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Regulation Outlook

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Executive summary

In the last quarter of 2018, the publication of the stress testing principles and the final standards on Pillar 3 by the BCBS stand out. In Europe, the EBA published the results of the 2018 stress test, a report on the impact of IFRS 9 and final GL on NPEs/FBE, whereas the ECB updated the general topics chapter of the guide to internal models. In Spain, the Government transposed the PSD2 Directive to the Spanish legal system.

Global publications

- At international level, the BCBS published the **2018 Stress testing principles**, which update and replace the ones published in 2009, addressing the objectives, governance, or methodologies of the stress testing framework, among other aspects.
- The BCBS also published the **final standards on Pillar 3 disclosure requirements**, that complete the third phase, and therefore, the review of the Pillar 3 framework due to the Basel III reform.

European publications

- At European level, the EBA published the **2018 EU-wide stress test results**, as well as the results for each bank, considering the impact of IFRS 9 application. In this regard, it also published **a report on the impact and implementation of IFRS 9 by EU institutions**.
- Moreover, the EBA published the **final Guidelines (GL) on management of non-perfoming exposures (NPEs) and forborne exposures (FBE)**, specifying the management practices and setting out the relevant requirements, as well as, **final GL on disclosure of NPEs and FBEs**.
- The ECB published an update of the **general topics chapter of the guide to internal models**, which includes principles on governance, model use, internal audit, etc.
- Furthermore, the ECB also announced the **2019 supervisory priorities for the Single Supervisory Mechanism (SSM)**, that will mainly focus on credit risk, risk management and activities comprising multiple risk dimensions (e.g. Brexit).
- Regarding capital and liquidity adequacy assessment processes, the ECB published the **final Guides to the ICAAP and ILAAP**, which include seven principles for each process in order to develop a more detailed set of supervisory expectations.

European publications (continuation)

- Concerning the credit risk, the EBA published **final RTS on the nature, severity and duration of an economic downturn**, which require institutions to consider relevant macroeconomic and credit factors when specifying the nature of an economic downturn; while the ECB published a **Regulation on the materiality threshold for credit obligations past due** in order to define the absolute and relative components of the materiality threshold.

Local publications

- In Spain, the Government approved the **Royal Decree-law 19/2018 on payments services and other financial measures**, which transposes the PSD2 in order to adapt this Directive to the Spanish legal system (e.g. scope of application of the payment services, or the transparency of information). Moreover, the Spanish Government also approved the **Royal Decree-law 14/2018, which amends the consolidated text of the Securities Market Law** in order to complete the transposition of MiFID II through the consideration of certain amendments (e.g. restrictions to inducements, or increase of oversight and control of products).
- In UK, the Bank of England (BoE) published the **results of the 2018 stress test of the UK banking system**, assessed against an annual cyclical scenario (ACS) under severe conditions and assuming the same variables as in 2017 stress test in order to isolate the impact of IFRS 9.
- Moreover, the PRA published the **Consultation Paper (CP) 23/18 on enhancing banks' and insurers' approaches to managing the financial risks from climate change**, with the aim of giving proposals regarding governance, risk management, scenario analysis and disclosure in order to address them.

Regulatory projections

At international level, the FSB final standard on TLAC will be applicable to those G-SIBS that are not headquartered in an emerging market economy, and the BCBS's large exposures framework will be applied. Moreover, the final GL on SREP and stress testing and the Final Guidelines on the ICAAP and the ILAAP will be applied. At local level, in USA new requirements on LTD and TLAC will be applicable and in UK the BoE ring-fencing rules will apply.

Regulatory projections

1. Next quarter

- **(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 RWAs, and 6% of the LR exposure, in accordance with the FSB.
- **(Global) January 2019**: the BCBS's large exposures framework will be applicable.
- **(Global) January 2019**: IFRS 16 on leases published by the IASB will be applied.
- **(Europe) January 2019**: the EBA final Guidelines on the treatment of connected clients will come into force.
- **(Europe) January 2019**: the ECB final Guides to the ICAAP and the ILAAP will be considered according to the SREP framework.
- **(Europe) January 2019**: the EBA final Guidelines on SREP and stress testing will be applicable.
- **(Spain) January 2019**: the Circular 2/2018 of the Bank of Spain amending Circular 4/2017, on public and confidential financial information rules and formats, and the Circular 1/2013 on the Risk Information Centre (CIR), will enter into force.
- **(USA) January 2019**: the new requirements on Long-Term Debt (LTD) and TLAC will be applicable.
- **(UK) January 2019**: the BoE ring-fencing rules will be implemented.

2. Next year

- **(Europe) To be determined**: the European Parliament (EP) and the Council are expected to approve the reform package of the financial system proposed by the EC, amending several legislative acts (CRD IV, CRR, BRRD, SRMR and EMIR).
- **(Europe) To be determined**: the EBA will publish several documents related to FinTech, among others, on cybersecurity or consumer protection.
- **(Europe) May 2019**: the EBA will update the O-SII list.
- **(Europe) June 2019**: the EBA Final Guidelines on IRRBB will be applicable.
- **(Europe) June 2019**: the EBA GL on management of NPE and FBE will be applicable.
- **(Global) November 2019**: the FSB will update the list of G-SIBs.
- **(Global) December 2019**: the BCBS will assess G-SIBs' progress in adopting the RDA&RR principles.
- **(Global) December 2019**: the FSB is expected to conduct a review of the technical implementation of TLAC.
- **(Global) December 2019**: the EBA final RTS on economic downturn will enter into force.
- **(Europe) December 2019:** the EBA final GL on disclosure of NPE and FBE will be applicable.

3. More than a year

- **(Global) December 2020**: the BCBS Guidelines on step-in risk will be applicable.
- **(Europe) December 2020**: the ECB Regulation on the materiality threshold for credit obligations past due will be applicable.
- **(Europe) January 2021**: the EBA Guidelines on IRB parameters estimation will be applicable.
- **(Europe) January 2021**: the EBA Guidelines on the new definition of default will be applicable.
- **(Europe) January 2021:** the EBA final RTS on an economic downturn will be applicable.
- **(Global) December 2021**: the BCBS new assessment methodology for G-SIBs will be applicable.
- **(Global January 2022**: the revised SA for credit risk, the revised IRB framework, the revised CVA framework, the revised operational and market risk framework published in Basel III by the BCBS will be implemented. Moreover, the LR framework using the revised exposure definition and the G-SIB buffer will be applicable.
- **(Global) January 2022**: the new disclosure requirements of the BCBS Pillar III updated framework will be implemented.
- **(UK) January 2022**: the PRA will require firms to comply with an end-state MREL.
- **(Europe) December 2022**: the application of IFRS 9 transitional arrangements will finish.
- **(Global) January 2027**: an output floor of 72.5% will be applicable according to the Basel III reform.

Publications of this quarter

Summary of outstanding publications of this quarter

Topic	Title	Date	Page
	Basel Committee on Banking Supervision		
Stress testing	• 2018 Stress testing principles	19/10/2018	8
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	Financial Stability Board / Basel Committee on Banking Supervision		
List of G-SIBs	• 2018 list of global systemically important banks (G-SIBs) • Information on global systemically important banks	19/11/2018	12
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NPL	• Final Guidance on management of non-performing and forborne exposures.	02/11/2018	15
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ICT risk	• Consultation Paper on Guidelines on ICT and security risk management.	17/12/2018	20
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NPL	• Final Guidelines on disclosure of non-performing and forborne exposure	18/12/2018	22
Benchmarking exercise	• Consultation Paper on ITS amending Commission Implementing Regulation (EU) 2016/2070 with regard to benchmarking of internal models	19/12/2018	23
IFRS 9	• Report on first observation on the impact and implementation of IFRS 9 by EU institutions.	20/12/2018	24
	European Central Bank		
Supervisory priorities	• SSM supervisory priorities for 2019	31/10/2018	25
ICAAP and ILAAP	• Guide to the internal capital adequacy assessment process (ICAAP) • Guide to the internal liquidity adequacy assessment process (ILAAP)	12/11/2018	26
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Materiality threshold	• Regulation (EU) 2018/1845 on the materiality threshold for credit obligations past due.	26/11/2018	29

19/10/2018
2018 Stress testing principles.

1. Context

In May 2009, the BCBS published Principles for stress testing practices and supervision. These principles established guidelines that focus on the main elements of the structure of stress testing by addressing: i) objectives; ii) governance; iii) design; and iv) implementation of stress testing. In particular, these principles were designed to address key weaknesses in stress testing practices that were highlighted by the global financial crisis.

In this context, due to the increased importance of stress testing, in combination with the number of measures taken by supervisory authorities, the BCBS has published its 2018 Stress testing principles, which update and replace the ones published in 2009.

2. Main points

- **Stress testing frameworks should have clearly articulated and formally adopted objectives**. Stress testing frameworks should be designed to meet clear objectives that are documented and approved at the board level of the organisation, or an appropriately senior-level governance body.
- **Stress testing frameworks should include an effective governance structure**. Stress testing frameworks should:
    - Include an effective governance structure that is clear, comprehensive and documented.
    - Specify the roles and responsibilities of senior management, oversight bodies and those responsible for the ongoing operation of the stress testing framework.
    - Identify all key stakeholders.
    - Ensure a full and consistent oversight and monitoring of the actions taken at the different stages of the stress testing process.
- **Stress testing should be used as a risk management tool and to inform business decisions**. Stress testing constitutes a key input into banks' and authorities' activities related to risk identification, monitoring and assessment. As such, stress testing should also contribute to formulating and pursuing strategic and policy objectives.
- **Stress testing frameworks should capture material and relevant risks and apply stresses that are sufficiently severe**. The risk identification process should include: I) a comprehensive assessment of risks, which may include those deriving from both on- and off-balance sheet exposures; ii) earnings vulnerabilities; iii) operational risks; and iv) other factors that could affect the solvency or liquidity position of the bank (or banks in the case of supervisory stress tests).
- **Resources and organisational structures should be adequate to meet the objectives of the stress testing framework**. Governance processes should ensure the adequacy of resourcing for stress testing, including ensuring that the resources have the appropriate skill sets to execute the framework. Resourcing decisions should take account of the fact that stress tests have become more sophisticated over time, increasing the need for specialised staff, systems and IT infrastructure.

2. Main points (continues)

- **Models and methodologies to assess the impacts of scenarios and sensitivities should be fit for purpose**. This implies:
  - The need to adequately define at the modelling stage the coverage, segmentation and granularity of the data and types of risk in line with the objectives of the stress test framework.
  - The level of sophistication of the models should be appropriate for both the objectives of the exercise and the type and materiality of the portfolios being monitored using the models.

  The models and methodologies used for stress tests should be well justified and documented.
- **Stress testing models, results and frameworks should be subject to challenge and regular review**. Regular review 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
  - Ensuring that the stress test results are being used in a way that is consistent with the framework's objectives.
- **Stress testing practices and findings should be communicated within and across jurisdictions**. Communication of stress testing activities across relevant internal and external stakeholders can have benefits for both banks and supervisors. Sharing of results can, where appropriate, provide important perspectives on risks that would not otherwise be available to an individual bank or authority.

12/12/2018
Final standards on Pillar 3 disclosure requirements – updated framework.

