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Prudential Regulation Review
October 2017

October saw the Basel Committee on Banking Supervision (BCBS) discuss the net stable funding ratio (NSFR) standard. It agreed to allow national discretion for the treatment of derivative liabilities and stipulated that national authorities could reduce the Required Stable Funding for gross derivative liabilities to 5%.

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Capital (including macro-economic issues and stress testing)

The European Central Bank (ECB) adopted an **opinion on the Commission's proposal to amend the European Market Infrastructure Regulation** (EMIR). The ECB highlighted that risks may emerge if information arising out of the European System of Central Banks' (ESCB) policy operations were to be leaked to the public and if market participants could identify the transactions of the ESCB. The ECB accordingly concluded that it is important that central bank transactions are fully exempted from reporting requirements.

The European Commission adopted an Opinion in favour of allowing the ECB to regulate **central counterparties (CCPs)** for monetary policy purposes. It noted that the changes would complement the Commission's proposal to amend EMIR by adapting the legal framework applicable to the ECB.

The European Banking Authority (EBA) published its latest **Risk Dashboard**, summarising the main risks and vulnerabilities in the Q2 2017 EU banking sector. It highlighted that banks' loan portfolios had improved and that EU banks' profitability continued to improve slightly. However, the EBA noted certain risks including the risk of fragmentation of asset quality and low profitability, and risks regarding the current level of non-performing loans (NPLs).

The ECB published a report on financial structures that showed **ongoing consolidation in the banking sector**. The report found that the number of credit institutions declined further in 2016, bringing the cumulative decline since 2008 to 25%.

Conduct of Business (including MiFID)

The Commission published a draft Implementing Regulation on the **extension, by an additional six months until 15 June 2018, of the transitional periods related to own funds requirements for exposures** to CCPs set out in the Capital Requirements Regulation (CRR) and EMIR. It noted that a further extension of the transitional period should enable institutions established in the Union to avoid significant increase in own funds requirements due to the lack of completion of the recognition process for CCPs.

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

The European Commission published a report providing an **assessment of the setting up and functioning of the Single Supervisory Mechanism** (SSM), in view of determining its effectiveness as the first pillar of the Banking Union. The report found that the establishment of the SSM had been overall successful but noted several areas for improvement, including those related to decision making processes at the ECB and the efficient functioning of joint supervisory teams.

Rethinking the domestic and international architecture for regulation

In a speech, Andrew Hauser, Executive Director for Banking, Payments and Financial Resilience at the BoE, said that **FinTech will have profound implications for the set of financial services available to households and firms**, and that central banks need to engage fully with these technological changes to keep delivering their monetary and financial stability objectives.

The EBA published its **work programme for activities in 2018** and a multiannual work programme highlighting key strategic areas of focus from 2018 to 2021. The EBA said that in 2018 it will focus on CRR/Capital Requirements Directive and Bank Recovery and Resolution Directive developments; reviewing the consequences of the revision of the trading book by the BCBS; enhancing its role as a data hub for banks in the EU; monitoring and evaluating the impact of Brexit; evaluating the Fintech regulatory perimeter; and contributing to tackling NPLs in Europe.

The EBA launched a **consultation on changes to the Pillar 2 framework** to review three guidelines aimed at enhancing institutions' risk management and supervisory convergence in the SREP. The EBA said it would focus on stress testing, particularly its use in setting Pillar 2 Capital guidance, as well as interest rate risk in the banking book (IRRBB).

The European Commission published a communication on **completing the Banking Union**, noting that while the completed parts of the Banking Union are functioning well, the European Deposit Insurance Scheme has yet to be completed and the Banking Union still lacks an effective, common backstop. The Council urged the European Parliament and Member States to reach a political agreement on a renewed commitment to complete the Banking Union by 2019.

The BCBS published its 13th progress report detailing the **adoption status of Basel III standards** and found that progress has been made in implementing the IRRBB, the net stable funding ratio (NSFR), and the large exposures framework. It highlighted that members are now turning to the implementation of total loss absorbing capacity holdings, the revised market risk framework, and the leverage ratio.

