



Banking prudential regulatory bulletin

PwC Ireland

Q3 2023

Executive summary

Welcome to this edition of the Banking prudential regulatory bulletin which covers key updates within the industry.

A number of significant developments occurred in the third quarter of the 2023, including the following:

- The European Banking Authority (“EBA”) published its [second mandatory Basel III monitoring report](#). The report assessed the impact of Basel III full implementation on EU banks in 2028. Overall, the results of the mandatory Basel III capital monitoring exercise show that European banks' minimum Tier 1 capital requirement would increase by 9.0% at the full implementation date in 2028. The overall minimum Tier 1 capital requirement for large and internationally active banks (Group 1) would increase by 10.0%. The requirements for the global systemically important institutions (G-SIIs, subset of Group 1) and for Group 2 banks would increase by 16.0% and 3.6%, respectively.
- The EBA published the results of its [2023 EU wide stress test](#). The test shows that European banks remain resilient under an adverse scenario which combines a severe EU and global recession, increasing interest rates and higher credit spreads.
- The EBA published its [Q1 2023 quarterly risk dashboard](#) (“RDB”). The publication presents the results of the EBA’s latest risk assessment questionnaire. The RDB also includes information on minimum requirements for own funds and eligible liabilities. As per RDB banks profitability continued to increase, their capital, funding and liquidity ratios remain strong.
- The EBA published its [annual asset encumbrance report](#). The report highlights EU banking sectors asset encumbrance weighted average decreased during 2022 with a ratio at 25.8% close to average pre-pandemic levels.
- And lastly on sustainable finance, the three European Supervisory Authorities (“ESA”) (EBA, EIOPA and ESMA) published an [annual report on the extent of voluntary disclosure of principal adverse impacts under article 18 of the Sustainable Finance Disclosure Regulation](#), providing an overview of good practices and areas that need improvement.

We hope you enjoy reading this quarter’s edition.

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Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