1. Context

Pillar 3 of the Basel framework seeks to promote market discipline through regulatory disclosure requirements. In this regard, the BCBS carried out a first phase and a second phase of the revised Pillar 3 disclosure requirements in January 2015 and March 2017, respectively. Further, in December 2017 the BCBS published 'Basel III: finalising post-crisis reforms', which revised the framework for credit, operational and credit valuation adjustment (CVA) risks, as well as the leverage ratio.

In this context, following the consultation launched in February 2018, the BCBS has now issued **Final standards on Pillar 3 disclosure requirements** that complete the third phase, and therefore, the review of the Pillar 3 framework. In particular, these standards cover three elements: i) new or revised requirements arising from the Basel III reform; ii) new disclosure requirements on asset encumbrance; and iii) new disclosure requirements on capital distribution constraints (CDC).

2. Main points

- **Revisions and additions to the Pillar 3 framework arising from finalisation of the Basel III post-crisis regulatory reforms**.
    - Revised and additional disclosure requirements for credit risk: the BCBS has introduced several amendments to the templates published in the January 2015 and March 2017 standards in order to reflect the revisions to the SA and IRB framework.
        - **Template CR4** (SA - credit risk exposure and credit risk mitigation effect) and **Template CR5** (SA - exposures by asset classes and risk weights) have been amended to reflect the addition of new asset classes (e.g. introduction of specialised lending asset classes) and the updates to risk weights under the revised SA; whereas **Template CR10** (IRB - specialised lending and equities under the simple risk-weight method) has been amended to remove the disclosure of equity exposures under the IRB approach's simple risk weight method.
        - An additional new **Table CRB-A** on additional disclosure related to prudential treatment of problem assets has been introduced to reflect new disclosure requirements, when required at the jurisdictional level.
    - Revised disclosure requirements for operational risk: the BCBS has developed a new Table ORA on general qualitative information on bank's operational risk framework; and three new disclosure templates, i.e. on historical losses (OR1), on the business indicator and subcomponents (OR2), and on minimum required operational risk capital (OR3).
    - Revised disclosure requirements for leverage ratio: the BCBS has amended Templates LR1 on summary comparison of accounting assets vs leverage ratio exposure measure; and Template LR2 on leverage ratio common disclosure template.
    - Revised disclosure requirements for CVA: the BCBS has included the following disclosure requirements:
        - **Two new qualitative disclosure requirements** (i.e. Table CVAA on general requirements, which is mandatory for all banks; and Table CVAB on qualitative disclosures for banks using the SA-CVA).
        - **Four new quantitative disclosure requirements** (i.e. Template CVA1 on the reduced basic approach for CVA (BA-CVA), which is mandatory for banks having part or all of their CVA risk charges measured according to the reduced version of BA-CVA; Template CVA2 on the full BA-CVA, which is mandatory for banks having part or all of their CVA risk charges measured according to the full version of BA-CVA; Template CVA3 on the SA-CVA, which is mandatory for banks using this approach; and Template CVA4 on RWA flow statements of CVA risk exposures under the SA, which is mandatory for banks using the SA-CVA.

2. Main points (continues)

  - <u>New disclosure requirements to compare modelled and standardised RWA</u>: the BCBS has introduced two new requirements, i.e. a Template CMS1 on comparison of modelled and standardised RWA at risk level; and a Template CMS2 on comparison of modelled and standardised RWA for credit risk at asset class level.
  - <u>Revised disclosure requirements on overview of risk management, key prudential metrics and RWA</u>: the BCBS has also revised the Template OV1 on overview of RWA (introduced in January 2015); and Template KM1 on key metrics (introduced in March 2017).
- **New disclosure requirements on asset encumbrance**. The BCBS has included a new Template ENC on asset encumbrance, which requires banks to disclose information on their encumbered and unencumbered assets.
- **New disclosure requirements on CDC**. The BCBS has introduced a new Template CDC which requires banks to disclose the CET1 capital ratios that would trigger CDC. In this regard, one ratio would take into account CET1 capital used to meet other minimum regulatory capital ratios and one ratio would only set forth the minimum CET1 requirement. In the case of G-SIBs, the disclosure extends to the leverage ratio.

3. Next steps

- The implementation deadline for the disclosure requirements related to Basel III is **1 January 2022**, which accords with the implementation of the Pillar 1 (minimum capital requirements) framework. The implementation deadline for the disclosure requirements for asset encumbrance, CDC and the prudential treatment of problem assets has been established by **end-2020**.

19/11/2018

- **2018 list of global systemically important banks (G-SIBs)**
- **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) which are updated annually. Moreover, the BCBS published in July 2018 a revised version of its G-SIBs assessment methodology, which will take effect in 2021 and will replace the July 2013 version.

In this context, the FSB has published the **2018 list of G-SIBs**, using end-2017 data and the assessment methodology designed by the BCBS in July 2013. In parallel with these publications, the BCBS has released **additional information** regarding the assessment methodology used for the purpose of the list of G-SIBs.

2. Main points

FSB - 2018 list of G-SIBs

- The list comprises **29 banks** (the 2017 list of G-SIBs comprised 30 banks) with one new bank, Groupe BPCE, being added and two banks, Nordea and Royal Bank of Scotland, being removed from the list. Moreover, there are **changes in the allocation across buckets** of the institutions, given that Bank of America has moved from bucket 3 to bucket 2, China Construction Bank has moved from bucket 2 to bucket 1, and Groupe BPCE has been included in bucket 1.
- 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.

BCBS - Additional information

- The BCBS has also 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 FSB will update the list of G-SIBs in **November 2019**.
- 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 2020**.

26/10/2018
2019 Work Programme.

1. Context

The EBA has published the **2019 Work Programme**. The 2019-2022 multi-annual work programme is defined by the strategic areas that the EBA has proposed for the forthcoming years. Furthermore, the 2019 work programme includes a summary of the main objectives derived from the mandates specified in the regulation and from the relevant EU banking sector legislation.

2. Main points

- **Strategic priorities**: The EBA has defined the key priorities for the organization:
    - Leading the Basel III implementation in the EU. The EBA will remain to develop a single Rulebook. Furthermore, the EBA is still likely to have a significant amount of regulatory mandates in the coming 3 years, following: i) the endorsement of the CRDV-CRR2-BRRD2 package, and ii) the preparation of the implementation of the Basel III framework.
    - Understanding risks and opportunities arising from financial innovation. Financial innovation offers great opportunities but also introduces new risks and challenges. Furthermore, financial technology will affect many aspects of banking, such as business models and consumer interaction, among others. As a result, the EBA will work in the following policy areas: i) authorisation and regulatory sandbox regimes; ii) prudential risks for institutions and the impact of FinTech on the business models of institutions; iii) broader cyber security issues; iv) consumer protection and retail conduct of business issues; v) the impact of FinTech on the resolution of credit institutions and investment firms; and vi) the impact of FinTech on AML/CFT.
    - Collecting, disseminating and analyzing banking data. The expanded access to supervisory data should allow further improved risk analysis and facilitate enhanced dissemination and disclosure of bank data, including Pillar 3.
    - Ensuring a smooth relocation of the EBA to Paris. The EBA staff and business will be affected by this change, which exposes the organisation to a high operational risk. In particular, the objective will be to implement a smooth relocation to Paris and reduce the level of disruption for staff and stakeholders to a minimum, in order to maintain business continuity.
    - Fostering the increase of the loss-absorbing capacity of the EU banking system. The EBA's objective will be to ensure that MREL decisions taken by resolution authorities are supported by the following: i) credible and consistent resolution-planning work, and ii) clarity on the expected composition and quality of MREL, in terms of both subordination and, if applicable, other eligibility criteria and potential exclusions.
    - Horizontal priorities for policy work across the EBA. The EBA establishes other main points to consider on its work programme. These points are the following: i) further efforts in implementing the proportionality principle; ii) strengthening supervisory convergence and integrity of the Single Rulebook; iii) enhancing consumer protection; and iv) preparation for the withdrawal of the UK from the EU.
- **EBA's activities**. The EBA includes an annual work programme with activities that will complement each strategic area, detailing the tasks to be delivered within the year and the resources needed for that purpose. These activities are the following: i) Capital; ii) liquidity risk and interest rate risk in the banking book; iii) Leverage ratio; iv) loss absorbency; v) accounting and audit; vi) Large exposures; vii) credit risk; viii) Market risk; ix) Operational risk and investment firms; x) Supervisory review; xi) Internal governance and remuneration; xii) Recovery and resolution; xiii) Reporting; xiv) Transparency; xv) Loans management and valuation; xvi) Activity 16: Market access, authorisation and equivalence; xvii) Banking markets, securitisation, covered bonds and sustainable finance; xviii) Innovation and FinTech; xix) Consumer and depositor protection; xx) Payment services; xxi) anti-money laundering and combating the financing of terrorism; xxii) Risk analysis; xxiii) Stress testing; xxiv) Data analysis and infrastructure; xxv) Statistical tools; xxvi) Ad hoc data collections; xxvii) Management of the notification process; xxviii) Economic analysis and impact assessment; xxix) Preparing for potential risks around the withdrawal of the UK from the EU; xxx)Policy coordination and communication; xxxi) Q&As; xxxii) Training for competent authorities; xxxiii) Legal services; xxxiv) Finance, procurement and accounting; xxxv) Human resources; xxxvi) Information technology; xxxvii) Corporate support.

02/11/2018
Final Guidance on management of non-performing and forborne exposures.

1. Context

In July 2017, the European Council concluded an Action Plan to tackle non-performing loans (NPLs) in Europe in order to prevent the emergence and accumulation of new non-perfoming exposures (NPEs) on banks' balance sheets. The EBA was invited by the Council to contribute to this Action Plan by providing supervisory actions to work with banks to improve strategies to reduce NPEs.

In this context, the EBA has now published the **Guidelines (GL) on management of NPEs and forborne exposures (FBE)** which specifies sound risk management practices for credit institutions for managing NPE and FBE; sets out requirements on processes to recognise NPEs and FBEs, as well as a forbearance granting process with a focus on the viability of forbearance measures; and establishes requirements for competent authorities' (CA) assessment of credit institutions' NPE management activity as part of the SREP.

In this regard, according to this CP, credit institutions whose NPL level is 5% or above should have in place a NPE strategy as well as a NPE governance and operations framework. Nevertheless, all credit institutions should apply the remain aspects included in these GL.

2. Main points

- **NPE strategy.** Credit institutions should have in place an adequate framework to identify, measure, manage, monitor and mitigate NPEs. Furthermore, in the development of their NPE strategies, credit institutions should take into account relevant consumer protection considerations and requirements, and ensure fair treatment to consumers. To this end, the following steps should be taken:
    - Developing the NPE strategy. The NPE strategy should lay out the credit institution's approach and objectives regarding effective management to maximise recoveries and ultimately a reduction in NPE stocks.
    - Assessment of the operating environment, including internal capabilities to effectively manage and reduce NPEs, external conditions and operating environment, and capital implications of the NPE strategy.
    - Development of the NPE strategy over short, medium and long-term time horizons, including time-bound quantitative NPE targets and foreclosed assets targets where appropriate supported by a corresponding comprehensive operational plan.
    - Implementation of the operational plan, which should rely on suitable policies and procedures, clear ownership and appropriate governance structures in order to integrate the NPE framework as a key element in the corporate culture.
    - Fully embedding the NPE strategy into the management processes of the credit institution, including regular review and independent monitoring.
- **NPE governance and operations**. Credit institutions should have in place appropriate governance structure and operational set-up to address their NPE issues in an efficient and sustainable manner. To this end, this governance and operations framework should cover: i) steering and decision making; ii) NPE operating model; iii) control framework; iv) monitoring of NPEs and NPEs workout activities; and v) early warning processes.
- **Forbearance**. Credit institutions should consider and comply with consumer protection requirements when deciding on which forbearance measures to take. In this regard, they should take into account the forbearance measures and their viability (distinguishing between short-term and long-term measures); as well as sound forbearance processes, covering the forbearance policy, borrower creditworthiness assessment, etc.

