



Prudential Regulation Review September 2017

After the summer break, September saw the European Commission publishing a major legislative package intended to reform and increase substantially the powers of the three European Supervisory Authorities (ESAs). The Commission encouraged the European institutions to treat the proposals “as a matter of priority” as it would like to ensure their entry into force before the end of the current legislative term of the Parliament in 2019, although this may be challenging.

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Capital (including macro-economic issues and stress testing)

The European Banking Authority (EBA) [published final technical standards on the Minimum Requirement for Own Funds and Eligible Liabilities \(MREL\)](#), reporting by resolution authorities, specifying templates and procedures to follow. Resolution authorities will report to the EBA the overall amount of MREL required for each institution under their jurisdiction, including all of the components of their MREL decision as set out in the EBA's Regulatory Technical Standard (RTS).

The EBA consulted on [significant risk transfer \(SRT\) in securitisation](#). The discussion paper seeks views on the standardisation of the SRT assessment process by National Competent Authorities (NCAs), safeguards and assessments relating to structural features widely present in securitisation transactions, and a set of proposals aimed at removing barriers in the current EU framework for measuring SRT.

The EBA published its [twelfth CRDIV-CRR/Basel III monitoring exercise for the European banking system](#), showing a further improvement of European banks' capital positions, with a total average Common Equity Tier 1 (CET1) ratio of 13.4%. Leverage ratios have increased to an average of 5.0% across all EU banks as of December 2016. The EBA also monitors Net Stable Funding Ratio (NSFR) compliance with the current Basel III standards, and their review showed that around 87.5% of participating banks would already meet the minimum NSFR requirement of 100%.

The ESAs Joint Committee issued its latest report [on risks and vulnerabilities in the EU's financial system](#). The report highlights the risks from an uncertain political environment in light of the UK's withdrawal from the EU; valuation risks in the context of an uncertain outlook for yields; low profitability; and challenges introduced by rapid developments in FinTech.

Sabine Lautenschläger, Member of the Executive Board of the European Central Bank (ECB) and Vice-Chair of the Supervisory Board of the ECB, spoke on the [importance of completing Basel III, and the need for a well-written but not too detailed EU rulebook](#) so as to allow supervisors flexibility, while eliminating loopholes in the system.

Mr Vitor Constancio, Vice President of the ECB, spoke at the European Systemic Risk Board (ESRB) annual conference on the [financial soundness of non-bank financial institutions, and the development of necessary tools to mitigate potential risk](#). His comments focussed on financial stability concerns arising from the increased size of the investment fund sector, and the amplified funding stresses stemming from the procyclical nature of existing margin and haircut-setting practices for collateralised securities and derivative transactions.

The Basel Committee on Banking Supervision published the results of its latest [Basel III monitoring exercise](#), finding all 200 banks in the sample met Basel III minimum and CET1 capital requirements, and all 30 G-SIBs met their fully phased-in liquidity requirements. The

Basel III minimum capital requirements are expected to be fully phased-in by 1 January 2019.

Governance and risk management (including remuneration)

The EBA published guidance to further harmonise [EU banks' internal governance](#). The guidelines emphasise the duties and responsibilities of the management body in its supervisory function in risk oversight; aim to enhance the information flow between the risk management function and the management body; and seek to ensure effective monitoring of risk governance by supervisors. The EBA Guidelines will apply by 30 June 2018.

The EBA and European Securities and Markets Authority (ESMA) published joint guidelines to assess the [suitability of members of management bodies and key function holders in line with CRD IV and MiFID II](#). Members should have sufficient time to cover all the necessary subjects, especially the establishment of business and risk strategies and the management of the main risks. The guidelines apply from 30 June 2018.

Conduct of Business (including MiFID)

The EBA issued its final recommendation to the EU Commission on the [new prudential regime for MiFID investment firms](#). The EBA specified its views on issues including the firm categorisation system; consolidated supervision; capital definition and composition; capital requirements and the methodology for calculation; liquidity requirements; concentration risk; Pillar 2 reporting; requirements for commodity derivatives investment firms; and remuneration and governance.

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

Daniele Nouy, Chair of the Supervisory Board of the ECB, spoke on [bank resolution frameworks](#). While she welcomed the progress made towards achieving the safety and soundness of banks, she reiterated that banks should be allowed to fail in a well-functioning market, but that it is crucial they do so in an orderly fashion. She highlighted that the Bank Recovery and Resolution Directive is currently being reviewed to make improvements, and that the EU has yet to complete the banking union by implementing a European Deposit Insurance Scheme.

Regulatory perimeter

The ECB [published](#) two draft guides for the assessment of license applications for credit institutions. The first guide sets out the **general process and requirements**, while the second is directed specifically at firms with a [FinTech business model seeking a full banking license](#). The guide for FinTech firms includes additional considerations for the supervisory assessment, including the level of technological knowledge of the management bodies; the adequacy of the initial capital held to ensure sound and prudent operation for at least three years; and the presence of specific and enhanced controls for IT, cyber, and

outsourcing risks.

The ECB published the first report from its joint research with the Bank of Japan to assess the [applicability of Distributed Ledger Technology \(DLT\) solutions in the area of financial markets infrastructures](#). The report found that DLT solutions could meet the needs of a Real-Time Gross Settlement system and potentially strengthen its resilience and reliability, but it also found that DLT performance is affected by network size and distance between nodes.

Rethinking the domestic and international architecture for regulation

The EU Commission published a communication on [reinforcing integrated supervision](#) and [adopted a package of proposals to amend the regulations establishing the ESAs and the ESRB](#), along with associated changes to the Solvency II and MiFID II Directives. The legislative proposals are intended to increase substantially the ESAs' powers, and also make material changes to their governance and funding.

The BIS appointed [Mark Carney as chair the Global Economy Meeting \(GEM\) and the Economic Consultative Committee \(ECC\)](#), effective on 1 December 2017. The GEM's main role is to assess developments, risks and opportunities in the world economy and the global financial system, and provide guidance to three Basel-based central bank committees. The ECC supports the GEM by preparing proposals for its consideration.

Disclosure, valuation and accounting

The EU Commission published the final draft of the RTS for the [disclosure of encumbered and unencumbered assets under the Capital Requirements Regulation](#). The rules require the disclosure of the balance sheet value per exposure class, broken down by asset quality, and the total amount of the balance sheet value that is unencumbered.

Information security and data privacy

The EU Commission outlined proposals for a [new EU Cybersecurity Agency to assist Member States in preventing and responding effectively to cyber-attacks](#). The EU Cybersecurity Agency will organise yearly pan-European cybersecurity exercises and will work to ensure better sharing of intelligence.

Central Bank of Ireland

Deputy Governor Sharon Donnery spoke at the joint Banco de Portugal - European Central Bank Conference on Risk Management in the context of the [changing European institutional architecture and regulatory environment](#).

Ed Sibley, Deputy Governor of Financial Regulation, spoke at the second annual ESRB conference on [the Irish experience, measures and solutions regarding NPLs](#).

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An economic letter by Naoise Metadger and Kitty Moloney considers the importance of the [definition of liquidity for stress tests on Investment Funds \(IFs\) and Money Market Funds \(MMFs\) and presents a prototype methodology](#) for liquidity monitoring based on maturity, sector and credit ratings of securities held by a number of Irish-domiciled funds.

Other

The EU Commission issued a draft regulation on the [final system of contributions to the administrative expenditures of the Single Resolution Board](#). Under the proposal, banks will contribute in proportion to the resource requirements they place on the Board, according to the size and risk of their activities.

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