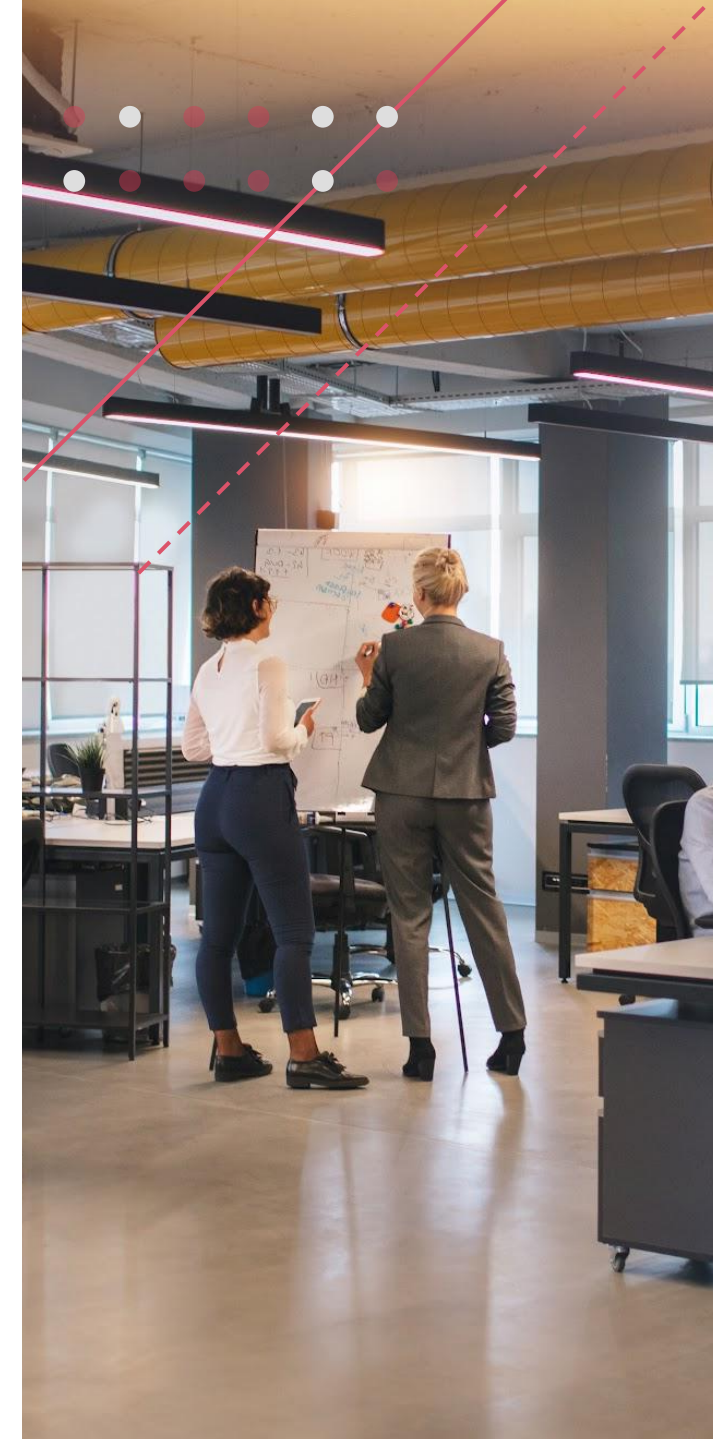
Supervisory reporting

ESG

Investment firms

Other updates

Contacts



Prudential regulatory developments

Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts

Capital and liquidity



EBA publishes validation requirements on initial margin models

In July, the EBA published its final draft Regulatory Technical Standards (“RTS”) on Initial Margin Model Validation (“IMMV”) under the European Markets Infrastructure Regulation (“EMIR”). These draft RTS set out the supervisory procedures to ensure the prudent use of initial margin models for OTC derivatives. In an accompanying Opinion, and as part of the ongoing negotiations on EMIR, the EBA calls on co-legislators to consider the establishment of a central validation function in the EU.



EBA notes a decrease in EU banks’ asset encumbrance ratio during 2022

In July, the EBA published its annual asset encumbrance Report. The Report highlights that banks have limited the use of central bank funding in 2022. As a result, the overall encumbrance ratio decreased by 3.3 percentage points in 2022 to 25.8%.



The EBA consults on technical standards to identify extraordinary circumstances to derogate from certain requirements in the area of market risk

In August, the EBA launched a public consultation on draft RTS to identify extraordinary circumstances of market disruption, permitting to waive certain requirements for the calculation of own funds requirements for market risk on the basis of internal models.

The consultation ended on 3 November 2023.



The EBA publishes Report on interdependent assets and liabilities in the net stable funding ratio

In July, the EBA published its Report on the treatment of interdependent assets and liabilities in the net stable funding ratio (“NSFR”). This Report assesses the conditions under which assets and liabilities can be treated as interdependent in the NSFR and the description of the list of activities that are considered to meet those conditions. The EBA has only limited recommendations for the Commission at this stage, which concern extendable maturity triggers for covered bonds and indirect derivatives client clearing activities.

Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts

Banks plan to issue more debt instruments to counterbalance expected decline in central bank funding, the EBA funding plans Report shows

In July, the EBA published its annual funding plans Report, covering 159 banks that submitted their funding plans for a forecast period from 2023 to 2025. The plans show banks' intentions to increase market-based funding over the forecast period. As extraordinary long-term central bank funding matures, banks plan to shift to short-term and long-term debt securities instead. This changing funding composition is particularly relevant in 2023 and 2024 when high amounts of central bank funding mature ("TLTRO") and MREL targets become applicable. The Report highlights a sizable increase in banks' interest margin, with interest rates for loans rising faster than for deposits. Central bank rate hikes and the rise in spreads for market-based funding instruments have contributed to higher funding costs.

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

In August, the EBA updated the 13 systemic importance indicators and underlying data for the 32 largest institutions in the EU whose leverage ratio exposure measure exceeds €200 billion. This disclosure includes updated data items specific to the recognition of the Banking Union and of institutions that are part of the Single Resolution Mechanism. 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.