2. Main points (continues)

- **NPE recognition**. Credit institutions should, among others:
  - Use the definition of NPE as defined in the Commission Implementing Regulation (EU) 680/2014 on supervisory reporting, in their risk management.
  - Recognise exposures as being past due and exposures as unlikely to pay in accordance with EBA GL on the application of the definition of default.
  - Reclassify NPEs, including forborne exposures, as performing in accordance with Commission Implementing Regulation (EU) 680/2014.
- **NPE impairment measurement and write-offs**. Credit institutions should estimate loss allowances for NPEs and FBEs subject to impairment in accordance with the EBA GL on credit risk management and accounting for expected credit losses (ECL). Further, they should consider in their governance and operations framework the following: i) NPE write-offs; ii) NPE impairment and write-offs; and iii) impairment and write-off procedures.
- **Collateral valuation for immovable and movable property** (e.g. commercial real estate, residential real estate, land, and shipping vessels). Credit institutions should obtain periodic financial information from borrowers and update property valuations regularly in order to assess the quality of exposures on their balance sheets and the adequacy of collateral. To this end, they should consider guidance provided on, among other aspects, governance, procedures and controls; frequency of valuations; valuation methodology; etc.
- **Supervisory evaluation of management of NPEs and FBEs**. CAs should monitor the application of these guidelines by the credit institutions, in particular the development and implementation of NPE strategies and related governance and operational frameworks regarding the elements covered in these GL. In this regard, CAs should request further actions from the credit institutions, if they assess that the proposed remediation actions are not sufficiently effective to eliminate the deviation from the plan.

3. Next steps

- The guidelines will be translated into the official EU languages and published on the EBA website. The deadline for competent authorities to report whether they comply with the guidelines will be two months after the publication of the translations. The guidelines will apply from **30 June 2019.**
- For the first application of these guidelines, credit institutions should calculate their NPL ratios using the reference date of **31 December 2018**.

07/11/2018
2018 EU-wide stress test results.

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 to adverse market developments and shocks. In particular, this exercise is designed to inform the Supervisory Review and Evaluation Process (SREP) carried out by Competent Authorities (CAs).

In this context, the EBA has published the **2018 wide stress test results**, as well as the results for each bank. In particular, this document assesses the results relative to CET1 capital ratios (phase-in and fully loaded), leverage ratio, profitability, and risk exposure amount, considering also the impact of IFRS 9 application.

2. Main points

- **Sample of banks**: 48 EU banks have participated in 2018 (51 EU banks participated in 2016) covering 15 countries in the EU and European Economic Area (EEA) at the highest level of consolidation.
- **Results**:
    - Impact of IFRS 9 implementation: The negative impact of IFRS 9 first implementation on CET1 capital ratio is -20 basis points (bps) on a fully loaded basis, and -10 bps phased-in.
    - Impact on CET1 capital ratios: The weighted average CET1 capital ratio moves from 14.5% phased-in and 14.2% fully loaded at the end of 2017, to 10.3% and 10.1% at the end of 2020 respectively under the adverse scenario, considering the IFRS 9 implementation. Banks report an aggregate decrease of the ratio of 410 bps in 2020 in the adverse scenario, compared to the starting point restated data (395 bps fully loaded basis).
    - Impact on leverage ratio: The impact of the first implementation of IFRS 9 on banks' weighted average leverage ratio is 5 bps phased-in (10 bps fully loaded basis). During the stress test exercise, the weighted average transitional leverage ratio drops under the adverse scenario 95 bps (90 bps fully loaded), from 5.4% in 2017 to 4.4% in 2020, and 5.1% to 4.2% on a fully loaded basis.
    - Impact on profitability: The following elements correspond to the main P&L components of the adverse scenario and the absolute cumulative contribution to profitability and CET1 capital over the time horizon of the exercise:
        - **Net Interest Income (NII)**: Aggregate NII falls by 55 bn€ between 2017-2020 in the adverse scenario compared to the starting point, an 18% drop from 306 bn€ to 251 bn€.
        - **Credit risk**: Credit risk losses over the exercise in the adverse scenario register a total of 358 bn€, of which 354 bn€ come from financial assets at amortised cost, which as a whole led to a -425 bps impact on the CET1 capital ratio.
        - **Market risk**: The impact on capital ratios coming from the market risk methodology in the first year of the adverse scenario is -94 bn€ (-110 bps), of which -63 bn€ (-75 bps) have an impact in the P&L account, the rest being accounted for in OCI. In this exercise, the methodology includes two additional features: the liquidity and model uncertainty shock for L2 and L3 instruments, as well as the requirements for projecting the clients revenues.
        - **Conduct risk and other operational risk**: Aggregate cumulative operational risk losses in the adverse scenario are 82 bn€, which has an impact of -100 bps in CET1, of which 65 bps are attributable to behavioral risk losses.
        - **Non-interest income and expenses**: The combined decrease of these sources of income is 25 bn€ or 15% from 2017 to 2020 in the adverse scenario. Among this exercise, the projection of dividend income and Net Fees and Commissions Income (NFCI) was carried out by making use of their own models and methodologies, but subject to a minimum reduction in the adverse scenario.
    - Impact on Risk Exposure Amount (REA): Under the adverse scenario, total exposure increases by 12% at the end of 2020 compared to the starting point, driving an impact on CET1 capital ratio of -160 bps. This increase is mainly driven by the increase on the exposure for credit risk and, in particular, by the IRB exposure.

19/11/2018
Final RTS on the specification of the nature, severity and duration of an economic downturn.

1. Context

Under the CRR, institutions shall use LGD and conversion factor (CF) estimates that are appropriate for an economic downturn if those are more conservative than the respective long-run average. In March 2017, the EBA launched a first consultation on RTS specifying the nature, severity and duration of an economic downturn, according to which institutions shall estimate the downturn LGD and CF.

In this context, following the second consultation paper launched in May 2018, the EBA has now published **Final RTS on the nature, severity and duration of an economic downturn**, which require institutions to consider relevant macroeconomic and credit factors when specifying the nature of an economic downturn, among other aspects.

2. Main points

- **Definition of an economic downturn**. These RTS set out that an economic downturn should be defined via three aspects which will be detailed below:
    - Its <u>nature</u> which is specified through macroeconomic or credit-related factors (i.e. economic factors) that are explanatory variables or indicators of the business cycle for the considered type of exposure.
    - Its <u>severity</u> which is specified as the set of the most severe values observed over a given historical period on the relevant economic factors.
    - Its <u>duration</u> which is specified via the concept of the downturn periods (i.e. period of time of at least 12 months during which the most severe values of several correlated relevant economic factors are reached simultaneously or shortly after each other).
- **Nature of an economic downturn**. These RTS establish that institutions shall identify the nature of an economic downturn by considering several economic factors as relevant:
    - For <u>all exposures</u>, factors such as: GDP, unemployment rate, etc.
    - Additionally, <u>other factors</u> regarding sector or industry-specific indices (for exposures to corporates and retail SMEs), house prices or house price indices (for residential real estate exposures to corporates and retail obligors), etc.
- **Severity of an economic downturn**. These RTS set out that institutions shall identify the severity of an economic downturn which shall be the most severe value relating to a 12-month period observed on the historical values of this economic factor for a minimum period that shall be one of the following: i) the preceding 20 years to the point in time at which the institution identifies an economic downturn; ii) a minimum period shorter than the precedent 20 years, if the considered relevant economic factor has been subject to a significant change and; iii) a period longer than the preceding 20 years, where the values observed are not sufficiently severe.
- **Duration of economic downturn**. These RTS establish that institutions shall apply a 12-month minimum duration for each downturn period which shall be the period where the most severe values are observed on the relevant economic factors selected and associated to the downturn period under consideration. Nevertheless, institutions shall apply a duration longer than 12-months in certain cases: i) where the historical data shows that the economic factors associated to the downturn period under consideration do not significantly deviate from their most severe values in a period longer than 12-month; ii) where the downturn period under consideration relates to different economic factors, the duration of this downturn period shall be long enough to cover all the peaks and troughs related to the most severe values of each of the economic factors belonging to the downturn period under consideration; and iii) the peaks or troughs related to the most severe value of one economic factor shows adjacent peaks or troughs related to the same overall economic condition.
- **Review of the specification of an economic downturn**. These RTS set out that institutions shall review their specification of an economic downturn at least annually and update it if a new downturn period has been identified.

3. Next steps

- These Final RTS shall enter into force on the **twentieth day** following that of its publication in the Official Journal of the European Union (OJEU).
- The Final RTS on an economic downturn will apply from **1 January 2021**.

13/12/2018

- **Final Guidelines on STS criteria for non-ABCP securitisation**
- **Final Guidelines on STS criteria for ABCP securitisation**

1. Context

In January 2018 the new EU securitisation framework, which comprises of the Regulation 2017/2402 (Securitisation Regulation) and of the Regulation 2017/2401, containing targeted amendments to the CRR with regards to securitisation, has entered into force with the aim to build and revive a sound and safe securitization market in the EU.

In this context, following the public consultation launched in April 2018, the EBA has published the **Final Guidelines (GL) on simple, transparent and standardised (STS) criteria for non asset-backed commercial paper (ABCP) securitisation**; and **Final GL on STS criteria for ABCP securitisation**, which will provide a harmonised interpretation of the criteria for the securitisation to be eligible as STS. In particular, these documents clarify and ensure common understanding of all the STS criteria, including those related to the expertise of the originator and servicer, the underwriting of standards, exposures in default and credit impaired debtors, and predominant reliance on the sale of assets.

These GL will be applied on a cross-sectoral basis throughout the EU (e.g. originators, investors) with the aim of facilitating the adoption of STS criteria, and applying a more risk-sensitive regulatory treatment under the new EU securitisation framework.

2. Main points

Final GL on the STS criteria for non-ABCP securitisation

- **Criteria related to simplicity**. This GL sets out criteria regarding: true sale, assignment or transfer with the same legal effect, representations and warranties; eligibility criteria for the underlying exposures, active portfolio management; homogeneity, obligations of the underlying exposures, periodic payment streams, no transferable securities; underwriting standards, originator's expertise; no exposures in default and to credit-impaired debtors/guarantors; at least one payment made; and no predominant dependence on the sale of assets.
- **Criteria related to standardisation**. This GL establishes criteria on: appropriate mitigation of interest-rate and currency risks; referenced interest payments; requirements in the event of enforcement or delivery of an acceleration notice; non-sequential priority of payments; early amortisation provisions/triggers for termination of the revolving period; expertise of the servicer; remedies and actions related to delinquency and default of debtor; and resolution of conflicts between different classes of investors.
- **Criteria related to transparency**. This GL includes criteria on: data historical default and loss performance; verification of a sample of the underlying exposures; liability cash flow model; environmental performance of assets.

