European Commission

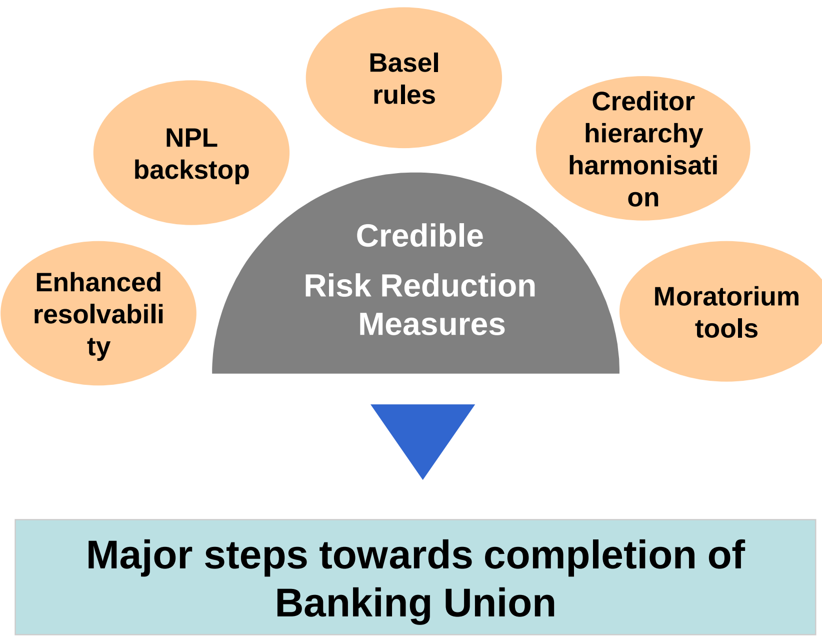
Banking Package

Florence School of Banking and Finance, 26 June 2019

Banking and finance

1. Further Risk Reduction in the EU Banking Sector

- Important milestone in **reducing risks** in the EU banking sector and strengthening the resilience and resolvability of EU banks
- Laid the basis for progress on the **completion of the Banking Union**, notably on the common backstop to the Single Resolution Fund
- Builds on existing banking rules and implements **international standards** (Basel, TLAC). Major step towards completion of post-crisis regulatory agenda
- At the same time increases the ability of banks to **finance the real economy**, **reduces the administrative burden** for smaller, less complex banks and improves **governance and supervision**
- Comes on top of previously agreed measures such as Creditor Hierarchy Directive (BRRD) and Regulation of IFRS 9 and is supplemented by the **NPL prudential backstop**



2. Implementation of Basel Standards
Leverage ratio

Provides a backstop to risk-based capital ratios. Already included in CRR for reporting and disclosure, now introduced as a hard requirement.

- Requirement: 3% Tier 1 capital
- G-SIB surcharge
- Exposure measure excludes:
  - Development bank (units) public interest lending exposures;
  - Officially guaranteed export credits;
  - Initial margins for client cleared derivative transactions
  - Central bank exposures (supervisory discretion in exceptional circumstances)
  - CSDs (banks) cash balances
- CCP exemption
- Preventing window dressing

2. Implementation of Basel Standards

Net Stable Funding Ratio (NSFR)

Long-term requirement to limit banks' reliance on short term, more volatile sources of funding - complementing the short-term liquidity requirement (LCR).

Implements the Basel standard with some adjustments:

- Specific treatment for European specificities such as covered bonds and trade finance & factoring
- Transitional arrangement for repos/reverse repos in view of the importance of this activity for market-making and the development of a Capital Markets Union
- Basel treatment of derivatives transactions (5% stable funding requirement)
- CCPs and CSDs exemption (if no significant maturity transformation)

2. Implementation of Basel Standards

Market Risk (FRTB)

After the adoption of the Commission proposal, the Basel Committee agreed on a review of the FRTB standard, which has been finalised in January 2019.

