



Prudential Regulation Review March 2018

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Capital (including stress testing and macro prudential)

The EBA updated its list of regional governments and local authorities that are treated as central governments under the [Standardised Approach for the calculation of capital requirements](#) under the CRR. The updated list includes changes to the regional governments and local authorities in Finland.

The EBA published its thirteenth Report of the [CRDIV-CRR/Basel III monitoring exercise](#) on the European banking system. This exercise presents aggregate data on EU banks' capital, leverage, and liquidity ratios assuming full implementation of the CRD IV-CRR/Basel III framework. The results showed a further improvement in European banks' capital positions, with a total average Common Equity Tier 1 (CET1) ratio of 13.8% (versus 13.4% as of 31 December 2016).

The EBA published its advice on the European Commission's proposal for a [statutory prudential provisioning backstop for newly non-performing loans](#). The EBA's analysis found that after 7 years, the statutory prudential backstop would lead to a decrease in the CET1 capital ratio of 56 basis points for the average European bank, rising to 205 basis points after 20 years.

The EBA published an [assessment of the current credit risk mitigation \(CRM\) framework](#) as a part of its work on the review of the internal ratings-based (IRB) approach. The EBA noted that the fulfilment of the three mandates for regulatory technical standards (RTS) in the area of CRM in the CRR could lead to disproportionate regulation with limited benefits, and recommended that the mandate RTS on liquid assets be deleted from the CRR.

The ECB consulted on draft Guides to the [internal capital and liquidity adequacy assessment processes \(ICAAP and ILAAP\)](#). The Guides clarify the ECB's expectations on both the interplay between ICAAP and ILAAP elements and the integration of the ICAAP and the ILAAP into the institution's overall risk management framework. The Guides are not legally binding, and the consultation closes on 4 May 2018.

The ECB published its Addendum to its [Guidance to banks on non-performing loans \(NPLs\)](#). The document sets out its supervisory expectations for prudential provisioning for NPLs and introduces a Pillar 2 backstop for newly non-performing loans. Newly non-performing loans which are fully unsecured should be fully covered after 2 years, while NPLs that are fully secured should be fully covered after 7 years.

The EC consulted on the [impact of the finalisation of Basel III](#). The consultation covers changes to the standardised approach for credit risk, internal ratings-based approaches for credit risk, the CVA

risk framework, the operational risk framework, and the output floor. The consultation closed on 12 April 2018.

The EC published a proposed [package of measures to reduce non-performing loans \(NPLs\)](#). The measures include: a Regulation introducing a Pillar 1 statutory prudential backstop for newly originated loans that become non-performing; a Directive facilitating out-of-court collateral enforcement and fostering the development of secondary markets for NPLs by developing an EU passport; and a non-binding blueprint for the set-up of national Asset Management Companies.

The BIS published follow-up reports on [Basel III implementation assessments](#). The Committee also updated its Handbook for jurisdictional assessments, which incorporates lessons from the Committee's experience in conducting the Committee's Regulatory Consistency Assessment Programme (RCAP) and expands the methodology to cover assessments of the Net Stable Funding Ratio (NSFR) and the large exposures framework.

The BIS published its 2018 [Regulatory Consistency Assessment Programme \(RCAP\)](#). This is a summary of post assessment follow-up actions, which are taken or planned by member jurisdictions after the assessments to address findings identified by the RCAP assessments. Findings reflect major divergences from the Basel standards or timing differences with respect to forthcoming standards.

Liquidity

Benoît Cœuré, Member of the Executive Board of the ECB, spoke on the importance of [euro interest rate benchmark reforms](#). He outlined plans to develop an adoption plan for a risk-free overnight rate that can serve as the basis for an alternative to the benchmarks currently used in the euro area, and to ensure a smooth transition to this new benchmark.

The ECB launched a second public consultation on a new [euro unsecured overnight interest rate](#). This consultation followed the ECB's earlier decision to [develop such a rate based on transactions already reported by banks in the Eurosystem](#). The consultation seeks to gather stakeholder views on the methodology for the rate and its key parameters.

Governance and risk management (including remuneration)

Danièle Nuoy, Chair of the Supervisory Board of the ECB, spoke on [governance](#). She highlighted five key areas in which banks need to improve: fit and proper assessments for board members; independence of the board; the link between internal control functions and the board; risk appetite frameworks; and data quality.

Sabine Lautenschläger, Vice-Chair of the Supervisory Board of the ECB, spoke on the need to [align banking regulation and supervision](#). She argued that large investment firms and third-country branches should be subject to European-level supervision; that options and national discretions contained in European banking regulation should be harmonised; and that a common approach to insolvency laws and moratoriums should be created.

The EC published proposals for a [Regulation](#) and a [Directive](#) on [cross-border distribution of investment funds](#). The proposals seek to reduce distribution costs to support a more integrated single market for investment funds. The draft Directive proposes to ban the imposition of physical presence for UCITS, through the use of electronic or other distance communication with investors.

The EBA consulted on its Guidelines on the [management of non-performing exposures \(NPEs\)](#) and forborne exposures. The Guidelines set out the key elements for developing and implementing an NPE workout framework, including governance and operations, the internal control framework, NPE monitoring, and early warning processes. The consultation closes on 8 June 2018.

The European Systemic Risk Board (ESRB) published a report on [macro prudential structural buffers](#) and a revised Handbook on Operationalising Macro-prudential Policy in the Banking Sector. The publications included additional guidance for national authorities on Other Systemically Important Institution (O-SII) buffer calibration and proposed an increase in the O-SII cap from 2% to 3%.