Final GL on the STS criteria for ABCP securitisation

- **Transaction-level criteria**. This GL establishes the criteria regarding: true sale, assignment or transfer with same legal effects, representations and warranties; eligibility criteria for the underlying exposures, active portfolio management; no exposures in default and to credit-impaired debtors/guarantors; at least one payment made; no predominant dependence on the sale of assets; appropriate mitigation of interest-rate and currency risks at ABCP transaction level; remedies and actions related to delinquency and default of debtor; data on historical default and loss performance; homogeneity, obligations of the underlying exposures, periodic payment streams, no transferable securities; referenced interest payments; requirements in the event of the seller's default or an acceleration event; underwriting standards, seller's expertise; triggers for termination of the revolving period in case of a revolving ABCP transaction; and transaction documentation.
- **Programme-level criteria**. This GL sets out criteria on: limited temporary non-compliance with certain STS transaction-level criteria; no resecuritisation; appropriate mitigation of interest-rate and currency risks at ABCP programme level; documentation of the ABCP programme; and expertise of the servicer.

3. Next steps

- These Final GL on STS criteria for non-ABCP and ABCP securitisation will apply from **15 May 2019**.

17/12/2018
Consultation Paper on Guidelines on ICT and security risk management.

1. Context

Information and communication technology (ICT) risk is defined as the current or prospective risk of losses due to the inappropriateness or failure of the hardware and software of technical infrastructures, which can compromise the availability, integrity, accessibility and security of such infrastructures and of data. Due to the increase of ICT risk, including security risks, in recent years, the EBA published Guidelines on security measures for operational and security risks of payment services under the PSD2 in December 2017.

In this context, the EBA has published a **Consultation Paper (CP) on Guidelines (GL) on ICT and security risk management** which establishes requirements for credit institutions, investment firms and payment service providers (PSPs) on the mitigation and management of their ICT risks and aims to ensure a consistent and robust approach across the Single market. In particular, this CP outlines expectation in relation to governance, risk assessment process, information security requirements, ICT operational management, security in the change and development processes and business continuity management to mitigate ICT and security risks, among others.

2. Main points

- **Principle of proportionality**. This CP sets out that all financial institutions should comply with its provisions in a way that is proportionate to the financial institutions' size, their internal organisation, the nature, scope, complexity and riskiness of the services and products that the financial institutions provide or intend to provide.
- **ICT governance and strategy**. This CP focuses on the management and mitigation of ICT risks through establishing sound internal governance and an internal control framework that sets clear responsibilities for financial institutions' staff including for the management bodies. It requires establishing the financial institutions' ICT strategy, and the management and mitigation of ICT risks through the three lines of defence, where applicable.
- **ICT risk management framework**. This CP requires financial institutions to maintain an up-to-date inventory of their business functions, supporting processes and information assets, classify them in terms of criticality, and assess operational risks related to ICT risks that impact them.
- **Information security**. This CP sets out requirements for information security to the extent that the information is held on ICT systems. Moreover, it defines requirements to implement a high degree of information security measures, including the establishment of an independent information security function; having an information security policy in place; testing information security measures; and establishing a training programme for all staff.
- **ICT Operations management**. This CP specifies high level principles on how ICT operations should be managed, including requirements to automate ICT operations, implement logging and monitoring procedures for critical ICT operations, or to maintain an updated inventory of their ICT assets, among others. Financial institutions should also establish and implement an incident and problem management process.
- **ICT Project and Change management**. This CP describes requirements for ICT project management, including the acquisition, development and maintenance of ICT systems and services. Financial institutions should ensure that changes to production systems are assessed, tested, approved and implemented in a controlled manner.
- **Business continuity management**. This CP specifies expectations with regard to business continuity management and developing response and recovery plans, including testing, and consequent update based on the testing results. Financial institutions should ensure that they have effective crisis communication measures in place.
- **Payment service user (PSUs) relationship management**. This CP prescribes requirements for PSUs relationship management, including allowing PSUs to disable specific payment functionalities (where product functionality permits), receiving alerts on initiated and/or failed attempts to initiate payment transactions, and providing PSUs with assistance on questions and requests for support.

3. Next steps

- Comments to this CP shall be submitted by **13 March 2019**.
- The Final GL will repeal the Guidelines on security measures for operational and security risks of payment services under the PSD2 published in December 2017.

17/12/2018

- **2018 Risk Assessment of the European Banking system**
- **2018 EU-wide transparency exercise**

1. Context

The EBA has published its **annual Risk Assessment Report (RAR)**, which describes the main developments and trends that have affected the EU banking sector since the end of 2017 and provides an outlook on the main risks and vulnerabilities.

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 the level of liabilities, operational risks or risks to the global economy.

Moreover, along with the RAR the EBA has published the **results of the EU-wide 2018 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 130 banks at the highest level of consolidation in the EU.

2. Main points

- **Sample of banks in the RAR**: 187 banks from 25 European Economic Area countries (150 banks at the highest EU level of consolidation). Based on total assets, this sample covers about 80% of the EU banking sector.
- **Reference date of the RAR**: the data presented in the RAR is as of June 2018.
- **Data for the RAR**: this report 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 continued to benefit from the positive macroeconomic developments in most European countries, which contributed to the increase in lending, further strengthening of banks' capital ratios and improvements in asset quality.
  - Capital position. The EU banks' solvency ratios have increased, despite rising RWA during the last two quarters. The aggregate CET1 capital ratio is 14.5% (14.3% fully loaded). The Tier 1 capital ratio and the total capital ratio reached 16.0% and 18.8%, respectively.
  - RoE. The aggregate weighted average RoE is 7.2% as of June 2018. Profitability has virtually not changed since last year, although it has benefited from the reduction of impairments and the increase of net fee and commission income.
  - NPL ratio. The average NPL ratio decreased from 4.4% to 3.6% between June 2017 and June 2018. The 2018 NPL ratio is the lowest since the NPL definition was harmonised across the EU in 2014, when it stood at 6.5%.
  - Coverage ratio of NPL. This ratio increases to 46.0%, compared to 45.0% in June 2017.
  - Liabilities position. Despite increasing stable customer deposit funding, banks are facing key challenges on the liability side (e.g. replacing financing from central banks or meeting the MREL).
  - Operational risks. Information and communication technology related (ICT) risks are currently one of the main challenges for the EU banks, with cyber risks and data security being the main drivers. At the same time, conduct and legal risks, including anti-money laundering regulations (AML), have been on the rise in 2018.
  - Risks to the global economy. Looking forward, geopolitical tensions are increasing, coupled with uncertainties surrounding financial and economic conditions in emerging market economies. Banks need to be prepared for adverse scenarios, which might impact funding, asset quality and profitability.

Overview of key figures:

CET1 ratio (transitional)	CET1 ratio (fully loaded)	RoE	NPL ratio	Coverage ratio of NPL	Leverage ratio (fully phased-in)
14.5%	14.3%	7.2%	3.6%	46.0%	5.1%

Reference date as of June 2018

18/12/2018
Final GL on disclosure of NPE and FBE.

1. Context

In July 2017, the Council defined an Action Plan to tackle non-performing loans (NPLs) in Europe in order to prevent the emergence and accumulation of new non-perfoming exposures (NPEs) on banks' balance sheets. The Council invited the EBA, among other authorities, to contribute to this Action Plan by providing supervisory actions to work with banks to improve strategies to reduce NPEs.

In this context, following the consultation launched in April 2018, the EBA has now published **Final Guidelines (GL) on disclosure of NPEs and forborne exposures (FBEs)**, which specifies the information related to these exposures and foreclosed assets that banks should disclose and provides uniform disclosure formats. In particular, these GL cover the scope and ten disclosure templates, of which four are applicable to all credit institutions and six apply only to significant credit institutions with a gross NPL ratio at a level of 5% or above.

2. Main points

- **Scope**. These final GL include templates that are applicable to all credit institutions that are subject to all or some disclosure requirements under the CRR, as well as other templates that are only applicable to those credit institutions that comply with the following criteria:
    - Significance. If they meet one or more of the following criteria are significant:
        - The credit institution is one of the **three largest credit institutions** in its home Member State.
        - The credit institution's consolidated assets exceed **30 billion €**.
        - The credit institution's 4-year average of total assets exceeds **20% of the 4-year average of its home Member State's GDP**.
        - The credit institution consolidated exposures exceed **200 billion €** or the equivalent in foreign currency using the reference exchange rate published by the ECB applicable at the end of the financial year.
        - The credit institution has been identified by competent authorities as a **G-SII** or as an **O-SII**.
    - Level of NPE reported. If the credit institution is significant and has a gross NPL ratio of 5% or above. For the purpose of this calculation, loans and advances classified as held for sale, cash balances at central banks and other demand deposits are to be excluded both from the denominator and from the numerator.
- **Disclosure templates applicable to all credit institutions**. These templates should be disclosed on a semi-annual basis by credit institutions identified as a G-SII or O-SII, and on an annual basis by all other credit institutions. However, those credit institution that are significant but not systemic and that, at the reference date for half-year disclosures, have a gross NPL ratio of 5% or above should disclose these templates at the half-year reference date.
    - Template 1. Credit quality of forborne exposures.
    - Template 3. Credit quality of performing and non-performing exposures by past due days.
    - Template 4. Performing and non-performing exposures and related provisions.
    - Template 9. Collateral obtained by taking possession and execution processes.
- **Disclosure templates applicable to significant credit institutions with gross NPL ratio of 5% or above**. These templates should be disclosed on an annual basis.
    - Template 2. Quality of forbearance.
    - Template 5. Quality of non-performing exposures by geography.
    - Template 6. Credit quality of loans and advances by industry.
    - Template 7. Collateral valuation - loans and advances.
    - Template 8. Changes in the stock of non-performing loans and advances.
    - Template10. Collateral obtained by taking possession and execution processes - vintage breakdown.

3. Next steps

- These Final GL will apply from **31 December 2019**.

19/12/2018

Consultation Paper on ITS amending Commission Implementing Regulation (EU) 2016/2070 with regard to benchmarking of internal models.

1. Context

According to the CRD IV, competent authorities (CAs) are required to conduct an annual assessment of the quality of internal approaches used for the calculation of own funds requirements. To assist CAs in this assessment, the EBA calculates and distributes benchmark values against which individual institutions' risk parameters can be compared, and that are based on data submitted by institutions as laid out in the European Commission (EC) Delegated Regulation 2016/2070 which specifies the benchmarking portfolios, templates and definitions to be used as part of the annual benchmarking exercises.

In this context, the EBA has now published a **Consultation Paper (CP) on ITS amending EC Regulation 2016/2070 on benchmarking of internal models**, in order to adjust the benchmarking portfolios and reporting requirements in view of the benchmarking exercise that will be carried out in 2020. In particular, this CP introduces changes in the definitions of the credit risk portfolios that are based on three main principles: i) a reduction of the number of portfolios to be reported in order to reduce the complexity of the exercise; ii) a simplification of the portfolio's design by a closer alignment to the COREP's structure; and ii) an implementation of stable portfolios definitions for the future. Further, this CP requires more information regarding the model used for pricing for the market risk part of the exercise.

