additional material impact on firms, regarding the following aspects:
    - Calibration of margins of conservatism in PD and LGD estimation. In this regard, the PRA expects that:
        - For the estimation of LGD, the main drivers of additional margins of conservatism should be the following: firms having limited direct recovery experience and less established recovery processes; differences in portfolio comparability between the external data and firms' lending; and any unobservable differences (e.g. product pricing, marketing strategies, etc.).
        - Firms should not consider to apply appropriate margins of conservatism at every step when using external data in the calculation of PD as it could result in excessive conservatism.
    - Calibration of Probability of Possession Given Default (PPGD). Among others, the PRA has clarified that the two reference points of 70% and 100% for estimating PPGD are reference points and are not floors, that deviations from the reference points may be appropriate on a case-by-case basis if a firm can justify them, etc.

3. Next steps

- The reporting changes regarding the UK LR come into effect immediately, so they will apply to firms' reporting and disclosure requirements for **end-December 2017 onwards**.
- The refined Pillar 2A capital framework will come into force on **1 January 2018**.
- The amendments regarding IRB approach apply with **immediate effect**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

11/12/2017

- **Consultation Paper 26/17 on Model risk management principles for stress testing**.
- **Consultation Paper 25/17 on Pillar 2: Update to reporting requirements**.

1. Context

In March 2017, the Bank of England (BoE) published a set of principles on stress test model management to the firms participating in the annual stress test which support banks in assessing their own stress test model management practices.

Furthermore, when conducting a Supervisory Risk and Evaluation Process (SREP) for a firm, the PRA should consider the risks to the firm that are either not captured, or not fully captured, under the Pillar 1 requirements of the CRR, and risks to which the firm may become exposed over a forward looking planning horizon.

In this context, the PRA has published a **Consultation Paper (CP) 26/17 on model risk management principles for stress testing**, including a set of principles and a proposal in order to support firms in developing and implementing policies and procedures through which to identify, manage and control the risks inherent in the use of stress test models and thereby meet the high standards of risk management and internal governance already required of them under CRD IV and PRA Rulebook; as well as a **CP 25/17 on Pillar 2: update to reporting requirements**, including proposals regarding the introduction of an additional Pillar 2 data item (PRA111), the frequency of reporting, and the consolidation of definitions.

2. Main points

<u>Consultation Paper 26/17 on model risk management principles for stress testing</u>

- **Principles**. The PRA considers that an effective model risk management framework in the context of stress testing is supported by the following principles:
  - Banks should have an established <u>definition of a model</u> and maintain a <u>model inventory</u>.
  - Banks should implement an <u>effective governance framework</u>, policies, procedures and controls to manage their model risk.
  - Banks should implement a <u>robust model development</u> and <u>implementation process</u>, and ensure appropriate use of models.
  - Banks should undertake <u>appropriate model validation</u> and <u>independent review activities</u> to ensure sound model performance and greater understanding of model uncertainties.
- **Proposal**. In this regard, the PRA establishes that:
  - <u>Firms participating</u> in the BoE's annual concurrent stress test should adopt the principles for all stress test models.
  - <u>Firms not participating</u> in the Bank's annual concurrent stress test should take into account their size, nature, scale, complexity of business activities and use of stress test models when seeking to apply the principles. For these firms the PRA proposes at a minimum to:
    - Establish a model definition, maintain a model inventory and implement an effective governance framework, policies and procedures.
    - Implement a robust model development process and undertake validation and independent review to models they have identified as material.