To avoid implementing an outdated international standard but at the same time allow banks to start preparations:

- Implementation of the FRTB as a reporting requirement only in a first phase.
- Reporting will start once the revised Basel provisions are incorporated in Union law by delegated act / RTS
- Review clause to invite the Commission to submit a level 1 proposal to turn reporting requirement into a capital requirement.
- The existing market risk framework continues to apply as a capital requirement in the meantime

2. Implementation of Basel Standards
Credit risk

- Targeted amendments for specific situations:
  - To incentivise banks to clear the legacy of the crisis, temporary possibility to exclude the additional losses caused by a massive disposal of defaulted loans from internal model calculations, subject to safeguards:
    - General rules on internal models continue to apply
    - Adjustment is limited to the difference between realised losses due to massive disposals and loss estimates for non-disposed exposures in default
    - Benefit only granted after sales corresponding to at least 20% of the bank's total defaulted exposures have taken effect
  - Specific calibration for the particular case of loans backed by salary and pension payments
- Equity investments into funds (Basel implementation)
  - Minimum value commitments

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3. Proportionality

- Set of measures to reduce administrative costs for smaller banks:
  - EBA cost/benefit analysis of reporting requirements, with cost reduction target for smaller banks
  - Feasibility study integrated reporting system
  - More proportionate disclosure requirements for smaller banks
- Where new (complex) standards are introduced, simple but conservatively calibrated alternatives are envisaged:
  - Simplified NSFR
  - Market risk (simplified standardised approach, exemption for small trading books)
  - Counterparty credit risk (simplified SA-CCR and OEM)
  - EBA mandate to develop simplified approach to interest rate risk in the banking book

4. Contribution to the CMU/Growth

- Sustainable finance dimension introduced in bank regulation
  - EBA report report on the possibility of introducing a more advantageous (punitive) capital treatment for assets that have a favourable (detrimental) environmental and social impact
  - EBA report on the possibility to include the monitoring of environmental and social risks in the review performed by supervisors (SREP)
  - Obligation to disclose environmental and social risks for large, listed banks
- Enhancing banks' capacity to lend to SMEs
  - More favourable SME supporting factor up to EUR 2,5 million
- Enhancing banks' capacity to fund infrastructure
  - Discount for high quality projects, including public private partnerships

5. Governance and Supervision

Pillar 2 & Macroprudential frameworks

- Pillar 2
  - Possibility for supervisors to impose Pillar 2 capital requirements confined to institution-specific cases
  - Distinction between Pillar 2 capital requirements (binding) and guidance (non-binding)
- Increased flexibility in the macroprudential toolbox to compensate for the removal of the macroprudential dimension of Pillar 2
  - Allowing for a use of the systemic risk buffer for certain sectors
  - Increasing the cap on the buffer rate that can be applied to O-SIIs, including subsidiaries
  - But Commission authorisation required in case the sum of the O-SII buffer and the systemic risk buffer exceeds 5%

5. Governance and Supervision

- Intermediate EU Parent Undertaking (IPU)
  - Threshold set at € 40 billion EU assets including those held by third country branches
  - G-SIBs are not automatically captured by the requirement if they do not meet the threshold
  - Transitional period of 3 years
- Enhanced reporting and coordination in supervision of third country branches + EBA report
- Supervisory approval of (mixed) financial holding companies
- Determination of the consolidating supervisor
  - Consolidating supervisor is the bank supervisor if there is at least one credit institution in a group
  - Determination according to balance sheet size if several credit institutions in the group

5. Governance and Supervision

- Anti-money laundering (AML)
  - Enhancement of the cooperation and the exchange of information between bank prudential supervisors and anti-money laundering authorities
  - Further strengthening of the AML dimension of certain prudential tools such as the SREP, the authorisation procedure and the checks on the members of the management body
- Remuneration & Governance
  - Clearer and more proportionate remuneration rules
  - Gender neutrality principle
  - Rules on supervisory oversight of loans to related parties and on the assessment of the suitability of members of the management body