2. Main points

- **Credit risk**. The proposed changes in the definitions of the credit risk portfolios are the following:
    - A reduction in the number of portfolios submitted. This CP proposes to reduce its number by limiting the portfolios which were collected for all risk types. Moreover, homogeneous portfolios in terms of rating, country, credit risk mitigation (CRM) and sectors covered will be collected in an independent manner, instead of achieving homogeneity of these characteristics simultaneously.
    - A simplification and alignment in structure. This CP proposes to simplify the portfolio's design by identifying specialised lending as a separate exposure class in the definition of the Low Default Portfolios (LDP), and by reflecting the full exposure class breakdown in COREP in the High Default Portfolios (HDP). Moreover, it is proposed to align the portfolio breakdown of HDP and LDP portfolios at least as regards the breakdown by CRM to the extent possible.
    - A number of technical refinements. This CP proposes to include certain refinements in the existing breakdowns of HDP and LDP portfolios, such as the inclusion of covered bonds, an update of the Indexed loan-to-value range (ILTV), Statistical Classification of Economic Activities of the EU (NACE) and CRM splits, and the introduction of a sub sample of large corporates with revenue below or above 500m€.
- **Market risk**. The proposed changes require institutions to submit, in a non-aggregated way, the pricing information for the benchmark instruments (e.g. risk of equity instruments, or risk of debt instruments) together with the initial market valuation (IMV), the price factors assigned to the instruments as well as the sensitivities of the instruments with regards to the assigned price factors.

3. Next steps

- Comments to this CP shall be submitted by **31 January 2019**.
- These revised benchmarking portfolios and reporting requirements are expected to be applicable for the submission of initial market valuation data in **Q3 2019** and of other market and credit risk data in **1H 2020** (i.e. with reference date 31 December 2019 for credit risk).

EBA EUROPEAN BANKING AUTHORITY

20/12/2018
Report on first observation on the impact and implementation of IFRS 9 by EU institutions.

1. Context

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

In this context, the EBA has now published a **Report on first observation on the impact and implementation of IFRS 9 by EU institutions**, which scrutinises the effective implementation of this standard by European institutions and its impact as initially observed. In particular, this Report provides preliminary observations on the first stages of implementation of IFRS 9, although it does not include any specific recommendations, as it is intended to be mainly factual.

2. Main points

- **Sample**: 54 institutions across 20 Member States, at the highest level of consolidation. The sample selected, which is the same as the one used in the two previous impact assessments, is considered representative of the banking sector in the EU.
- **Sources of information**: the quantitative data used for the purpose of this assessment correspond to the 2Q2018 supervisory data submitted by institutions (COREP and FINREP templates).
- **Main observations**:
    - The IFRS 9 day-one impact on CET1 ratios is broadly consistent with the impact forecasted by banks at the time of the second EBA impact assessment (second IA). In particular, the negative CET1 day-one impact reported by a sub-sample of banks for which the information was available for both exercises (i.e. 38 banks) corresponds to 47 bps (42 bps in the second IA) on simple average and 27 bps (31 bps in the second IA) on weighted average of total assets of the banks in the sample.
    - Banks using mainly an IRB approach experienced a smaller negative impact in terms of the CET1 fully loaded ratio (19 bps on simple average) than banks mainly using an SA approach for credit risk (157 bps on simple average), on the transition date. The increase in provisions on day one is higher for mainly IRB banks (11.4%) than for mainly SA banks (7.4%). The difference in relative terms between the impact on provisions and the corresponding impact in CET1 terms could be mainly attributed to the differences in terms of regulatory calculations, where, for IRB banks, regulatory expected losses are already reflected in CET1.
    - The classification and measurement impact on transition to IFRS 9 seems to be considered relevant only for a minority of banks in the sample, as the balance sheet structure for the banks in the sample remains broadly the same.
    - Regarding the solely payments of principal and interest (SPPI) test, it seems to have a limited impact in terms of mandatorily classifying financial instruments in the residual category (fair value through profit or loss (FVPL).
    - The supervisory data for the 2Q2018 indicates that 85% of on-balance-sheet exposures are allocated to stage 1, 8% to stage 2 and 7% to stage 3.
    - In some cases the 90 days past due criterion does not lead to transfer to stage 3, as it was observed that some of the exposures more than 90 days past due are not classified in stage 3. Regarding the consideration of the 30 days past due criterion for transfers to stage 2, the observation is similar.
    - Regarding the transfers between stages, considering the supervisory data for the 2Q 2018, the most frequent transfers occurred from stage 3 to stage 1 or 2.
    - Finally, regarding the application of IFRS 9 transitional arrangements, the CET1 impact resulting from the add-back of provisions (i.e. under Regulation 2017/2395 on transitional arrangements for mitigating the impact of IFRS 9) for all the banks in the sample corresponds to 118 bps on simple average (48 bps on weighted average).

3. Next steps

- The EBA will carry out **further work on IFRS 9 modelling aspects** to better understand the practices followed by banks and assess which aspects might merit further investigation. In this regard, the EBA is planning to monitor some qualitative dimensions as well.

EUROPEAN CENTRAL BANK
EUROSYSTEM

31/10/2018
SSM supervisory priorities for 2019.

1. Context

The ECB has published its **2019 priorities for supervising significant banks** in the euro area, which warrants a continuation of the high-level priority areas from 2018, albeit with amendments. They build on an assessment of the key risks faced by supervised banks (e.g. geopolitical uncertainties, 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 **three areas** that will guide banking supervision are: i) credit risk; ii) risk management, and iii) activities comprising multiple risk dimensions. For each of the priorities, a number of supervisory initiatives will be carried out. Furthermore, major supervisory activities on business models, area included among the high-level priority areas in 2018, have now been finalised, although business models will continue to be supervised day-to-day by the Joint Supervisory Teams (JSTs).

2. Main points

- **Credit risk**. The ECB will continue to supervise in 2019:
  - Follow-up on non-performing loans (NPL) guidance. The current aggregate level of NPLs in the euro area remains elevated compared to international standards, therefore ECB Banking Supervision will continue to address the stock of NPLs and will remain to cooperate with affected institutions. The aim is to ensure continued progress to reduce legacy risks and achieve consistent coverage of the NPLs over the medium term.
  - Credit underwriting criteria and exposure quality. The quality of banks' lending practices will be examined and lending standards will be scrutinised with a view to mitigating potential risks. In addition, the quality of specific asset class exposures will be examined through dedicated on-site inspections related to areas such as real estate and leverage finance.
- **Risk management**. The ECB will carry out as part of day-to-day supervision numerous activities, including the assessment of banks' governance procedures. Moreover, it will give special attention to the following initiatives:
  - Targeted review of internal models (TRIM). The ECB will continue in 2019 with the overarching aim of reducing unwarranted variability of risk-weighted assets and confirming the adequacy of banks' approved Pillar I internal models through its TRIM on-site investigations. It also plans to update the existing ECB guide to internal models.
  - ICAAP and ILAAP. Improvement of banks' ICAAPs and ILAAPs, captured in the finalised ECB guides on ICAAP/ILAAP available from 2019 onwards. Work will also continue on improving the transparency around the risk-by-risk composition of the Pillar II capital requirements.
  - IT and cyber risk. ECB Banking Supervision will launch a number of on-site inspections on IT risk-related topics. In addition, significant institutions will continue to report any significant cyber incidents to the ECB under the SSM cyber incident reporting process.
  - Liquidity stress test. The 2019 stress test, as in 2017, will seek to assess banks' resilience against liquidity shocks.
- **Multiple risk dimensions**. Supervisory activities planned for 2019 to address multiple risk dimensions include:
  - Brexit preparations. Supervisors will closely monitor the implementation of banks' Brexit plans, scheduled for March 2019, to ensure that they comply with supervisory expectations. In addition, ECB Banking Supervision will further prepare to take over the direct supervision of a number of institutions that are newly identified as significant owing to the relocation of activities from the United Kingdom to an SSM country.
  - Trading risk and asset valuations. ECB Banking Supervision will continue its dialogue to ensure that banks prepare their systems appropriately to comply with the new market risk framework (FRTB). Likewise, a number of on-site missions with an enhanced focus on trading and market risk aspects are also planned.

12/11/2018

- **Guide to the internal capital adequacy assessment process (ICAAP)**
- **Guide to the internal liquidity adequacy assessment process (ILAAP)**

1. Context

In 2016, the ECB published its expectations for ICAAPs and ILAAPs for supervised banks. Following a careful assessment, the ECB identified significant differences in the approaches taken by individual banks and a need for improvements at all banks. Further, in early 2017 the ECB launched a multi-year plan for ICAAP and ILAAP for significant institutions in order to foster improvements.

In this context, following the publication of two Draft Guides in March 2018, the ECB has published a **Final Guide to the ICAAP** and a **Final Guide to the ILAAP** with the aim to develop a more detailed set of supervisory expectations regarding these two processes. In particular, these Guides include seven principles for the ICAAP and seven principles for the ILAAP, which are defined in parallel taking into account each risk's specifications, regarding several aspects such as internal governance, management, continuity of the institutions, and material risks.

These Final Guides are relevant for any credit institution that is considered to be a significant supervised entity according to the SSM Framework Regulation.

2. Main points

Final Guide to the ICAAP

- **Principle 1. The management body is responsible for the sound governance of the ICAAP**. The ECB establishes that the management body shall approve the key elements of the ICAAP (e.g. governance framework and internal documentation requirements) and shall provide an assessment of the capital adequacy of the institution by producing the capital adequacy statement (CAS). Further, it is expected to approve an ICAAP governance framework with a clear and transparent assignment of responsibilities, adhering to the segregation of functions.
- **Principle 2. The ICAAP is an integral part of the overall management framework**. The ECB sets out that, among others, the quantitative and qualitative aspects of the ICAAP are expected to be consistent with each other and with the institution's business strategy and risk appetite. The ICAAP is expected to be integrated into the business, decision-making and risk management processes of the institution, as well as to be consistent and coherent throughout the group.
- **Principle 3. The ICAAP contributes fundamentally to the continuity of the institution by ensuring its capital adequacy from different perspectives**. The ECB states that the ICAAP plays a key role in maintaining the continuity of the institution by ensuring its adequate capitalisation. In this regard, the institution is expected to implement a normative perspective (i.e. fulfillment of capital-related regulatory and supervisory requirements) and an economic perspective (i.e. identification and quantification of all material risks that may cause economic losses and deplete internal capital).
- **Principle 4. All material risks are identified and taken into account in the ICAAP**. The ECB establishes that the institution is expected to identify at least annually risks that are material, using its own internal definition of materiality. This risk identification process is expected to result in a comprehensive internal risk inventory.
- **Principle 5. Internal capital is of high quality and clearly defined**. The ECB establishes that the definition of internal capital is expected to be consistent with the economic capital adequacy concept and internal risk quantifications of the institution. Further, internal capital is expected to be of sound quality, and determined in a prudent and conservative manner.
- **Principle 6. ICAAP risk quantification methodologies are adequate, consistent and independently validated**. The ECB sets out that the institution is responsible for implementing adequate risk quantification methodologies under both the economic and normative perspectives, and for establishing and implementing an effective data quality framework. The key parameters and assumptions are expected to be consistent throughout the group and between risk types; and all risk quantification methodologies are expected to be subject to independent internal validation.
- **Principle 7. Regular stress testing is aimed at ensuring capital adequacy in adverse circumstances**. The ECB states that the institution is expected to define an adequate stress-testing programme for both normative and economic perspectives. In addition, the institution is expected to conduct reverse stress testing in a proportionate manner.

