

Banking prudential regulatory bulletin

PwC Ireland

Q3 2022


pwc



Executive summary

This quarter, the three European Supervisory Authorities (EBA, EIOPA and ESMA - ESAs) issued their Autumn 2022 joint risk report. This report highlights that the deteriorating economic outlook, high inflation and rising energy prices have significantly impacted the risk environment of the financial sector, with increased financial market volatility across the board.

The EBA published a number of items targeting Capital and Liquidity, including the following:

- **Risk Dashboard**, which points to high capital and liquidity ratios but also indicates first signs of deterioration in asset quality not least related to geopolitical tensions;
- First mandatory **Basel III Monitoring Report** which assesses the impact the full implementation of Basel III will have on EU banks in 2028. According to this assessment, full implementation would result in an average increase of 15.0% of the current Tier 1 minimum required capital of EU banks;

- Final guidelines on the criteria for the exemption of small and non-interconnected investment firms from the liquidity requirements in accordance with the Investment Firms Regulation (IFR);
- Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP); and
- Final draft Regulatory Technical Standards (RTS) on Pillar 2 add-ons for investment firms, to ensure a consistent EU wide determination of additional capital requirement.

In the area of Environmental, Social, and Governance (ESG) the three ESAs published the first annual report on the extent of voluntary disclosure of principal adverse impact under the Sustainable Finance Disclosure Regulation (SFDR).

We hope you enjoy reading this quarters edition.

John McDonnell
Partner, FS Risk & Regulatory

Contents

Executive summary	2
Prudential regulatory developments	3
Capital and liquidity	3
Recovery and resolution	5
Supervisory reporting	6
ESG	7
Investment firms	8
Other updates	9
Contacts	12

Prudential regulatory developments

Capital and liquidity

→ **EBA Risk Dashboard points to high capital and liquidity ratios and indicates first signs of deterioration in asset quality not least related to geopolitical tensions**

The EBA published its quarterly Risk Dashboard together with the results of the autumn edition of the Risk Assessment Questionnaire (RAQ).

→ **EBA analyses the use of specific exemptions included in the large exposures regime**

The EBA published a Report on the use of some exemptions included in the large exposures regime. The Report analyses banks' use of the various exemptions from different perspectives and quantifies the impact of a potential removal of individual exemptions.

Overall, the Report shows that some of the assessed exemptions are widely used across the EU and their removal would have a material impact while other exemptions are widely used across the EU but their removal would not have material impact. In addition, some exemptions are relevant only for some countries or appear to be rarely used.

→ **EBA consults on its draft technical standards on homogeneity of underlying exposures in simple, transparent and standardised securitisations**

The EBA launched a public consultation on draft Regulatory Technical Standards (RTS) specifying the criteria for the underlying exposures in securitisation to be deemed homogeneous. Such specification is part of the requirements under the Securitisation Regulation and as amended by the Capital Markets Recovery Package (CMRP).

The homogeneity requirement aims to facilitate the assessment of underlying risks in a pool of underlying exposures and to enable investors to perform robust due diligence.

The consultation ended on 28 October 2022.





→ **EBA consults on technical standards to help originator institutions determine the exposure value of synthetic excess spread in securitisations**

The EBA launched a public consultation on its draft Regulatory Technical Standards (RTS) on the determination by originator institutions of the exposure value of synthetic excess spread (SES) in securitisations.

The Capital Markets Recovery Package (CMRP) amended the Capital Requirements Regulation (CRR) in several aspects, including a preferential treatment for senior tranches of simple, transparent and standardised (STS) on-balance-sheet securitisations. It also introduced a provision on how to determine the exposure value of SES in synthetic securitisations.

The proposals set out in this Consultation Paper will contribute to a more risk sensitive prudential framework in the area of synthetic securitisation.

→ **EBA issues Opinion on measures to address macroprudential risk following notification by De Nederlandsche Bank**

The EBA published an Opinion following the notification by De Nederlandsche Bank (Central Bank of the Netherlands) of its intention to extend a macroprudential measure introduced in 2020 and activated on 1 January 2022. The measure imposes a minimum average risk weight on Dutch housing loan portfolios for credit institutions that have adopted an internal ratings-based (IRB) approach. Based on the submitted evidence the EBA does not object to the extension of the measure.

