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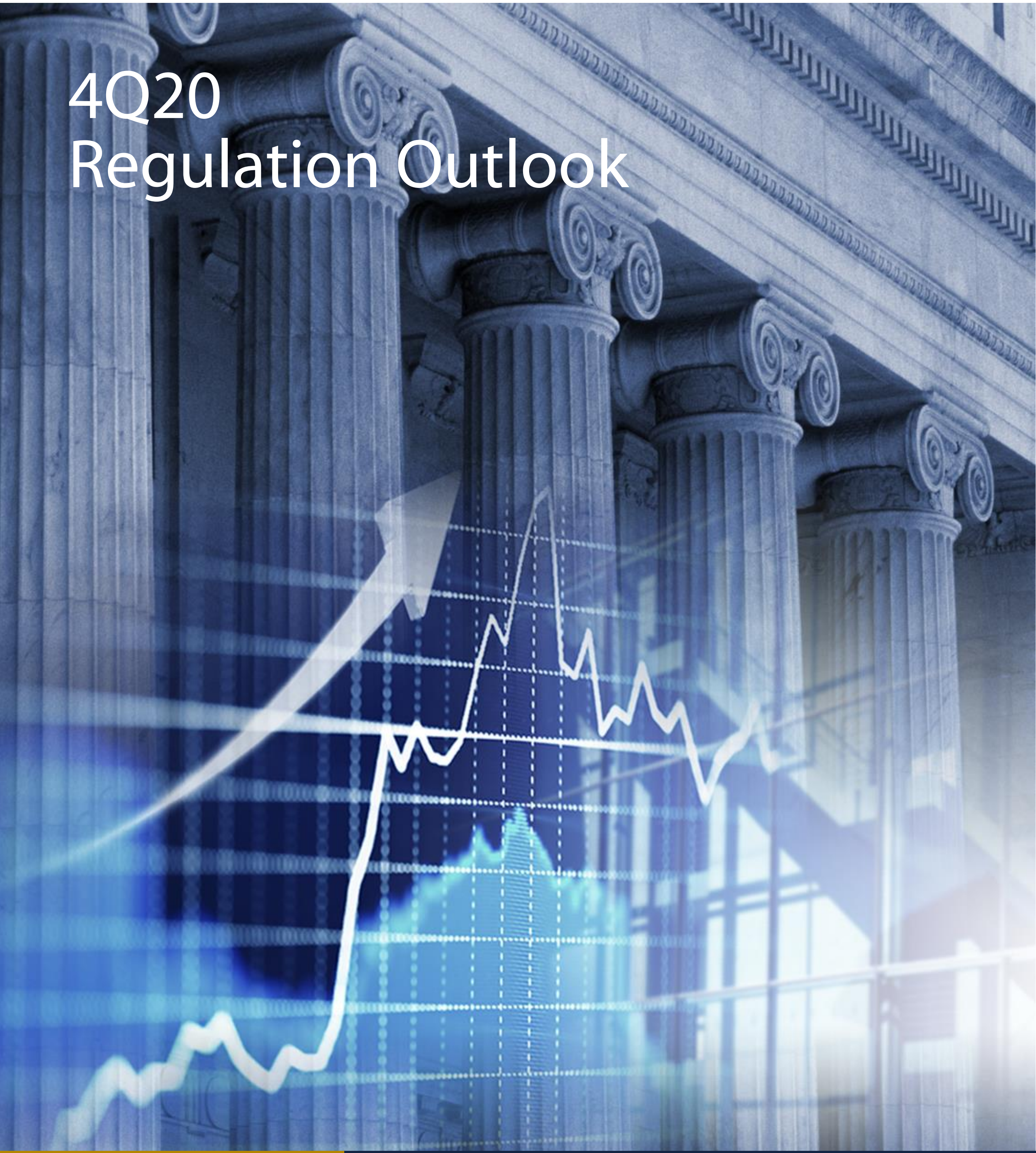
4Q20 Regulation Outlook



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Executive Summary

In the fourth quarter of 2020, the publication of the FSB of the Global Transition Roadmap (GTR) for LIBOR stands out. At European level, several bodies have published standards and guidelines on ESG risks management and supervision. At local level, the PRA has issued several Statements related to prudential treatment of software assets and Pillar 2

Global publications

- At international level, FSB has published the **Global Transition Roadmap (GTR) for LIBOR** which is intended to inform those with exposure to LIBOR benchmarks of some of the steps they should be taking to end-2021.

- For its part, the BCBS has published a **technical amendment on the capital treatment of securitisations of NPLs**. According to BCBS the securitisations of NPLs are subject to different risk drivers compared to securitisations of PL, requiring a specific treatment to reflect these differences in a risk-sensitive and conservative way.

- The BCBS has also published **the results of its latest Basel III monitoring report**.

- Furthermore, the SRB has published the **Multi-Annual-Programme 2021-2023 (MAP)** including Annual Work Programme 2021 where it sets out a roadmap with a clear focus on achieving resolvability and a robust bank resolution of the banks under its remit over the next three years.

European publications

- In Europe, the EC has published the **Delegated Regulation on EU classification system for green investments** with the aim of establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation.

- For its part, the EBA has published the **Discussion Paper on ESG risks management** and supervision which provides a comprehensive proposal on how ESG factors and risks could be included in the regulatory and supervisory framework for credit institutions and investment firms.

European publications (continuation)

- Furthermore, the ECB has published its **Guide on climate-related and environmental risks** which outlines the ECB's understanding of the safe and prudent management of climate-related and environmental risks.

- The EBA has published the Final **methodology, draft templates** and template guidance for the **2021 EU-wide stress test**.

- On the other side, the EBA has published an **update to the reporting framework and the ITS on institutions' Pillar 3**.

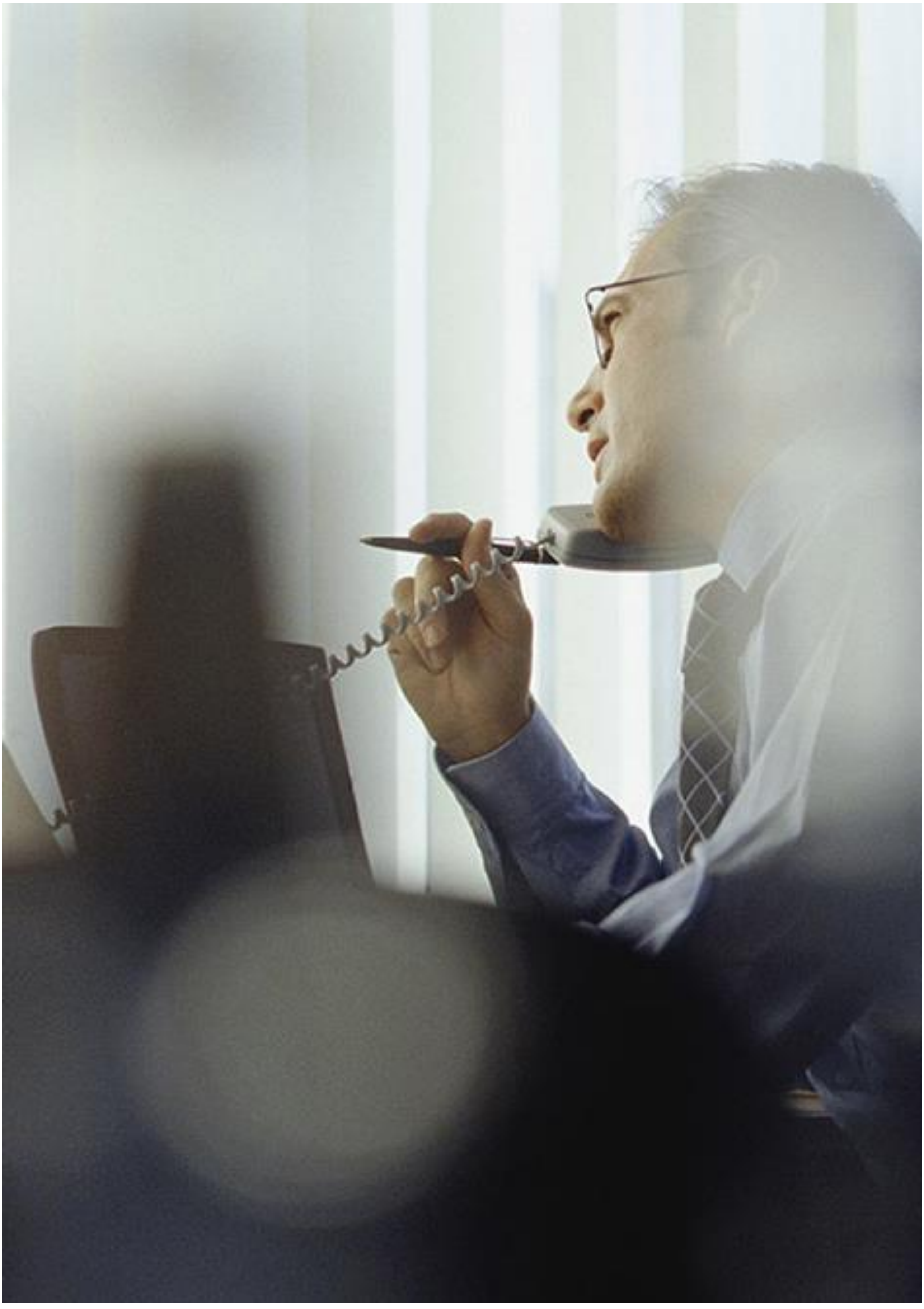
- Furthermore, the EBA has published its updated **impact study** on the implementation of **Basel III**.

Local publications

- In Spain, the Government has published **Law 7/2020 for the digital transformation of the financial system** which set out several measures that ensure that the financial authorities have adequate instruments to continue to comply with their obligations in the digital context and to facilitate the innovative process of access to financing for the various productive sectors.

- In the US, the Fed, FDIC and OCC published a **Final Rule on Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments** with the aim of reducing both interconnectedness within the financial system and systemic risks.

- The PRA has published the **Policy Statement (PS) 29/20** on CRD V and the **statement on the EU requirement on prudential treatment of software assets.** Furthermore, the PRA has published the **Supervisory Statement** (**SS) 31/15 on the ICAAP and SREP and PS on the PRA's methodologies for setting Pillar 2 capital**. Finally, the PRA has published the **SS 32/15 on Pillar 2 reporting**.



Regulatory projections

At European Level, the EBA 2021 EU-wide stress test will be launched and CRR II will be applicable. In Spain, the Circular 2/2020 on advertising of investment products and services will enter into force. In the US, the Final Rule on Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments will enter into force

Regulatory projections

1. Next quarter

- **(Global) January 2021**: the IASB Phase 2 of the Interest Rate Benchmark Reform, with proposed amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16 will apply.
- **(Europe) January 2021**:
  - The EBA GL on the new definition of default will be applicable.
  - The EBA GL on CRM for institutions applying the A-IRB approach will be applicable.
  - The ESMA GL on securitisation repository data completeness and consistency thresholds will apply.
  - Launch of the exercise EBA EU-wide stress test.
- **(Spain) January 2021:** The BoS Circular 5/2020 on public and private financial reporting standards for currency exchange establishments will enter into force.
- **(Spain) February 2021**: The CNMV Circular 2/2020 on advertising of investment products and services will enter into force.
- **(Europe) March 2021**:
  - The EP and the Council Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector will enter into force.
  - The EBA Reactivation of Guidelines on legislative and non-legislative moratoria will apply to this date.

2. Next year

- **(Europe) 2021**: EIOPA's occupational retirement provisions 2019 stress test results will be published.
- **(US) April 2021**: Fed/FDIC/OCC Final Rule on Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments will enter into force.
- **(Europe) June 2021**:
  - The CRR II of the EP and the Council will be applicable with certain exceptions.
  - The EP and the Council adaptation of the investment firms prudential framework will be applicable.
  - The EBA Guidelines on loan origination and monitoring will enter into force.
  - The ESMA Guidelines on outsourcing to cloud service providers will enter into force.
  - The EBA new regulatory framework for investment firms will enter into force.
  - The EBA Final draft comprehensive ITS on institutions' Pillar 3 disclosures will apply.
  - The EBA Final draft ITS on supervisory reporting (Framework 3.0) will apply.
  - The EBA Guidelines specifying the conditions for the application of the alternative treatment of institutions' exposures related to tri-party repurchase agreements for large exposures purposes will apply.
  - The ECB´s temporary exclusion of certain exposures (i.e. leverage ratio denominator) to central banks from the total exposure measure in view of the COVID-19 pandemic.
  - The EBA final Report on management and supervision of ESG risk will be published.
- **(Europe) July 2021**:
  - The amendments introduced by the CRR II on the ECB Guide which updates the risk-type-specific chapters of the Guide to the TRIM on internal models will apply.
  - The EIOPA Guidelines on ICT security and governance will apply.

2. Next year (cont.)

- **(US) July 2021**:
  - FED and FDIC Final Rule on modifications to resolution plan requirements will be applicable for companies subject to category I, II and III standards.
  - Fed/FDIC/OCC Final Rule on NSFR: Liquidity Risk Measurement will apply.
- **(Europe) September 2021**: the EBA's ITS on specific reporting requirements for market risk will apply.
- **(Global) November 2021**: the FSB will update the list of G-SIBs.
- **(Global) December 2021**: the BCBS new assessment methodology for G-SIBs will be applicable.
- **(UK) December 2021**: the PRA will next reassess firms' Systemic Risk Buffer rates.

3. More than a year

- **(Spain) 2022:** it is expected that the BdE Expectations on risks arising from climate change and environmental impact will apply.
- **(Europe) 2022**: the proposed new framework would be introduced in the 2022 EU-wide stress test.
- **(Europe) January 2022**:
  - The EBA GL on IRB parameters estimation will be applicable.
  - The EBA final RTS on an economic downturn as well as the GL for the estimation of LGD appropriate for an economic downturn will be applicable.
  - The ESAs provisions regarding product disclosure in periodic reports RTS on ESG disclosure standards will apply.
  - The EBA GL on CRM for institutions applying the IRB approach with own estimates of LGDs will apply.
  - The EC Delegated Regulation on EU classification system for green investments will apply.
- **(UK) January 2022**:
  - The PRA will require firms to comply with an end-state MREL.
  - The PRA PS 11/20 on credit risk: PD and LGD estimation will enter into force.
- **(US) July 2022**: the Final Rule of the Fed and the FDIC on modifications to resolution plan requirements for covered companies that are triennial reduced filers will apply.
- **(Europe) July 2022**: It will be applicable the EP and Council Directive (EU) 2019/2162 and Regulation (EU) 2019/2160 on exposures in the form of covered bonds.
- **(Europe) December 2022**: the EBA will issue an impact assessment of MREL on banks' profitability.
- **(Global) January 2023**:
  - The revised SA for credit risk, the revised IRB framework, the revised CVA framework, the revised operational and market risk framework published in Basel III and the standard on the minimum capital requirements for market risk by the BCBS will be implemented. Moreover, the LR framework using the revised exposure definition and the G-SIB buffer will be applicable.
  - Most of the new disclosure requirements of the BCBS Pillar III updated framework will have to be implemented.
  - The BCBS technical amendment on the capital treatment of securitisations of NPLs will enter into force.
  - The amendments to IFRS 17 proposed by the IASB will enter into force.
- **(Europe) January 2024**: SRB's deadline of meeting external and internal MREL, including subordination requirements.
- **(Global) January 2028**: an output floor of 72.5% of RWA in the SA approach will be applicable according to the Basel III reform of the BCBS.

Quarterly publications

Summary of outstanding publications of this quarter

FSB FINANCIAL STABILITY BOARD

21/10/2020
Global Transition Roadmap for LIBOR

1. Context

The FSB has identified that continued reliance of global financial markets on LIBOR poses clear risks to global financial stability. The LIBOR benchmarks are not guaranteed to continue to be available after the end of 2021 and therefore preparations should be underway to reduce reliance on these rates well ahead of that point. Use of LIBOR in the five LIBOR currencies (USD, GBP, EUR, JPY and CHF) is widespread internationally. As such, transition away from LIBOR by end-2021 requires significant commitment and sustained effort from both financial and non-financial institutions across many LIBOR and non-LIBOR jurisdictions.

In this context, the FSB has published the **Global Transition Roadmap (GTR) for LIBOR** which is intended to inform those with exposure to LIBOR benchmarks of some of the steps they should be taking now and over the remaining period to end-2021 to successfully mitigate these risks. These are considered prudent steps to take to ensure an orderly transition by end-2021 and are intended to supplement existing timelines/milestones from industry working groups and regulators. However, this does not constitute regulatory advice or affect any transition expectations set by individual regulators, which may require firms to move faster in some instances.

2. Main points

- **Firms should already have at a minimum (and if not, should promptly):**
  - Identified and assessed all existing LIBOR exposures.
  - Identified other dependencies on LIBOR outside of its use in financial contracts.
  - Agreed a project plan to transition in advance of the end of 2021 including clear governance arrangements.
  - Understood industry or regulator recommended best practices in relevant jurisdictions and built these into their plans.
  - Assessed what changes may be needed to supporting systems and processes in order to enable use of alternative reference rates in new and existing contracts.
  - Those who currently provide clients with products that reference LIBOR should have begun to implement a plan for communicating with end-users of LIBOR referencing products maturing beyond end-2021 to ensure they are aware of the transition and the steps being taken to support moving those products to alternative rates.
- **By the effective date of the International Swaps and Derivatives Association (ISDA) Fallbacks Protocol:**
  - Adhere to the ISDA protocol, subject to individual firms' usual governance procedures and negotiations with counterparties as necessary.
  - Providers of cleared and exchange-traded products linked to LIBOR should also ensure that these incorporate equivalent fallback provisions as appropriate.
- **By the end of 2020, at a minimum:**
  - Lenders should be in a position to offer non-LIBOR linked loan products to their customers.
- **By mid-2021, firms should:**
  - On the basis of a full assessment of their stock of legacy contracts, have determined which can be amended in advance of end-2021 and establish formalised plans to do so in cases where counterparties agree.
  - Where LIBOR linked exposure extends beyond end-2021, make contact with the other parties to discuss how existing contracts may be affected and what steps firms may need to take to prepare for use of alternative rates.
  - Have implemented the necessary system and process changes to enable transition to robust alternative rates.
  - Aim to use robust alternative reference rates to LIBOR in new contracts wherever possible.
  - Take steps to execute formalised plans, where realistic, to convert legacy LIBOR-linked contracts to alternative reference rates in advance of end-2021.
- **By end-2021, firms should:**
  - Be prepared for LIBOR to cease.
    - All new business should either **be conducted in alternative rates or be capable of switching at limited notice**.
    - For any legacy contracts for which **it has not been possible to make these amendments**, the implications of cessation or lack of representativeness should have been considered and discussed between the parties, and steps taken to prepare for this outcome as needed.
    - All **business critical systems and processes** should either be conducted without reliance on LIBOR, or be capable of being changed to run on this basis at limited notice.