Consultation Paper 25/17 on Pillar 2: update to reporting requirements

- **New data item for ICAAP stress testing**. The PRA proposes to introduce an additional Pillar 2 data item (PRA111) to capture stress test data currently provided in firms' ICAAP documents, in an electronic and standardised format. In particular, this new data item consists of:
  - Contents: the proposed information requested in PRA111 consists of base and stress scenario projections of, among others, macroeconomic variables and market drivers, impairment and loss data, and risk weighted assets (RWAs) and exposures.
  - Scope: the PRA111 would be required to be completed by firms with total assets equal to or greater than £5 billion, at the relevant level of consolidation used as the basis of their ICAAP.
  - Format: it would be aligned to the Stress Test Data Framework (STDF) used for the BoE's annual concurrent stress test. But the level of granularity would be significantly reduced in order not to place undue burden on firms not participating in the BoE's annual concurrent stress test.
- **Frequency of Pillar 2 reporting requirements**. The PRA proposes amending Pillar 2 reporting to:
  - Remove the requirement for significant firms that do not submit an ICAAP on an annual basis to submit the relevant Pillar 2 data items annually.
  - Remove the requirement for firms that are not significant and that do not submit an ICAAP on an annual basis but that have permission from the PRA to use the Advanced Measurement Approach (AMA) to submit the relevant Pillar 2 data items annually.
  - Extend the requirement of Reporting Pillar 2 to all firms that do not submit their ICAAPs on an annual basis.
- **Consolidation of glossary definitions**. The PRA proposes to consolidate the definitions used in the reporting parts of the PRA Rulebook into the glossary.

3. Next steps

- Comments to these CPs shall be submitted by **6 March 2018**.
- The proposed implementation date for the proposal in CP 26/17 is **1 June 2018**.
- Following the consultation, the PRA will issue the final policy of CP 25/17 which it proposes to take effect from **1 October 2018**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

12/12/2017

- **Supervisory Statement on recovery planning (SS9/17)**.
- **Recovery plan information template**.

1. Context

Recovery planning is a key component of the regulatory reform agenda introduced by the PRA following the financial crisis of 2007-2008. It addresses the risk that the management of firms concentrate disproportionately on growth opportunities at the expense of managing downside risk. In this regard, the PRA expects firms to undertake recovery planning so that they are ready for periods of financial stress, can stabilise their financial position and can recover from financial losses.

In this context, the PRA has now published a **Supervisory Statement on recovery planning (SS9/17)** that supersedes SS19/13 and sets out the PRA's expectations on the content of recovery plans and group recovery plans. In particular, this SS establishes the key recovery plan components and considerations, as well as PRA's expectations regarding recovery planning for UK subsidiaries of non-EU parents.

This SS is relevant to firms (i.e. UK banks, building societies, PRA-designated investment firms and qualifying parent undertakings) to which the Recovery Planning Part of the PRA Rulebook applies.

2. Main points

- **Key recovery plan components and considerations**. The SS sets out the PRA's expectations relating to the minimum elements to be contained in a recovery plan and general considerations firms should take into account when developing their recovery plans. In particular, it covers:
    - <u>Recovery options</u>. Firms should include in their plans a sufficiently broad range of recovery options to maximise the chance that there will be implementable options in different types of stress (i.e. easily implementable recovery options and more radical options). To this end, they should justify the choice of options, impact, timelines and dependencies of recovery options; and should analyse the access to central bank liquidity facilities and those aspects regarding wind down of the trading book.
    - <u>Recovery capacity</u>. Firms should provide a self-assessment of their existing and potential recovery capacities, meaning the financial benefits they could currently credibly realise under different types of stress (e.g. by selling assets to raise capital). This recovery capacity should be quantified in terms of CET1, leverage ratio and liquidity coverage ratio percentage points and relevant nominal amounts for each scenario included in the plan.
    - <u>Indicators</u>. Firms should address a range of indicators which identify the signs of emerging stress and should consider several factors to satisfy that recovery plan indicators are appropriately calibrated (e.g. the range of credible recovery options, the expected time required to execute recovery options and the firm's risk appetite and risk tolerance).
    - <u>Scenario testing</u>. All global systemically important institutions (G-SIIs) and other systemically important institutions (O-SIIs) should include an analysis of at least four scenarios in their recovery plans whereas all other firms should include at least three scenarios. In this regard, the PRA has established expectations regarding its design and its use (e.g. adequacy and consistency).
    - <u>Fire drills</u>. Firms should carry out at least one fire drill exercise on its recovery plan prior to each submission of the recovery plan to the PRA, subject to a minimum of one fire drill taking place every three years. The PRA determines the frequency with which firms should submit their recovery plan on a firm-by-firm basis, with larger firms tending to submit their plans on an annual cycle.
    - <u>Governance</u>. Firms should include a sufficiently clear description regarding the governance associated with any implementation of the recovery plan and the governance associated with the production, review and sign off of the recovery plan.
    - <u>Interaction between group and subsidiary plans</u>. Firms that are parent entities of an international group should demonstrate how they have covered different entities in other jurisdictions in their group recovery plan.
    - <u>Interaction with other relevant regimes and requirements</u>. Firms should consider the relationship between firm's recovery planning and contingency funding plans, ICAAP and ILAAP, the concurrent stress test, and the Senior Managers Regime.
    - <u>Other areas</u>. Firms should consider PRA's expectations regarding recovery plan information template, playbooks and structure of recovery plans, communication plan, etc.