6. Integration of EU Banking Sector (CRR/CRD part)

- Home/host balance
  - No extension of the possibility for supervisors to waive individual capital and liquidity requirements to cross-border situations
  - Supervisors given the possibility to consider the Banking Union as a single geographic area for the purpose of the calculation of the G-SII score in order to remove disincentives for banks to operate across borders within the Banking Union

7. Other Changes to the Prudential Framework

- Own funds rules
  - Non-deduction of software
  - Extension of transitional arrangement for insurance holdings
  - Adjustments for MPE groups
  - Recognition of profits and loss transfer agreements
  - Payment out of reserves
- Counterparty credit risk
  - Introduction of SA-CCR
  - Exposures to CCPs
- Large exposures
- Exemptions from the scope of CRR/CRD
- Interest rate risk in the banking book

8. MREL as part of BRRD-1 and SRMR-1

- BRRD-1 rules applied from 2015, with bail-in related provisions applicable from 2016
- MREL= Minimum Requirement or own funds and Eligible Liabilities
- Objective: ensure smooth and effective absorption of losses and recapitalisation
- Scope of application: all banks (with limited exceptions)
- Level of application: individual entity and group
- Determination: bank-specific assessment by resolution authorities taking into account criteria specified in the law
- Provisions aim to achieve neutral treatment of SPE and MPE strategies

9. Calibration of MREL in BRRD-2 and SRMR-2

Overall calibration structure:

- MREL expressed in % of RWA and LRE, equal to the sum of:

Loss absorption amount
(prudential Pillar 1 + Pillar 2R)

+

Recapitalisation amount
(post - resolution prudential Pillar 1 + Pillar 2R) +
(market confidence buffer, with reference level based on CCBR less countercyclical buffer)

Adjustments:

- Loss absorption being equal to prudential Pillar 1 + Pillar 2R requirements, **cannot be adjusted**
- Recapitalisation amount and market confidence buffer **can be adjusted upwards/downwards**

10. Subordinated portion of MREL

- **New mandatory Pillar 1 subordinated MREL** requirement for:
  - **GSIIs**, which could go beyond TLAC rule:

TLAC rule

Max of [_(18% RWA + CCBR_; _6.75% of LRE_; _8% TLOF*_]
* *with possible reduction factor of [1-(3.5% RWA/(18% RWA + CCBR)]*

  - « **Top-tier banks** » (non-GSIIs with resolution group size above €100bn assets)

Max of [(_13.5% RWA + CCBR_; _5% of LRE_; _8% TLOF*_] **
* *with possible reduction factor of [1-(3.5% RWA/(18% RWA + CCBR)]*
** *capped at 27% RWA if certain conditions are met*

  - « **Fished banks** » subject them to the same treatment as top-tier banks if conditions met

