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Regulatory News Alert

EU banking package - CRD V/CRR II/BRRD II: Parliament adopts revised capital requirements and rules on resolution

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Context and objectives

In November 2016, the European Commission (EC) proposed a **banking reform package** to introduce further risk-reduction measures and advance the completion of the European post-crisis regulatory reforms. This banking package, as **agreed by the European Parliament on 16 April 2019**, implements some **international rules for banks** – set by the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) – and aims to make the financial system more resilient and stable.

In particular, the package, also known as **"Risk Reduction Measures (RRM) package"**, comprises amendments to:

i. the **Capital Requirements Regulation (CRR)** and the **Capital Requirements Directive (CRD)**, which were adopted in 2013 and set out prudential requirements for credit institutions and investment firms as well as rules on governance and supervision;

ii. the **Bank Recovery and Resolution Directive (BRRD)** and the **Single Resolution Mechanism Regulation (SRMR)**, which were adopted in 2014 and specify the rules on recovery and resolution of failing institutions as well as establish the Single Resolution Mechanism.

However, as the BCBS finalized its global standards only after the EC's proposal from 2016, the current version of the banking package **does not fully implement the Basel III framework**. The more recent changes to that framework, most notably those on credit and operational risk, are not included. This will be included in the next iteration of CRD.

Amendments to the existing rules

The key changes introduced by the banking reform package consist of the following:

- **Leverage Ratio**: A binding LR requirement, independent from the riskiness of the underlying exposures, introduced as a backstop to risk-weighted capital requirements. It is set at 3% of Tier 1 capital and applies in addition to the risk-based capital requirements.

- **Net Stable Funding Ratio (NSFR)**: The Basel NSFR standard is implemented. Yet, as recommended by the European Banking Authority (EBA), some adjustments were made with regard to pass-through models and covered bonds issuance. More specifically, the adjusted rules reflect the preferential treatment granted to these activities in the EU Liquidity Coverage Ratio (LCR). In addition, the Basel treatment for short-term transactions will not fully apply during a period of four years.
- **Market risk**: The Fundamental Review of the Trading Book (FRTB) framework as adopted by the BCBS in 2017 has been explicitly excluded from the scope of the banking package. Instead, the co-legislators adopted a reporting requirement, which will be applicable once the elements reviewed at international level are introduced via a number of delegated acts.
- **Proportionality**: The disclosure requirements become more proportionate for smaller and less complex banks. In addition, small banks will benefit from more simple and conservative prudential standards, notably for market risk, the NSFR, counterparty credit risk, interest rate risk in the banking book, and remuneration.
- **Sustainable finance**: The EBA obtained a mandate to investigate (i) how to incorporate environmental, social, and governance (ESG) risks into the supervisory process and (ii) what the prudential treatment of assets associated with environmental or social objectives should look like. ESG-related risks will also need to be publicly disclosed by large institutions.
- **Anti-Money Laundering (AML) rules**: The cooperation and exchange of information obligations between prudential and AML authorities is reinforced and an explicit AML dimension is added to several key prudential instruments, such as authorization, fit and proper tests and the supervisory review and evaluation process.
- **Bank crisis management framework**: The rules on the subordination of Minimum Requirement for own funds and Eligible Liabilities (MREL) instruments are tightened and a new category of large banks, the so-called “top-tier banks” with a balance sheet size greater than EUR 100bn, is introduced.

Other key measures relate to intermediate parent undertakings (IPU) that must be set up by third-country groups operating in the EU, the implementation of the Standardized Approach for Counterparty Credit Risk (SA-CCR) or the revision of the preferential treatment for SME financing.

Where we stand today

On **16 April 2019**, the European Parliament endorsed the provisional agreement reached with Member States during the political trialogue meetings at the beginning of December. The legislative texts still need to be formally adopted by the Council of Ministers.

A publication of the final texts in the Official Journal of the EU can be expected earliest at the **end of May or beginning of June**.

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How Deloitte can help?

Deloitte's advisory specialists and dedicated services can help you design and implement your business strategy in light of the evolution of regulatory frameworks and market trends.

Deloitte also offers the RegWatch Kaleidoscope service, assisting you with staying ahead of regulatory developments to better manage and plan upcoming regulations.

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