- **PRA's expectations on recovery planning for UK subsidiaries of non-EU parents**. The SS clarifies how UK subsidiaries of non-EU parents should meet expectations for recovery planning by providing a core set of information that their recovery plan should include (e.g. summary of the UK entity business, UK specific recovery options, etc.).

3. Next steps

- In general, the PRA expects firms to meet the expectations sets out in this SS by **30 June 2018**,or by the firm's first annual update of their recovery plan following publication of this SS, whichever is later.
- Nevertheless, firms should meet other expectations (e.g. full separability analysis for disposal options, modelling of capital and liquidity profiles in each scenario) by **30 June 2019**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

12/12/2017

Supervisory Statement on the minimum requirement for own funds and eligible liabilities (MREL) – buffers and threshold conditions (SS16/16).

1. Context

In November 2016, the PRA published the Supervisory Statement (SS) 16/16, which sets out how the PRA views the relationship between MREL and the buffer requirements from the two going-concern regimes: i) risk-weighted capital buffers (i.e. capital conservation, countercyclical capital, G-SII, systemic risk, and the one set by the PRA); and ii) leverage buffers (i.e. countercyclical leverage ratio buffer, and G-SII additional leverage ratio buffer).

SS16/16 states that the PRA expects firms not to simultaneously count CET1 capital towards both MREL and the buffer requirements. Subsequently, the PRA has been asked about the situation where MREL is calibrated on the basis of one going-concern regime (e.g. leverage, in circumstances where the minimum leverage requirement is larger than the minimum risk-weighted requirement), but the largest requirement for buffers derives from the other regime (e.g. risk-weighted capital).

In this context, the PRA has published a **Supervisory Statement on MREL**, which updates the previous version of the SS16/16 by setting out the PRA's expectations on the relationship between MREL and both capital and leverage ratio buffers, as well as the implications that a breach of MREL would have for the PRA's consideration of whether a firm is failing, or likely to fail, to satisfy the threshold conditions.