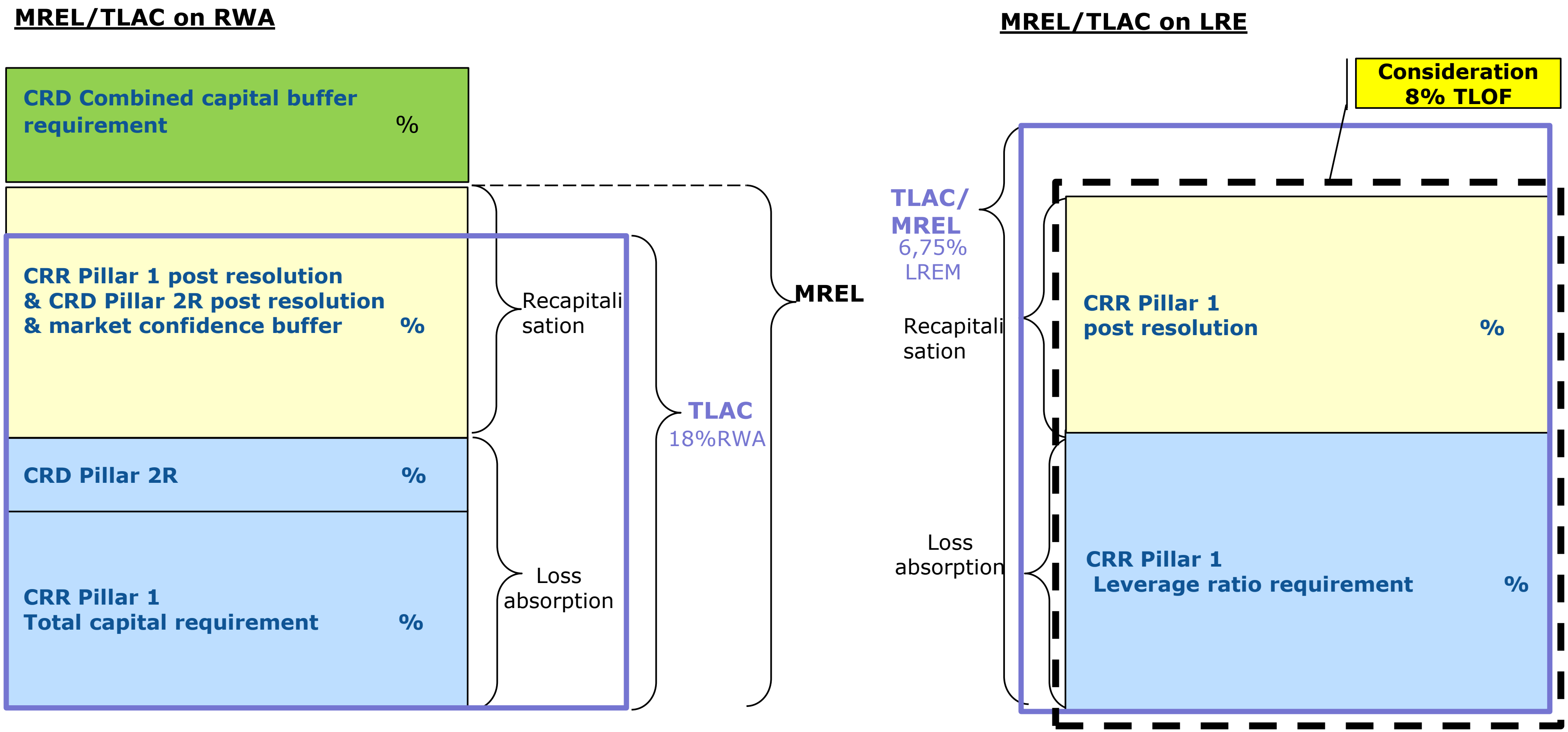
- **Discretion to require additional subordination up to a cap**

Max of [_8% TLOF_; (_2 x CRR Pillar 1+ 2 x CRD Pillar 2R + CCBR)_]

  - **For a subset of banks:** max 30% of number of G-SIIs, top-tier and fished banks in BU (national option to increase this threshold in MS outside the BU), if
    - unaddressed impediments to resolvability, OR
    - resolution strategy is deemed not feasible, nor credible enough, OR
    - bank belongs to the 20% riskiest banks in terms of Pillar 2R of BU / or in its jurisdiction

- **Subordination requirement for other banks:**
    - discretionary, based on case-by-case assessment of the need to respect NCWO
    - same overall quantitative cap as for G-SIIs, top-tier and fished banks

11. MREL calibration for a G-SII – stylised example



- CRD CCBR stacks on top of MREL expressed as RWA, but does not stack on top of MREL based on LRE
- CET1 capital used to meet the CCBR can be used to meet MREL when expressed as % of LRE

12. Eligibility criteria for TLAC and MREL

Items eligible to comply with TLAC (in CRR-2):