16/11/2020
2020 list of G-SIBs

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. In addition, the BCBS published a revised version of its methodology, which is expected to be implemented by 2022.

In this context, the FSB has published the **2020 list of G-SIBs**, using end-2020 data and the assessment methodology designed by the BCBS. 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, based on bank data at the end of 2019.

2. Main points

FSB - 2018 list of G-SIBs

- **Compared with the list of G-SIBs published in 2019, the number of banks identified as G-SIBs remains 30:**
    - Three banks have moved to a lower bucket: JP Morgan Chase has moved from bucket 4 to bucket 3, Goldman Sachs and Wells Fargo have moved from bucket 2 to bucket 1.
    - One bank has moved to a higher bucket: China Construction Bank has moved from bucket 1 to bucket 2.
- **The FSB applies the following requirements** to G-SIBs:
    - 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 12- high-level indicators for each bank in the sample used to calculate these denominators.
    - The cut-off score used to identify the G-SIBs and bucket thresholds with the purpose of calculating the specific higher loss absorbency requirements.

3. Next steps

- The FSB will update the list of G-SIBs in **November 2021**.

02/12/2020
Final Technical amendment on the capital treatment of securitisations of NPLs

1. Context

The current BCBS securitisation standard was designed and calibrated using a range of securitisation transactions, all of which involved performing assets, reflecting the predominance of such securitisations in the market. Recent observations on securitisations in which the securitised portfolio consists mostly of non-performing loans (NPLs) have since shed light on potential mis-calibration of the risk weights applicable to these transactions under the Basel III securitisation framework.

In this context, the BCBS has published a **technical amendment on the capital treatment of securitisations of NPLs** to implement certain modifications, without changing any of the existing rules for securitisations of performing assets. The BCBS is of the view that securitisations of NPLs are subject to different risk drivers compared to securitisations of performing assets, which points to a need for a specific treatment to reflect these differences in a risk-sensitive and conservative way.

2. Main points

- **NPL securitisations definition**. This document includes the establishment of a standardised definition of NPL securitisations as securitisation transactions where there is a percentage of at least 90% of defaulted assets in the portfolio at inception and at a later time where assets are added to or removed from the underlying pool due to replenishment, restructuring or any other relevant reason.
    - Re-securitisations are expressly excluded from this definition of NPL securitisations.
    - This definition is a minimum standard, and national supervisors should be able to implement stricter criteria, in particular with the prevailing objective of preventing regulatory arbitrage.
- **SEC-IRBA**. The amendment stablishes a ban on the use of IRB Approach where the bank uses the foundation approach to calculate the K_{IRB}.
- **Risk weight**. The document includes:
    - The introduction of a 100% risk weight floor for exposures to securitisations of NPLs that are risk weighted under the SEC-IRBA or the standardised approach (SEC-SA).
    - For the senior tranches of securitisations of NPLs where the non-refundable purchase price discount is equal to, or greater than, 50% of the securitised portfolio, the risk weight under SEC-IRBA or SEC-SA is 100%.

    All other provisions of the current securitisation standard, including the use of external ratings-based approach (SEC-ERBA) and the possibility of capping the capital requirement for exposures from the same transaction, will also apply to securitisations of NPLs.
- **Securitisation framework**. In conjunction with the foundation IRB parameters ban and the 100% risk weight floor, the current provisions of the securitisation framework continue to apply to all other exposures to NPL securitisations (i.e. senior tranches of non-qualifying NPL securitisations, and mezzanine and junior tranches of all NPL securitisations).
- **Capital requirements**. Those banks that are allowed, under the current rules, to apply a maximum capital requirement for their securitisation exposures in the same transaction can continue to apply the same maximum capital requirement as applicable under current rules. This applies to originator and sponsor banks as well as investor banks using the SEC-IRBA.

3. Next steps

- This amendment to the securitisation standard will come into effect by no later than **1 January 2023**.

11/12/2020

- **BCBS – Basel III Monitoring Report**
- **EBA Report on Basel III Monitoring**

1. Context

In 2016, the BCBS published an updated standard for the regulatory capital treatment of securitisation exposures for simple, transparent and comparable (STC) securitisations. In the same year, the standard on minimum capital requirements for market risk (FRTB) was also published, and it has been recently revised in January 2019. Furthermore, in December 2017, the BCBS published the final set of revisions to the Basel III framework addressing undue variability in risk-weighted assets (RWAs) calculations and amending, credit risk calculation methods (SA and IRB), credit valuation adjustment (CVA), calculation method for operational risk (SMA) which replaces the previous ones, and establishes an output floor. It also modifies the exposure measure of the leverage ratio (LR) and introduces an additional buffer on this ratio for global systemically important banks (G-SIBs).

In this context, the BCBS has published the results of its latest **Basel III monitoring report** which sets out the impact of the finalisation of the Basel III reforms, and it also reflects the finalisation of the market risk framework published in January 2019. In parallel with this report, the EBA has issued a **Report on its Basel III monitoring exercise** which includes a preliminary assessment of the impact of the Basel reform package on EU banks, assuming its full implementation.

2. Main points

BCBS - Basel III Monitoring Report

- **Sample of banks**: 173 banks, including:
  - Group 1: 105 internationally active banks that have Tier 1 capital of more than €3 billion; and where 30 institutions have been designated as G-SIBs.
  - Group 2: 68 banks that have Tier 1 capital of less than €3 billion or are not internationally active (i.e. all other banks).
- **Reference date**: the results are based on data as of 31 December 19. Therefore, the impact of COVID-19 in not taken into account.
- **General aspects**:
  - This Report does not take into account any transitional arrangements (i.e. phase-in of deductions and grandfathering).
  - This Report does not reflect any additional capital requirements under Pillar 2 of the Basel II framework, any higher loss absorbency requirements for domestic systemically important banks, nor does it reflect any countercyclical capital buffer requirements.
  - Prior to Covid-19, large internationally active banks made further progress towards meeting fully phased-in final Basel III capital requirements and their liquidity ratios improved compared with end-June 2019.

	30 June 2019			31 December 2019		
	Group 1	G-SIBs	Group 2	Group 1	G-SIBs	Group 2
Increase of the mínimum requirement of Tier 1 MRC[1]	3.0%	3.4%	8.5%	2.1%	2.2%	8.4%
CET1 ratio (%)	12.2%	12.1%	13.0%	12.5%	12.4%	13.2%
Target capital shortfalls[2] (MM€)	24.7	22.8	3.8	10.7	10.7	2.9
TLAC shortfalls (MM€)	78.0	78.0	N/A	1.9	1.9	N/A

(1) Minimum required capital
(2) Tier 1 + Tier 2

2. Main points (cont.)

EBA Report on Basel III Monitoring

- **Sample of banks**: 106 banks form 18 European Economic Area (EEA) countries, including:
  - Group 1: 40 banks internationally active banks that have Tier 1 capital of more than €3 billion, of which 8 are G-SIIs.
  - Group 2: 66 banks that have Tier 1 capital of less than €3 billion or are not internationally active (i.e. all other banks).
- **Reference date**: the results are based on data as of 31 December 2019. Therefore, the impact of COVID-19 in not taken into account.
- **General aspects**:
  - This Report assesses the impact on EU banks of the final revisions of credit risk, operational risk, and leverage ratio frameworks, as well as of the introduction of the aggregate output floor. It also quantifies the impact of the new standards for market risk (FRTB) and credit valuation adjustments (CVA).
  - The impact is assessed on the assumption of the full implementation of the Basel reforms (i.e. 2028).
  - The Report presents the impact of the reforms in terms of changes in Tier 1 MRC, comparing the fully implemented revised Basel III requirements with the fully phased-in CRR / CRD IV requirements.

Change in total T1 MRC (weighted average in %) Reduced estimation bias

Group	Credit Risk				Market risk	CVA	Op. Risk	Output floor	Total risk-based	Revised LR	Total
	SA	IRB	Securit.	CCPs							
All banks	2.2	2.4	0.4	0.0	0.6	3.0	3.8	6.2	18.3	-2.8	15.4
1	1.9	2.2	0.4	0.0	0.7	3.2	4.1	7.0	19.1	-2.9	16.2
G-SIB	2.1	3.5	0.6	0.0	0.5	3.1	6.2	6.8	22.6	0.4	23.0
2	4.4	3.3	0.0	0.0	0.4	1.5	2.3	1.9	13.8	-2.7	11.1

Change in total T1 MRC (weighted average in %) Conservative estimation

Group	Credit Risk				Market risk	CVA	Op. risk	Output floor	Total risk-based	Revised LR	Total
	SA	IRB	Securit.	CCPs							
All banks	2.2	2.4	0.4	0.0	2.3	3.0	3.8	6.0	19.7	-3.1	16.7
1	1.9	2.2	0.4	0.0	2.6	3.2	4.1	6.7	20.8	-3.1	17.7
G-SIB	2.1	3.5	0.6	0.0	4.0	3.1	6.2	6.3	25.7	-0.1	25.6
2	4.4	3.3	0.0	0.0	0.4	1.5	2.3	1.9	13.8	-2.7	11.1

Single Resolution Board

02/12/2020
2021-2023 Multi-Annual-Programme including Annual Work Programme 2021

1. Context

The SRB has published the **Multi-Annual-Programme 2021-2023(MAP) including Annual Work Programme 2021** where it sets out a roadmap with a clear focus on achieving resolvability and a robust bank resolution of the banks under its remit over the next three years, as well as further operationalistation of the Single Resolution Fund (SRF). The objectives set out in this roadmap take into account the current economic, political and regulatory context characterised by the COVID-19 pandemic.

2. Main points

- **Multi-Annual Programme 2021-2023**. The SRB will focus on:
  - Resolvability of SRB banks and Less significant Institutions (LSIs). The objectives set for 2021-2023 in this respect are:
    - **Implement SRB Expectation for Banks (EfB)** as the key document of reference for banks to build the capabilities to become resolvable, by 2023 at latest.
    - **Update and operationalise the resolution plans**.
    - **Conduct resolvability assessments** that will feed into a central “heat-map”, aimed to track individual banks’ progress and benchmark it across SRB banks.
    - **Gradually develop the design and perform on-site inspections** (OSI).
    - **Enhance oversight function of LSI** which are under the National Resolution Authority (NRAs’) direct remit, with the SRB performing oversight functions.
  - Robust Resolution framework. The key areas of development for 2021-2023 are: i) to refine the 2020 MREL policy to complete the implementation of the Banking Package’s new rules; ii) extend the SRB methodology and iii) stablish policy work on financial continuity framework.
  - Preparing and carrying out effective crisis management. The priorities for 2021-2023 are: i) operationalise resolution tools other than bail-in; ii) refining data, procedures, documents and tools for crisis cases; iii) elaborate policy stances and operational procedures on impacts on business model or governance arrangements and iv) to test crisis preparedness by dry-run exercises.
  - Operationalising the SRF. The fund can be used to ensure the effective application of resolution tools. The main priorities related to this are: i) the monitoring of the evolution of covered deposits; ii) monitoring of the implementation of the 2021 investment plan and iii) analysing the optimal financing instruments for capital and/or liquidity support, covering any possible combination of resolution tools.
- **2021 Work Programme**. The SRB will focus on:
  - Resolvability of SRB banks and LSIs. The SRB will implement in 2021 the priorities in this area along the same priorities streams of the MAP, particularly the SRB will:
    - **Apply its revised 12-months Resolution Planning Cycle** (RPC).
    - Develop a **stepwise approach** to be prepared for OSI.
    - Develop a first **set of guidelines** to NRAs when performing tasks for LSIs.
    - Benefit in 2021 from **harmonised horizontal criteria** aligned with the EfB and applicable MREL policy.
  - Fostering a robust Resolution framework. In 2021, the SRB will implement the MAP priorities by applying, in close cooperation with NRAs through the so-called Resolution Committee (CoRes), the necessary revisions to SRB policies. In addition, the SRB will continue to conduct systematic quality review of resolution plans based on its enhanced methodology developed in 2020.
  - Preparing and carrying out effective crisis management. In 2021, the work will continue on refining procedures, tools, templates and specific Information and Communication Technology (ICT) solutions to be used in crisis.
  - Operationalising the SRF. The SRF was established by the Single Resolution Mechanism Regulations (SRMR) and, where necessary, may be used to ensure the effective application of resolution tools. 2021 priorities will be divided into three broad areas: i) contributions; ii) investments; and iii) funding and financing.

16/12/2020
EU's Cybersecurity Strategy for the Digital Decade

1. Context

The EU has developed a coherent and holistic international cyber policy since its 2013 EU Cybersecurity strategy. In addition, in 2017 it was published the EU cyber diplomacy toolbox to further contribute to international security and stability in cyberspace. An increase of cyber-attacks during the COVID-19 crisis have shown how important it is to protect hospitals, research centres and other infrastructure. Therefore, strong action in the area is needed to future-proof the EU's economy and society.

In this context, the EC has published the **EU's Cybersecurity strategy for the Digital Decade** which aims to safeguard a global and open Internet, while at the same time offering safeguards, not only to ensure security but also to protect European values and the fundamental rights.

2. Main points

- **Resilience, technological sovereignty and leadership**. The EC will focus on:
    - Resilient infrastructure and critical services. The EC proposes to reform the rules on the security of Network and Information Systems (NIS) in order to increase the level of cyber resilience of critical public and private sectors.
    - Building a European Cyber Shield. The EC proposes to build a network of Security Operations Centers across the EU.
    - Securing the next generation of broadband mobile networks.
    - The internet of Secure Things. The EC will consider a comprehensive approach, including possible new horizontal rules to improve the cybersecurity of all connected products and associated services placed on the Internal Market.
    - The greater global Internet security. The EC will develop a contingency plan, supported by EU funding, for dealing with extreme scenarios affecting the integrity and availability of the global Domain Name System (DNS) root system.
    - A reinforced presence on the technology supply chain.
    - A Cyber-skilled EU workforce.
- **Building operational capacity to prevent, deter and respond**. The EC will focus on:
    - A Joint Cyber Unit to strengthen cooperation between EU bodies and Member State authorities responsible for preventing cyber-attacks.
    - The use of EU cyber diplomacy toolbox to prevent, tackle and discourage cyber-attacks.
    - Boosting cyber defence capabilities encouraging Member States to make full use of the Permanent Structured Cooperation.
- **Advancing a global and open cyberspace**. The EU must continue to work with third countries, international organisations as well as the multi-stakeholder community, to develop and implement a coherent and holistic international cyber policy. Therefore, the EU focus on:
    - EU leadership on standards, norms and frameworks in cyberspace.
    - Cooperation with partners and the multi-stakeholder community.
    - Strengthening global capacities to increase global resilience.

3. Next steps

- The EC is committed to implementing the new Cybersecurity Strategy in the **coming months**.

EUROPEAN COMMISSION

02/12/2020
Delegated Regulation on EU classification system for green investments

1. Context

The EC published in 2019 the European Green Deal, which sets out a series of climate and energy targets for 2030, and contains a commitment for Europe to become climate neutral by 2050. Furthermore, in 2020 the EC published the Taxonomy Regulation which provides uniform criteria for companies and investors to determine which economic activities can be considered environmentally sustainable. The Taxonomy creates a common language that investors can use everywhere when investing in projects and economic activities that have a substantial positive impact on the climate and the environment.

In this context, the EC has published the **Delegated Regulation on EU classification system for green investments** with the aim of establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives. In addition, the Regulation includes two annexes that develop the screening criteria for determining whether an economic activity meets climate objectives.

2. Main points

- **Conditions and climate criteria**. This Delegated Regulation contains the technical screening criteria for determining the conditions under which an economic activity qualifies to climate change mitigation. These criteria should ensure that the economic activity makes a positive impact on the EU's climate objective or reduces negative impact on this objective. In this regard, the EC outlines the criteria that should be taken into account within the main sectors with the greatest potential for achieving these climate objectives:
    - Agricultural sector. The technical screening criteria should reflect this role and take into account the long timeframes required for climate benefits to materialize, in particular for maximizing and maintaining the carbon sink potential of land.
    - Forest sector. Technical screening criteria for forest activities should be complemented, reviewed and where necessary revised by end of 202.
    - Manufacturing sector. The criteria for this sector should be specified both for manufacturing activities associated with the highest levels of greenhouse gas emissions and for manufacturing of low-carbon products and technologies.
    - Energy sector. The technical screening criteria for this sector should signal the decarbonisation path for the electricity or heat generation activities to ensure that the greenhouse gas emissions are reduced or avoided.
    - Building sector. The criteria should therefore be laid down for the construction of new buildings, for building renovation, installation of different energy efficiency equipment, on-site renewables, provision of energy services, and for the acquisition and ownership of buildings.
    - Information and communication sector. The criteria should be laid down for data processing and hosting activities that emit high volumes of greenhouse gas, and for data-driven solutions that enable reductions in greenhouse gas emissions in other sectors.
    - Research, development and innovation sector. The criteria for these activities should focus on the potential of processes and technologies for reducing greenhouse gas emissions.
    - Other economic activities. The criteria for determining whether an economic activity contributes substantially to climate change adaptation should be laid down for engineering and financial and insurance activities, that have the potential to facilitate climate change adaptation in other sectors. This criteria should aim at increasing the resilience of economic activities against climate risks.
- **Significant environmental harm**. The EC determines the technical screening criteria for determining whether an economic activity causes no significant harm to one or more of the environmental objectives:
    - Use and protection of water and marine resources. The criteria should aim at avoiding that activities are detrimental to the status of bodies of water or the status of marine waters.
    - Pollution prevention and control. The criteria should reflect sector specificities to address the relevant sources and types of pollution into air, water or land.
    - Protection and restoration of biodiversity and ecosystems. The criteria should be specified for all activities that can pose risks to the status or condition of habitats, species or ecosystems and should require that environmental impact assessments or appropriate assessments are undertaken and the conclusions achieved from such assessments are implemented.