2. Main points

- **Buffers**. The SS covers the following aspects:
    - Calculating an amount of CET1 to meet buffer requirements that cannot also be counted to meet MREL. In this regard, the PRA expects firms to meet both MREL and maintain an amount of CET1 that reflects their risk-weighted capital and leverage buffers and not to double count CET1 towards both of them (i.e. MREL and buffers). The amount that reflects risk-weighted capital and leverage buffers should be calculated to be the amount of CET1 that a firm is required to maintain (in sterling terms) in addition to the largest minimum of either the risk-weighted capital or leverage regimes.
    - Risk-weighted capital buffers. In this regard, the PRA sets out that, among others:
        - The buffers (CRD IV combined buffers, systemic risk buffer, if relevant, and PRA buffer) are maintained in addition to minimum risk-weighted capital requirements.
        - If a firm does not have, or expects that it will not have, sufficient CET1 (in addition to any own funds and liabilities counted towards its MREL) to meet the amount of CET1 as calculated before, the firm will be considered to have used, or be about to use, the buffers of the regime where the total amount of capital required to meet minimum requirements plus buffers (risk-weighted capital or leverage) is largest.
        - Where a firm does not have sufficient CET1 to meet its minimum risk-weighted capital requirements and the CRD IV combined buffer, automatic restrictions on distributions will apply.
    - Leverage ratio buffers. In this regard, the PRA sets out that, among others:
        - The countercyclical leverage ratio buffer (CCLB) and a G-SII additional leverage ratio buffer (G-SII ALRB) are maintained in addition to minimum leverage requirements.
        - The PRA expects firms not to meet the amount of CET1 as calculated before with any CET1 capital counted towards their MREL.
        - If a firm does not, or expects that it will not, have sufficient CET1 (in addition to any own funds and liabilities counted towards MREL) to meet the amount of CET1 as calculated before, the firm will be considered to have used, or be about to use, the buffers of the regime under which the total amount of capital required to meet minimum requirements plus buffers (risk-weighted capital or leverage) is largest.
- **Threshold conditions**. The SS establishes that firms should expect the PRA to investigate whether any firm in breach or likely breach of its MREL is failing, or likely to fail with a view to taking further action as necessary. However, a breach or likely breach by a firm of its MREL does not automatically mean that the PRA will consider the firm is failing, or likely to fail.

3. Next steps

- Firms are expected to comply with an end-state MREL from **1 January 2022**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

13/12/2017

- **Statement of Policy on the PRA's methodologies for setting Pillar 2 capital**.
- **Supervisory Statement on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP)**.
- **Policy Statement on Pillar 2A capital requirements and disclosure (PS30/17)**.

1. Context

The PRA sets Pillar 2A capital for risks that are not fully captured under CRR. It assesses those risks as part of the SREP, in light of both the calculations included in a firm's Internal ICAAP document and the PRA's Pillar 2A methodologies set out in this regard.

In this context, the PRA has published three documents regarding the UK's Pillar 2 framework: i) **Statement of Policy on the PRA's methodologies for setting Pillar 2 capital**; ii) **Supervisory Statement on the ICAAP and the SREP**; and iii) **Policy Statement on Pillar 2A capital requirements and disclosure**. In particular, these documents covers the Pillar 2A methodologies and information on the purpose of the PRA buffers (Pillar 2B); the expectations of firms undertaking an ICAAP, stress testing, scenario analysis and capital planning, reverse stress testing, and SREP; as well as clarifications on the PRA's Pillar 2A framework, respectively.

2. Main points

Statement of Policy (SoP) on the PRA's methodologies for setting Pillar 2 capital

- **Pillar 2A methodologies**. This SoP sets out the scope, reporting criteria and methodologies that the PRA will consider to inform the setting of a firm's Pillar 2A capital requirement for:
    - Credit risk (e.g. the methodology used is based on comparison of firms' SA risk weights at a portfolio level to an IRB risk-weight benchmark)
    - Market risk (e.g. the PRA may require firms to hold additional capital under Pillar 2A to cover risks likely to be underestimated or not covered under Pillar 1).
    - Operational risk (e.g. the methodology's approach considers non-conduct risk separately from conduct risk).
    - Counterparty credit risk (e.g. the PRA should consider several aspects such as the qualitative requirements for this risk or the relationship with concentration risk to set out its relevant methodology).
    - Credit concentration risk (e.g. in the PRA's methodology consider both the sector concentration risk and the geographic concentration risk).
    - Interest rate risk in the banking book (e.g. the PRA employs a comprehensive approach to this risk assessment that reviews duration, basis and, as necessary, optionality risks).
    - Pension obligation risk (e.g. the PRA's methodology considers the firm's own assessment of the appropriate level of Pillar 2A pension obligation risk capital and a set of stresses).
    - Pillar 2A for ring-fenced banks (RFB) group risk (e.g. the methodology considers the difference between the minimum capital, i.e. Pillar 1 or Pillar 2A, of the RFB sub-group for an identified risk, and RFB sub-group's share of the minimum capital for that risk on a consolidated basis).
- **Pillar 2B**. In this regard, the SoP sets out information regarding the PRA buffer, how it is determined and how it relates to the CRD IV buffers. To this end, the PRA should consider, among others, the PRA buffer assessment, severity of the stress scenario, starting assumption as to the amount of capital a firm is expected to maintain under stress, other factors affecting the PRA buffer assessment, etc. Further, it also provides details on the PRA's approach to tackling weak governance and risk management under Pillar 2B and RFB group risk.