- **Own funds**, except CET1 used to comply with the CCBR (when MREL calibrated on RWA basis)
- **Amortised Tier 2 instruments**
- **Eligible liabilities**:
  - Criteria and exclusions are based on TLAC Termsheet, with several additions that aim to ensure that the 1 year maturity rule is effective, ie that the instrument does not include clauses which would enable its redemption before maturity
  - Possibility to use non-subordinated debt up to 3.5% RWA or 5% *de minimis* rule in case of structural subordination, if permitted by resolution authority

Items eligible to comply with MREL (in BRRD-2 and SRMR-2)

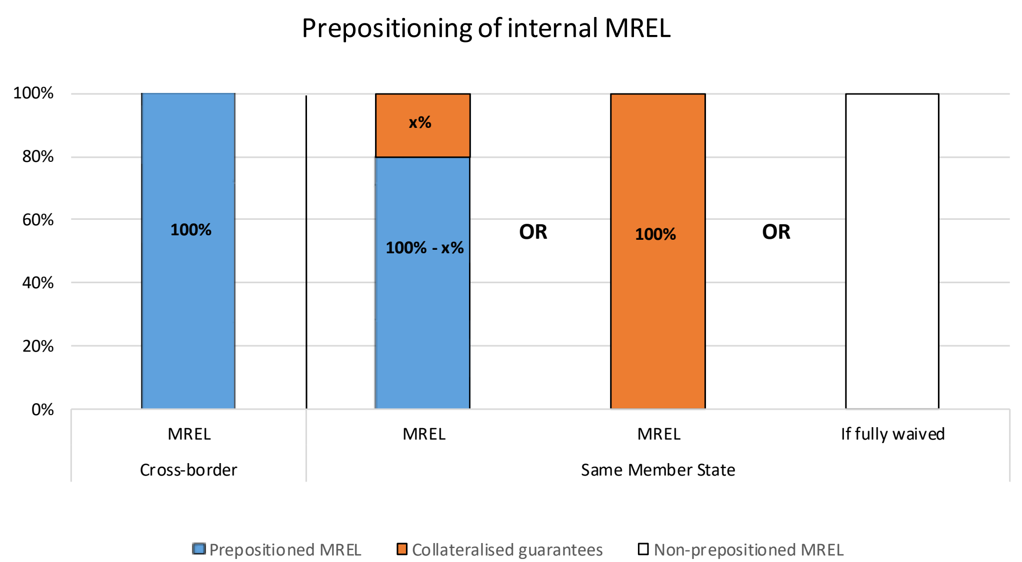
- The above criteria in CRR-2 applicable, except the subordination criterion
- Additional eligibility:
  - structured notes, subject to specific conditions
  - issuances from subsidiaries to minority shareholders outside the resolution group count as external MREL at resolution entity level, subject to specific conditions

Specific eligibility criteria in case of internal TLAC & internal MREL

- Issuance to resolution entity, directly or indirectly through other entities in the same resolution group
- Subordination to instruments issued outside of the resolution group

13. Allocation of MREL within groups

- **Calibration of MRELs**:
  - Home and host RAs to reach joint decision at the same time on external and internal MREL requirements
  - If no joint decision, first internal MRELs are determined, followed by decision on external MREL by respective RAs
- **Allocation mechanism:** Subsidiaries issue MREL liabilities internally to the resolution entity directly or indirectly through other entities in the resolution group ("daisy chain")
- **Pre-positioning of internal MREL**: implicitly 100%, unless waivers or collateralised guarantees are used *but only within the same Member State*



