



## Prudential Regulation Review

June 2018

June saw a number of supervisory bodies, including the EBA and EIOPA releasing their annual reports highlighting the work that EU and UK supervisory authorities have been undertaking on stress testing, resolvability, non-performing loans and financial stability. In addition, there was considerable attention on Macro Financial Stability and monetary policy.

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## Capital (including stress testing and macro prudential)

The EBA stated that it does not object to the Swedish FSA's proposals to apply a stricter national measure for credit institutions [using the IRB approach](#) to calculate regulatory capital requirements applicable to retail exposures collateralized by property. Specifically the Swedish FSA intends to change the risk weight floor method for Swedish mortgages. The EBA acknowledged the macro prudential risks in the Swedish economy related to residential mortgage loans and residential mortgage indebtedness, which it noted justified the stricter measures proposed.

The EBA consulted on the conditions to allow institutions to [calculate capital requirements of securitized exposures \(KIRB\)](#) in accordance with the purchased receivables approach of the Capital Requirements Regulation (CRR). The draft technical standards include specifications on internal credit and models for calculating KIRB for securitisations, the use of different risk factors, and due diligence requirements.

The ECB published a working paper on [Expected Loss Best Estimate \(ELBE\) and Loss Given Default \(LGD\) in-default](#). The paper proposes advanced Internal-Ratings Based models for defaulted exposures, as the ECB deems the current regulatory guidelines too general, with the potential to cause great variability in risk-weighted assets between institutions. The proposed methodologies seek to enable model comparability that can be adopted by most institutions.

The European Commission adopted a Delegated Regulation aligning [Solvency 2 Delegated Regulation with the Securitization Regulation](#). The definitions of securitization used in the Solvency II Delegated Act will be aligned with those in the STS Regulation, and so will repeal certain provisions in the Solvency II Delegated Act to avoid insurers being subject to different requirements. The Commission has also developed a new calibration for non-senior tranches of STS securitisations, which should also benefit from an adapted capital charge under Solvency II.

Valdis Dombrovskis, European Commission Vice-President, gave a speech on the [Pan-European Pension Product](#), sustainable finance, and the review of Solvency II. He said that now is the appropriate time to revise some of the rules on deferred taxes in Solvency II, but that the proposal to use a relative shift approach to model interest rate risk in the standard formula could be reviewed in 2020 rather than this year.

EIOPA published its spring [Financial Stability Report](#). The report found that insurers were adequately capitalized and remained profitable despite the low yield environment, but that there were significant disparities across insurers and countries. The report also identified a number of risks to insurers' financial stability including the low interest rate environment, sudden yield spike scenarios, and climate-related risks.

The FSB called for feedback on the [technical implementation of the Total Loss-Absorbing Capacity \(TLAC\) standard](#). The call for feedback covers, among other things, cross border implementation, distribution of TLAC instruments, and issuance strategies. The FSB indicated it may consider development of further implementation guidance in future.

## Liquidity

The ECB announced its methodology for [calculating Euro Short-Term Rate \(ESTER\)](#), and released the time-lagged publication of daily rate, volume and dispersion data based on the main methodological features of the forthcoming ESTER, called pre-ESTER. The first publication of pre-ESTER covered historical time series data for the reserve maintenance periods from 15 March 2017 to 2 May 2018. Regular releases for each reserve maintenance period will be issued from the summer of 2018 onwards.

ESMA published its [Risk Dashboard](#) for risks in the EU's securities markets for the first quarter of 2018. It noted that EU equity markets had experienced significant price corrections and the return of market volatility, which confirmed ESMA's concerns about high levels of market risk. While ESMA's outlook for liquidity, contagion and credit risk remained unchanged, ESMA judged that operational risk arising from Brexit-related risks to business operations and cyber-attacks continues to be elevated.

ESMA published an opinion on [CCPs' liquidity risk assessment under EMIR](#), which stated that CCPs should include, in the measurement of their liquidity needs, the default of their top two clearing members in all their capacities through the CCP. In addition, CCPs should also assess all entities to which they have a liquidity exposure in their stress testing scenarios.

## Governance and risk management (including remuneration)

Daniele Nouy, Chair of the Supervisory Board of the ECB, spoke on "[Good governance - an asset for all seasons](#)". She discussed the tools the ECB used to address governance, such as the SREP, fit and proper evaluations of Board members, and benchmarking. She also highlighted areas where banks still needed to improve, including boards' oversight of senior management, the quality of risk management controls, and the data quality of risk reports submitted to boards.

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

The FSB [Regional Consultative Group for Europe](#) discussed current financial vulnerabilities, including global and regional macroeconomic and financial market developments. In particular, the group discussed reforms to interest-rate benchmarks across Europe and the implementation of EU benchmark legislation. Members also discussed the importance of implementing the FSB's recommendations to address vulnerabilities in asset management activities.