Supervisory Statement (SS) on the ICAAP and the SREP

- **Expectations of firms undertaking an ICAAP**. In this regard, the SS establishes the PRA's expectations regarding firms' coverage and treatment of interest rate risk in the non-trading book, market risk, group risk, operational risk, pension obligation risk and foreign currency lending to unhedged retail and SME borrowers. It also provides additional detail on data that firms are required or expected to submit with their ICAAP document or otherwise as applicable.
- **Stress testing, scenario analysis and capital planning**. The SS sets out the PRA's expectation of firms in relation to the overall approach, governance, scenarios and common stress scenarios, forward-looking and multi-year risk assessment regarding stress testing, scenario analysis and capital planning.
- **Reverse stress testing**. The SS establishes the PRA's expectations on how firms should carry out reverse stress testing, its conditions (i.e. appropriateness to the nature, size and complexity of the firm's business and of the risks it bears), etc.
- **SREP**. The SS sets out the factors that the PRA takes into consideration to assess a firm's ICAAP. It also explains, among others, the setting of firm specific capital requirements and the PRA buffer, the consequences in the event a firm fails to meet its Total Capital Requirement (TCR) or uses the PRA buffer, and disclosure.

3. Next steps

- The SoP and the SS will be effective by **1 January 2018**. However, the aspects relevant for RFBs apply from **1 January 2019**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

13/12/2017
Consultation Paper 27/17 on Solvency II: Internal models update.

1. Context

In September and November 2016, the PRA published Supervisory Statement on Solvency II: Changes to internal models used by UK insurance firms (SS12/16) and Supervisory Statement on Solvency II: internal models regarding the assessment, model change and role of non-executive directors (SS17/16), respectively, in order to provide guidance on internal model change policies and process.

In this context, the PRA has published the **Consultation Paper (CP) 27/17 on Solvency II: Internal models update** aiming to introduce updates to the PRA's guidance to reduce the burden on firms, make better use of supervisory resources and review the effectiveness of certain aspects of the model change process. In particular, this CP includes proposals on the following aspects: i) model change process, ii) model change policies, and iii) the reporting of minor model changes.

2. Main points

- **Model change accumulations**. In this regard, the PRA proposes among other aspects:
  - An additional annual reset of minor model change accumulations that applies to minor model changes, which do not trigger the major change threshold within an annual cycle (that firms may specify) and that are not linked to a major model change.
  - To consider that the reset of minor model change at the end of an annual cycle would reduce the frequency with which an accumulation of minor changes would trigger the need for firms to submit a model change application.
  - To discuss with firms the accumulated minor changes prior to resetting accumulations with the aim of ensuring a common understanding of the minor changes and their interaction with the model as a whole.
- **Model change policies**. The PRA considers that in order to implement an annual reset of minor model change accumulation, firms will need to modify their model change policies. In this regard:
  - Firms may wish to review their major model change thresholds at the same time as, and to take account of, any change to the minor model change accumulation reset point.
  - Proposed changes to model change policies need to be approved by the PRA before being implemented.
  - The PRA states out that the proposals would improve the effectiveness of identifying and reporting all relevant sources of change that would impact the Solvency Capital Requirement (SCR), as well as the consistency in the types of model changes which are identified and reported.
- **Minor model change reporting**. The PRA proposes that firms with an approved internal model should submit their quarterly minor model change report:
  - Via the Bank of England Electronic Data Submission (BEEDS) portal, which would align the process with other Solvency II quantitative and qualitative reporting submissions, and ensure more secure tracking and recording procedures.
  - Within five weeks of a quarter end, as this would align the submission with the quantitative quarterly reporting submission periods that will apply after the rules of the PRA Rulebook cease to have effect, and help to support timely supervisory analysis of changes.
  - Using a standardised template, which is optional, but would allow quicker analysis.

