



Prudential Regulation Review

April 2018

April saw a number of significant regulatory developments: Non-performing and forborne loans were the subject of new proposed guidelines, following the high level of focus on this issue in recent months; and crypto-assets and crypto-currencies were the subject of a number of speeches and comments by senior regulators in the EU.

Capital (including stress testing and macro prudential)

The European Banking Authority (EBA) **published** its [Risk Dashboard for Q4 2017](#). It found that European banks have strengthened their capital ratios, with CET1 ratios now above 11% for all institutions. However, it noted that profitability and high levels of nonperforming loans (NPLs) continue to be a challenge for the European banking sector.

The European Central Bank (ECB) **published** a report on [how competition and regulation drive bank and investment fund risk profiles](#) and their market shares. Findings included that an increase in an asset's credit risk is associated with a decline in bank holdings of that asset, while the opposite is true for banks' holdings with respect to liquidity risk. Findings also suggest that higher capital requirements make the banking sector as a whole more reluctant to hold risky assets and thereby contribute to increases in banks' holdings of safe assets.

Liquidity

The Bank for International Settlements (BIS) published its Fourteenth progress report on [adoption of the Basel regulatory framework](#). The report focused on ensuring Basel III standards are transformed into national law or regulation according to the internationally agreed timeframes, and includes for the first time the finalised Basel III post-crisis reforms. Findings show the leverage ratio is in force in most member jurisdiction, 24 members have issued draft/final rules for the Net Stable Funding Ratio (NSFR), and 19 have issued draft/final rules for the revised securitisation framework.

Governance and risk management (including remuneration)

The EBA **consulted** on its Guidelines on the [types of exposures to be associated with high risk](#) under Article 128 (3) of the CRR, including specifications around speculative investments. The proposed Guidelines further clarify the notion of investments in venture capital firms and private equity. The consultation closes on 17 July 2018.

Danièle Nuoy, Chair of the Supervisory Board of the ECB, **spoke** on [risk appetite frameworks](#). She highlighted the areas in which she considers banks need to improve, including: the inclusion of non-financial risks; governance; the application of risk limits; and the embedding of risk appetite frameworks in the strategic decision-making process.

Crisis management (including special resolution, systemically important firms, and business continuity)

Sabine Lautenschläger, Vice-Chair of the Supervisory Board of the ECB, **contributed** to the Eurofi Newsletter.

She discussed the [need to refine the regulatory framework in the banking union](#), including the need to remove the overlap between standard supervisory measures and early intervention measures. Elke König, Chair of the SRB, **spoke** at the SRB press breakfast. She discussed the [SRB's priorities for 2018](#), including: determining binding MREL targets at the consolidated level; identifying substantive impediments to resolution, including the lack of adequate availability of data; and adopting resolution plans for the majority of banking groups under its remit. Elke König, also **spoke** on [resolution in Europe](#). She noted several areas in which she considered banks need to improve, including: building up MREL; addressing inadequate IT systems; and ensuring that the necessary data is instantly available during a crisis situation. She stated that further work is needed to help ensure liquidity in resolution and harmonise national insolvency procedures.

Elke König further **published** an article in Eurofi on MREL. She stated that the SRB will develop guidance on [solo/internal MREL and MREL calibration under transfer strategies](#) and will conduct further work on defining the need for subordination. The SRB will strive to implement internal MREL for banking groups with resolution colleges during the 2018 planning cycle.

Mauro Grande, SRB Board Member, **spoke** at the European Parliament on [money laundering in the banking system](#), noting that reputational risks can cause a bank to fail in a short period of time. He further stated that key relevant information on AML risks should be communicated to supervisors, and that supervisory dialogue should better assess business models that are more susceptible to reputational risks.

The IMF **launched** the [Global Financial Stability Report](#). This noted that economic recovery remained resilient despite market volatility. Also that short term risks to financial stability have increased, and medium-term risks remain elevated. The report discussed three main vulnerabilities: stretched valuations across many asset classes; borrowing by emerging markets and low-income countries; and bank dollar liquidity mismatches.

Dietrich Domanski, Secretary General of the FSB, gave a **speech** on the [FSB work plan 2018](#). Planned work includes completion of the outstanding G20 reforms (including whether further guidance on CCP resolution is needed), evaluation of these reforms (such as looking at the effects of reforms on financial intermediation), and monitoring of new and emerging risks (such as assessing crypto-assets).

Rethinking the domestic and international architecture for regulation

Valdis Dombrovskis, the European Commission Vice-President, **spoke** at the first informal ECOFIN press conference in Sofia. He encouraged Ministers to agree on a [general approach on the 2016 Banking package at the May ECOFIN](#). He further stated that at the June summit ECOFIN should make progress on a European deposit insurance scheme (EDIS) and strive for a clear mandate for a workable backstop for the Single Resolution Fund.

Ignazio Angeloni, Member of the ECB Supervisory Board, **presented** on Europe's Banking Union. He noted a number of [remaining hurdles to completing the Banking Union](#), including an incomplete macro prudential policy framework; an underdeveloped framework for resolution and crisis management; and the lack of progress on EDIS.

Danièle Nuoy, Chair of the Supervisory Board of the ECB, was **interviewed** for the Eurofi Newsletter. She discussed the causes of [low levels of cross-border consolidation](#), including national-level ring-fencing and a lack of regulatory harmonisation. She further stated that cross-border waivers on capital should be introduced.

Pentti Hakkarainen, Member of the Supervisory Board of the ECB, **delivered** a speech on "[Financial Integration, Competition and Efficiency](#)". He highlighted that financial integration and an international level playing field are necessary to achieve a truly competitive banking market. In this regard, at the EU level, the creation of a common deposit insurance system and regulatory cooperation will be needed to increase the integration of European markets.

The Single Resolution Board (SRB) **identified** the [obstacles to the defragmentation of the Banking Union](#), and a way forward. Observing that once the banking union is completed, member states would have little reason to maintain ring-fencing practices. The SRB strongly encouraged legislators to harmonise national insolvency laws, in order to create a level-playing field.

Disclosure, valuation and accounting

The EBA **launched** a consultation on its Guidelines on [disclosure by credit institutions of information on non-performing and forborne exposures](#). The guidelines specify the information related to non-performing (NPE), and forborne exposures and foreclosed assets, that banks should disclose, and provide uniform disclosure formats. The guidelines seek to allow supervisors to gain a better insight into the features and distribution of firms' problem assets, the quality and value of their collateral, and the efficiency of their recovery function.

Information security and data privacy

Tobias Adrian, IMF Financial Counsellor and Director of the Monetary and Capital Markets Department at the IMF, delivered a **speech** at the IMF FinTech roundtable. He highlighted the [risks that the rise of \(and the lack of regulatory coordination on\) crypto-assets](#) may cause in terms of financial stability and market fragmentation. He encouraged the creation of international standards on crypto-assets and argued for the regulation of ICOs and active supervision of crypto-exchanges.

Central Bank of Ireland

Sharon Donnery, Deputy Governor, Central Banking, has highlighted the progress made to date in tackling [non-performing loans \(NPLs\) in Ireland](#), though notes the significant complexity in dealing with the outstanding arrears cases. Research published today documents how NPLs arose following the Irish financial crisis and how they are still adversely affecting banks and the economy, and remain a cause of distress to many borrowers. The article outlines the policies and procedures, which have been implemented by the Central Bank to ensure a deliberate and determined reduction in NPLs, while ensuring borrowers are protected.

The Central Bank of Ireland has today published its first [Financial Stability Note](#). This new series will cover financial stability related topics including those relating to risks and vulnerabilities facing the Irish and European financial system.

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