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Prudential Regulation Review

July 2018

July saw a series of important developments around interest rate benchmark reform. The FSB issued a statement in which it concluded that for some markets, it will be important that transition away from interbank offered rates is to the overnight risk free rates (RFRs) rather than to term RFR rates. The EBA published its final guidance on strengthening the Pillar 2 Framework, updated its Risk Dashboard and found that the average ratio of NPL's has now reached its lowest level since Q4 2014.

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CENTRE *for* REGULATORY STRATEGY EMEA

Capital (including stress testing and macro prudential)

The EBA **published** final guidance to strengthen the Pillar 2 framework. The report included changes to the supervisory review and evaluation process (SREP) guidelines, revised guidelines on the management of interest rate risk in the banking book, and revised guidelines on institutions' stress testing.

The EBA **updated** its Risk Dashboard and found that the average ratio of non-performing loans (NPLs) had reached its lowest level since Q4 2014 (3.9%). Among the observations made by the EBA were that profitability remained a concern for the EU banking sector and, separately, that the loan-to-deposit ratio remained broadly stable.

The ECB **announced** that it will set bank-specific supervisory expectations for the provisioning of NPLs. Under this approach, the ECB said it would engage individually with each bank to define its supervisory expectations. It noted that bank-specific supervisory expectations are based on a benchmarking of comparable banks and an individual bank's current NPL ratio and main financial features.

The BCBS **published** its revised assessment methodology and the higher loss absorbency requirement for globally systemic banks. It introduced a number of enhancements, including amendments to the definition of cross-jurisdictional indicators as well as the introduction of a trading volume indicator and modification of weights in the substitutability category.

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

The ECB **published** a report on recovery planning. The ECB highlighted that not all banks adequately comply with the EBA guidelines on recovery plan indicators, as some banks fail to reflect in their indicator frameworks the risks and vulnerabilities that are most relevant to them. Furthermore, it specified that each bank's recovery plan should include a sufficiently wide range of recovery options, in line with the nature of its business, its size and its interconnectedness within the financial system.

Elisa Ferreira, Vice-Governor of the Bank of Portugal, **spoke** on completing the Banking Union and emphasised the need to establish the European Deposit Insurance Scheme. Furthermore, she observed that resolution authorities need to be able to rely on alternative sources to support resolution funds, especially in the current period of transition during which loss-absorbing capacity is not yet available.

The Committee on the Global Financial System at the Bank for International Settlements (BIS) **published** a paper on the implications of a prolonged period of low interest rates. It found that a "low for long" scenario would have a more adverse impact on insurers and private pension funds than on banks. Furthermore, it found that even in the absence of greater risk-taking, a future snapback in interest rates could be challenging for financial institutions.

Regulatory perimeter

The FSB **consulted** on the effects of financial regulation reforms on infrastructure finance. The FSB noted that while none of the G20 reforms specifically target the provision of infrastructure finance, a broad range of regulations can potentially affect it, for example, Basel III. Overall, the FSB concluded that its analysis thus far did not identify material negative effects of the reforms on infrastructure finance.

Innovative technology

TThe EBA **published** a report assessing the risks and opportunities from FinTech and **published** a report on Fintech's impact on incumbents' business models. The EBA assessed the microprudential risks of seven use cases in the banking industry, including biometric authentication, mobile wallets and robo-advice. Its report on business models identified risks to the sustainability of incumbents' business models, in which context it noted potential challenges such as formal and slow governance structure, further restricted by legacy ICT systems, or legacy non-performing assets.

Marja Nykänen, Member of the Board of the Bank of Finland, gave a **speech** on banking in the digital age. She observed that the more digital a bank becomes, the more vulnerable it is to cyber-attacks. Furthermore, she predicted that the industry would look more diverse, with new entrants providing financial services. She added that it will be important that authorities actively monitor the structural transformation and ensure a fair and uniform operating environment.

BIS **published** a paper on innovative technology in financial supervision (SupTech). It found that SupTech can help enhance supervisory effectiveness, cut costs and improve capabilities. A number of supervisory agencies, particularly those active in exploring data analytics applications, recently created dedicated units. However, the report highlighted that agencies face challenges including computational capacity constraints and increased operational risks, including cyber-risk, data quality, finding the right talent, management support and buy-in from supervision units.

Central Bank of Ireland

The Central Bank of Ireland triggered the countercyclical capital buffer (CCyB). From 5 July 2019, banks in Ireland will be required to hold an extra capital buffer equivalent to one percent of their risk-weighted exposures. Since its inception in December 2015, the Irish CCyB has been set at zero percent. The CCyB is to promote resilience in the banking sector: by requiring extra capital during upswings in the financial cycle, credit supply during future downturns can be supported by a corresponding reduction in the CCyB.

The Central Bank of Ireland published the Behaviour and Culture report into the five main Irish retail banks. The report, involving reviews conducted by the Central Bank in collaboration with the Dutch Central Bank, focused on the executive leadership team.

Other

Francois Villeroy de Galhau, Governor of the Bank of France, **delivered** a speech entitled "Europe in a disruptive world". He spoke of a new cycle of disruption in banking and predicted a "new financial constellation in Europe" post-Brexit, new customer needs and new players within the banking industry, and new technologies which would necessitate new regulations.

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