3. Next steps

- This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the EU and it shall apply from **1 January 2022**.

EUROPEAN
COMMISSION

27/11/2020
Proposal on Data Governance Act

1. Context

Over the last few years, digital technologies have transformed the economy and society, affecting all sectors of activity and daily life. Data is at the centre of this transformation: data-driven innovation will bring enormous benefits for citizens, for example through improved personalised medicine, new mobility, and its contribution to the European Green Deal, among others. In this sense, the EC described the vision of a common European data space, a Single Market for data in which data could be used irrespective of its physical location of storage in the Union in compliance with applicable law.

In this context, the EC has published the **Proposal on Data Governance Act** with the aim of foster the availability of data for use by increasing trust in data intermediaries and by strengthening data-sharing mechanisms across the EU. The aim of this proposal it is not to amend or remove the substantial rights on access and use of data, but to complement the Directive on open data and the re-use of public sector information.

2. Main points

- **Re-use of categories of protected data** held by public sector bodies. It applies to data held by public sector bodies which are protected on grounds of: i) commercial confidentiality; ii) statistical confidentiality; iii) protection of intellectual property rights of third parties; and iv) protection of personal data.
    - Prohibition of exclusive arrangements. An exclusive right to re-use data may be granted to the extent necessary for the provision of a service or a product in the general interest. Public sector bodies which are competent under national law to grant or refuse access for the re-use of data shall make publicly available the conditions for allowing such re-use of data.
    - Conditions for re-use. Public sector bodies may impose obligations to access and re-use the data within:
        - A **secure processing environment** provided and controlled by the public sector.
        - The **physical premises** in which the secure processing environment is located, if remote access cannot be allowed without jeopardising the rights and interests of third parties.
    - Competent bodies. Member States shall designate one or more competent bodies, which may be sectoral, to support the public sector bodies which grant access to the re-use of the categories of data.
    - Single information point. Member States shall ensure that relevant information concerning the conditions and fees that must be paid for re-use of data, is available through a single information point, which shall receive requests for the re-use of data and shall transmit them to the competent public sector bodies.
- **Requirements applicable to data sharing services**.
    - Providers and conditions for providing data sharing services. Any provider of data sharing services who intends to provide certain services described in a previous proposal shall submit a notification to the competent authority.
    - Competent authorities. Each Member State shall designate in its territory one or more authorities competent to carry out the tasks related to the notification framework and to monitor and supervise the requirements applicable to data sharing services. This authorities shall be legally distinct from any provider of data sharing services.
- **Data altruism**. Each competent authority designated shall keep a register of recognised data altruism organisations and shall monitoring compliance with the requirements that the data altruism organization shall meet. The competent authority shall monitor and supervise the register of data altruism organisations, and shall have the power to request information and require cessation in the event of a breach.
- **European data innovation board**. The EC shall establish a European Data Innovation Board ("the Board") in the form of an expert group. The board will assist the EC in facilitating cooperation between national competent authorities within the framework of this regulation and will advise about the prioritization of cross-sector standards to be used and developed for data use and cross-sector data sharing.

3. Next steps

- This Regulation shall enter into force on the **twentieth day** following that of its publication in the Official Journal of the EU and it shall apply from **12 months** after its entry into force.

EUROPEAN
COMMISSION

23/10/2020
2021 Work Programme

1. Context

The EC has adopted the **2021 Work Programme** which is designed to make Europe healthier, fairer and more prosperous, while accelerating its long-term transformation into a greener economy, fit for the digital age. The work programme sees a shift from strategy to delivery across all six political priorities and it confirms the EC's resolve to lead the tween green and digital transition.

2. Main points

- **European Green Deal**. The EC's focus will be overhauling the relevant climate and energy legislation to align with the newly proposed target to reduce emissions by at least 55% by 2030, as compared to 1990 levels. This will cover wide-ranging policy areas, from renewables to energy efficiency first, energy performance of buildings, as well as land use, energy taxation, effort sharing and emissions trading.
- **Europe fit for the digital age**. The EC will put forward a roadmap of clearly defined 2030 digital targets. The actions to be taken will involve legislation covering the safety, liability, fundamental rights and data aspects of artificial intelligence and a Data Act to set the right conditions for better control and conditions for data sharing for citizens and businesses.
- **Economy that works for people**. To ensure that the health and economic crisis does not turn into a social crisis, the EC will put forward an ambitious action plan to implement fully the European Pillar of Social Rights, making sure that no one is left behind in Europe's recovery. The EC will search the best way to stability and competitiveness through a deeper Economic and Monetary Union, which will also ensure a stronger international role of the euro.
- **Stronger Europe in the world**. The EC will ensure that Europe plays its vital role in this fragile world, including by leading the global response to secure a safe and accessible vaccine for all. It will also be strengthened the EU's contribution to rules-based multilateralism and will propose a renewed partnership with Southern neighborhood and present a Communication on the Arctic to update EU policy towards a region particularly exposed to climate change.
- **Promoting our European way of life**. The EC will propose to build a stronger European Health Union, notably by strengthening the role of existing agencies and establishing a new agency for biomedical advanced research and development. It will also propose a number of measures on legal migration and will continue to strengthen the Security Union by tacking measures on tackling organized crime.
- **A new push for European democracy**. The European Democracy action plan to be adopted will be a stepping stone to improve the resilience of our democracies, address the threats of external interference in European elections and counter disinformation. To build a union of equality, the EC will present new strategies on rights of the child and for persons with disabilities, as well as a proposal to combat gender-based violence.

EUROPEAN CENTRAL BANK
EUROSYSTEM

03/12/2020
Guide on climate-related and environmental risks

1. Context

Following the adoption of the Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development in 2015, governments are making strides to transition to low-carbon and more circular economies on a global scale. In Europe, the European Green Deal sets out the objective of making Europe the first climate-neutral continent by 2050. In this sense, the financial sector is expected to play a key role and for the second year, the ECB has identified climate-related risks as a key risk driver on the SSM Risk Map for the euro area banking system.

In this context, the ECB has published the **ECB Guide on climate-related and environmental risks** which outlines the ECB's understanding of the safe and prudent management of climate-related and environmental risks (hereafter referred to as climate risks) under the current prudential framework, the expectations on how institutions should consider these risks when formulating and implementing their business strategy and governance and risks management frameworks, and the expectations on how institutions should become more transparent by enhancing their disclosure of information.

2. Main points

- **Scope of application and definitions**.
  - The expectations set out in this guide are to be used in the ECB's supervisory dialogue with significant institutions directly supervised. However, this guide has been developed jointly by the ECB and the national competent authorities (NCAs) and therefore, NCAs are recommended to apply in substance the expectations established in this guide in their supervision of less significant institutions (LSIs), proportionately to the risk profile and business model of the institution.
  - For the purposes of this guide, materiality should be considered in the light of the applicable CRD and CRR provisions. It is worth noting that the assessment of materiality is an institution-specific assessment, taking into account the specificities of the respective business model, operating environment and risk profile.
- **Characteristics of climate-related and environmental risks**. The magnitude and distribution of physical and transition risks depend on the level and timing of mitigation measures and whether the transition occurs in an orderly or disorderly fashion. Irrespective of this, some combination of physical and transition risks will, in all probability, materialise on the balance sheets of euro area institutions and the economic value of their exposures:
  - Interconnection between climate-related change and environmental risks may result in combined effects capable of potentially generating even greater impacts.
  - Assets that are directly or indirectly associated with the extraction, processing, combustion or use of fossil fuels, or which are not sufficiently energy efficient, may suddenly and significantly decrease in value or even become "stranded assets".
- **Supervisory expectations relating to business models and strategy**. Institutions are expected to identify, assess and monitor the current and forward-looking impact of climate-related and environmental factors on their business environment and to ensure the sustainability and resilience of their business model going forward. In general, institutions are expected to adopt granular approaches to mapping these impacts on their business environment. Depending on the type of climate-related and environmental impact, granular approaches may include "within-sector" differences, taking into account supply chain effects or using detailed geographic location data.
- **Supervisory expectations relating to governance and risk appetite**. Institutions are expected to embed climate risks in their governance and risk appetite frameworks, while adequately involving all relevant functions. Additionally, appropriate and regular reporting on these risks to the management body is expected to ensure proper management of these risks. The management body is expected to consider the knowledge, skills and experience of its members in the area of climate-related and environmental risk in its assessment of the collective suitability of such members.

2. Main points (cont.)

- **Supervisory expectations relating to risk management**. This guide provides detailed guidance on integrating climate risks into credit, operational, market and liquidity risk management, as well as into the ICAAP, including risk quantification by means of scenario analysis and stress testing.
    - Risk management framework. Institutions are expected to incorporate climate risks as drivers of established risk categories into their existing risk management framework, with a view to managing and monitoring these over a sufficiently long-term horizon, and to review their arrangements on a regular basis. Furthermore, institutions are expected to identify and quantify these risks within their overall process of ensuring capital adequacy.
    - Credit risk management. Institutions are expected to consider climate risks at all stages of the credit-granting process and to monitor the risks in their portfolios.
    - Operational risk management. Institutions are expected to consider how climate-related events could have an adverse impact on business continuity and the extent to which the nature of institutions' activities could increase compliance-related risks, such as liability, litigation and/or reputational risks, stemming from climate-related and environmental issues.
    - Market risk management. Institutions are encouraged to monitor on an ongoing basis the effect of climate-related and environmental factors on their current market risk positions and future investments, and to develop stress-testing scenarios that incorporate climate-related and environmental risks.
    - Scenario analysis and stress testing. Institutions with material climate risks are expected to evaluate the appropriateness of their stress testing, with a view to incorporating them into their baseline and adverse scenarios.
    - Liquidity risk management. Institutions are expected to assess whether material climate risks could cause net cash outflows or depletion of liquidity buffers and, if so, incorporate these factors into their liquidity risk management and liquidity buffer calibration.
    - Materiality assessment. Institutions are expected to comprehensively include climate-related and environmental risks in their assessment of materiality for all of their business areas in the short, medium and long-term under various scenarios.
- **Supervisory expectations relating to disclosures**. This guide establishes that for the purposes of their regulatory disclosures, institutions are expected to publish meaningful information and key metrics on climate risks that they deem to be material, as a minimum, in line with the European Commission's Guidelines on non-financial reporting: Supplement on reporting climate-related information.

3. Next steps

- This Guide is applicable since its **date of publication**.
- As part of the supervisory dialogue, **from early 2021**, significant institutions will be asked by Joint Supervisory Teams to inform the ECB of any existing divergences in their practices from the supervisory expectations described in this guide and to inform the ECB of arrangements aimed at progressively addressing these expectations

06/10/2020
2021 Work Programme

1. Context

The ESMA has published the **2021 Work Programme** setting out its priorities and areas of focus for the next 12 months in support of its mission to enhance investor protection and promote stable and orderly financial markets. For 2021, ESMA's planned activities will respond to the challenges faced by the EU, its capital markets and its citizens, including developing the retail investor base to support the Capital Markets Union (CMU), promoting sustainable finance and long-term oriented markets, dealing with the opportunities and risks posed by digitalisation, strengthening the EU's role in global capital markets and ensuring a proportionate approach to regulation.

2. Main points

- **Transversal themes**. During 2021, the ESMA will focus on:
  - CMU. ESMA considers the development of the CMU as one of its strategic priorities in order to finance the economy and ensure economic growth, job creation and to speed up the recovery. In this respect, ESMA is ready to provide its support to the CMU action plan, where appropriate and necessary.
  - ESG. Given the pervasiveness of ESG factors across different areas of legislation, building common approaches for incorporating ESG factors in NCAs' supervisory practices will be a priority for ESMA's work on supervisory convergence. To this effect ESMA will:
    - Produce a **roadmap for supervisory convergence in sustainable finance**, building on the sustainable finance strategy it published in 2020.
    - Have an important role, among others, in the implementation of the **Regulation on the establishment of a framework to facilitate sustainable investment** and amending taxonomy regulation. This includes in particular the support to the work for the preparation of the delegated acts and its role in the Platform on Sustainable Finance.
    - Assist the EC with new initiatives resulting from the **renewed sustainable finance strategy** in the context of the recovery, to be adopted by the EC by the end of the year.
  - FinTech. ESMA believes that technology can contribute to well-functioning financial markets and investor protection. ESMA will therefore continue its work on financial innovation by continuing its actions under the FinTech Action Plan and by contributing to the Digital Finance Package.
- **Key priorities**. During 2021, in addition to transversal themes implementing ESMA's new mandates, the key areas of focus under its activities of supervisory convergence, assessing risks, single rulebook and direct supervision will be:
  - Promoting supervisory convergence. Supervisory convergence priorities will be to build an EU common risk-based and outcome-focused supervisory culture. Areas of focus will include fund liquidity risk and liquidity management tools, retail investment products costs and performance, quality and usability of data, supervision of ESG reporting and ESG data usage, and the implementation of EMIR.
  - Assessing risks to investors, markets and financial stability. In the risk assessment area, ESMA will focus on integrating the new focus on financial innovation and ESG developments into their risk analysis. It will also focus on data for risk-based supervision, in particular in support of ESMA's new supervisory mandates, and to support policy and convergence work. Finally ESMA will continue to monitor the impact on markets of the COVID-19 pandemic and following the end of the UK's transition period, intervening when necessary in support of investor protection, orderly markets and financial stability.
  - Completing a single rulebook for EU financial markets. ESMA, as part of a programme of regular post-implementation reviews of laws and technical standards, will:
    - Contribute to the **legislative reviews of MiFID and AIFMD** and assess whether changes to the rulebook are needed to develop the CMU.
    - Enhance the **attractiveness of EU capital markets**.
    - **Promote sustainable finance** and proportionality.

    Following the review of EMIR and the changes introduced under EMIR Refit, review technical standards where necessary. Depending on market developments, these reviews may be in the area of clearing thresholds and the clearing obligation.
  - Directly supervising specific financial entities. Under its direct supervision activity, in 2021, ESMA will focus on third country central counterparty supervision as critical financial market infrastructures under EMIR 2.2. In addition, ESMA will prepare for new supervisory mandates regarding Benchmarks and Data Service Providers, as well as continuing direct supervision in the areas of Credit Rating Agencies, Trade Repositories and Securitisation Repositories.

17/12/220
Opinion on the 2020 review of Solvency II

1. Context

On January 2016, Solvency II Directive entered into application. Solvency II provides that certain areas of the Directive should be reviewed by the European Commission (EC) at the latest by 1 January 2021, namely: i) long-term guarantees measures and measures on equity risk; ii) methods, assumptions and standard parameters used when calculating the Solvency Capital Requirement standard formula; iii) Member States' rules and supervisory authorities' practices regarding the calculation of the Minimum Capital Requirement, and iv) group supervision and capital management within a group of insurance or reinsurance undertakings.

In this context, the EIOPA has submitted to the European Commission its **Opinion on the Solvency II 2020 Review**. The measures proposed aim at keeping the regime fit for purpose by introducing a balanced update of the regulatory framework, reflecting better the economic situation and completing the missing elements from the regulatory toolbox. From a prudential perspective, EIOPA is of the view that, overall, the Solvency II framework is working well and no fundamental changes are needed at this point in time but a number of adjustments are required to ensure that the regulatory framework continues as a well-functioning risk-based regime.

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2. Main points

- **Long-term guarantee measures and equity risk**. The main proposals from EIOPA include:
    - Risk-free interest rates: change the method of extrapolating risk-free interest rates to better reflect market rates.
    - Volatility adjustment: better align the design of the adjustment to its objectives, in particular reward insurers for holding illiquid liabilities.
    - Risk margin: recognise diversification over time thereby reducing size and volatility of the margin, especially for long-term liabilities.
    - Equity risk: revise the criteria for the ability to hold equity long-term, by making a link with longterm illiquid liabilities.
- **Solvency capital requirements**. EIOPA proposes to increase the capital requirement for the interest rate to reflect the steep fall of interest rates experienced during the last years and the existence of negative interest rates.
- **Proportionality**. EIOPA proposes to:
    - Increase proportionality across the three pillars of Solvency II, especially regarding low risk undertakings.
    - Introduce a new process for applying and supervising the principle of proportionality characterised by clarity, predictability, risk sensitiveness, supervisory dialogue and reversal of the burden of proof.
    - Increase the effectiveness of proportionality embedded in the supervisory review process.
    - Increase the transparency on the use of proportionality measures across the three pillars of Solvency II.
- **Macroprudential policy**. EIOPA proposes to:
    - Supplement the current microprudential framework with a macroprudential perspective.
    - Introduce tools and measures to equip national supervisory authorities with sufficient powers to address all sources of systemic risk.
- **Recovery and resolution**. EIOPA proposes to develop a minimum harmonised and comprehensive recovery and resolution framework for (re)insurers to deliver increased policyholder protection and financial stability in the EU.
- **Insurance guarantee schemes**. EIOPA proposes to introduce a European network of national insurance guarantee schemes or alternative mechanisms that should meet a minimum set of harmonised features for the benefit of policyholders and financial stability.

04/12/2020
Discussion Paper on methodology on inclusion of climate change in Nat Cat standard formula

1. Context

In 2019 the EIOPA published the Opinion on Sustainability within Regulation of Solvency II, which considered that further work was needed to investigate whether additional climate change-related perils could be better captured in this Regulation framework. Solvency II is a risk-based approach that should consider the natural catastrophe risk (Nat Cat). The Nat Cat module calculates the Solvency Capital Requirement (SCR) linked with Nat Cat events.

In this context, the EIOPA has published the **Discussion Paper on methodology on inclusion of the climate change in Nat Cat standad formula** with the aim to evaluate and introduce the methodology, as well as define process changes to include climate change in the Nat Cat SCR standard formula.

2. Main points

- **Methodology for the Nat Cat SCR calibration**. The current methodology covers several exposures and perils that are used in conjunction with a number of parameters that consider the hazard, vulnerability and exposure of the corresponding regions, and the country factor in order to calculate the Nat Cat Solvency Capital Requirements (SCR).
- **Perils and countries impacted by climate change**. The EIOPA focuses on the dangers arising from climate change that are relevant to the insurance sector: i) the increasing of mean temperature; ii) the increasing of temperature variability; and iii) increased moisture capacity in atmosphere due to higher temperatures. The effects of climate change requires adaptation measures that can contribute to the components of weather-related risks. Furthermore, these adaptation measures must be taken into account because they not only contribute to the risk components but also contribute to anticipate the adverse effects of the climate change and minimize the damage that these risks may cause.
- **Inclusion of climate change in the Nat Cat SCR calibration**. The current parameters in the Nat Cat Standard Formula (SF) do not explicitly consider climate change and this could be potentially inadequate for some countries/perils which are more affected by the impact climate change.