2. Main points (continues)

Final Guide to the ILAAP

- **Principle 1. The management body is responsible for the sound governance of the ILAAP**. The ECB establishes that the management body shall approve the key elements of the ILAAP (e.g. governance framework and internal documentation requirements) and shall provide an assessment of the capital adequacy of the institution by producing the capital adequacy statement (LAS). Further, it is expected to approve an ILAAP governance framework with a clear and transparent assignment of responsibilities, adhering to the segregation of functions.
- **Principle 2. The ILAAP is an integral part of the overall management framework**. The ECB sets out that, among others, the quantitative and qualitative aspects of the ILAAP are expected to be consistent with each other and with the institution's business strategy and risk appetite. The ILAAP is expected to be integrated into the business, decision-making and risk management processes of the institution, as well as to be consistent and coherent throughout the group.
- **Principle 3. The ILAAP contributes fundamentally to the continuity of the institution by ensuring its liquidity adequacy from different perspectives**. The ECB states that the ILAAP plays a key role in maintaining the continuity of the institution by ensuring an adequate liquidity and funding position. In this regard, the institution is expected to implement an economic and a normative perspectives (as set out for the ICAAP); and to have a formal liquidity contingency plan (LCP) that clearly sets out the measures for addressing liquidity difficulties under stressed circumstances.
- **Principle 4. All material risks are identified and taken into account in the ILAAP**. The ECB establishes that the institution is expected to identify at least annually risks that are material, using its own internal definition of materiality. This risk identification process is expected to result in a comprehensive internal risk inventory.
- **Principle 5. The internal liquidity buffers are of high quality and clearly defined; the internal stable sources of funding are clearly defined**. The ECB states that the institution is expected to define, assess and maintain internal liquidity buffers and stable sources of funding under the economic perspective.
- **Principle 6. ILAAP risk quantification methodologies are adequate, consistent and independently validated**. The ECB sets out that the institution is responsible for implementing adequate risk quantification methodologies under both the economic and normative perspectives, and for establishing and implementing an effective data quality framework. The key parameters and assumptions are expected to be consistent throughout the group and between risk types; and all risk quantification methodologies are expected to be subject to independent internal validation.
- **Principle 7. Regular stress testing is aimed at ensuring liquidity adequacy in adverse circumstances**. The ECB states that the institution is expected to define an adequate stress-testing programme for both normative and economic perspectives. In addition, the institution is expected to conduct reverse stress testing in a proportionate manner.

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3. Next steps

- These Guides will not replace or supersede any applicable law implementing provisions on ICAAP and ILAAP as set out in the CRD IV.
- The ECB will use these Guides from **1 January 2019** when assessing banks' ICAAPs and ILAAPs.

15/11/2018

Guide to internal models – General topics chapter.

1. Context

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

In this context, following the consultation launched in March 2018, the ECB has now published a **Guide to internal models**, which covers the update of the first chapter of the Guide to the TRIM. In particular, this first chapter is devoted to general topics and contains principles for the following non-model-specific topics: i) overarching principles for internal models, ii) roll-out and permanent partial use, iii) internal governance, iv) internal validation, v) internal audit, vi) model use, vii) management of changes to the IRB approach, and viii) third-party involvement.

Moreover, it should be highlighted that the section on overarching principles for internal models covers all Pillar 1 internal models regarding credit risk, market risk and CCR (unless stated otherwise), whereas all subsequent sections only cover credit risk Pillar 1 models. All other models, including operational risk models, Pillar 2 and managerial models are not included in the scope of this Guide, unless otherwise mentioned.

2. Main points

- **Overarching principles for internal models**. Among others, this Guide sets out that institutions should develop binding group-wide (i.e. consolidated) principles and guidelines relating to the life cycle of internal models; document all internal models; implement a model risk management framework; clearly define the roles and responsibilities of their management body and senior management with regard to internal models and in relation to each risk type; carry out an annual validation of all internal models; and regularly review internal models by an independent internal audit unit.
- **Roll-out and permanent partial use**. This Guide covers the application of the IRB approach (i.e. quantitative and qualitative aspects), governance of the roll-out plan for the IRB approach, changes to the roll-out plan for the IRB approach, and monitoring of compliance with permanent partial use provisions.
- **Internal governance**. This Guide provides principles regarding the materiality of rating systems, the management body and senior management (including decision-making responsibilities, internal reporting, and understanding of the rating systems), and responsibilities of the credit risk control unit (CRCU).
- **Internal validation**. This Guide covers the validation level (consolidated, sub-consolidated or individual basis) at which internal validation should be performed; the content and frequency of tasks of the validation function; as well as the reporting and follow-up to the senior management and the management body.
- **Internal audit**. This Guide establishes that the internal audit unit should carry out, annually and on the basis of up-to-date information, a general risk assessment of all aspects of the rating systems for the purpose of drawing up the appropriate internal audit work plan, and should execute this plan.
- **Model use**. This Guide covers issues regarding the use test requirement; risk management, credit approval and decision-making process; internal capital assessment and allocation; corporate governance functions; and assignment of exposures to grades or pools (including non-rated exposures and outdated ratings, as well as analysis of overrides).
- **Management of changes to the IRB approach**. This Guide sets out that institutions should have in place a policy related to changes to the IRB Approach, including detailed criteria to ensure that the classification of changes is consistent and that any arbitrage in that regard is avoided. Further, this document provides issues regarding the content of the change policy, notification process, classification of changes/extensions, impact assessment process, and re-rating process.
- **Third-party involvement**. This Guide provides preliminary principles on outsourcing and contract requirements, and on third-party involvement in internal functions and tasks (e.g. internal validation and internal audit tasks, and use of external credit risk parameters or ratings).

EUROPEAN CENTRAL BANK

EUROSYSTEM

26/11/2018
Regulation (EU) 2018/1845 on the materiality threshold for credit obligations past due.

1. Context

According to the CRR, the ECB has the power to set a threshold for assessing the materiality of a credit obligation past due that should remain consistent over time. In particular, such materiality threshold brings the added benefit of increased comparability of bank's defaulted exposures among institutions in the same jurisdiction.

In this context, the ECB has published a **Regulation on the materiality threshold for credit obligations past due** in order to define the absolute and relative components of materiality threshold. In particular, this threshold will comprise an absolute component, expressed as a specific maximum amount for the sum of all amounts past due owed by an obligor, and a relative component, expressed as a percentage reflecting the amount of the credit obligation past due in relation to the total amount of all on-balance sheet exposures to that obligor.

2. Main points

- **Scope**. The definition of the materiality threshold will be applied to all significant credit institutions within the SSM, both for retail and for non-retail exposures, irrespective of the method used for the calculation of their risk-weighted exposure amounts.
- **Definition of the materiality threshold**. Credit institutions shall assess the materiality of a credit obligation past due against a threshold, which comprises the following two components:
    - A limit in terms of the sum of all amounts past due owed by the obligor to the credit institution, the parent undertaking of that credit institution or any of its subsidiaries, equal:
        - For retail exposures, to **100€**.
        - For exposures other than retail exposures, to **500€**.
    - A limit in terms of the amount of the credit obligation past due in relation to the total amount of all on-balance sheet exposures to that obligor for the credit institution, the parent undertaking or any of its subsidiaries, excluding equity exposures, equal to 1%.
- **Default of an obligor**. It shall be deemed to have occurred when both of the above-mentioned limits set out are exceeded for 90 consecutive days.

3. Next steps

- The Regulation shall enter into force on the **twentieth day following** that of its publication in the Official Journal of the European Union (OJEU).
- Credit institutions shall apply this threshold no later than **31 December 2020**. Nevertheless, credit institutions shall notify the ECB, before **1 June 2019**, of the exact date on which they will commence applying such threshold.

19/10/2018
2019 Work Programme.

1. Context

The European Supervisory Authorities (ESAs) cooperate closely to ensure cross-sectoral consistency as well as supervisory convergence in line with their institutional role. The three ESAs (EBA, EIOPA and ESMA) regularly coordinate their supervisory activities within the scope of their respective responsibilities and ensure consistency in their practices. The ESAs work, in particular, in the areas of risks and vulnerabilities for financial stability and micro-prudential analysis of cross-sectoral developments, retail investment products, supervision of financial conglomerates, accounting and auditing, and measures combating money laundering. The ESAs, jointly explore and monitor potential emerging risks for financial markets participants and the financial system as a whole.

In this context, the ESAs have published the **2019 Work Programme** through which the joint committee will continue to focus its work on the following aspects: i) Consumer protection and financial innovation; ii) areas of risks and vulnerabilities; iii) anti-money laundering; iv) financial conglomerates. In addition, in this Work Programme, other actions will be carried out by the ESAs during the coming year covering the following aspects: i) issues emanating from the UK withdrawing from the EU; ii) ongoing developments regarding the proposals to enhance the operation of the ESAs; iii) Securitisation Regulation and; v) the work on the long-term performance of retail investment products.

2. Main points

- **Consumer Protection and Financial Innovation**. The ESAs enhances confidence and strengthens the protection of European consumers in relation to banking, insurance and securities products. The following activities are included:
    - PRIIPs work on review of the Regulation and Delegated Regulation
    - PRIIPs Level 3 work
    - Sustainability
    - Follow up on Complaints Handling Guidelines
    - Fintech/Digitalisation of financial services
    - Use of behavioural finance findings for supervisory purposes
- **Risk Assessment**. The analysis will highlight the assessments by the ESAs of key trends and vulnerabilities to financial stability and continue to include appropriate cross-referencing in the sectoral risk reports.
- **Anti-Money Laundering**. In the field of anti-money laundering and countering the financing of terrorism (AML/CFT), the ESAs will continue to provide an important forum for the identification of current and emerging risks and the exchange of information, and good practices in relation to the AML/CFT supervision of credit and financial institutions. In addition, the focus in 2019 will be on the implementation of proposed actions to be set out in the EU AML Roadmap. In particular, the following activities are included:
    - Joint Guidelines on Risk Factors
    - Supervisory cooperation and information exchange
    - Review of Guidelines and Technical Standards
    - EU AML Roadmap Actions
- **Financial Conglomerates**. Includes the effective supplementary supervision of financial conglomerates and discusses the appropriate regulatory and supervisory actions. In particular, this section includes:
    - Annual list of financial conglomerates
    - Specific reporting formats for conglomerates
- **Securitisation**. The Joint Committee will work on new mandates under the Securitisation Regulation, which amend the European Markets Infrastructure Regulation (EMIR).

02/11/2018
Consultation Paper: revised draft ITS on the mapping of ECAIS' credit assessments.

1. Context

In the Implementing Regulations on the mapping of External Credit Assessment Institutions (ECAIs), adopted by the European Commission on 11 October 2016, the three European Supervisory Authorities (EBA, EIOPA and ESMA - ESAs) specified an approach that establishes the correspondence between credit ratings and the credit quality steps defined in the Capital Requirements Regulation (CRR) and in the Solvency II Directive.

In this context, the Joint Committee of the three ESAs has launched a public **Consultation Paper (CP) of a revised draft ITS on the mapping of credit assessments of ECAIs for credit assessment**. In particular, this CP consults on changes to: i) amendments due to the re-allocation of the credit quality, and ii) amendments due to changes in credit rating scales/types.

2. Main points

- **11 ECAIs updated**. The JC of the ESAs is required to monitor the existing mappings and has therefore analysed whether the mapping of existing ECAIs remains appropriate. The review has identified that the existing ITS must be updated for 11 ECAIs, either as a result of i) changes in the existing mappings due to an updated assessment of the risk in line with the EBA methodology, or ii) the need to introduce mappings for new credit rating types subsequently introduced by existing ECAIs.

