Prudential Regulation Review

January 2018

The New Year brought a number of significant regulatory developments.

Andrea Enria, European Banking Authority (EBA), and Stefan Ingves, Basel Committee on Banking Supervision, spoke on the finalisation of Basel III. They both highlighted that the agreement in December was a major milestone.

The EBA launched its 2018 EU-wide stress test and released the macroeconomic scenarios for the test. Also, the EBA finalised guidelines on uniform disclosure requirements for transitional arrangements for IFRS 9.

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Capital (including stress testing)

The EBA published its Risk Dashboard for Q3 2017. It concluded that EU banks continued to strengthen their capital ratios; the ratio of non-performing loans (NPLs) kept a modest downward trend; profitability indicators have improved slightly; and the loan-to-deposit ratio for households continued to decrease.

The European Commission released its first progress report on the reduction of NPLs in Europe. It found that the NPL ratio declined to 4.6% in the EU in Q2 2017, down roughly 1% year-on-year and by a third since Q4 2014. Furthermore, the Commission stated that it will propose a package of measures to reduce the level of existing NPLs and to prevent a build-up in the future.

European Commission Vice-President, Valdis Dombrovskis, spoke on the Economic and Monetary Union. He observed that immediate priorities include completing the Banking Union and developing the European Stability Mechanism. He highlighted the ongoing work on reducing NPLs, and stated his desire for Europe to lead on tackling tax evasion.

Danièle Nouy, Chair of the Supervisory Board of the European Central Bank (ECB), spoke on the 2018 priorities for banks and supervisors. She encouraged banks to adapt their business models in light of low profitability and highlighted the work that the ECB is doing to reduce NPLs, noting that an addendum to the ECB's guidance on NPLs, currently subject to consultation, will be finalised in Q1 2018.

The EBA launched its 2018 EU-wide stress test and released the macroeconomic scenarios for the test. It said that the adverse scenario implies a deviation of EU GDP from its baseline level by 8.3% in 2020, resulting in the most severe scenario to date. The EBA highlighted that it would publish the results of the exercise by 2 November 2018.

Andrea Enria, Chairperson of the EBA, spoke on the Basel reform process. He explained that the package agreed in December was a "major achievement" and that it allayed some of his previous concerns. For example, the agreed restrictions on the scope of loss-given default (LGD) estimation for low-default portfolios reflected evidence that LGD estimation and wholesale portfolios are the most important targets when it comes to risk weighted asset variability in credit risk.

Stefan Ingves, Chairman of the Basel Committee on Banking Supervision (BCBS), spoke on the finalisation of Basel III as an important milestone. He noted, however, that work still remains in three key areas: to implement Basel III nationally, evaluate its effectiveness in reducing the excessive variability of risk-weighted assets and continue to monitor and assess emerging risks.

The Bank for International Settlements published a report assessing structural changes in banking after the crisis. It found that banks have become more resilient to risks and have strengthened their capital and liquidity buffers since the crisis, but return on equity has declined across countries and business model types since the crisis, in part because of lower leverage.

Liquidity

The European Commission published a Draft Delegated Regulation amending the Delegated Regulation on the liquidity coverage requirement for credit institutions. It proposed changes to align the calculation of the expected liquidity outflows and inflows on repos, reverse repos and collateral swaps transactions with the international liquidity standard developed by the Basel Committee; alter the treatment of certain reserves with central banks and non-EU Public Sector Entities; introduce a waiver for the minimum issue size for certain non-EU liquid assets; and introduce the new standardised criteria for securitisation.

Disclosure, valuation and accounting

The PRA published a "Dear CFO" letter regarding expected credit loss (ECL) accounting requirements under the International Financial Reporting Standard 9 (IFRS 9). In its letter, the PRA set out its expectations based on discussions with firms regarding core transition disclosures that should be provided to the market at the point of transition to IFRS 9. It highlighted that transition disclosures should include a quantitative assessment of the impact of each of the main differences between International Accounting Standard (IAS) 39 and ECL provisioning models and an explanation of the implications of ECL on governance, risk management, and regulatory capital.

The EBA finalised guidelines on uniform disclosure requirements for transitional arrangements for IFRS 9. The guidelines covered, among other things, own funds, the risk-based capital ratio and the leverage ratio. The EBA made clear that competent authorities must notify it that they comply or intend to comply with the guidelines, or otherwise give reasons for non-compliance.

The EBA issued a report on the implementation of its guidelines on methods for calculating contributions to deposit guarantee schemes. It found that its guidelines have broadly met the aim of introducing different contribution levels for institutions according to their riskiness. However, it said that the current method may allow for too much flexibility and may need to be reviewed in the future to ensure a consistent approach.

Deloitte Ireland Publication

Following the increased regulatory scrutiny (BMA assessment undertaken as part of the Supervisory Review and Evaluation Process), Deloitte Ireland has published an article focusing on the key drivers incentivising and forcing increased focus from financial services firms around Business Model Analysis. We also outlined, how institutions can prepare for the assessment of their business model and highlighted a number of factors firms should consider when analysing their business model.

Contact Us

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