3. Next steps

- Comments to this document can be submitted until **26 February 2021**.

03/12/2020
Consultation Paper on the relevant ratios to be mandatorily disclosed by insurers and reinsurers

1. Context

The European Commission (EC) published in 2020 the Taxonomy Regulation, whose main objective is to establish relevant criteria to determine whether an economic activity can be qualified as environmentally sustainable. In addition, this Regulation enables the EC to carry out delegated acts to complement some of its provisions, especially with regard to the European Supervisory Authorities (ESAs) to carry out delegated acts in relation to the transparency of entities in non-financial statements.

In this context, the EIOPA has published the **Consultation Paper on the relevant ratios to be mandatorily disclosed by insurers and reinsurers** with the aim to consider whether the mandatory ratios of non-financial undertakings, as set out in the Taxonomy Regulation, are relevant and appropriate to depict insurance and reinsurance activities or whether they need to be 'translated' to the most appropriate and comparable key performance indicators for insurance and reinsurance businesses.
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2. Main points

- **Relevant ratios for insurance and reinsurance undertakings**.
  - <u>Non-financial undertakings' capital expenditure and operating expenditure</u>. The objectives in this area are:
    - To understand to what extent the insurer's **undertakings' 'assets', in relation to 'total assets'** are directed at funding economic activities identified as environmentally sustainable in the EU taxonomy and can be considered an appropriate ratio.
    - To propose in case the previous one is not an appropriate ratio, an **additional ratio** to measure the extent to which the undertaking is engaging in environmentally sustainable activities.
  - <u>Non-financial undertakings' turnover</u>. The suggestion of the EC is to relate the 'turnover' ratio to nonlife insurance and reinsurance underwriting and to exclude life insurance written premiums. In this context, measuring the insurer's or reinsurer's underwriting exposure associated with taxonomy activities could be depicted by the extent to which technical provisions are associated with taxonomy activities.
- **Economic activities**. Insurance and reinsurance undertakings should provide a narrative basis for the allocation of their insurance activities identified as environmentally sustainable and to provide an appropriate proxy in case the underlying portfolio of insurance contracts is too complex to decipher. Therefore, the mandatory ratios should be accompanied by relevant disclosure about the accounting policies applied, in particular on the level of granularity when assessing individual contracts and the extent to which enabling services have been provided.
- **Other considerations**.
  - <u>Specifying disclosures of insurers versus reinsurers and their corresponding activities</u>. Considering the objective to identify the levels of funding provided to environmentally sustainable economic activities, there is no obvious distinction between insurance and reinsurance undertakings that would require different key performance indicators.
  - <u>Retroactive application of the disclosure requirements</u>. The consideration to apply the disclosure requirements retroactively is particularly important considering the staggered approach of the Taxonomy Regulation where the disclosure requirements apply to climate change mitigation.
  - <u>Potential impact of the recommendation</u>. The suggested key performance indicators (KPI) are relevant to depict the degree to which insurance and reinsurance undertakings carry out environmentally sustainable economic activities.

3. Next steps

- Comments to this CP can be submitted until **12 January 2021**.

01/12/2020

Consultation Paper on Statement on supervisory practices and expectations in case of breach of the SCR

1. Context

This Supervisory Statement is based on the Solvency II Directive, approved in 2009, which establishes the level of Solvency Capital Requirements (SCR) for insurance and reinsurance undertakings. In addition, the Regulation stablishing the EIOPA was approved in 2010, in which the Authority may develop new practical instruments and convergence tools to promote common supervisory approaches and practices.

In this context, the EIOPA has published the **Supervisory Statement on practices and expectations in case of breach of the CSR** with the aim to promote supervisory convergence in the application of the supervisory ladder, in particular addressing the recovery plan required in case of breach of the CSR.

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2. Main points

- **Non-compliance with the SCR**. Insurance and reinsurance undertakings should consider as the date of non-compliance with the SCR the date on which non-compliance with the SCR has been observed through their on-going monitoring.
- **Request of a recovery plan and causes of non-compliance**. Insurance and reinsurance undertakings are required to submit to the supervisory authorities a realistic recovery plan within two months upon the observation of a breach of the SCR. In addition, the supervisory authorities should request from these undertakings, as part of the recovery plan, an analysis of the causes of non- compliance and of any shortcomings in their risk management system, including possible inadequacy of: i) internal risk appetite; ii) quantitative or qualitative indicators/measures; iii) overall risk tolerance limits; iv) metrics used within the risk management system to measure risks; v) stress test framework; and vi) monitoring process.
- **Assumptions and scenarios of the recovery plan**. Insurance and reinsurance undertakings should take at least the following into account when preparing their recovery plan:
    - <u>The forecast balance sheet and estimates</u> should be based on realistic assumptions and should be tested for the different business lines, and where applicable and appropriate for the parent company, subsidiaries and branches.
    - The scenarios <u>should consider any foreseeable and probable relevant adverse events</u>. The forecast balance sheet and estimates should reflect an assessment of the business exposures related to the risk coverages or guarantees of the insurance products.
    - In case the forecast <u>balance sheet and estimates</u> reflect the implementation of management actions leading to investment gains, reduction of expenses/commissions or release of technical provisions, those actions should be consistent with the business strategy and with any re-calculation of the technical provisions.
    - <u>When preparing recovery plans in the context of the COVID-19 pandemic</u>, undertakings should take into account how the pandemic might evolve including possible further waves.
- **Recovery measures and period**. Insurance and reinsurance undertakings should detail the realistic and timely recovery measures to restore their solvency position and sustain it in a medium to long-term period. The recovery plan should document the feasibility of the recovery measures, including foreseeable and probable relevant adverse events.
- **Monitoring and non-compliance at the end of the recovery period**. After a recovery plan has been submitted, insurance and reinsurance undertakings should notify supervisory authorities of any significant change in the extent of the solvency or liquidity shortfall.

3. Next steps

- Comments to this CP can be submitted until **17 February 2021**.

15/10/2020
Guidelines on information and communication technology security and governance

1. Context

Information and communication technology (ICT) risk is considered part of operational risk, defined as the possibility of loss due to breaches in the confidentiality of information, failures in the integrity of systems and data, unavailability of systems, as well as the impossibility of adequate ICT change management. Given the growing increase in ICT risk, including cyber-security-related risks in recent years, the EIOPA considers the management of these risks to be essential for the achievement of the objectives of insurers and reinsurers.

In this context, EIOPA has published **Guidelines on ICT security and governance** with the aim of ensuring a consistent management approach in the sector. Specifically, these document specify through 25 guidelines the expectations of EIOPA on aspects such as governance and strategy, ICT and security risk management framework, information security policy, access control, ICT security monitoring, ICT operations management, security incident and continuity management, and the outsourcing of ICT systems and services.

2. Main points

- **Governance and strategy**. It defines the Board's responsibility for establishing strong internal governance and an internal control framework that assigns clear roles to the staff of the organizations. In addition, it requires the establishment and communication of an ICT strategy aligned with the business strategy and the management and mitigation of security and ICT risks through independent and objective control functions (ensuring the independence of the three lines of defense and reporting the second line of defense directly to the board).
- **Security and ICT risk management framework**. Insurers and reinsurers are required to maintain an up-to-date inventory of their business functions, roles, support processes and information resources, classifying them according to their criticality in terms of confidentiality, integrity and availability, and to periodically assess operational risks related to security and ICT risks, with an impact on the organisation. In addition, periodic audits of the management and governance of ICT risks are required.
- **Information security policy**. It requires the establishment of an information security policy that sets out at a high level the principles and rules for protecting the confidentiality, integrity and availability of information, as well as the roles and responsibilities for managing ICT risks. The policy should be communicated to all employees of the organization and be applicable to service providers.
- **Access control**. These guidelines place special emphasis on access control and monitoring, establishing minimum requirements regarding: need-to-know, minimum privilege and segregation of duties, use of generic accounts, privileged users, means of authentication, access rights management, remote access management and establishment and monitoring of access logs.
- **ICT security monitoring**. It requires the implementation of procedures to ensure the confidentiality, integrity and availability of ICT systems and services through the protection and implementation of mechanisms that ensure the integrity of the organization's assets, as well as continuous monitoring and periodic analysis to identify vulnerabilities.
- **Management of ICT operations**. It describes the requirements for the management of ICT projects, including the acquisition, development, and maintenance of ICT systems and services. Entities must ensure the controlled evaluation of changes in their production, testing, approval and implementation.
- **Continuity and Security Incident Management**. Expectations regarding business continuity management and security incident management are specified. Insurers and reinsurers must ensure that they have effective response, recovery and communication plans and procedures.
- **Outsourcing of ICT systems and services**. The need to guarantee the adequate management of the outsourced services is established, with service level agreements, control requirements, access and audit rights, as well as specifying the location of the data, having to be established contractually.

3. Next steps

- These Guidelines shall apply from **1 July 2021**.

08/10/2020
Consultation on the draft Opinion on the supervision of the use of climate change risk scenarios in ORSA

1. Context

In 2019, EIOPA released an Opinion on Sustainability within Solvency II, which recommended that (re)insurers consider climate risks beyond the one-year time horizon through the system of governance, risk-management system and their Own Risk and Solvency Assessment (ORSA). In EIOPA's view, it is essential to foster a forward-looking management of climate change-related risks by insurers, also in the long term, and to enhance supervisory convergence across Europe.

In this context, EIOPA has published the **Consultation on the draft Opinion on the supervision of the use of climate change risk scenarios in ORSA** where it sets out EIOPA's expectations to national competent authorities (CA) on how to supervise the integration of climate change scenarios by insurers in their ORSA, applying a risk-based and proportionate approach.

2. Main points

- **Integration of climate change risk in ORSA in the short and long term**. CAs should require undertakings to integrate climate change risks in their system of governance, risk-management system and ORSA. They should expect undertakings to assess climate change risk in the short and long terms using scenario analysis to inform the strategic planning and business strategy.
- **Definition of climate change risk**. CAs should expect undertakings to take a broad view of climate change risk, including all risks stemming from trends or events caused by climate change. Climate change risk can broadly be categorised into two drivers of risk:
    - Transition risks are risks that arise from the transition to a low-carbon and climate-resilient economy.
    - Physical risks are risks to that arise from the physical effects of climate change.
- **Materiality assessment of climate change risks**. CAs should expect undertakings to identify the materiality of exposures to climate change risks through a combination of qualitative and quantitative analyses:
    - A qualitative analysis could provide insight in the relevance of the main drivers of climate change risk in terms of traditional prudential risks, counterparty risk, underwriting risk, operational risk, reputational risk and strategic risk.
    - A quantitative analysis could be used to assess the exposure of assets and underwriting portfolios to transition risk and physical risks.
- **Range of climate change risk scenarios**. Supervisors should expect insurers to subject material climate change risks to at least two long-term climate scenarios, where appropriate:
    - A climate change risk scenario where the global temperature increase remains below 2°C, preferably no more than 1.5°C, in line with the EU commitments.
    - A climate change risk scenario where the global temperature increase exceeds 2°C.
- **Evolution of climate change risk analyses**. CAs should expect that the scope, depth and methodologies of undertakings' quantitative analyses of climate change risk evolve, as modelling approaches advance and undertakings gain more experience.
- **Supervisory reporting and consistent disclosure**. CAs should expect undertakings to present and explain in the ORSA supervisory report the analysis of short and long-term climate change risks, including:
    - An overview of all material exposures to climate change risks, an explanation how the undertaking assessed the materiality and, where relevant, an explanation if the undertaking concluded that climate change risk is not material.
    - The methods and main assumptions used in the undertaking's risk assessment of material exposures, including the long-term scenario analysis.
    - The quantitative and qualitative outcomes of the scenario analyses and the conclusions drawn from the results.

3. Next steps

- Comments to this document can be submitted until **5 January 2021**.

23/12/2020

- **Final Report RTS on methodology to estimate P2 and CBR for setting MREL requirements**
- **Final Report on ITS on reporting of MREL decisions**
- **Resporting framework 3.0 and technical standards on Pillar 3 disclosure**

1. Context

The EBA has published its **final draft Regulatory Technical Standards (RTS) specifying the methodology to be used by resolution authorities to estimate the Pillar 2 (P2R) and combined buffer requirements (CBR) at resolution group level** for the purpose of setting the minimum requirement for own funds and eligible liabilities requirement (MREL). Furthermore, the EBA has also published its **final draft Implementing Technical Standards (ITS) specifying uniform reporting templates, instructions and methodology for the identification and transmission, by resolution authorities to the EBA, of information on MREL**. Both standards are part of the EBA's major programme of work to implement the BRRD and address the problem of too-big-to-fail banks.

Moreover, the EBA has published an **update to the reporting framework 3.0 and the ITS on institutions' Pillar 3 public disclosures**. These updates are the result of the EC's adoption of the ITS on Supervisory Reporting (v3.0), the EBA publication of the revised version of the mapping between disclosures and reporting, and the EBA release of phase 1 of its technical package on the reporting framework v3.0.

2. Main points

Final Report RTS on methodology to estimate P2 and CBR for setting MREL requirements

- **Methodology for MREL requirements**. The BRRD tasked the EBA with developing a methodology for authorities to use in estimating the capital requirements to be used as inputs when calibrating MREL. These draft RTS set out this methodology which:
    - Introduces a threshold to capture only resolution groups that differ sufficiently from the prudential group.
    - Aims to be pragmatic by combining top-down and bottom-up approaches to estimating the additional own fund requirement (P2R) and the CBR.
    - Aims to minimise the burden on resolution authorities while creating a positive dynamic between banks, resolution authorities and competent authorities to improve the calibration of MREL at resolution group level, where resolution groups differ from prudential groups.

Final Report on ITS on reporting of MREL decisions

- **ITS reporting templates, instructions and methodology for MREL**. The draft ITS set out in this consultation paper (CP) replace the previous ITS on MREL reporting in order to properly reflect the changes introduced to the BRRD. These draft ITS set out minimum procedural obligations covering reporting periods and submission dates, as well as templates to be used by resolution authorities when informing the EBA of the MREL requirements they have set. The templates laid down in the annexes to the ITS are to be used for reporting on each component of the decision in compliance with the methodology laid down in the BRRD. This information will help the EBA in monitoring and promoting the consistent application of the legal framework on MREL.

Reporting framework 3.0 and technical standards on Pillar 3 disclosure

- **Adoption of ITS on Supervisory Reporting**. The EBA updated its website to reflect the EC's adoption of the Supervisory Reporting Implementing Act and its Annexes, which included changes introduced by the CRR2 and the Prudential Backstop Regulation.
- **Disclosures and ITS on Supervisory Reporting**. The Pillar 3 ITS on institutions' public disclosures have been developed to foster consistency across supervisory reporting. The EBA has updated the mapping of quantitative disclosure data and supervisory reporting, which aims at facilitating institutions' compliance and improving the consistency and quality of the information disclosed. The EBA also published a file summarising the frequency at which each type of institution should disclose each template and table, in accordance with the CRR2.
- **Phase 1 of technical package of reporting framework**. The technical package of the reporting framework provides the standard specifications for the implementation of the EBA reporting requirements. The package includes the validation rules, the Data Point Model (DPM) data dictionary and the XBRL taxonomies for v3.0.

3. Next steps (cont.)

- The draft RTS on methodology to estimate P2 and CBR for setting MREL requirements and the Final Report on ITS on reporting of MREL decisions will be submitted to the EC for endorsement before being published in the Official Journal of the European Union. This RTS will apply from the **twentieth day following that of their publication in the Official Journal of the European Union.**
- The EBA reporting framework 3.0 is expected to apply from **30 June 2021.**

17/12/2020

Final Draft RTS on the calculation of the stress scenario risk measure under Article 325bk(3) of CRR2.

1. Context

In November 2016, the European Commission proposed the amendments to the Capital Requirements Regulation (CRR), which required that institutions shall calculate the stress scenario risk measure (SSRM, Stress Scenario Risk Measure) for all the non-modellable risk factors (NMRF, Non-Modellable Risk Factors) of the trading book positions in a given portfolio. In this line, the publication of these amendments included to CRR in May 2019, setting up a mandate to the EBA to develop draft Regulatory Technical Standards (RTS, Regulatory Technical Standards) to specify how to calculate the 'extreme scenario of future shock' and how to apply it to the NMRF to form the stress scenario risk measure. On the other hand, in December 2017, the EBA published a Discussion Paper (DP) on the EU implementation of market risk and counterparty credit risk revised standards. Considering the feedback received on the discussion paper, and in light of the final international standards, the EBA launched in July 2019 a data collection exercise presenting several SSRM calculation method variants.

In this context, and after the consultation launched in June 2020, the EBA has published the **Final Draft Regulatory Technical Standards (RTS) on the calculation of the stress scenario risk measure** with the aim of setting out a clear methodology is deemed necessary to ensure a level playing field among institutions in the EU. In particular, these Final draft RTS set out the methodologies that institutions are required to use for the purpose of determining the extreme scenario of future shock that, when applied to the NMRF, provides the SSRM.