→ **The EBA publishes its Report on the first mandatory exercise on Basel III full implementation impact**

The EBA published its first mandatory Basel III Monitoring Report which assesses the impact that Basel III full implementation will have on EU banks in 2028. According to this assessment, which uses a significantly larger sample than in previous years and applies the same methodology as the Basel Committee on Banking Supervision (BCBS), the full Basel III implementation would result in an average increase of 15.0% of the current Tier 1 minimum required capital of EU banks.

To comply with the new framework, EU banks would need EUR 1.2 billion of additional Tier 1 capital. The overall impact includes the economic impact of the COVID-19 pandemic on participating banks that materialised up to December 2021, the reference date of this Report. The Report also includes a separate Annex on the impact of the EU Commission proposal for the EU implementation under the Capital Requirements Regulation (CRR3).

Recovery and resolution

→ EBA reports on the successful mitigation of possible infection risk stemming from legacy instruments

The EBA published an analysis of how its Opinion on the prudential treatment of legacy instruments has been implemented across the EU. Since the issuance of this Opinion, the EBA has been working in close cooperation with competent authorities to monitor any action taken by institutions to mitigate the infection risk related to such legacy instruments. Overall, the EBA found that both institutions and competent authorities have made significant efforts to implement the EBA Opinion in an effective and consistent manner.

→ EBA publishes Guidelines on transferability to support the resolvability assessment for transfer strategies

The EBA published its final Guidelines on transferability to support the resolvability assessment for transfer strategies. In particular, the guidelines on transferability provide guidance relating to:

- the definition of the transfer perimeter and
- the steps to operationalise the implementation of the transfer.

The transferability Guidelines complement the resolvability Guidelines, which were published on 13 January 2022.

Institutions and resolution authorities should comply with these Guidelines in full by 1 January 2024.



Supervisory reporting

→ EBA releases the technical package for phase 3 of its 3.2 reporting framework

The EBA published the technical package for phase 3 of version 3.2 of its reporting framework. The technical package supports the implementation of the updated reporting framework by providing standard specifications and includes the validation rules, the Data Point Model (DPM) and the XBRL taxonomies for version 3.2.

The updated technical package supports the amendments to v3.2 Phase 3, which covers the following:

- the new Guidelines on remuneration benchmarking and gender pay gap for credit institutions with reference date December 2023;
- the Guidelines on remuneration benchmarking and gender pay gap for investment firms with reference date December 2022;
- the Guidelines on High earners for credit institutions and investment firms with reference date as of December 2022.

→ EBA updates version 5.2 of its filing rules for supervisory reporting

The EBA published an updated version of its 5.2 filing rules document for supervisory reporting. In particular, the update modifies rule 3.6 to redefine the condition to apply the new reporting subject and to explicitly instruct the usage of entity types to indicate aggregate levels in the reporting subject of an aggregate reporting document.