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

Daniele Nouy, Chair of the Supervisory Board of the ECB, spoke on [opportunities and challenges for European banks](#). She cited old challenges stemming from the financial crisis, non-performing loans (NPLs), the long period of low interest rates, as well as new challenges such as technological change, and digital transformation. She cited Greek banks as an example, speaking about their improving conditions but also their continuing NPL challenge.

The Basel Committee published the results of its latest [Basel III monitoring exercise](#) based on data as of 30 June 2017. Findings show that all the banks in the sample meet both the Basel III risk-based capital minimum Common Equity Tier 1 (CET1) requirement of 4.5% and the target level CET1 requirement of 7%. All banks reported a Liquidity Coverage Ratio (LCR) at or above the 90% minimum requirement for 2018.

Sabine Lautenschläger, Vice-Chair of the Supervisory Board of the ECB, spoke on [banks and the market](#). She outlined the important role banks play in the European economy, and how they must be able to fail, otherwise the economy will suffer in the long run. However, banks must fail in an orderly manner as otherwise financial stability will suffer; and the European resolution framework helps to make this possible.

Regulatory perimeter

Ignazio Angeloni, Member of the Supervisory Board of the ECB, spoke on [proportionality in banking supervision](#). He cautioned against pursuing “proportionality” aimed only at softening the prudential burden for certain institutions. He also said that the ECB does not favour a modification of the existing legal framework to allow for less frequent reporting requirements for smaller banks.

The ECB published two guides for the assessments of [licence applications for banks and FinTech credit institutions](#). The first document presents the general application process and requirements regarding governance, risk management and capital. The second complements the first and explains the specific requirements for applications from FinTech firms.

The EBA issued an opinion on [measures to address macro prudential risk](#). The EBA did not object to the French High Council for Financial Stability's intention to tighten large-exposure limits applicable to large and highly indebted non-financial corporations (NFCs) in France. The applied measure prevents French systemically important institutions incurring an exposure exceeding 5% of their eligible capital (versus the prescribed large exposure limit of 25%) for highly indebted NFCs or groups of connected NFCs.

The EBA published a report on the [functioning of supervisory colleges](#) in 2017. It found that significant improvements had been achieved in college interactions, responsiveness, and in the quality, coverage and reasoning of the joint decision documents, but that further efforts are expected from both home and host supervisors to enhance the joint decision process and the completeness of SREP assessments.

The FSB published its [Global Shadow Banking Monitoring Report 2017](#). The report sets out a number of observations on the interconnectedness and activities of the shadow banking sector, including that the activity-based, narrow measure of shadow banking grew by 7.6% in 2016 and represented 13% of the total financial system assets in the jurisdictions monitored.

The FSB published a letter from its Chair to the G20 Finance Ministers and Central Bank Governors, setting out the [FSB's priorities](#) under the Argentine Presidency. These include vigilant monitoring to identify, assess

and address new and emerging risks; completing the G20's outstanding financial reform priorities; and evaluating policies that have been implemented to ensure the reform program is efficient.

The Basel Committee discussed [its work programme, current policy work, implementation of its standards, and initiatives to promote strong supervision](#).

The Committee agreed to assess further a recent stock take of identified transactions and behavioral responses by banks that could potentially constitute a form of regulatory arbitrage; exchanged views on recent market and supervisory developments, including the impact on the banking system of volatility in financial markets in the first quarter of 2018; and discussed the implications of the emergence of crypto-assets.

Rethinking the domestic and international architecture for regulation

The EC published its [Action Plan on sustainable finance](#). It is proposing to incorporate sustainability into prudential requirements and put in place a unified EU classification system to define sustainability, create an EU “green label” for financial products deemed sustainable, and identify the areas where sustainable investment can make the biggest impact. Valdis Dombrovskis, Vice-President of the EC, also gave a [speech](#) in support of the plan.

Mario Draghi, President of the ECB, spoke, on [the relevance of central clearing for monetary policy](#). Draghi viewed the EMIR amendments for enhanced third-country supervision and role of the ECB as “welcome and necessary”. He stressed that “the existing regime was never intended to cope with large-scale euro-denominated clearing activities being carried out in a country outside the EU”, and said the adoption of amendments to EMIR should be finalised in advance of Brexit.

Disclosure, valuation and accounting

The European Commission published a consultation on the [fitness check on the EU framework for public reporting by companies](#). The consultation aims to assess whether the EU reporting framework is still fit for purpose, and fit for new challenges such as digitalization and sustainability.

The BCBS consulted on a technical amendment to the [additional Pillar 3 disclosure requirements](#) for jurisdictions implementing an expected credit loss (ECL) accounting model as well as for those adopting transitional arrangements for the regulatory treatment of accounting provisions. The changes introduce additional disclosure requirements around the impact of ECL requirements on Total Loss-Absorbing Capacity and the credit quality of assets. The consultation closes on 4th May 2018.

Central Bank of Ireland

The Central Bank has published [CP118 - Review of the Consumer Protection Code for Licensed Moneylenders](#), seeking feedback from consumers and other interested parties, proposing new measures which would enhance the framework of protections for customers of licensed moneylenders.

The Central Bank of Ireland's Director General, Financial Conduct, Derville Rowland, today set out mitigating actions the Central Bank could require lenders to take depending on the outcome of [behaviour and culture assessments](#) which are currently underway.

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