2. Main points

- **Overarching approach for determining the extreme scenario of future shock and determination of the stress period for the NMRF**. These final draft RTS require institutions to determine the stress scenario risk measure from risk factor observations collected for the stress period. In other words, the observation period that is used to calibrate the shock applicable to the NMRF is the stress period. It implies that the institution calculates the SSRM as the loss occurring when the extreme scenario of future shock is applied to the NMRF. Also in this case, such SSRM is then rescaled to reflect the liquidity horizons of the NMRF directly in the aggregation formula set out in these final draft RTS.
- **Determination of the extreme scenario of the shock**. Institutions are required to determine a scenario of future shock by applying one of the two methodologies proposed, which have two variants for each methodology depending on whether the institution calculates the stress scenario risk measure for a single NMRF or for the NMRF belonging to a non-modellable bucket.
    - Direct method for future shock: the direct method requires institutions to derive the scenario of future shock by directly calculating the expected shortfall of the portfolio losses.
    - Stepwise method for future shock: the stepwise method requires institutions to determine the scenario of future shock by steps.
- **Regulatory extreme scenario of future shock that institution may use (or may be required to use) when unable to develop an extreme scenario of future shock**. In this case, the competent authority may require the institution to consider the maximum loss that may occur due to a change in the as the stress scenario risk measure for that NMRF. Where such maximum loss does not take a finite value, then institutions shall use an approach using quantitative and qualitative information available to determine a prudent value of the loss that can occur due to a change in the value of the NMRF. Such loss must be determined targeting a level of certainty equal to 99.95% (i.e. it cannot be exceeded in the 99.95% of the cases on a 10 business day horizon).
- **Circumstances under which institutions may calculate a SSRM for more than one NMRF**. These Final draft RTS set out that institutions may calculate a unique SSRM for more than one NMRF if those risk factors belong to the same regulatory bucket and the institutions use the regulatory bucketing approach for assessing the modellability of those risk factors.
- **Aggregation of the stress scenario risk measures**. These Final draft RTS propose an aggregation formula that aims at capturing the following effects:
    - The non-linearity in the loss function for NMRF for which the institution identified the extreme scenario of future shock using the stepwise method. However, when losses grow faster than linearly, the expected shortfall of losses for varying is higher than the loss of the expected shortfall, such non-linear effects should be captured in the aggregation formula.
    - The uncertainty due to the lower observability of non-modellable risk factors, statistical estimation error and the uncertainty in the underlying distribution for NMRF. It should be noted that where the institution applies the stepwise method such uncertainty is already captured where identifying the extreme scenario of future shock; accordingly, such effect has to be captured in the aggregation formula only for risk factors where the extreme scenario of future shock has been identified applying the direct method.
    - The liquidity horizons of the relevant NMRF since the general methodology has been designed to get a 10-days SSRM.
    - The correlation among NMRF.

3. Next steps (cont.)

- The final draft RTS will apply from the **twentieth day** following that of their publication in the Official Journal or the European Union.

16/12/2020

Final Draft Regulatory on Technical Standards (RTS) for the contractual recognition of stay powers under Bank Recovery and Resolution Directive (BRRD)

1. Context

Directive (EU) 2019/879 of the European Parliament and of the Council of 20 May 2019 amended Directive 2014/59/EU by introducing, amongst other, certain safeguards in order to enhance effective resolution execution in relation to financial contracts subject to third-country law in the absence of a statutory cross-border recognition framework, which ensures the effectiveness of the contractual recognition of stay powers by a Member State's resolution authority. This amendment also align the BRRD with the relevant international standards for cross-border effectiveness of resolution actions such as the Financial Stability Board's 'Key Attributes of Effective Resolution Regimes for Financial Institutions', and 'Principles for Cross-border Effectiveness of Resolution Actions'.

In this context, the EBA has published **the Final Draft RTS on the contractual recognition of stay powers under BRRD** with the aim to determine the content of the contractual term to be included in financial contracts, so that the parties recognize that the contract may be subject to the exercise of the powers of the resolution authorities to suspend or restrict the rights and obligations established in BRRD.

2. Main points

• **Contents of the contractual term**. Contractual recognition term in a relevant financial contract governed by third country law shall include all of the following terms:

- Acknowledgement and acceptance by the parties that the contract may be subject to the exercise of powers by a resolution authority to suspend or restrict rights and obligations under BRRD.
- Description of or a reference to the powers of the relevant resolution authority as set out in BRRD and a description of the conditions of exclusion of certain contractual terms in early intervention and resolution.
- Recognition by the parties that they are bound by the effect of an application of the powers and requirements referred in the previous point and by the requirements of exclusion of certain contractual terms in early intervention and resolution. This powers are specifically:
    - The suspension of any **payment or delivery obligation**.
    - The restriction of enforcement of any **security interest**.
    - The suspension of any **termination right** under the contract.
- Acknowledgement and acceptance by the parties that the contractual recognition term is exhaustive on the matters described therein to the exclusion of any other agreements, arrangements or understandings between the counterparties relating to the subject matter of the relevant agreement.

3. Next steps

- The final draft RTS will apply from the **twentieth day** following that of their publication in the Official Journal or the European Union.

16/11/2020
Final draft RTS on prudential requirements for investment firms

1. Context

On 5 December 2019, the European Parliament and the Council published the Investment Firm Directive (IFD) and Investment Firm Regulation (IFR) which separates the prudential treatment of investment firms (IFs) and credit institutions and will be applicable 18 months after their entry into force. In the IFD/IFR, a significant number of mandates has been given to the EBA, often in consultation with the European Securities and Markets Authority (ESMA), which has direct implications for the implementation of the framework. In this sense, the EBA published in June 2020 its roadmap for the implementation of the new regulatory framework for investment firms which contains several mandates that cover a broad range of areas related to the prudential treatment of IF.

In this context, the EBA has published the **Final Draft RTS on prudential requirements for Investment Firms** which will ensure a proportionate implementation of the new prudential framework for IF taking into account the different activities, sizes and complexity of these.

2. Main points

- **Final Draft RTS on prudential requirements for IFs**. This document includes a set of Final draft RTS which cover the following aspects:
    - The first draft RTS included in this final report have been developed for the mandates in line with the EBA roadmap related to the authorisation of certain credit institutions:
        - Draft RTS on the **information to be provided for the authorization of IFs as Credit Institutions**, which consist of a subset of the information to be provided to competent authorities for the authorisation of a credit institution, as well as a set of requirements that is proposed in the EBA Draft RTS and ITS on Authorisation of Credit Institutions.
    - The second group of the mandates regarding the EBA roadmap related to capital requirements for IFs at solo level. The mandates are implemented by developing the following draft RTS:
        - Draft RTS to **specify the calculation of the fixed overheads requirement** and where the notion of material change is specified.
        - Draft RTS to **specify the methods for measuring the K-factors** which provides clarification on the measurement of most of the Risk-to-Client (RtC) K-factors and some of Risk-to-Firm (RtF) K-factors.
        - Draft RTS to **clarify the notion of segregated account** by setting the conditions for their identification for the purpose of calculating the capital requirement related to the K-factor client money held (K-CMH).
        - Draft RTS to **specify adjustments to the daily trading flow (K-DTF) coefficients** in the event that, in stressed market conditions, K-DTF requirements seem overly restrictive and detrimental to financial stability.
        - Draft RTS to **specify the calculation of the amount of the total margin** for the calculation of the K-factor clearing margin given (K-CMG) and the criteria for avoiding regulatory arbitrage in the event that K-CMG approach is used.
        - Draft RTS on the **criteria for subjecting certain IF to the CRR** which set the quantitative thresholds above which, an investment firm's activities should be considered to be of a significant scale which could lead to a systemic risk.
    - The Final Draft contains several accompanying documents which include a Draft on cost-benefit analysis/impact assessment concerning these draft RTS that assess the possible costs and benefits of the considered options and the relative scale of these costs and benefits for different stakeholders.

3. Next steps

- The RTS on prudential requirements for investment firms shall apply from **26 June 2021**.

15/12/2020
Updated Basel III impact study

1. Context

On December 2017, the Basel Committee on Banking Supervision (BCBS) finalised the Basel III framework, with the objective to reduce excessive variability of risk-weighted asset (RWAs) and improve the comparability of banks' capital ratios. Furthermore, in May 2018, the European Commission (EC) released a Call for Advice (CfA) requesting technical advice from the EBA on the implementation of Basel III reforms in the EU. The advice, published in 2019, included a quantitative impact assessment at the highest level of consolidation, a set of policy recommendations and a macroeconomic impact assessment.

In this context, the EBA has published its updated ad-hoc **impact study on the implementation of Basel III in the EU**. This report presents the updated quantitative impact assessment of the final Basel III reforms and a complementary analysis of the potential impact of the COVID-19 pandemic. The EBA conclusions in the original report remain unchanged. The EBA continues to support the policy recommendations published in its advice in 2019.

2. Main points

- **Sample and reference dates**. The study is based on a sample of 99 banks and has a reference date of December 2019.
- **Key findings of the quantitative analysis**. The overall impact is presented under two implementation scenarios:
    - <u>Basel III scenario</u>. This scenario updates the impact presented in the previous CfA reports. Under the Base IIII scenario:
        - The **minimum required Tier 1 capital** (MRC) increases by +18.5%.
        - The impact would determine a EUR 52.2 billion **total capital shortfall**, of which EUR 30.2 billion of CET1.
        - The **increases in MRC and capital shortfall** are noticeably lower than the estimates reported in the December 2019 CfA report, for a consistent sample.
    - <u>EU-specific scenario</u>. This scenario considers the additional features requested by the EC in its CfA. Under the EU-specific scenario:
        - The **MRC impact** would reduce to +13.1%, resulting in a total capital shortfall of EUR 33.0 billion, of which EUR 17.4 billion of CET1.
- **Complementary analysis on the potential effects of Covid-19 on Basel III**. There is still uncertainty around how banks' balance sheets will change as a result of the Covid-19 crisis. A complete assessment of how the Basel III reforms interact with the effects of the crisis is not possible in the absence of data that illustrate the actual impacts once these effects materialise. Therefore, the Report includes an analysis that is mainly qualitative in nature and reflects on the potential interactions between the different elements of Basel III framework and the expected shocks.

14/12/2020

- **2020 Risk Assessment of the European Banking system**
- **2020 Autumn 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 2019 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 Autumn EU-wide 2020 transparency exercise** which provides detailed information for 129 banks across 26 European Economic Area (EEA) countries and for 6 banks from UK. In April, the EBA already published an additional transparency exercise which came as a response to the outbreak of COVID-19 and provided market participants with bank-level data as of 31 December 2019, prior to the start of the crisis.

2. Main points

- **Sample of banks in the RAR**. The RAR builds on the supervisory reporting data that competent authorities submit to the EBA on a quarterly basis for a sample of 162 banks from 29 EEA countries (131 banks at the highest EU level of consolidation from 27 countries). 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 30 June 2020.
- **Data for the RAR**. The RAR is based on qualitative and quantitative information collected by the EBA. The report's data sources are the following:
    - EU supervisory reporting.
    - The EBA risk assessment questionnaire (RAQ), addressed to banks and market analysts.
    - Market intelligence as well as microprudential qualitative information.
- **Results of the RAR**. Despite the COVID-19 shock, banks have maintained solid capital and liquidity ratios and have increased their lending to the real economy. However, economic uncertainty persists, profitability is at record low levels, and there are several early signs for a deterioration in asset quality.
    - Banks have maintained strong capital and liquidity positions while they have increased lending to the real economy. Capital and liquidity ratios well above regulatory minimum allowed banks to provide necessary financing to non-financial corporations at the beginning of the crisis. Public guarantees and regulatory relief measures helped CET1 levels to recover from the initial hit after the outbreak of the pandemic, while extraordinary central bank facilities helped banks to maintain ample liquidity buffers despite tensions in wholesale funding markets. However, the leverage ratio fell slightly as total assets grew more than capital.
    - Asset quality is expected to deteriorate materially over the next quarters. Banks have booked significant provisions on performing loans that have resulted in a material increase in cost of risk. Although NPL ratios have continued to decline, other asset quality metrics already show signs of deterioration. Loans classified under IFRS 9 stage 2 and forborne exposures have increased markedly. The phasing out of COVID-19-related measures, such as moratoria on loan repayments and public guarantees, will also likely affect asset quality. In the long term, it is noteworthy that, according to an EBA preliminary analysis, more than 50% of exposures to large corporates are to sectors potentially vulnerable to climate risk.
    - Banks' operational resilience has been broadly unaffected despite the challenges posed by COVID-19. Nonetheless, the usage of information and communication technology (ICT) has grown further, increasing technology-related risks. Money laundering cases still pose important legal and reputational risks.
    - Banks' structural profitability challenges remain. Low interest rates, which may stay lower for longer than expected prior to the pandemic, and strong competition from both banks and non-banks, like FinTech firms, are adding pressure to banks' core revenues. The recent fall in operating expenses has offset somewhat the pressure on pre-provision profits, yet these costs might bounce back once the pandemic is over. COVID-19 might at the same time be the catalyst for many clients to become digital customers, hence increasing branch overcapacity. Banks might opt for M&A deals to exploit potential cost synergies.

Overview of key figures:

	CET1 ratio (transitional)	CET1 ratio (fully loaded)	Liquidity coverage ratio	NPL ratio	Share of Stage 2 loans	RoE	Leverage ratio (fully phased-in)
Q2 2020	15.0%	14.7%	166.0%	2.9%	8.2%	0.5 %	5.2%
Q1 2020	14.6%	14.4%	148.9%	3.0%	7.0%	1.3 %	5.2%

Reference date as of 31 March 2020 (Q1) and 30 June 2020 (Q2)

04/12/2020

Final Draft RTS on the treatment of non-trading book positions subject to foreign exchange risk or commodity risk

1. Context

CRR2 implements in EU legislation, inter alia, revised requirements to compute own funds requirements for market risk. In accordance with that Regulation, institutions are required to calculate own funds requirements for market risk for: i) positions held in the trading book; and ii) positions held in the banking book (i.e. non-trading book) bearing foreign exchange (FX) or commodity risk. Furthermore, the EBA is mandated to develop draft regulatory technical standards (RTS) to specify how institutions should calculate the own funds requirements for non-trading book positions that are subject to FX risk or commodity risk in accordance with the alternative standardised approach (SA) and the alternative internal model approach (IMA).

In this context, the EBA has published the **final draft RTS on the treatment of non-trading book positions subject to foreign exchange risk or commodity risk** that: i) specify the value that institutions are to use when computing the own funds requirements for market risk for banking book positions; ii) lay down a prudential treatment for the calculation of the own funds requirements for market risk of non-monetary items held at historical cost that may be impaired due to changes in the foreign-exchange rate; and iii) specify an ad-hoc treatment with respect to the calculation of the actual and hypothetical changes associated to banking book positions for the purpose of the backtesting and the profit and loss (P&L) attribution requirements.

2. Main points

- **Own funds requirements for non-trading book positions subject to FX risk**. The final draft RTS specify that institutions can use either the last available accounting value or the last available fair value as a basis for calculating the own funds requirements for non-trading book positions subject to FX risk. Although institutions are not expected to perform a full revaluation of non-trading book positions attracting FX risk, the draft RTS require them to update the FX component of those positions. The frequency at which such updates must be performed is monthly for institutions using the SA for capitalising the FX risk stemming from the banking book and daily for those using the IMA.
- **Non-monetary items**. The draft RTS also set out the treatment for non-monetary items held at historical cost that may be impaired due to changes in the relevant exchange rate. In this respect, the draft RTS identify a specific methodology that institutions should use when capitalising the FX risk stemming from those items under the alternative SA, while they require institutions to directly model the risk of an impairment due to changes in the relevant exchange rate when they capitalise the FX risk of those positions using the alternative IMA.
- **Non-trading book**. As regards non-trading book positions attracting commodity risk, the draft RTS set out that institutions are to use the last available fair value when computing the corresponding own funds requirements. The draft RTS specify that the fair value must be updated monthly where the own funds requirements for those positions are calculated using the alternative SA and daily where they are calculated using the alternative IMA.
- **Backtesting and P&L attribution requirements**. These draft RTS also include provisions about the calculation of the hypothetical profit and loss (HPL) and actual profit and loss (APL) for non-trading book positions. Specifically, for positions that are subject to FX risk or to commodity risk, the draft RTS generally expect institutions not to include in the effects of APL and HPL changes that are not related to FX risk or commodity risk and that may lead, for example, to overshootings when comparing those changes against the Value-at-Risk numbers. However, the draft RTS also foresee specific treatments that reduce the operational burden that institutions may be subject to if they were to isolate those components under all circumstances.

3. Next steps

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

03/12/2020
Reactivation of Guidelines on legislative and non-legislative moratoria

1. Context

The EBA Guidelines on legislative and non-legislative loan repayments moratoria were published on 2 April 2020 to ensure that banks, while maintaining comparable metrics, would be able to grant payment holidays to customers avoiding the automatic classification of exposures under the definition of forbearance or as defaulted under distressed restructuring. With the unfolding of the COVID-19 pandemic, in June 2020, the EBA extended the application date of its Guidelines by three months, from 30 June to 30 September 2020, and on the 21 September, communicated its phasing-out.

In this context, the EBA has decided to **reactivate its Guidelines on legislative and non-legislative moratoria**. This reactivation will ensure that loans, which had previously not benefitted from payment moratoria, can now also benefit from them. The EBA revised Guidelines, which will apply until 31 March 2021, include additional safeguards against the risk of an undue increase in unrecognised losses on banks' balance sheet.

2. Main points

- **New constraints**. As part of the re-activation of its Guidelines on legislative and non-legislative moratoria, the EBA has introduced two new constraints to ensure that the support provided by moratoria is limited to bridging liquidity shortages triggered by the new lockdowns and that there are no operational restraints on the continued availability of credit:
    - Only loans that are suspended, postponed or reduced under general payment moratoria not more than 9 months in total, including previously granted payment holidays, can benefit from the application of the Guidelines.
    - Credit institutions are requested to document to their supervisor their plans for assessing that the exposures subject to general payment moratoria do not become unlikely to pay. This requirement will allow supervisors to take any appropriate action.

  Institutions may apply these guidelines to reclassifications of exposures as defaulted due to distressed restructuring and/or forborne on the basis of moratoria that were applied between 1 October 2020 and 1 December 2020 and meet the other requirements. Where institutions do so, the 9-month cap requirement applies to changes in the payment schedule agreed in relation to such exposures.

3. Next steps

- This Guidelines will apply until **31 March 2021**.

16/11/2020

- **Methodological Note of the EU-wide Stress Test 2021**
- **2021 EU-wide Stress Test-Template Guidance**
- **2021 EU-wide Stress Test-Templates**

1. Context

In March 2020, the EBA decided to postpone the EU-wide stress test exercise to 2021 to allow banks to focus on and ensure continuity of their core operations, including support for their customers. The objective of the EU-wide stress test is to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of EU banks and the EU banking system to shocks, and to challenge the capital position of EU banks. The exercise is based on a common methodology, internally consistent and relevant scenarios, and a set of templates that capture starting point data and stress test results to allow a rigorous assessment of the banks in the sample.

In this context, the EBA has published the **Final methodology, draft templates and template guidance for the 2021 EU-wide stress test** along with the key milestones of the exercise. The methodology and templates include some targeted changes compared to the postponed 2020 exercise, such as the recognition of FX effects for certain P&L items, and the treatment of moratoria and public guarantees in relation to the current COVID-19 crisis.