→ EBA issues revised list of validation rules

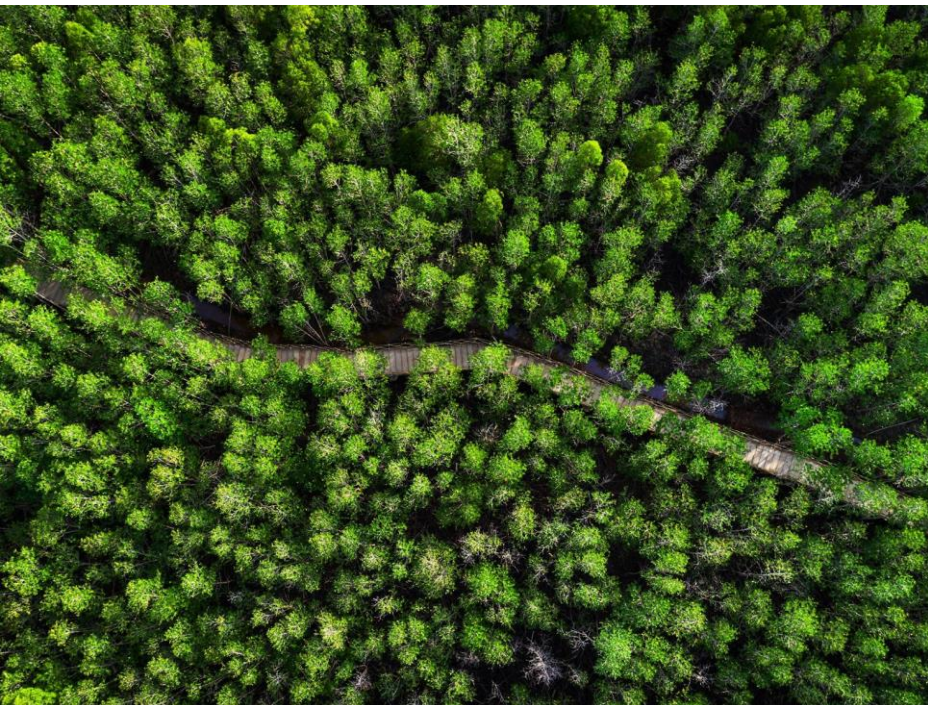
The EBA issued a revised list of validation rules for its reporting standards (Technical Standards and Guidelines), highlighting those which have been deactivated either for incorrectness or for triggering IT problems. Competent Authorities throughout the EU are informed that data submitted in accordance with these reporting standards should not be formally validated against the set of deactivated rules. In addition, the EBA also reactivated some validation rules, which should be applied again.

→ EBA launches 2022 EU-wide transparency exercise

The EBA launched its annual EU-wide transparency exercise, as part of its efforts to monitor risks and vulnerabilities and to reinforce market discipline. As in the past, the exercise is exclusively based on supervisory reporting data, which will keep the burden for the banks to a minimum.

Results are expected to be published at the beginning of December.





ESG

→ ESAs issue report on the extent of voluntary disclosure of principal adverse impact under the Sustainable Finance Disclosure Regulation

The Joint Committee of the three ESAs published the first annual report on the extent of voluntary disclosure of principal adverse impact under the Sustainable Finance Disclosure Regulation (SFDR) – Article 18 of Regulation (EU) 2019/2088.

→ ESAs propose disclosures for fossil gas and nuclear energy investments

The three ESAs have delivered to the European Commission (EC) their Final Report with draft Regulatory Technical Standards (RTS) regarding the disclosure of financial products' exposure to investments in fossil gas and nuclear energy activities under the Sustainable Finance Disclosure Regulation (SFDR).

→ EBA has been awarded top European standard for its environmental performance

The EBA has become the first European agency in France to be registered for its environmental performance under the European Eco-Management and Audit Scheme (EMAS). The registration was issued by the French Ministry for the Ecological Transition for a duration of three years. The scope of EMAS covers all the EBA's operational and core business activities.

Investment firms

→ EBA publishes final regulatory products to harmonise the supervisory review and evaluation process of investment firms

The EBA jointly with the ESMA, published the final Guidelines on common procedures and methodologies for the supervisory review and evaluation process (SREP) for investment firms. The EBA published also the final draft Regulatory Technical Standards (RTS) on Pillar 2 add-ons for investment firms. Both regulatory products are based on the Investment Firms Directive (IFD) and aim to harmonise the supervisory practices regarding the supervisory review and evaluation process of investment firms.

→ EBA publishes its final guidelines on the criteria for the exemption of investment firms from liquidity requirements in accordance with Investment Firms Regulation

The EBA published its final guidelines on the criteria for the exemption of small and non-interconnected investment firms from the liquidity requirements in accordance with the Investment Firms Regulation (IFR). These Guidelines ensure that all competent authorities granting this exemption follow the same harmonised approach, while preserving the IFR general objective of maintaining the prudential requirements proportional to the size and complexity of the smaller investment firms.