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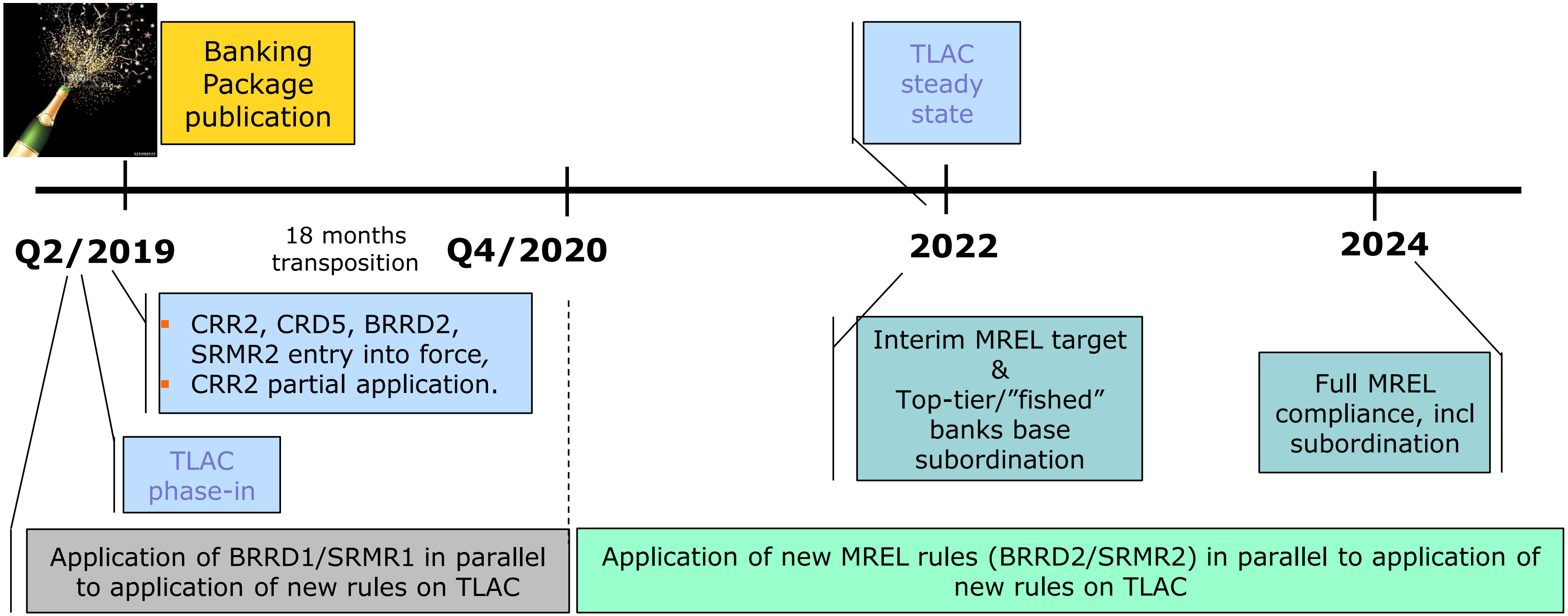
14. Key dates (MREL)



<u>CRR2</u>: date of application of TLAC related provisions is the date of entry into force of CRR2 (e.g. TLAC rule, phase-in and steady-state requirement, eligibility, grandfathering, reporting, disclosure). Most of other parts of CRR2 are applicable 2 years following entry into force.

<u>BRRD2, SRMR2:</u> date of application of the two legislative acts aligned, for BRRD2 date of application is the same as date of transposition (18 months following date of entry into force).

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15. Summary of changes to MREL framework

- Implementation of TLAC for G-SIIs into EU law
- Adaptation of MREL calibration to ensure sufficient loss absorption and recapitalisation capacity
- Significant strengthening of subordination rules for G-SIIs and top-tier banks
- Strengthened and elaborated other eligibility criteria for external internal MREL
- Tools to achieve subordination (non-preferred senior debt category)
- Clarified application of SPE and MPE strategies
- New MREL reporting and disclosure rules, promoting discipline and transparency
- Strengthened consequences in case of MREL breaches

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Thank you for you attention !

Questions?