The BCBS discussed the NSFR standard and **agreed to allow national discretion for the NSFR's treatment of derivative liabilities**. It stipulated that national authorities could reduce the Required Stable Funding (RSF) for gross derivative liabilities to 5%. Under the NSFR framework, the RSF for gross derivative liabilities is currently set at 20%.

The BCBS released final guidelines on identification and management of step-in risk, with the aim of **mitigating potential spillover effects from the shadow banking system to banks**. The guidelines introduced an approach that does not prescribe an automatic Pillar 1 capital or liquidity charge additional to the existing Basel standards. The BCBS stated its expectation that the guidelines should be implemented in member jurisdictions by 2020.

The **FSB held a plenary meeting where it discussed its 2018 work plan**, noting that monitoring and publicly reporting on member jurisdictions' implementation of agreed reforms remains a priority. The FSB stated it will undertake an evaluation of the effects of reforms on financial intermediation and infrastructure investment financing. In addition, the FSB confirmed Mark Carney would remain as chairman for another year.

Disclosure, valuation and accounting

The ECB published an addendum to **guidance to banks on NPLs**, providing quantitative supervisory expectations for minimum levels of prudential provisions for exposures newly classified as Non-Performing Exposures (NPEs). It required that all banks should ensure prudential provisioning levels of 100% for the unsecured portion of new NPEs after two years, and 100% for secured portions after seven years.

Information security and data privacy

The FSB published a Stocktake of Publicly Released Cybersecurity Regulations, Guidance and Supervisory Practices capturing recent developments in the **regulatory approach to cyber security for financial services** among its 25 member jurisdictions.

The Stocktake noted that all of the FSB's jurisdictions had at least one regulatory standard or supervisory initiative in place addressing cybersecurity, but that across jurisdictions the approach was often inconsistent in scope or maturity. It also noted significant upcoming activity on cyber risk by regulators and supervisors, with 72% of the FSB's member authorities reporting that they intended to announce new measures in the next twelve months.

Central Bank of Ireland

The Central Bank of Ireland issued a statement in relation to the **tracker mortgage examination** maintaining that the Central Bank's consistent priority remains to ensure that lenders identify all customers affected by their unacceptable failings and pay appropriate redress and compensation.

The Central Bank of Ireland published its first **systemic risk pack**, which will be a bi-annual indicator pack providing an overview on current level of systemic risks in line with the objectives of the Central Bank's macro prudential policy.

Deputy Governor, Prudential Regulation, of the Central Bank of Ireland, Ed Sibley addressed the BFI National Conference covering **transforming banking for customers: a regulatory perspective.**

Deputy Governor Ed Sibley also spoke at the Financial Centres Summit, presenting his priorities for **prudential regulation fo the financial services sector in Ireland**.

A research paper by Michael Wosser identifies the balance sheet variables most closely associated with **systemic risk in European banks**; bank size, maturity-mismatch, market-to-book ratio and, to a lesser extent, non-performing loans.

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A number of regulatory requirements have recently been issued by various regulatory bodies including BCBS and the European Banking Authority which will impact **pillar 3 reporting** for institutions. In this article, we explore the requirements that are driving pillar 3 disclosures to become an integrated business as usual reporting requirement for firms and the increasing content of the disclosures, leading to a number of challenges for firms.

The **FRTB rules**, which represent a key post-crisis banking reform in the regulatory landscape, require all banks to implement the revised market risk standards by January 2019, imposing significant challenges for banks. In this article, we explore the key elements of the revised standardised and internal model approaches, some expected implementation challenges and we outline how firms can address the challenges.

Other

The European Commission published a report on **securities financing transactions (SFT) and mitigating associated risks**. The Commission concluded that there does not seem to be a need for further regulatory action at this stage. It noted it will continue to monitor developments in SFT markets and will reassess the added value of qualitative standards and haircut floors on the basis of a report to be prepared by ESMA once comprehensive SFT data is available.

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