2. Main points

- **Sample of banks and scope of consolidation**.
    - 49 EU banks will participate in the exercise covering broadly 70% of the banking sector in the euro area, each non-euro area EU Member State and Norway. In case the UK transitional period for negotiating additional arrangements with the EU is extended beyond 31 December 2020 and UK entities were to be included in the sample of the 2021 EU-wide stress test, HSBC France would need to be excluded from the sample. For its part, Bankia and CaixaBank have agreed on a merger that is planned to take place in 2021, however, the merger is pending the shareholders' approval. In case the shareholders approve the merger by beginning of December, the two banks will be excluded from the sample and replaced by Bankinter, Mediobanca – Banca di Credito Finanziario and Banco Comercial Português.
    - To be included in the sample, banks have to hold a minimum of €30 billion in assets. Nonetheless, CAs could request to include additional institutions in their jurisdiction provided that they have a minimum of €100 billion in assets.
    - The scope of consolidation is the perimeter of the banking group as defined by the CRR/CRD.
- **Reference date**. The exercise is carried out on the basis of year-end 2020 figures, and the scenarios will be applied over a period of 3 years from end 2021 to end 2023.
- **Macroeconomic scenarios**. The stress test includes a baseline scenario and an adverse scenario, applied over a period of 3 years from end 2021 to end 2023.
    - The exercise is conducted on the assumption of static balance sheet as in previous exercises, which applies on a solo, sub-consolidated and consolidated basis for both the baseline and the adverse scenario.
- **Risk coverage**.
    - Banks are required to stress test the following common set of risks:
        - **Credit risk**, including securitisation.
        - **Market risk**, **counterparty credit risk** (CCR) and **credit valuation adjustment** (CVA).
        - Operational risk, including conduct risk.
    - Banks are also requested to project the effect of the scenarios on net interest income (NII) and to stress P&L and capital items not covered by other risk types.
    - The risks arising from sovereign exposures are covered in credit risk and in market risk, depending on their accounting treatment.
    - FX effects have impacts on the net fee and commissions income (NFCI) and other remaining administrative expenses, as well as on the NII (which already applied to ST 20).
- **Results**.
    - The impact of the EU-wide stress test will be reported in terms of CET1. In addition, the Tier 1 capital ratio and total capital ratio, as well as the leverage ratio, will be reported for every year of the exercise.
    - Like in the 2016 and 2018 stress test, no hurdle rates or capital thresholds are defined for the purpose of the exercise. CAs will apply the results as an input to the SREP.

2. Main Points (cont.)

- **Process**. It involves close cooperation between the EBA, the CAs and the ECB, as well as the European Systemic Risk Board (ESRB) and the European Commission.
    - The ESRB and the ECB develop the macroeconomic adverse scenario and any risk type specific shocks linked to it.
    - The ECB supplies the macroeconomic baseline scenario.
    - The EBA coordinates the exercise, defines the common methodology as well as the minimum quality assurance guidance for competent authorities.
    - The CAs are responsible for the quality assurance process.
- **Main changes on the templates**. Two additional tabs are required:
    - COVID-19: banks are required to provide information regarding exposures under COVID-19 related moratoria, and newly originated exposures subject to COVID-19 public guarantee schemes (PGS).
    - Non-performing exposures (NPL Calendar): contains exposure values, components of the actual loss coverage, minimum loss coverage levels and amounts of insufficient coverage related to non-performing exposures in the scope of Regulation (EU) No 2019/630 amending CRR as regards minimum loss coverage.

3. Next steps

- **Key milestone dates of the 2021 EU-wide stress test exercise:**
    - Launch of the exercise at the end of January 2021.
    - Submission of results to the EBA: i) First submission at the beginning of April 2021; ii) Second submission in mid-May 2021; iii) Third submission at the end of June 2021; and iv) Final submission in mid-July 2021.
    - Publication of results by end-July 2021.

10/11/2020

Monitoring report on TLAC-MREL eligible liabilities instruments of European Union Institutions

1. Context

On May 2019, co-legislators adopted a package of amendments to the banking framework that modified CRR2, CRD5, BRRD2 and SRMR2, known as the banking package. This package updates the framework for the minimum requirement for eligible liabilities (MREL) and implements the Financial Stability Board (FSB) total loss-absorbing capacity (TLAC). For its part, CRR2 also expands the scope of the EBA's ongoing review of the quality of own funds and the quality of TLAC and MREL instruments.

In this context, the EBA has published the **first monitoring report on TLAC-MREL eligible liabilities instruments** with the objective to inform stakeholders about the implementation review on TLAC / MREL instruments and to present its views and current recommendations on specific features commonly seen in these instruments. This report it is not meant to analyse the final compliance of any given instrument, but to assess the application of the eligibility criteria and to present best practices. In addition, this Report highlights the importance to provide further guidance on the interaction between the clauses used for environmental, social and governance (ESG) capital issuances and the eligibility criteria for eligible liabilities instruments.

2. Main points

- **Sample**. This Report is based on the review of 27 transactions issued in 14 jurisdictions for a total amount of EUR 22,75bn. In particular, the Report includes EUR 21bn of senior non-preferred (SNP) issuances and EUR 1,75bn of senior holding company (HoldCo) issuances. According to the EBA quantitative report on MREL, out of the 222 resolution groups that were considered in the shortfall analysis, 117 show an MREL shortfall, totalling EUR 178 billion as of December 2018.
- **Results of the report**. The EBA observes that European banks have not waited for the adoption of the new banking package to start issuing MREL and TLAC instruments. The EBA also has obtained a set of conclusions on the following areas of analysis:
    - Availability. Availability criteria can generally not be verified solely on the basis of the contract. A complementary analysis may be warranted to establish that the issuing entity is a resolution entity or that the holders are not themselves resolution group entities or funded by the resolution group.
    - Subordination. The main areas covered in this section include: i) contractual subordination; ii) statutory subordination and iii) structural subordination. The recommendations include:
        - **Issuers should set out unambiguous terms on the ranking of notes in national insolvency**, and there should be no doubt that the notes are subordinated to statutory excluded liabilities.
        - Subordination of interest to excluded liabilities is not imposed as an eligibility criterion. However, **there should always be clarity in the terms and conditions of the bonds of the ranking of interest**.
    - Capacity for loss absorption. This section includes an analysis of the clauses on set-off and netting, acceleration of the interest and principal payments of the notes, interest and dividend, write-down and conversion and negative pledges. The recommendations include:
        - **Investigate further the interaction between set-off and netting clauses and relevant national laws** to better understand the effectiveness of such a clause in practice.
        - **A compensatory payment in the terms and conditions of the** notes from the holder in case an amount due to the issuer is unduly discharged as a result of netting or set-off can be seen as best practice.
        - **Acceleration can occur only on the ground of insolvency or liquidation**, and that, it cannot occur in resolution (or a moratorium).
    - Maturity. This section includes an analysis of the clauses on call and put options, incentives to redeem and supervisory approval for early redemption. The recommendations include:
        - **Careful monitoring of the wording of options**, especially for put options that are not exercised on the initiative of the issuer, to ensure in particular that put options cannot be exercised at any time.
        - **An explicit reference to prior approval of reductions** in eligible liabilities is recommended as for own funds.
    - Other aspects. In this section, the EBA assessed governing law, tax and regulatory calls, and tax gross-up clauses. The recommendations include:
        - **Tax gross-up should be accepted only under certain conditions**, as applicable to eligible liabilities instruments.

05/11/2020
Discussion paper on management and supervision of ESG risks

1. Context

In 2015 the EU adopted as a commitment the binding target of reducing greenhouse gas emissions by at least 40% by 2030, compared to 1990. In addition, the EU presented in 2019 the European green deal which included the objective that Europe would become climate neutral by 2050. For its part, the financial sector is expected to play a key role in financing the transition to a sustainable economy, which is why CRDV and the Investment Services Firms Directive (IFD) contain a mandate to the EBA to produce a report providing uniform definitions of Environmental, Social and Governance risks (ESG), as well as appropriate qualitative and quantitative criteria (including stress tests and scenario analysis) for the assessment of the impact of ESG risks on the financial stability of institutions in the short, medium and long term.

In this context, the EBA has published the **Discussion Paper on ESG risks management and supervision** aiming to collect feedback for the preparation of its final report on the topic. This paper provides a comprehensive proposal on how ESG factors and risks could be included in the regulatory and supervisory framework for credit institutions and investment firms. This Paper also provides details on the risks stemming from environmental factors, especially climate change, and illustrates ongoing initiatives and progress achieved on this topic over the recent years. In addition, this discussion paper also contains a non-exhaustive list of factors, indicators and ESG metrics.

2. Main points

- **Common definitions of ESG factors, ESG risks and their transmission channels**. This section provides definitions and examples about:
    - Environmental risks. Can include physical risks and transition risks. The first ones are defined as one of the transmission channels through which climate-related risks can materialise, impacting negatively the financial position of counterparties and, hence, potentially causing the depreciation of assets. The second ones comprise the risks related to the depreciation of assets due to policy, legal, technological and/or behavioral changes.
    - Social risks. Are related to the rights, well-being and interests of people and communities, which may have an impact on the activities of the institutions' counterparties.
    - Governance risks. Are the risks posed by the exposure of institutions to counterparties that may potentially be negatively affected by governance factors
    - Liability risks. Financial risks stemming from the exposure of institutions to counterparties potentially held accountable for the negative impact of their activities on ESG.
- **Quantitative and qualitative indicators, metrics and methods to assess ESG risks**. Quantitative and qualitative indicators will help to classify ESG risks. In addition, the following methodologies will support the identification, assessment and evaluation of these risks
    - Alignment method. The key principle behind this approach is for institutions, investors and supervisors to understand in how far portfolios are in line with globally agreed climate targets. The advantage of this method is that it introduces explicit and directly oriented objective. The disadvantage is that it's not focused on individual exposures.
    - Risk framework method. This method is a purely risk driven approach, it is focused on the sensitivity of portfolios and the impact climate change has on exposures actual riskiness. It does not make any statements on how the portfolio composition positions relative to global climate targets and as such does not provide an explicit guide to banks on how they would have to shift their portfolios to align with ESG factors. This method has the advantage of being risk-based, while its disadvantages are complexity and uncertainty.
    - Exposure method. This method is a tool that banks can apply directly to the assessment of individual clients and individual exposures, even in isolation. The basic principle of this approach is to directly evaluate the performance of an exposure in terms of ESG. This method has the advantage of being transparent and simple, while its disadvantage is the problems of comparability with some ratings

2. Main Points (cont.)

- **The management of ESG risks by institutions**. This section is structured around the three main elements:
  - Business strategies and business processes. The most relevant areas in order to reflect the ESG risks are i) monitoring the changing business environment and evaluating long-term resilience; ii) setting ESG risk-related strategic objectives and/or limit; iii) engaging with customers and other relevant stakeholder and iv) considering the development of sustainable products.
  - Internal governance. In relation to governance, aspects relating to the roles that institutions should have in order to successfully implement ESG risk management are included. Specifically, the following aspects are covered: i) management body and committees; ii) internal control framework and iii) remuneration.
  - Risk management. Active ESG risk management is consequently fundamental to ensure that institutions identify such risks in a timely manner, hence being able to respond to them. The main ones are:
    - **Risk appetite, risk policies and risk limits**. Institutions should also include in ICAAP and ILAAP frameworks a description of the risk appetite levels, thresholds and limits set for the identified material risks.
    - **Data and methodology**.
    - **Risk monitoring and mitigation**.
    - **Stress testing for climate risk**.
    - **Reporting and disclosure**. Consideration of ESG factors in the company's investments and activities should be included and reflected in reporting and disclosure.
  - Investment firms-specific considerations. Investment firms have very similar characteristics to banks and may therefore also be subject to ESG risks. In this respect, these firms are expected to consider ESG factors in their activities and to reflect their risk tolerance for ESG risks.
- **ESG factors and ESG risks in supervision**. This section elaborates details on how ESG risks could be reflected in supervisory review, building on common definition and the elements to be considered by institutions related to business strategies, business processes, governance and risk management. The main risks that should be assessed are:
  - ESG risks in business model analysis. Describes how the integration of ESG risks into the business strategy can be evaluated by the supervisors as an additional perspective when analysing the business model of credit institutions.
  - Internal governance and institution wide controls. Analyse the adequacy of banks' internal governance arrangements is assessed in the light of the risk profile, the business model, the nature, size and complexity of the bank.
  - Assessment of risks to capital. The relevant risks for assessing capital risks are:
    - **Credit risk**. While credit risk is generally assessed in the short to medium term, the introduction of ESG controls in the credit risk assessment carries the need to enhance the extension of the horizon of the analysis through the use of forward looking metrics (e.g. scenario analysis).
    - **Market risk**. Supervisors must assess how credit institutions proactively monitor the impact of ESG risks on their market risk positions.
    - **Operational risk**. Supervisors may consider that the risks that institutions finance increase the risk of future reputational or legal damage.
  - Assessment of risks to liquidity and funding. Supervisors must assess the risk of institutions to the lack of reliable and comparable information on climate exposure, which could create uncertainty and lead to pro-cyclical market dynamics.

3. Next steps

- Comments to this paper can be sent until **3 February 2021**.
- The report is expected to be delivered in **June 2021**.

16/10/2020

Final draft RTS on the prudential treatment of software assets

1. Context

As part of the Risk Reduction Measures (RRM) package adopted by the European legislators, the deductions from Common Equity Tier 1 (CET 1) items have been amended, introducing, inter alia, an exemption from the deduction of intangible assets in case of "prudently valued software assets, the value of which is not negatively affected by resolution, insolvency or liquidation of the institutions".

In this context, and after the consultation paper issued in June 2019, the EBA has published the **Final draft Regulatory Technical Standards (RTS) on the prudential treatment of software assets** which specifies the application of the exemption to the deduction of intangible assets from CET 1 and the materiality of the negative effects on the value which do not cause prudential concerns. In this sense, the EBA aimed at achieving an appropriate balance between the need to maintain a certain margin of conservatism/prudence in the treatment of software for prudential purposes, and the acknowledgment of the relevance of software assets from a business and economic perspective, in a context of increasing digital environment.

2. Main points

- **Prudential treatment of software assets based on their amortisation**. This final draft RTS contains an approach developed based on prudential amortization. Under this approach, the positive difference between the prudential and the accounting accumulated amortization would be fully deducted from CET 1 capital, while the residual portion of the carrying amount of software would be subject to a 100%risk-weighted. Furthermore, this approach would appropriately take into account the manner the recoverable value of software assets is negatively affected over time. The useful life of software estimated for accounting purposes should be shorter than the prudential amortization period. In this sense, the calibration of the prudential amortization period is set at 3 years. Institutions shall calculate the prudential amortization of software assets by multiplying the result derived from the calculation of the two following points:
    - <u>The amount at which the software assets have been initially recognised in the balance sheet of the institution in accordance with the applicable accounting framework</u>, divided by the lower of:
        - The number of days of **useful life** of the software asset, as estimated for accounting purposes.
        - **3 years** starting from the date on which the software asset is available for use and begins to be amortised for accounting purposes.
    - <u>The number of calendar days elapsed</u> since the date on which the software asset is available for use and begins to be amortised for accounting purposes, provided that this does not exceed the period of the previous point.
- **Supervision**. This final draft RTS covers a number of areas where a close scrutiny will be warranted by regulators, supervisors and external auditors, as a change in the current treatment might affect the accounting practices currently used by the supervised institutions and to what extent this would have an impact on the regulatory metrics. In this regard, potential areas to be monitored deal with the practices adopted for:
    - <u>The capitalization of the costs</u> related to internally generated software.
    - <u>The estimation of the expected useful life and the amortization methodology</u> of software assets.
    - <u>The treatment of software assets acquired as part of business combinations</u>.

3. Next steps

- This Regulation shall enter into force on the **day following that of its publication** in the Official Journal of the European Union and shall be binding in its entirety and directly applicable in all Member States.

02/10/2020
2021 Work Programme

1. Context

The EBA has published the **2021 Work Programme** describing the activities and tasks of the Authority for the coming year and highlighting its key strategic areas of work. The EBA 2020 work programme was adjusted to take into account the COVID-19 crisis, addressing the immediate concerns, while delivering on existing mandates and delaying some. One key adjustment to the 2020 work programme was to postpone the EU-wide stress test exercise from 2020 to 2021 to allow banks to focus on and ensure continuity of their core operations and support customers early in the pandemic. The EBA also revisited its planning for 2021, reprioritised its tasks, and identified a new horizontal priority to address the aftermath of COVID-19.

2. Main points

- **Strategic priorities**. The EBA has defined the key priorities for the organization:
  - <u>Supporting deployment of the risk reduction package and the implementation of effective resolution tools</u>. The EBA will continue to:
    - Fulfil the mandates assigned for the full implementation of the new **CRD/CRR, BRRD and IFD/IFR** legislative packages.
    - Prepare technical standards, guidelines and reports to support the timely implementation of the new **prudential regime for investment firms**.
    - Work to foster the increase of the **loss absorbency capacity** of the EU banking system.
    - Facilitate the **operationalisation of the resolution tools** and the interactions with securities and competition laws.
  - <u>Reviewing and upgrading the EU-wide EBA stress testing framework</u>. The 2021 EU-wide stress test will follow a similar structure in terms of methodology, sample and timing of the 2020 exercise stable. However, the EBA has already started a reflection on more structural long-term changes and it will design a new methodology to be introduced for the 2023 EU-wide stress test at the earliest.
  - <u>Becoming an integrated EU data hub, leveraging on the enhanced technical capability for performing flexible and comprehensive analyses</u>. The EBA will be a data hub at the service of competent authorities and the public as it expects an increase in data requests from national competent authorities (NCAs) and external stakeholders. Quantitative Pillar 3 data will be integrated with supervisory reporting data to the greatest possible extent, and the EBA will act as a hub for Pillar 3 disclosure.
  - <u>Contributing to the sound development of financial innovation and operational resilience in the financial sector</u>. The EBA will continue to focus on ensuring technological neutrality in regulation and supervisory approaches. Specific areas of work will include platformisation, regulatory and supervisory technologies, further work on operational resilience, and understanding developments in crypto-assets, artificial intelligence and big data.
  - <u>Building the infrastructure in the EU to lead, coordinate and monitor AML/CFT supervision</u>. The EBA will continue to lead policy development and promote effective and consistent policy implementation by NCAs. Qualitative and quantitative information will be gathered by the EBA in 2021 in order to build a database to foster the exchange of information between NCAs and support the new AML colleges.
  - <u>Providing the policies for factoring in and managing ESG risks</u>. The EBA will:
    - Produce the **report on the incorporation of ESG into the risk management of institutions and supervision**, setting out policy direction, indicators and methods on ESG-related governance, risk management and supervision.
    - Prepare the **ITS on ESG disclosures in Pillar 3** outlining the qualitative and quantitative information on environmental, social and governance factors.
    - Support and monitor market efforts to improve approaches to **scenario analysis and stress testing**, while gathering evidence around the prudential treatment of assets associated with environmental and/or social objectives.
    - Participate in global, European and national **initiatives in ESG risks**.
- **Focus on horizontal priorities for 2021**. Stemming from the horizontal strategic priorities, the EBA will take special care of the following in 2021:
  - <u>Establishing a culture of sound and effective governance and good conduct in financial institutions</u>. The EBA will work to ensure that issues around governance, conduct, including the treatment of customers and AML/CFT, as well as sustainability factors, are adequately captured in relevant supervisory frameworks, in particular ensuring that governance and conduct issues are sufficiently addressed including through the internal control framework of financial institutions.
  - <u>Addressing the aftermath of COVID-19</u>. The EBA will be active in monitoring and mitigating the effects of Covid-19 on EU banks, promoting coordinated actions of competent authorities. The EBA will intensify the assessment of asset quality as well as monitoring the use of moratoria and public guarantees in order to ensure that risk metrics remain reliable and that banks can support the recovery and cope with potentially increasing losses.

