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Regulatory News Alert

Capital Requirements Directive (CRD) – Episode 5 | The saga continues

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Three years on from CRD IV/CRR being finalized, the EU's banking sector now faces a revised **Capital Requirements Directive and Capital Requirements Regulation (CRD V and CRR II)**, and a host of other legislative amendments (notably on the Bank Recovery and Resolution Directive, BRRD), in a 500+ page package published by the European Commission on 23 November 2016.

The stated objective is to further strengthen the resilience of the banking sector by introducing more risk-sensitive capital requirements. At the same time, the new measures should make CRD/CRR rules more proportionate and less burdensome for smaller financial institutions, and improve banks' lending capacity to support the EU economy.

Scope of the proposal

The package contains notable reforms, of which the most impactful for Luxembourg institutions are summarized below.

Pillar 1	**Full implementation of Leverage Ratio (LR) and Net Stable Funding Ratio (NSFR)**	• Binding 3% Leverage Ratio for all banks • Introduction of some exemptions/waivers to reduce the leverage exposure measure • Binding NSFR, with clarification of rules to calculate the ratio, including 0% Required Stable Funding (RSF) for High Quality Liquid Assets (HQLA) Level 1 – eligible sovereign debt
	Fundamental Review of the Trading Book (FRTB)	• New standard on treatment of market risk (new standardized approach)
	Standardized Approach for Counterparty Credit Risk (SA-CCR)	• Replacement of the Mark-to-Market Method by the Standardized Approach for Counterparty Credit Risk and removal of the Standardized Method (modified Original Exposure Method is retained)
	Interest Rate Risk in the Banking Book (IRRBB)	• Standardized approach to capture IRRBB • European Banking Authority (EBA) to detail the standardized approach and define the supervisory shock scenarios to be used as part of SREP
	SME and infrastructure exposures	• Changes to capital requirements for exposures to SMEs • Preferential treatment for specialized lending exposures to infrastructure projects
Pillar 2	**Maximum Distributable Amount (MDA)**	• Clarification of the use of Pillar II requirements • Clarification of the rules on MDA triggers
	Remuneration	• Exemptions for the “smallest and least complex” institutions from certain remuneration requirements (incl. deferral rules and pay-out in instruments) • Added flexibility and proportionality
Pillar 3	**Disclosure and proportionality**	• Differentiated reporting and disclosure requirements for firms based on their categorization (“significant,” “small,” or “other”)

Discover a more detailed overview of this new regulatory package in this **PDF presentation**.

What’s next for these proposals?

The European Council and European Parliament will now begin a legislative process that should end by Q1 2019. At that point, secondary rulemaking by the European Banking Authority (EBA) and national regulators must also occur. As a result, the implementation of these rules by banks is still several years away, and some uncertainty will linger for some time as to how and when the requirements will be applied.

What should banks do now?

The CRD V/CRR II package will be among the most important regulatory developments for banks operating in the EU in the coming years and will demand an in-depth analysis. In particular, banks should assess the likely impact of these new rules on their product-by-product capital and liquidity requirements, risk management, and risk measurement capabilities.

This will be difficult to do, especially given that CRD V/CRR II is likely to be followed by yet another round of EU legislation in the coming years, implementing the remaining elements of the so called “Basel IV” framework. The EU’s declining appetite to “copy out” all aspects of the BCBS agenda, and the potential for greater international regulatory fragmentation arising from a new administration in the United States make such an assessment all the more challenging.

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