3. Next steps

- Comments to this CP shall be submitted by **20 March 2018.**
- The PRA proposes that the updated guidance on the model change process and model change policies would be implemented in **2Q18**. However, changes to the model change policy are subject to supervisory approval.
- The PRA proposes that the changes in relation to minor model change reporting would take effect from **June 2018**.

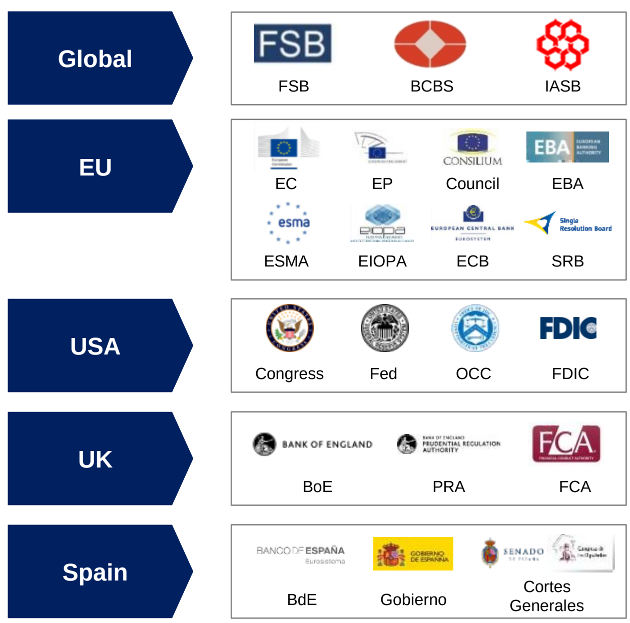
Management Solutions' Alert System on Regulation

Through the Alert System on regulation, Management Solutions drives immediate knowledge on new regulations among its professionals and clients

Alert System on Regulation

- The R&D department in Management Solutions monitors on a daily basis the regulatory publications from more than 20 financial regulators and supervisors.
- For those publications which are more likely to give rise to significant effects upon MS clients, the R&D department has been sending out publication alerts since the beginning of 2013, addressed to its professionals and to those clients who requested it.
- Alerts are published in Spanish and English in less than 24 hours since the publication by the regulatory body.
- Moreover, quarterly MS publishes the Regulation Outlook, a report that collects the alerts of the period and anticipates the main upcoming regulatory changes.
- To be included in the Alert System on financial regulation, please send an email to investigacion-desarrollo@msspain.com

Regulators



Our goal is to exceed client expectations, becoming their trusted partners

Management Solutions is an international consultancy firm focusing on providing business, risk, financial, organizational and process-related advice, both in respect of functional components and in the implementation of related technologies.

With a cross-functional team of 2,000 professionals, Management Solutions operates through 24 offices across Europe (11), the Americas (12) and Asia (1).

To meet these requirements, Management Solutions structures its activities by industry (Financial Institutions, Energy, Telecommunications, Consumer Products and Industry, Government and Construction), grouping together a wide range of areas of specialization, including Strategy, Sales and Marketing Management, Organization and Processes, Risk Management and Control, Management and Financial Reporting and New Technologies.

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