Following completion of the [resolution of Banco Popular](#) Valuation 3 report - which determine whether shareholders and creditors would have received better treatment if the institution had been wound up under normal insolvency proceedings - the SRB announced that it now plans to provide affected shareholders and creditors with the right to be heard.

Thereafter, the SRB will adopt its final decision on whether compensation needs to be granted to those parties.

The SRB published a paper on [critical functions in resolution planning](#). It sets out the SRB's approach to the 2017 resolution planning cycle, in which the assessment of whether a function is critical is based on its impact and substitutability, and informed by reported data, comparison with peers and expert judgment. The methodology and guidance will be refined and enhanced over time.

The FSB launched its third thematic peer review on [bank resolution planning](#), to evaluate implementation of the international standard set out in the FSB's earlier guidance. The review will focus on banks other than G-SIBs, namely domestic systemically important banks (D-SIBs) and any other banks whose failures could cause systemic risk.

Dietrich Domanski, Secretary General of the FSB, spoke on [global resolution regimes](#). He highlighted several upcoming publications, including the final principles on bail-in execution and guidance on funding in resolution, due in the coming weeks. He also stressed the importance of other regulatory and industry measures, such as institution-specific cross-border cooperation agreements and the ISDA resolution stay protocols.

### [Rethinking the domestic and international architecture for regulation](#)

The ECB working group on [euro risk-free rates](#) launched a consultation on its assessment of three candidate euro risk-free rates against key selection criteria. The new euro risk-free rate will replace EONIA, which will no longer meet the criteria of the EU Benchmarks Regulation as of 2020.

The FSB published its [Principles on bail-in execution](#) to assist authorities when developing resolution strategies. It covers a number of topics including instruments within the scope of bail-in, valuations, and communications to creditors and the market.

The FSB also published an overview of responses to the Consultation on its [Funding Strategy Elements of an Implementable Resolution Plan](#). These include the need for authorities to identify correspondent banks in resolution plans, and to consider how to address impediments to the mobilization of collateral located in different jurisdictions.

The BCBS published a progress report on banks' adoption of its Principles for [effective risk data aggregation and risk reporting](#), BCBS 239. It noted that out of 30 G-SIBs, only three fully complied with the Principles and most had made only marginal progress. The non-compliance was attributed largely to the complexity and interdependence of IT improvement projects.

Claudio Borio, head of the Monetary and Economic Department at the BIS, spoke on [macro prudential frameworks](#). He noted that further work is required to identify risks and calibrate macro prudential tools, develop tools that target the non-banking sector, and implement mechanisms to address "cross-country leakages". He also observed that macro prudential measures need to be embedded in a "more holistic macro-financial stability framework."

### [Disclosure, valuation and accounting](#)

The EBA published the final [amended technical standards on supervisory disclosure](#), which specify the format, structure, content list and annual publication date of supervisory information to be disclosed by competent authorities. The standards also clarify the scope and split of supervisory responsibilities to disclose information between the ECB and national competent authorities.

The EBA **issued** a revised [list of validation rules](#) in its Implementing Technical Standards (ITS) on supervisory reporting, highlighting those which have been deactivated either for incorrectness or for triggering IT problems.

EIOPA published an expanded set of [Solvency II statistics on the European insurance sector](#). The new statistics provide granular details about the sector's financial exposures, including information about the types and location of exposures, asset classifications, and real estate exposures.

### [Other](#)

The EBA published its [2017 Annual Report](#), which highlighted its key publications, decisions and achievements in 2017. Over the course of 2017, the EBA made progress in finalizing aspects of the Single Rulebook for banking. It committed to strengthen banks' balance sheets and reduce non-performing loans, largely through its ongoing support for the European Council's action plan.

### [Central bank of Ireland](#)

CBI published its first [Macro-Financial Review of 2018](#) which provides an overview of the current state of the macro-financial environment in Ireland and highlights risks to the economy and financial system. The report noted the substantial growth in the domestic economy which in itself gives rise to potential risk. Sharon Donnery, Deputy Governor of Central Bank of Ireland, raised concerns over the stronger growth as it could add to overheating pressures if not managed prudently. Thus, emphasizing the need to ensure that the banks and financial system are sufficiently resilient to withstand unexpected shocks and give active consideration to using all of the tools available to help maintain sustainable and balanced growth.

An economic letter examines the implications of monetary union for [macro-financial stabilization policies](#) at national and area-wide levels. The paper states that the future evolution of the euro area will depend on both economic and political forces. Also, national and area-wide policymakers must make use of the improved institutional architecture to do a better job in terms of ex-ante risk management and ex-post crisis management.

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