ECAI	Amendments to:	
	Credit rating scales/types	Credit Quality Steps Allocation
AM Best Europe-Rating Services Ltd. (AMBERS)	Yes	No
BCRA-Credit Rating Agency AD	Yes	No
Capital Intelligence Ratings Ltd	Yes	No
Creditreform Rating AG	Yes	Downgrade
CRIF Ratings S.r.l.	Yes	No
DBRS Ratings Limited	Yes	No
European Rating Agency, a.s.	No	Upgrade
Fitch Ratings Limited	Yes	No
Moody's Investors Service Ltd	Yes	No
Spread Research	Yes	No
S&P Global Ratings	Yes	No

3. Next steps

- Comments on this CP must be sent before the **31st December 2018**.
- This Regulation shall enter into force on the **twentieth day** following that of its publication in the Official Journal of the European Union.

31/10/2018

European enforcers to focus on new IFRS and non-financial information in issuers' 2018 annual reports.

1. Context

The European Securities and Markets Authority (ESMA) has published the **European common enforcement priorities 2018**. It includes the priorities and highlights other considerations for 2018 annual financial reports of listed companies. In addition to the European common enforcement priorities, enforcers might set additional national enforcement priorities focusing on other relevant topics.

2. Main points

- **Priorities related to IFRS financial statements**. This points have being selected based on the significant changes that the new requirements have introduced.
    - IFRS 15. This regulation changes the main notions and principles of revenue recognition. Irrespective of the significance of the impact, entity-specific accounting policies should be clear as to how the IFRS 15 principles apply to the entity's revenue streams. ESMA also reminds issuers of the importance of disclosing the entity-specific transition impact accompanied by explanations for each significant effect having material impact on financial position and performance.
    - IFRS 9. The new standard includes a reclassification of financial assets and financial liabilities upon its initial application. Credit institutions are expected to be most significantly impacted by IFRS 9, but this standard is applicable to all issuers. ESMA expects issuers to provide relevant, material and entity-specific disclosures, taking into account the importance of financial instruments in their business operations. Where appropriate, issuers shall disclose the eventual changes made to accounting policies due to IFRS 9 implementation, such as to policies on modification/de-recognition and write-off of financial assets.
    - IFRS 16. This regulation will replace the requirements on Leases and related interpretations in IAS 17 1 January 2019. ESMA expects that the impacts of the initial application of the new standard will be known or reasonably estimable at the time of the preparation of the 2018 accounts and thus should be disclosed.
- **Topics related to other parts of the annual report**.
    - Non-financial information. Issuers are required to record non-financial information aimed at improving transparency on aspects relating, at a minimum, to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.
    - Alternative Performance Measures (APM). Issuers are required, among others, to disclose definitions of the APMs used and their components as well as the basis of calculation adopted, including details of any material hypotheses or assumptions used. Furthermore, they should provide disclosures that enable investors to understand the extent of and rationale for any changes to the APMs used.

26/10/2018
Analysis of IFRS 17 Insurance Contacts.

1. Context

On 18 May 2017 the IASB published IFRS 17 about Insurance Contracts. Considering that its predecessor, IFRS 4, sets out a limited set of high-level guidelines and disclosure requirements for the accounting of insurance contracts, this new accounting standard means a significant change to insurers' and reinsurers' accounting and consequently their financial statements.

In this context, the European Insurance and Occupational Pensions authority (EIOPA) has published a **Report which includes an analysis of IFRS 17**, presenting several which have been analysed, such as, potential effects on financial stability and the European public good, on product design, supply and demand of insurance contracts; and IFRS 17's practical implementation in light of the applicable inputs and processes for Solvency II. In particular, this report includes analyses on the following aspects: i) expected impact on financial stability and the European public good; ii) potential effects on attractiveness, competitiveness and availability of insurance products; and iii) using solvency II inputs, approaches and processes.

2. Main points

- **Expected impact on financial stability and the European public good.** The following aspects are analysed: i) reliance on principle-based accounting standards; ii) use of reliable and relevant values; iii) recognition of the allocation and magnitude of risks; iv) provision of comparable financial statements; v) provision of clear and understandable financial statements; vi) portrayal of the financial situation (liquidity, profitability, solvency); vii) alignment of accounting rules with sound risk management practices; viii) promotion of a forward-looking recognition of risks; ix) avoidance of negative and promotion of positive externalities; y x) enhancement of market confidence and corporate governance. Concluding on the analysis made, the EIOPA found the following aspects:
    - IFRS 17 is expected to enhance transparency through a risk-oriented and current valuation of insurance obligations and deeper insights in insurers' profitability.
    - The complexity of the accounting according to IFRS 17 system from the inherently complex insurance business and the relatively high degree of optionality and loosely described principles in key areas, such as the risk adjustment or the discount rate.
    - IFRS 17 is expected to reflect volatility in the balance sheet of insurers through a current valuation based on current inputs from financial markets, since both insurers 'assets and liabilities are indeed exposed to interest rate and other financial risks
- **Potential effects on attractiveness, competitiveness and availability of insurance products.**
    - <u>Observable trends and developments in life and non-life insurance</u>. Economic developments have led to significant changes in product design and product availability in the European Economic Area. A greater impact is produced on business strategies, supply of contracts or contract features, pricing and consumers' demand due to the economic reality, than changes to the regulatory framework.
    - <u>Analysis of potential effects of regulatory change.</u> No significant effects have been found in the SII framework and its market-consistent, risk-sensitive valuation on insurers' investments or product availability. Furthermore, Insurers' behaviour is certainly influenced by economic conditions, but is not significantly influenced by the introduction of Solvency II.

2. Main points (continues)

- **Using solvency II inputs, approaches and processes**. The analysis targets key areas and building blocks of IFRS 17's accounting model of IFRS 17, for which the application of Solvency II's valuation elements may be particularly useful. The analysis of those areas could be summarised as follows:
    - Initial recognition of obligations. Expected profits at inception are recognized in the reconciliation reserve (equity) of that period under Solvency II and are allocated over the lifetime of the contract according to the service provided under IFRS 17. This reflective of the different objectives of regulatory and accounting frameworks. The accounting framework needs to present the entity´s performance, including the allocation of gains and losses to specific reporting period.
    - Definition of cash flows. Cash flows and expenses included in the valuation of Solvency II technical provisions are expected to be consistent with IFRS 17 in most cases.
    - Grouping and aggregation of contracts and contract boundaries. The Solvency II requirement to identify homogenous risk groups can be considered as a basis for IFRS 17's requirements on grouping contracts.
    - Determination of the appropriate discount rate. Solvency II's techniques and approaches for the volatility adjustment (VA) and matching adjustment (MA) may be used, taking into consideration IFRS 17-specific assumptions.
    - Risk adjustment. Risk margin in Solvency II is conceptually different from the risk adjustment in IFRS 17 (transfer vs entity-specific). Nevertheless, for the practical implementation of IFRS 17, Solvency II's risk margin's underlying principles, inputs and processes may be considered for IFRS 17, subject to potential adaptation.
    - Reinsurance. According to Solvency II, the measurement of reinsurance contracts held is consistent with the underlying contracts issued, while under IFRS 17 the measurement model is applied separately, using consistent assumptions and inputs, to the reinsurance contract held and to the underlying insurance contracts

02/10/2018
Real Decreto-ley 14/2018, por el que se modifica el texto refundido de la Ley del Mercado de Valores, aprobado por el Real Decreto Legislativo 4/2015.

1. Context

In May 2014, the European Parliament and the Council approved the Directive 2014/65/EU on markets in financial instruments (MiFID II) which aims at making financial markets in the EU more robust and transparent, and establishing a new legal framework that enhances investor protection.

In this context, the Spanish Government has approved a **Real Decreto-ley 14/2018, which amends the consolidated text of the Securities Market Law**, in order to complete the transposition of MiFID II into the Spanish legal system. In particular, this Real Decreto-ley introduces certain amendments to the current Law, including restrictions to the receipt of inducements; higher oversight and control of products; record of telephone conversations or electronic communications; introduction of new requirements for marketing structured deposits; and the requirement to establish a branch in Spain.

This Real Decreto-ley shall apply to all financial instruments whose issuance, negotiation or marketing take place in Spain, to investment firms based in Spain, to market operators of regulatory markets, Multilateral Trading Facility (MTF) or Organised Trading Facility (OTF) based in Spain, as well as those providers of data based on Spain.

2. Main points

- **Restrictions to inducements or retrocessions**. This Real Decreto-ley determines the obligations and conditions needed to receipt inducements for the provision of investment advice by trading companies (mainly credit institutions) for the sale of products generated by managers. Thus, its perception is limited to enhancing the quality of service provided to a client and provided that the inducement does not only generate a profit for the investment firm, but that there is also a benefit for clients.
- **Oversight and control of products**. This Real Decreto-ley established the following:
    - The obligation to design products according to a consistent process and with a correct identification of potential clients (level of financial knowledge, risk profile, etc.), in order to ensure that the product is appropriate for the type of client. This procedures should be approved by the Board.
    - The analysis realised ensures that, once the target client is defined, the characteristics of the financial product are adequate to the needs and characteristics of this group of clients. The analysis should also include all those aspects related to the distribution channels.
- **Recording of telephone conversations and electronic communications**. This Real Decreto-ley establishes that investment firms should develop a register which includes all telephone and electronic communications related to the execution order of clients, with the objective of enhance the supervision tasks of the CNMV and the firm's internal control.
- **Structured deposits**. This Real Decreto-ley establishes the following:
    - Structured deposits (i.e. those whose profitability is linked to other underlying assets) are included within its scope.
    - Credit institutions that marketing structured deposits should comply with institution's corporate governance rules; provide measures regarding the internal organization and measure to avoid conflicts of interest; comply with those obligations on the recording and respect certain conduct rules on the classification of clients, design of products and inducements.
- **Requirement to establish a branch in Spain.** This Real Decreto-ley establishes that the investment firms from third countries should have a branch in Spain when they provide investment services to retail clients in national territory.

3. Next steps

- This Real Decreto-ley has entered into force **on the day following that of its publication** in the Official Journal.

26/11/2018
Real Decreto-ley 19/2018, de servicios de pago y otras medidas urgentes en materia financiera.

1. Context

In November 2015, the European Parliament and the Council published the Directive 2015/2366 (PSD2), on payment services in the internal market, with the aim of creating an integrated framework for this type of services in the EU, addressing new challenges and proposed changes to the card-based transactions through internet or mobile payments, and reinforcing security in electronic payments.

In this context, the Spanish Government has approved the **Real Decreto-ley 19/2018**, on payments services and other financial measures, which transposes the PSD2 in order to adapt this Directive to the Spanish legal system. In particular, this Real Decreto-ley introduces amendments to the current legal framework regarding the scope of the payment services, its legal system, the transparency of the conditions and requirements related to the information, and the relevant rights and obligations of the payment services.