Other updates

EBA updates the list of Other Systemically Important Institutions

The EBA updated the list of Other Systemically Important Institutions (O-SIIs) in the EU, which, together with Global Systemically Important Institutions (G-SIIs), are identified as systemically important by the relevant authorities according to harmonised criteria laid down in the EBA Guidelines. This list is based on end-2020 data and also reflects the O-SII score and the capital buffers that the relevant authorities have set for the identified O-SIIs. The list is available also in a user-friendly visualisation tool.

The EBA observes a reduction of high earners in 2020 and a slight decrease of bonus levels in the context of the COVID-19 pandemic

The EBA published its Report on benchmarking of remuneration practices in EU banks for the financial years 2019 and 2020 and high earners data (EU27/EEA) for 2020. The number of high earners went down from 1 444 (EU27/EEA) or 4 963 (EU28/EEA) in 2019 to 1 383 (EU27/EEA) in 2020. While the bonus level for high earners remained relatively stable, a visible reduction can be observed for risk takers (identified staff).

EBA launches discussion on 2023 EU-wide stress test methodology

The EBA published its 2023 EU-wide stress test draft methodology, templates and template guidance, which will be discussed with the industry. The methodology covers all risk areas and builds on the one prepared for the 2021 EU wide stress test.

Some aspects of the methodology have been improved based on the lessons from the 2021 exercise. As a new feature, the projections on net fee and commission income (NFCI) will be based on a top-down model. This is a first step of revising the EU-wide stress test framework towards a hybrid (bottom-up and top-down) approach.

Also, the sample coverage has been increased. An additional 26 banks have been added to the stress test sample compared to the 2021 exercise and further proportionality has been introduced into the methodology. The 2023 exercise will assess EU banks' resilience to an adverse economic shock and inform the 2023 Supervisory Review and Evaluation Process (SREP).

EBA launches call for candidates to expand its reserve list for the Banking Stakeholder Group

The EBA launched a call for interest to expand its reserve list of candidates who can be appointed in the current Banking Stakeholder Group (BSG) when a vacancy arises. The EBA is expanding the existing reserve list so as to fulfil its needs until the end of the current BSG mandate on 30 June 2024.

The deadline for application ended on 16 September 2022.

→ EBA updates data on deposit guarantee schemes across the European Economic Area

The EBA published 2021 extended data related to two key concepts and indicators in the Deposit Guarantee Schemes Directive (DGSD), namely available financial means (AFMs) and covered deposits. The EBA publishes these data on a yearly basis to enhance the transparency and public accountability of DGSs across the EEA to the benefit of depositors, markets, policymakers, DGSs and Members States.

→ EBA consults on revised Guidelines on methods for calculating contributions to deposit guarantee schemes

The EBA launched a public consultation on its draft revised Guidelines on deposit guarantee schemes (DGS) contributions. The revised Guidelines aim at enhancing the proportionality between the risk of a credit institution and its contributions to the DGS and at streamlining and simplifying the original Guidelines.

The consultation ended on 31 October 2022.

→ The EBA updates data used for the identification of global systemically important institutions (G-SII)

For the first time in the context of the G-SII identification methodology and buffer rates allocation, the EBA disclosed on 29 September 2022 data items specific to the recognition of the Banking Union and of institutions that are part of the Single Resolution Mechanism.

The publication covers 13 indicators and updated underlying data for the 30 largest institutions in the EU whose leverage ratio exposure measure exceeds EUR 200 bn. Acting as a central data hub in the disclosure process, the EBA updates this data on a yearly basis and provides user-friendly tools to aggregate it across the EU.

→ EBA publishes final draft technical standards on the performance-related triggers for non-sequential amortisation systems in STS on-balance-sheet securitisations

The EBA published its final draft Regulatory Technical Standards (RTS) specifying the minimum performance-related triggers for simple, transparent and standardised (STS) on-balance-sheet securitisations that feature non-sequential amortisation.

The Capital Markets Recovery Package amended the Securitisation Regulation in several aspects, including creating a specific framework for STS on-balance-sheet securitisation to ensure that the Union securitisation framework provides for an additional tool to foster economic recovery in the aftermath of the COVID-19 crisis.



→ EBA Publishes its work programme for 2023

The EBA published its annual work programme for 2023, describing the key strategic areas of work for the Authority for the coming year, as well as related activities and tasks.