BANCO DE ESPAÑA
Eurosistema

10/12/2020
Circular 5/2020 sobre normas de información financiera pública y reservada

1. Context

In 2001, the BoS published Circular 6/2001 on holders of currency exchange establishments which determined the obligations that such holders had to report to the BoS. In addition, in 2017, published Circular 4/2017 on public and confidential financial reporting standards with the aim of adapting the accounting regime of Spanish credit institutions to the changes in the European accounting system resulting from the adoption of two new International Financial Reporting Standards (IFRS), IFRS 15 and IFRS 9. In this regard, Circular 4/2017 expresses the compatibility strategy to be carried out by the BoS with IFRS-EU when establishing a complete accounting framework, with special development of the most relevant aspects for financial activities.

In this context, the BoS has published **Circular 5/2020 on public and private financial reporting standards and model financial statements**, which amends Circular 6/2001 and takes as a reference and incorporates improvements and clarifications to Circular 4/2017, as it requires payment institutions and electronic money institutions to apply the same accounting standards as credit institutions. Additionally, this Circular represents a step forward in the homogenization of national accounting regulations for financial institutions in their convergence with the European accounting framework.

2. Main points

- **Public financial information**.
  - Content of financial information. It determines the documents to be published by payment institutions and electronic money institutions (annual accounts, management report and audit report) and general requirements on the content of the annual accounts, both individual and consolidated: (i) submission to the BoS of the primary individual financial statements; and (ii) submission of the financial statements on payment services and electronic money issuance by the 20th day of the second month following the month to which they relate.
  - Recognition, measurement and reporting criteria. Payment institutions and electronic money institutions shall report separately in the annual report of the individual and consolidated accounts on the activities of providing payment services or issuing electronic money, activities of providing other closely related operational or auxiliary services and other economic activities performed.
- **Reserved financial information**.
  - Processing criteria. It establishes that groups are subject to the specificities set out in this Circular, regardless of whether they apply the accounting criteria of this regulation or IFRS-EU directly. In addition, payment institutions and electronic money institutions will include in their databases, as a minimum, all the attributes of persons and transactions with debit or credit balances required to prepare public and reserved statements.
  - Reserved States. It includes the specificities of the reserved states, both individual and consolidated and relating to the statistical requirements of the Economic and Monetary Union, in terms of models, breakdowns, frequency and time of transmission.
- **Internal accounting development and management control**. Payment institutions and electronic money institutions must comply with the requirements for internal accounting development, management control and registration of guarantees, powers of attorney and procedures stipulated in Circular 4/2017.
- **Presentation of financial information in the BoS**. Payment institutions and electronic money institutions shall send the BoS the annual accounts, the management report and the audit report, as well as the public and reserved states in accordance with the requirements established in Circular 4/2017. In addition, the BoS may require from institutions, in general or in particular, all the information it needs to clarify and detail the public and confidential financial statements.

3. Next steps

- This Circular will come into force on **1 January 2021**.
- The first reserved financial statements to be sent with the new models will be those corresponding to **30 June 2021**.

BANCO DE ESPAÑA
Eurosistema

30/10/2020
Expectativas sobre los riesgos derivados del cambio climático y del deterioro medioambiental

1. Context

Climate change and environmental impact is a global concern that is being transformed into initiatives in different areas. In December 2019, the European Commission (EC) presented the European Green Deal, which contains a set of measures aimed at making Europe climate neutral by 2050. The BoS has also promoted initiatives aimed at addressing the implications of the energy transition for Spanish banks and has developed various public initiatives to promote awareness and preparedness in the banking sector.

In this context, the BoS has published the **Expectations on risks arising from climate change and environmental impact**, which aims to make explicit how institutions should progress in order to take these risks into account. This document is relevant to holding groups of banks and to banks not belonging to one of these holding groups.

2. Main points

- **Business model and strategy**. The BoS expects institutions to incorporate those risks arising from climate change and environmental impact that they consider may be material in the short and long term into their strategy, business model and risk appetite framework. Institutions may consider the following aspects:
  - Business environment. Entities could consider longer time horizons than traditional ones for the strategic planning of these risks.
  - Key performance indicators. Entities could incorporate these new risks by monitoring key indicators in their main lines of business.
  - Analysis of stress scenarios and exercises. Entities will advance in the development and use of tools such as scenario analysis and stress exercises.
  - Risk appetite framework. This framework is expected to include the description of these risks and their impact.
- **Corporate Governance**. The new challenges associated with climate and environmental risks make it necessary for the organisational structure and internal governance of the entities to be adapted so that these risks are taken into account. The BoS expects that the Board of Directors will be responsible for integrating the risks arising from climate change and environmental impact into the general strategy.
- **Risk management**. The BoS expects institutions:
  - Consider risks arising from climate change and environmental impact in an integrated manner in their current risk management procedures, and adopt a comprehensive approach to their identification, assessment, monitoring and mitigation.
  - Incorporate risks arising from climate change and environmental impact into their internal capital adequacy and liquidity assessment processes (ICAAP and ILAAP).
  - Explore the use of scenario analysis and stress test.
  - Make an effort to improve the availability and quality of existing data on climate change risks.
- **Disclosure**. The disclosure of consistent and comparable information on risks arising from climate change and environmental impact is essential to enable investors and other stakeholders to make informed decisions. The BoS expects institutions to consider risks arising from climate change and environmental impact that are material in their prudential reporting.

3. Next steps

- The BoS does not expect institutions to implement all the expectations set out in this document from the outset, but plans to start analysing their progress in relation to these **18 months after its publication**, so that the progress made by the institutions, the difficulties encountered and the areas for improvement can be assessed.

GOBIERNO DE ESPAÑA

17/11/2020
Ley 7/2020 para la transformación digital del sistema financiero

1. Context

The digital transformation of the economy and the financial sector represents a phenomenon of structural change that is driven by technological factors and by variations in the demand for services requested by citizens and companies. In particular, in the financial sector, new technologies produce efficiencies for the provider and users of financial services, as well as the reduction of information asymmetries and the improvement in the supervision of the financial sector. In this sense, the digital transformation must ensure that the capacity of the entire financial system to boost the economy and social and territorial cohesion is strengthened.

In this context, the Spanish Government has published **Law 7/2020 for the digital transformation of the financial system** with the aim of accompanying the digital transformation of the financial system with a set of measures aimed at establishing a regulatory framework for the regulatory sandbox in Spain. These measures are aimed at ensuring that the financial authorities have adequate instruments to continue to comply with their obligations in the digital context and to facilitate the innovative process of access to financing for the various productive sectors.

2. Main points

- **Controlled testing space**. This is a set of provisions that cover the controlled and delimited realization of tests within a project that can provide a technology-based financial innovation applicable in the financial system. There are three key aspects of the testing environment: i) it is a controlled space, which must be safe for the participants; ii) the controlled testing space is a regulatory and supervisory instrument; and iii) it is composed by a regulatory framework. The following regimes are discussed in this section:
    - Access regime. It establishes a system of single financial window for the presentation of projects by technological companies, financial entities, research centers or any other interested promoter.
    - System of guarantees and protection for participants. Seven main precautions are established, especially aimed at tests involving real users: (i) informed consent and protection of personal data; (ii) right of withdrawal; (iii) responsibility of the promoter; (iv) guarantees covering the responsibility of the promoter; (v) confidentiality; (vi) supervisory monitoring throughout the exercise of the tests; and (vii) possibility of interruption of the tests.
    - Output regime. The examination of the results will be carried out by the promoter of the tests and included in a report that will be sent to the authorities who have monitored the tests. The existence of a gateway to the activity is also contemplated, which implies a lightening of the legal and regulatory procedures required.
- **Other measures**. In this section the following measures are developed:
    - Specific provisions for the application of the principle of proportionality in all actions of public authorities in the financial sector.
    - A direct communication channel with the supervisory authorities is foreseen to give confidence to the innovators.
    - A channel is established for written consultations on regulatory and other aspects that may arise in the pursuit of evidence that may function as barriers to entry for different financial actors.
- **Institutional arrangements and accountability**.
    - Collaboration between authorities and coordination in their actions related to the digital transformation.
    - Constitution of a Commission to carry out the coordination between the authorities in order to establish homogeneous guidelines.

3. Next steps

- This law has come into force on the **day of its publication in the BOE**

17/11/2020
Circular 2/2020 sobre publicidad de los productos y servicios de inversión

1. Context

The publicity used by entities subject to the CNMV's supervisory activities can be very relevant for investors. Therefore, it is necessary that adequate regulation and supervision measures are established to ensure that the advertising is clear, sufficient, impartial and not misleading. In this sense, Order EHA/1717/2010, on the regulation and control of advertising for investment services, determined a system of advertising control based on a preventive and corrective approach that allowed the CNMV to require the cessation of advertising that does not comply with the applicable rules and obligations.

In this context, the CNMV has published **Circular 2/2020 on advertising of investment products and services**, which aims to develop the rules, principles and criteria to which the advertising activity of investment services and products should be subject, in accordance with the provisions of Order EHA/1717/2010, on the regulation and control of advertising of investment services and products.

2. Main points

- **Scope of application**.
  - This Circular is applicable to investment service companies, credit institutions and collective investment institution management companies when they carry out advertising activities for certain products and services.
  - Activities considered as advertising include activity on financial products, and services or activities subject to the supervision of the CNMV. The informative contents for the contracting of products or services subject to this Circular will not be considered advertising activity.
- **Control of advertising**.
  - Content and format of the advertising message. The information contained in commercial communications must be consistent with the information provided, including warnings, required by regulatory provisions or by requirement of the CNMV.
  - Commercial communication policy. Entities that carry out advertising activities must establish a commercial communication policy that includes adequate internal procedures and controls in order to guarantee compliance with the provisions of this Circular.
  - Registration of advertising. Entities shall keep an internal record properly updated of their advertising activities that complies with the conditions of truthfulness, completeness, accessibility and traceability necessary to facilitate the CNMV to perform its supervisory functions.
- **Supervision of advertising activity**. This Circular establishes the procedure to require the cessation or rectification of the advertising activity. In this sense, the CNMV may require entities to provide specific information on advertising campaigns or pieces in order to assess compliance with the requirements of Order EHA/1717/2010 and this Circular.

3. Next steps

- This Circular will come into force on **13 February 2021**, except for Rule 7 on the registration of advertising, which will come into force **six months after** the publication by the Bank of Spain of technical specifications.

30/10/2020

Final Rule on Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments

1. Context

U.S. global systemically important bank holding companies (GSIBs), as well as U.S. intermediate holding companies of foreign GSIBs, are required to issue debt with certain features under the Fed's total loss-absorbing capacity rule (TLAC) issued in December 2016. That debt could be used to recapitalize the holding company during bankruptcy or resolution if it were to fail. The objective of the TLAC rule is to enhance financial stability by reducing the impact of the failure of covered banking organizations by requiring such organizations to have sufficient loss-absorbing capacity on both a going-concern and a gone-concern basis.

In this context, the Agencies have published a **Final Rule on Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments** that applies to advanced approaches banking organizations with the aim of reducing both interconnectedness within the financial system and systemic risks. The final rule requires deduction from a banking organization's regulatory capital for certain investments in unsecured debt instruments issued by foreign or U.S. GSIBs for the purposes of meeting minimum TLAC requirements.

2. Main points

- **Scope of Application**. The final rule applies to advanced approaches banking organizations and generally requires deductions from capital for direct, indirect, and synthetic exposures to covered debt instruments and any other unsecured debt instruments with equal force or subordinated to covered debt instruments.
- **Deduction from Tier 2 Capital**. Under the final rule, an advanced approaches banking organization treats investments in covered debt instruments as investments in tier 2 capital instruments for purposes of applying the corresponding deduction approach in the capital rule. Deduction from capital is required for:
    - Investments in a covered bank holding company's or advanced approaches covered intermediate holding company's own covered debt instruments, as applicable.
    - Reciprocal cross holdings with another financial institution of covered debt instruments.
    - Investments in covered debt instruments of a financial institution while also holding 10 percent or more of the financial institution's common stock.
    - Investments in covered debt instruments that, together with investments in the capital of unconsolidated financial institutions, exceed 10 percent of the advanced approaches banking organization's CET 1 capital.

    Under the final rule, an advanced approaches banking organization may exclude from deduction investments in certain covered debt instruments up to five percent of its CET 1 capital, as measured on a gross long basis. For U.S. GSIBs, only excluded covered debt instruments are eligible for the five percent exclusion in the final rule. Generally, excluded covered debt instruments in the final rule are investments in covered debt instruments that are held in accordance with market making activities.

3. Next steps

- The Final Rule on Regulatory Capital Treatment for Investments in Certain Unsecured Debt Instruments is effective on **April 1, 2021**.

28/10/2020
Final Rule on NSFR: Liquidity Risk Measurement Standards and Disclosure

1. Context

Following the 2008 financial crisis, the Agencies implemented several requirements designed to improve the largest and most complex banking organizations' liquidity positions and liquidity risk management practices. In 2014, the Agencies adopted the liquidity coverage ratio (LCR) rule to improve the banking sector's resiliency to a short-term liquidity stress. In addition, the Fed also adopted the enhanced prudential standards rule, which established general risk management, liquidity risk management, and stress testing requirements for certain bank holding companies and foreign banking organizations. These reforms in the post-crisis regulatory framework did not include a requirement that directly addresses the relationship between a banking organization's funding profile and its composition of assets and off-balance commitments.

In this context, the Agencies have issued a final rule strengthening the resilience of large banks by requiring them to maintain a minimum level of stable funding over a one-year period. The **Final Rule on net stable funding ratio (NSFR)** will require large banks to maintain a minimum level of stable funding, relative to each institution's assets, derivatives, and commitments. As a result, the NSFR rule will support the ability of banks to lend to households and businesses in both normal and adverse economic conditions by reducing liquidity risk and enhancing financial stability.

2. Main points

- **NSFR**. The final rule requires large banking organizations to avoid excessively funding long-term and less-liquid assets with short-term or less-reliable funding and thus reduces the likelihood that disruptions in a banking organization's regular funding sources would compromise its funding stability and liquidity position. In addition, the final rule
    - Establishes a minimum NSFR requirement that is applicable on a consolidated basis to certain top-tier banking organizations with total consolidated assets of $100 billion or more, together with certain depository institution subsidiaries (covered companies).
    - Requires a covered company to calculate an NSFR based on the ratio of its available stable funding (ASF) amount to its required stable funding (RSF) amount and maintain an NSFR equal to or greater than 1 on an ongoing basis.
    - Includes public disclosure requirements for U.S. depository institution holding companies and U.S. IHC of foreign banking organizations that are subject to the final rule.

3. Next steps

- The Final Rule will be effective on **July 1, 2021**. Holding companies and any covered nonbank companies regulated by the Fed will be required to publicly disclose their NSFR levels semiannually beginning in 2023.

07/10/2020
Regulatory Capital Rule on Revised Transition of the Current Expected Credit Losses Methodology for Allowances

1. Context

In 2016, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) on Measurement of Credit Losses on Financial Instruments. The update resulted in significant changes to credit loss accounting under US generally accepted accounting principles (GAAP). The revisions to credit loss accounting under GAAP included the introduction of the current expected credit losses methodology (CECL), which replaces the incurred loss methodology for financial assets measured at amortized cost.

In this context, the Fed, FDIC and OCC have published the **Regulatory Capital Rule on Revised Transition of the Current Expected Credit Losses Methodology for Allowances** that delays the estimated impact on regulatory capital stemming from the implementation of ASU on Measurement of Credit Losses on Financial Instruments.

2. Main points

- **Temporary deferral**. The final rule provides banking organizations that implement CECL during the 2020 calendar year the option to delay for two years an estimate of CECL's effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period. The agencies are providing this relief to allow these banking organizations to better focus on supporting lending to creditworthy households and businesses in light of recent strains on the U.S. economy as a result of the COVID-19, while also maintaining the quality of regulatory capital.

3. Next steps

- This Final Rule **has come into force** after its publication.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

23/12/2020

- **PS 29/20 on CRD V**
- **PRA statement on the EU requirement on prudential treatment of software assets**
- **SS 31/15 on the ICAAP and the SREP**
- **PS on the PRA's methodology for setting Pillar 2 capital**
- **SS 32/15 on Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082, and PRA111**

1. Context

The PRA has published the **policy statement (PS) 29/20 on CRD V** that provides the final policy to consultation paper (CP) on designation of firms within certain consolidation groups. It also contains final PRA Rulebook instruments, statements of policy (SoP), supervisory statements (SS), and templates as published in near-final form in PS on CRD V. Moreover, the PRA has also published a **PRA statement on the EU requirement on prudential treatment of software assets**. CRR exempts software assets from the deduction requirement for intangible assets from Common Equity Tier 1 (CET1). In accordance with the European Union Withdrawal Agreement Act 2020, this requirement now applies to PRA-regulated firms.