2. Main points

- **General provisions**.
  - The scope is limited to the payment services and two new services are included:
    - **Payment initiation services**, which allow the service provider to certainly communicate to the payee the initiation of the payment transaction. These services offer a solution to both merchants and the payment service user, and are considered as an alternative to card-based payments when ordering online.
    - **Account information services**, which provide the payment service user online aggregated information regarding one or several payment accounts held in one or more providers of payment services, allowing the payment service user to have immediate and global access to its financial information.
  - This Real Decreto-ley is applicable to all services provided in Spain, whatever the origin or final destination of the transactions.
- **Legal framework of the payment institutions**. The Bank of Spain is now in charge of pursuing and granting authorisation to payment institutions, instead of the Ministerio de Economía y Empresa.
- **Transparency regarding the information's conditions and requirements**.
  - The payment service provider will facilitate the payment service user all the information and conditions relating to the provision of payment services, on an easy manner.
  - The payment service provider will not charge the cost of providing information to the payment service user, and the provider must demonstrate compliance with the information's requirements.
- **Rights and obligations**.
  - Third parties access to banks' infrastructure is provided. Thus, it is granted third parties access to the banks customers' accounts, either to aggregate the information or to initiate the payment process, on behalf and with customer's prior authorisation.
  - Strong customer authentication requirement is introduced to access to an online account in order to improve security.
  - The amount of maximum losses that the customer should bear relating to any unauthorised payment transaction resulting from the use of a lost or stolen card or from the misappropriation of another payment instrument is reduced, from 150€ to 50€.
  - The reply's timeframe for the resolution by the institution of the payment services users' complaints is reduced to 15 days, instead of the two months previously established.

3. Next steps

- This Real Decreto-ley has entered into force **on the day following that of its publication** in the Official Journal (BOE). Nevertheless, those provisions on the transparency regarding the information's conditions and requirements, and on the rights and obligations will be applicable **3 months** after its publication on the BOE.

GOBIERNO DE ESPAÑA

19/12/2018
Real Decreto-ley 22/2018, por el que se establecen herramientas macroprudenciales.

1. Context

In the current complex and interconnected financial system, it is essential that competent authorities have a broad catalogue of macroprudential measures that impact the system as a whole, and go beyond the microprudential measures applied to individual financial institutions. Since 2009, several international and European institutions such as the FSB, IMF, or the European Systemic Risk Board (ESRB), have issued recommendations on the introduction of macroprudential measures in the short term in order to address potential vulnerabilities of the financial system.

In this context, the Spanish Government has approved the **Royal Decree-law 22/2018, on macroprudential measures**, with the aim to assign the Bank of Spain (BdE), the National Securities Market Commission (CNMV), and the Directorate General for Insurance and Pension Funds (DGSFP), the needed macroprudential tools to prevent and mitigate systemic risks.

In particular, this Royal Decree-Law introduces amendments on: i) Law 35/2003, on collective investment institutions; ii) Law 10/2014, on the regulation, supervision and solvency of credit institutions; iii) Law 22/2014, regulating venture capital and private equity entities, other closed-ended investment entities and investment managers for closed-ended investment entities; iv) Law 20/2015, on the regulation, supervision and solvency of insurance and reinsurance institutions; and v) Royal Decree-law 4/2015, amending the consolidated text of the Securities Market Law.

2. Main points

- **Law 35/2003, on collective investment institutions**. Regarding the supervision of leverage limits, the adequacy of credit assessment processes and the liquidity risk, it is established that the CNMV may require, on a temporary basis and justifying the need and proportionality of the adopted measure, the collective investment scheme management companies, at individual or regarding a group of them, to strengthen the liquidity level of the managed portfolios of the collective investment institutions and, in particular, to increase the percentage of investment in high liquid assets.
- **Law 10/2014, on the regulation, supervision and solvency of credit institutions**. The following amendments are introduced:
  - <u>Specific countercyclical capital buffer</u>. It is established that the BdE may require the application of a countercyclical capital buffer to all exposures of the institution or group, or to exposures to a particular sector.
  - <u>Limits to sectoral concentration</u>. It is established that the BdE may require credit institutions to limit their exposure to a particular sector if the aggregate exposure of the credit institutions or a subgroup of credit institutions to that economic sector reaches a level that may cause systemic risk.
  - <u>Conditions on loan granting and other transactions</u>. It is established that the BdE may establish limits and conditions on granting loans, acquiring fixed-income securities and derivatives by credit institutions, for those private transactions based in Spain.
- **Law 22/2014, regulating venture capital and private equity entities, other closed-ended investment entities and investment managers for closed-ended investment entities**. Regarding the supervision of leverage limits, the adequacy of credit assessment processes and the liquidity risk, it is established that the CNMV may require, on a temporary basis and justifying the need and proportionality of the adopted measure, the collective investment scheme management companies, at individual or regarding a group of them, to strengthen the liquidity level of the managed portfolios of the collective investment institutions and, in particular, to increase the percentage of investment in high liquid assets.

2. Main points (continues)

- **Law 20/2015, on the regulation, supervision and solvency of insurance and reinsurance institutions**. The following amendments are introduced regarding the macroprudential supervision measures, according with the DGSFP may:
    - Set out exposure limits to certain economic sectors or asset's categories if the aggregate exposure of the insurance and reinsurance institutions, to a specific economic sector reaches a level that may cause systemic risks.
    - Set out limits and conditions on those risk transfer operations and insurance portfolio carried out by insurance and reinsurance institutions, if they involve a shift of investments or a shift of other balance sheet items that may impact the future sustainability of the institutions or the financial system as a whole.
- **Royal Decree-law 4/2015, amending the consolidated text of the Securities Market Law**. Regarding the capacities to strengthen the macroprudential supervision, it is established that the CNMV may introduce limits and conditions to the activity of its supervised institutions in order to avoid an excessive indebtedness of the private sector that could impact the financial stability.

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3. Next steps

- This Royal Decree-law into force on the **day following that of its publication** in the Official Journal.

30/11/2018
2018 stress test results of the UK banking system.

1. Context

In March 2018, the BoE launched the 2018 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 2018 stress test includes the annual cyclical scenario (ACS) and is the first to be conducted under the new accounting standard IFRS 9.

In this regard, the BoE has published the **results of the 2018 stress test of the UK banking system** that have been assessed against the ACS scenario which 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.). Moreover, the stresses applied to these variables were the same as in the 2017 test in order to allow the BoE to isolate, as far as possible, the impact of IFRS 9

2. Main points

- **Aggregate results of the 2018 ACS scenario**. The BoE establishes that UK system is resilient to deep simultaneous recessions in the UK and global economies that are more severe overall than the global financial crisis. In particular, the stress test shows that:
  - Major UK banks have continued to strengthen their capital positions. They started the 2018 stress test with an aggregate CET1 capital ratio nearly 3.5 times higher than before the global financial crisis.
  - Despite facing loss rates consistent with the global financial crisis, the participating banks would have in aggregated at the low point of the stress:
    - A **CET1 capital ratio** of 9.2% in 2019.
    - A **Tier1 leverage ratio** of 4.6% in 2018.
  - In this regard, banks could maintain the supply of credit to UK households and businesses in the stress, with lending to the real economy expanding by around 2% in total over the five years of the scenario.
  - The qualitative review on the bank's stress testing shows that all the banks participating on it have demonstrated an increased awareness of the need to implement effective model risk management framework.
- **Individual results of the 2018 ACS scenario**. This stress test reveals that no bank needs to strengthen its capital position as a result of the stress test, and the Financial Policy Committee (FPC) sets out that any bank was required to submit a revised capital plan. Regarding the minimum stressed ratio after all strategic' management actions (including CRD IV related restrictions) and before the conversion of AT1, the 2018 stress test cover the following individual results:

Participating banks	CET1 Ratio	LR
Barclays plc	**8,9%** (2019)	**3,9%** (2018)
HSBC Holdings plc	**9,1%** (2019)	**4,6%** (2018)
Lloyds Banking Group plc	**9,3%** (2019)	**4,5%** (2019)
Nationwide Building Society	**14,1%** (2019)	**5,1%** (2019)
The Royal Bank of Scotland Group plc	**9,7%** (2019)	**5,2%** (2020)
Santander UK Group Holdings plc	**10,9%** (2018)	**3,9%** (2021)
Standard Chartered plc	**7,9%** (2019)	**4,9%** (2020)

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

18/10/2018

Consultation Paper 23/18, enhancing banks' and insurers' approaches to managing the financial risks from climate change.

1. Context

The PRA published a Draft Supervisory Statement regarding financial risks from climate change, as well as a strategic approach to reduce these risks. In particular, the mentioned financial risks from climate change arise through two primary risk factors: physical and transition. Firstly, physical risks arise from a number of factors, and can be related to specific weather events and longer term shifts in climate. On the other side, transition risks can arise from the process of adjustment towards a low-carbon economy. This adjustment can be influenced by the developments among regulations, or the emergence of disruptive technology or business models.

In this context, the Prudential Regulation Authority (PRA) has published a **Consultation Paper enhancing banks´ and insurers´ approaches to managing the financial risks from climate change**, with the aim of giving proposals for how to address them. In order to do so, these proposals can be summarised under the following sections: i) governance; ii) risk management; iii) scenario analysis; and iv) disclosure.

Moreover, this CP is relevant to all UK insurance and reinsurance firms and groups, i.e. those within the scope of Solvency II and non-Solvency II firms (banks, building societies, and PRA-designated investment firms).

2. Main points

- **Governance**. The PRA proposes that firms fully embed the consideration of the financial risks from climate change into their governance framework.
- **Risk management**. The PRA proposes that firms address the financial risks from climate change through their existing risk management framework, in line with their board-approved risk appetite, while recognising that the nature of financial risks from climate change requires a strategic approach.
- **Scenario analysis**. The PRA proposes that firms use scenario analysis to assess the impact of the financial risks from climate change on their current business strategy, and to inform the risk identification process.
- **Disclosure**. The PRA expects that firms will develop and maintain an appropriate approach to disclosure of climate-related financial risks, which takes into account not only the interaction with existing categories of risk, but also the distinctive elements of the financial risks arising from climate change (far-reaching in breadth and magnitude, uncertain and extended time horizons, foreseeable nature and, dependency on short-term actions).

3. Next steps

- Responses to this Consultation Paper are requested by the **15th January 2019**.

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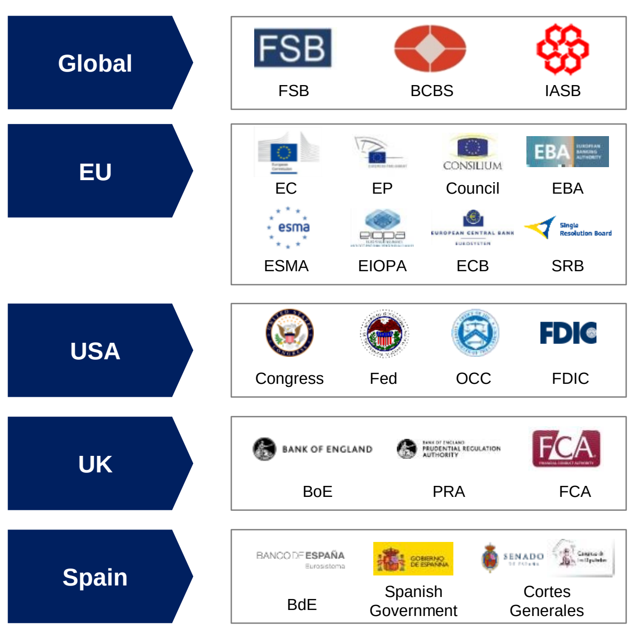
Alert System on Regulation

- 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
- 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.
- Management Solutions' service on financial regulatory alerts is provided through the FinRegAlerts App for mobile devices, which is available for free download in the main app stores:

Regulators



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