→ EBA's annual Bank funding plans report shows plans to issue more debt instruments in the coming years intended to counterbalance expected decline in central bank funding

The EBA published its annual Funding Plans Report. 159 banks submitted their funding plans for a forecast period from 2022 to 2024. The Report highlights strong deposit growth and increase of public sector sources of funding in 2021. The plans show banks' intentions to increase market-based funding over forecast period, while the gap between planned debt issuances and maturing targeted longer-term refinancing operations (TLTRO) in the coming two years remains significant.

→ ESAs warn of rising risks amid a deteriorating economic outlook

The three ESAs issued their Autumn 2022 joint risk report. The report highlights that the deteriorating economic outlook, high inflation and rising energy prices have increased vulnerabilities across the financial sectors. The ESAs advise national supervisors, financial institutions and market participants to prepare for challenges ahead.

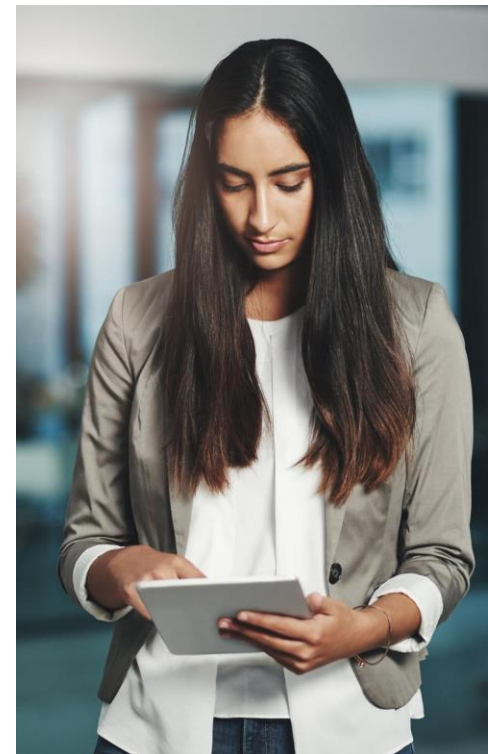
→ EBA consults on supervisory handbook for the validation of internal ratings based systems

The EBA launched on 28 July 2022 a consultation on its supervisory handbook for the validation of internal ratings based systems. This handbook clarifies the role of the validation function as part of corporate governance, in particular in terms of scope of work and interaction with the credit risk control unit.

The consultation ended on 28 October 2022.

→ EBA responds to the EU Parliament's 2020 Discharge report

The Opinion follows up on the observations made by European Parliament in its 2020 discharge report and elaborates on measures taken by the EBA in response to it. Out of the 30 observations, which cover the areas of budget and financial management, performance, staff policy, procurement, prevention and management of conflicts of interest and transparency, internal control, and COVID response and business continuity, the EBA is of the view that 26 have already been implemented or are no longer applicable. For 3 observations the implementation of follow-up actions is ongoing and for one observation the status has to be further considered.





Contacts



John McDonnell
Partner - FS Risk & Regulatory

e: john.mcdonnell@pwc.com
t: +353 87 239 0701



Ciarán Cunningham
Partner- FS Risk & Regulatory

e: ciaran.j.cunningham@pwc.com
t: +353 87 649 4780



Trisha Gibbons
Director - FS Risk and Regulatory

e: trisha.gibbons@pwc.com
t: +353 87 689 9978



Iarla Power
Director - FS Risk & Regulatory

e: iarla.power@pwc.com
t: +353 86 783 2708



Des Crofton
Director - FS Risk & Regulatory

e: des.crofton@pwc.com
t: +353 87 639 6717



Cian Meagher
Senior Manager - FS Risk & Regulatory

e: cian.meagher@pwc.com
t: +353 87 6134170



Michael McInerney
Senior Manager - FS Risk and Regulatory

e: michael.mcinerney@pwc.com
t: +353 87 435 9368



Alexandra Antonio
Senior Manager - FS Risk and Regulatory

e: alexandra.antonio@pwc.com
t: +353 87 436 9794

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 155 countries with over 327,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.ie.

PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

© 2022 PwC. All rights reserved