Furthermore, the PRA has published a **SS 31/15 on the ICAAP and SREP** which is aimed at firms to which CRD applies and provides further detail on the high-level expectations outlined in the PRA's approach to banking supervision. Aditionally, the PRA has published the **PS on the PRA's methodologies for setting Pillar 2 capital** which sets out the methodologies that the PRA uses to inform the setting of Pillar 2 capital for firms to which CRD IV applies. Finally, the PRA has published the **SS 32/15 on Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082, and PRA111** which sets out the PRA's expectations of firms and provides further clarity on Pillar 2 data reporting.

2. Main points

PS 29/20 on CRD V

- **CRR consolidated prudential requirements**. The PRA introduces a new rule to designate the PRA subsidiaries of parent financial holding companies (FHCs) or parent mixed financial holding companies (MFHCs) as responsible for ensuring compliance with the group's CRR consolidated prudential requirements until the date on which its parent FHC or MFHC application for approval or exemption has been finally determined. This rule applies to a subsidiary firm controlled by a parent FHC in an EU Member State, or a parent MFHC in a Member State, that would be under an obligation to comply with CRR requirements on a consolidated basis with the same effect it had in the UK before its withdrawal from the EU.

PRA statement on the EU requirement on prudential treatment of software assets

- **Treatment of software assets**. Following the publication of the EBA Regulatory Technical Standards (RTS) on the prudential treatment of software assets, the PRA intends to consult in due course to maintain the earlier position whereby all software assets continue to be fully deducted from CET1 capital. In the meantime, while the revised EU requirement now applies to PRA-regulated firms, the PRA recommends firms not to base their distribution or lending decisions on any capital increase from applying this requirement. Firms should also take into account any significant software assets included in their regulatory capital in making capital management decisions.

SS 31/15 on the ICAAP and the SREP

- **ICAAP and SREP**. This SS includes the following chapters:
    - Expectations of firms undertaking an ICAAP. This sets out expectations in relation to the ICAAP and the requirements set out in the ICAA part of the PRA Rulebook.
    - Stress testing, scenario analysis and capital planning. This sets out expectations of firms in relation to stress testing, scenario analysis and capital planning, and the requirements set out in the ICAA part of the PRA Rulebook.
    - Reverse stress testing. This sets out expectations of firms in relation to reverse stress testing, and the requirements set out in the ICAA part of the PRA Rulebook.
    - The SREP. This sets out the factors that the PRA takes into consideration to assess a firm's ICAAP, including the setting of form-specific capital requirements and the PRA buffer.

2. Main Points (cont.)

PS on the PRA's methodologies for setting Pillar 2 capital & SS 32/15 on Pillar 2 reporting, including instructions for completing data items FSA071 to FSA082, and PRA111

- **Pillar 2**. This PS includes the following sections:
  - Pillar 2A methodologies. This sets out the methodologies that the PRA will use to inform the setting of a firm's Pillar 2A capital requirement for credit risk, market risk, operational risk, counterparty credit risk, credit concentration risk, interest rate risk in the non-trading book (IRRBB), pension obligation risk and Ring-fenced bodies (RFBs) group risk.
  - Pillar 2B. This provides information on the purpose of the PRA buffer, how it is determined and how it relates to the CRD IV buffers. This section also provides details on the PRA's approach to tackling weak governance and risk management under Pillar 2B and RFB group risk.

  Firms are required by the Reporting Pillar 2 part of the PRA Rulebook, or may be asked, to submit data to inform the PRA's approach to setting Pillar 2A capital requirements. Data may be requested on an individual, consolidated and/or sub-consolidated basis as applicable.
- **Reporting Pillar 2**. Firms are required to report Pillar 2 data to the PRA. This information, together with data already collected in other regulatory reports, allows the PRA to assess a firm's ICAAP and to calculate capital benchmarks for Pillar 2 risks. The data collection covers:
  - The results of the Pillar 2 capital methodologies calculated by firms.
  - Data that are used by the PRA to process the Pillar 2A capital methodologies.
  - Data that allow supervisors to verify the calculation of the Pillar 2A capital methodologies.
  - Data that allow supervisors to assess firms' stress test results and facilitate the calculation of the PRA buffer.
  - Data that provide additional information on the nature and scale of the Pillar 2 risks to which a firm is exposed.

  Firms are required to return the data items in conjunction with their ICAAP submission. Frequency of submission will depend on the frequency of ICAAP submission

3. Next steps

- The Rule on CRR consolidated prudential requirements applies from **28 December 2020** until the end of the transition period.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

03/11/2020

- **Consultation Paper 8/20 on Bank Recovery and Resolution Directive II**
- **Consultation Paper 9/20 on Resolution assessments: Amendments to reporting and disclosure dates**
- **Consultation Paper 20/20 on Operational continuity in resolution: Updates to the policy**

1. Context

In December 2018, the PRA published a consultation paper (CP) where it outlined its thinking on the scope of operational continuity arrangements and committed to reviewing its existing Operational Continuity In Resolution (OCIR) policy in light of the Bank of England's (BoE) thinking and firms' experiences of implementation. On the other hand, regarding the Brexit, the UK is required to transpose the BRRD II amendments by 28 December 2020 but will subsequently cease to have effect from 31 December 2020, because of the implementation period (IP) completion day resulting from the withdrawal from the EU. Therefore BRRD II will apply for 4 days in the UK.

In this context, the PRA has published the **CP 18/20 on BRRD II** which sets out proposals relating to its Contractual Recognition of Bail-in (CROB) and Stay in Resolution Rules ("Stays") of the PRA Rulebook. Furthermore, the PRA has also published **CP 19/20 on Resolution assessments** which sets out the proposal to move back, by one year, the dates by which firms are first required to submit a report of their assessment of their preparation for resolution, and to first publish a summary of that report. Aditionally, the PRA has published **CP 20/20 on OCIR** that sets out its proposals to revise its OCIR policy and aims to improve firms' resolvability.

2. Main points

Consultation Paper 18/20 on Bank Recovery and Resolution Directive II

- **CROB and Stays**. In order to avoid two different impracticability notification regimes being in force at the same, and to provide firms with clarity as to which impracticability notification regime applies throughout those four days, the PRA proposes to:
  - Temporarily suspend part of the CROB Part of the PRA Rulebook from 28 December 2020. Reinstate the existing CROB Part, with minor amendments, to come into force immediately after IP completion day.
  - Amend the Stays Part of the PRA Rulebook from 28 December 2020 until IP completion day. Reintroduce the existing Stays Part, immediately after IP completion day.

Consultation Paper 19/20 on Resolution assessments: Amendments to reporting and disclosure dates

- **Reports and public disclosures**. The PRA proposes to move back, by one year, the dates by which firms are required to submit a report of their assessment of their preparation for resolution, and to first publish a summary of that report, as follows:
  - Firms would submit their first reports by the first Friday in October 2021, rather than by the first Friday in October 2020.
  - Firms would publish a summary of their reports by the second Friday in June 2022, rather than by the second Friday in June 2021.

  The dates of firms' subsequent reports and public disclosures would follow biennially, from October 2021 and June 2022 respectively.

2. Main points (cont.)

Consultation Paper 20/20 on Operational continuity in resolution: Updates to the policy

- **Continuity of critical functions and core business lines**. The proposals in this CP would require firms to consider the operational arrangements that support the viability of the firm, and its key drivers of revenue and profit in addition to those supporting its critical functions. This acknowledges that the process of resolution could take 3 to 6 months to execute and that implementation of a post-resolution restructuring plan is likely to extend beyond the point at which the firm has exited from resolution. The firm needs to be able to continue to operate throughout this process.
- **Financial Arrangements**. The PRA is proposing changes to its policy regarding the way firms' financial arrangements facilitate operational continuity. This proposal acknowledges that, since much of the firm will continue during resolution, firms would only need to cover situations in which financial resources would be available within the group, but might not be accessible in a timely manner. Firms would need to know how much financial resources they would need, and when and where those financial resources would be needed during resolution. They would also be expected to consider what might prevent such resources from being available in resolution.
- **Proposals to support continuity through changes to service provision**. Firms should be capable of ensuring continuity while being restructured following resolution. The PRA has proposed a number of changes to provide greater clarity compared with the existing policy, as well as amendments to the policy requirements that facilitate continuity throughout post-resolution restructuring. This includes amendments to the change capabilities needed to support transitional service arrangements and the need for predictable and transparent charging structures.

3. Next steps

- Comments to the CP 18/20 can be submitted until **30 November 2020**.
- Comments to the CP 19/20 and CP 20/20 can be submitted until **31 January 2021**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

26/10/2020
Consultation Paper 17/20 on further implementation of CRD V

1. Context

The EU published in May 2019 some of the remaining Basel III prudential reforms agreed by the Basel Committee on Banking Supervision (BCBS). This legislation is composed by CRD V, which is required to be transposed by 28 December 2020 and by CRR II, which applies directly in the EU. Both regulations will become a specific type of UK law known as 'retained EU law', through the operation of the EU Withdrawal Act 2018 at the end of the transition period.

In this context, the PRA has published the **Consultation Paper (CP) 17/20 further implementation on CRD V** which sets out proposed changes to the PRA rules, supervisory statements (SS) and statements of policy (SoP) to implement elements of the CRD V. This document also proposes to update aspects of the UK framework as a result of amendments in CRR II and which apply during the EU Exist Transition Period. This CP is relevant to banks, building societies, PRA-designated investment firms, UK financial holding companies, and UK mixed financial holding companies of certain PRA-authorised firms.

2. Main points

- **Implementation of certain elements of CRD V**.
    - Holding companies. The PRA makes a series of proposals for evaluating applications for certain types of parent financial holding company (FHC) or mixed financial holding companies (MFHC) approval or exemption.
    - Application of prudential requirements to approved holding companies. The PRA proposes to amend the relevant parts of the PRA Rulebook with the objective of ensuring that prudential requirements are meet at the appropriate level.
    - Interest rate risk in the banking book (IRRBB). The PRA proposes to implement the BCBS IRRBB standards directly in the PRA regulatory framework, including those requirements that CRD V was due to implement from the end of the transition period.
    - Capital buffers. The PRA proposes not to amend its framework for the identification of Other Systemically Important Institutions (O-SIIs), or to expand the range of firms to which a buffer rate applies. In implementing the O-SII buffer, the PRA proposes to continue its current approach to addressing group risk that arises from setting a buffer at individual firm and sub-consolidated level, but not consolidated level.
    - Maximun Distributed Amount (MDA). CRD IV requires that the PRA's existing approach precludes firms from making distributions that would cause their CET1 levels to fall into the combined buffer; CRD V does not amend this requirement so in order to increase the usability of the combined buffer, the PRA proposes to remove this restriction after the transition period ends.
    - Pillar 2. Under CRD V, firms are required to meet Pillar 2 Requirements (which are implemented by the PRA as Pillar 2A) with at least 56.25% CET1 capital, consistent with the proportion of Pillar 1 requirements CRR required to be met with CET1 capital. The PRA proposes to align with CRD V and require firms to meet Pillar 2A with 56.25% CET1.
    - Governance. The PRA proposes to apply CRD V's governance requirements to approved holding companies on a consolidated basis or sub-consolidated basis.
- **Implementation of certain elements of CRR II**.
    - Variable risk weights for real estate exposures. The PRA proposes the implementation of a discretion under CRR II to set stricter criteria than those specified in CRR, in order to apply a 50% risk weight to commercial real estate (CRE) exposures under the Standardised Approach to credit risk (SA).
    - Methods of consolidation. This CP proposes to make amendments to the methods of consolidation rules within the Groups Part of the PRA Rulebook.

3. Next steps

- Comments to this CP can be submitted until **17 November 2020**.

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

07/10/2020

Consultation Paper 14/20 on Internal Ratings Based UK mortgage risk weights: Managing deficiencies in model risk capture

1. Context

UK Financial institutions using the IRB approach for the calculation of credit risk capital show substantially lower mortgage risk weights than the EU average. Overall, the PRA considers that models delivering very low UK mortgage risk weights are not adequately taking into account relevant tail-risk events, and are likely materially deficient in risk capture.

In this context, the PRA has published the **Consultation Paper 14/20 on Internal Ratings Based UK mortgage risk weights and managing deficiencies in model risk capture** with the aim to address the prudential risks stemming from inappropriately low IRB UK mortgage risk weights. An additional benefit from these proposals would be a narrowing of differentials between IRB and standardised approach (SA) UK mortgage risk weights, and a limit on future divergence. The PRA considers that this would support competition between firms on the different approaches.

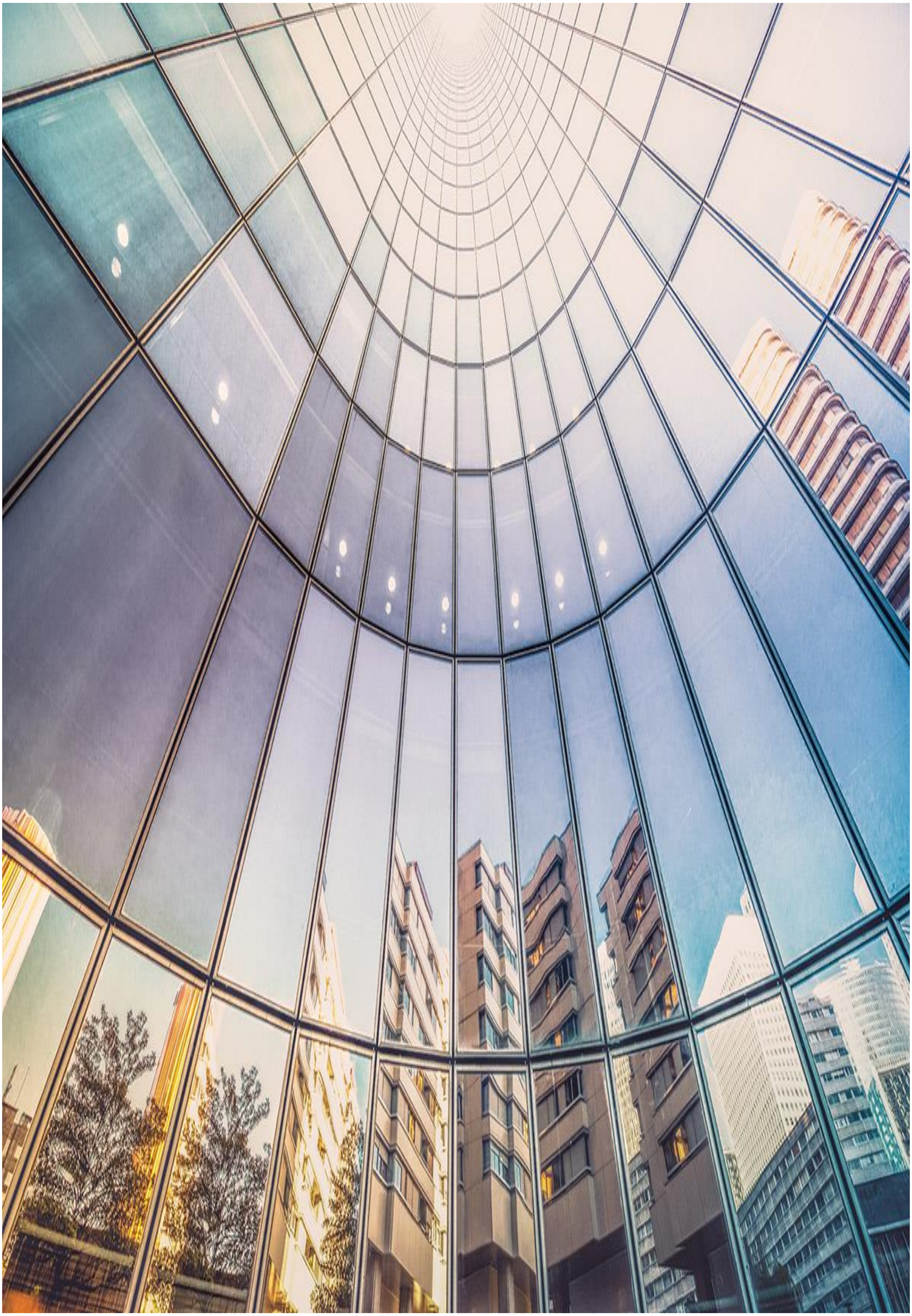
2. Main points

- **General aspects**. The PRA proposes to introduce two complementary expectations on the level of IRB UK mortgage risk weights, as all mortgage lending comes with a degree of risk. The PRA considers models delivering risk weights below these levels are likely to be materially deficient in risk capture. The PRA therefore proposes the following measures:
    - A risk weight of at least 7% for each individual UK residential mortgage exposure. This proposal is a simple, targeted, and efficient measure to encourage all IRB UK mortgage lending to be appropriately risk-weighted and capitalised, and would address any potential for deficiency in risk capture by IRB mortgage models.
    - An exposure-weighted average risk weight of at least 10% for all UK residential mortgage exposures to which a firm applies the IRB approach. The PRA considers that, at a portfolio level, this proposal represents a minimum level below which an IRB mortgage model is likely to be materially deficient in risk capture. The PRA recognises that firms' IRB models and risk management practices can support risk-sensitive lending at lower risk weights than those set under the finalised Basel III post-crisis SA approach level of 20%. However, the PRA considers that average IRB UK mortgage lending should not fall below half of the lowest future individual SA mortgage risk weight (20%).

  Both proposals would apply at all levels of consolidation, and cover all UK residential mortgage exposures.
- **Areas of concern**. Calculating IRB mortgage risk weights is inherently uncertain. Following detailed analysis over recent years, the PRA has identified the following particular areas of concern:
    - There is large variation in IRB risk weights between firms, particularly for low loan-to-value (LTV) mortgages, including variation between loans with similar LTVs.
    - Average UK IRB mortgage risk weights, including at low LTVs, are below international peers.
    - Risk weights for low LTV mortgages can be difficult to calibrate due to limited historical experiences of either extreme house price falls or the varying effects different types of economic downturn might have.
    - A minimum risk weight of 35% is currently applied to residential mortgages under the SA. This will reduce to 20% under the finalised Basel III post-crisis reforms for low LTV mortgages.
    - IRB mortgage risk weights have been falling for a number of years and it is unclear whether the trend will continue in the short term given the global pandemic.

3. Next steps

- Comments to this CP can be submitted until **30 January 2021**.
- The PRA proposes that the final policy resulting from this CP would take effect from **1 January 2022** alongside other



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