The EBA second mandatory exercise on Basel III full implementation shows a significantly reduced impact on EU banks with shortfalls nearly fully absorbed

In September, the EBA published its second 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 sample of 157 banks for the point-in-time analysis, in terms of minimum Tier 1 capital the impact has significantly decreased in relation to the previous reference date of December 2021. In terms of estimated capital shortfall, the impact of the reform has been nearly fully absorbed.

EBA publishes the results of its 2023 EU-wide stress test

In July, the EBA published the results of its 2023 EU-wide stress test, which involved 70 banks from 16 EU and EEA countries, covering 75% of the EU banking sector assets. This stress test allows supervisors to assess the resilience of EU banks over a three-year horizon under both a baseline and an adverse scenario. The adverse scenario is characterised by severe negative shocks to economic growth, higher unemployment combined with higher interest rates and credit spreads. In terms of GDP decline, the 2023 adverse scenario is the most severe used in the EU wide stress up to now. The individual bank results promote market discipline and are used as part of the EU supervisory decision-making process.

Recovery and resolution

>> The EBA publishes final guidance on the overall recovery capacity in recovery planning

In July, the EBA published its final Guidelines on the overall recovery capacity (“ORC”) in recovery planning. The Guidelines establish a consistent framework for the determination of the ORC by institutions in their recovery plans and the respective assessment by competent authorities and aim at strengthening institutions’ effective crisis preparedness.

>> BA launches public consultation on amendments to the ITS on disclosures and reporting on MREL and TLAC

In July, the EBA launched a public consultation on amendments to the draft ITS on disclosure and reporting of the MREL and the total loss absorbency requirement (TLAC). These amendments aim to reflect changes to the prudential framework that came or will soon come into force and provide clarifications on the information to be reported in the insolvency ranking templates. The consultation paper also includes an updated mapping between disclosure and reporting requirements.

The consultation ended on 18 August 2023.

>> The EBA publishes its first Report on the implementation of the European Resolution Examination Programme

In August, the EBA published for the first time a Report which monitors the progress made by resolution authorities in embedding the key topics identified in the [EBA's 2022 European Resolution Examination Programme \(“EREP”\)](#) into their respective priorities and resolution colleges in 2022.

The Report observes that, overall, resolution authorities incorporated the work priorities set by the EBA, with minimum requirements for own funds and eligible liabilities (“MREL”) monitoring being a key focus. The EREP priorities set for 2024 mainly confirmed the areas of focus set for 2023 although with updated specific elements and extension of the operationalisation of the bail-in tool to cover the operationalisation of the resolution strategy more generally.

>> The EBA updates on the monitoring of Additional Tier 1, Tier 2 and TLAC/MREL eligible liabilities instruments of European Union institutions

In July, the EBA published an updated Report on the monitoring of Additional Tier 1 (AT1), Tier 2 and total loss absorbing capacity (“TLAC”) and MREL instruments of EU institutions. The Report merges the information of the two previous separate reports in these fields and adds new recommendations on certain contractual clauses of the corresponding documentation. By merging the contents of these two reports, the EBA aims to facilitate the reading and to highlight the commonalities in terms of eligibility criteria between own funds and eligible liabilities instruments.

Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts



Supervisory reporting

» EBA publishes its final amending technical standards on supervisory reporting to introduce new reporting on interest rate risk in the banking book

In July, the EBA published its final ITS on supervisory reporting with respect to IRRBB. The amended final draft ITS equip supervisors with the appropriate data to monitor risks arising from interest rates' changes. In addition, they aim at providing quality data to supervisors to monitor institutions' IRBB risk and the implementation of the policy package published by the EBA in October 2022.

» EBA issues revised list of ITS validation rules

In September, the EBA issued a revised list of validation rules in its ITS on supervisory reporting, 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 ITS should not be formally validated against the set of deactivated rules.

» The EBA is collecting bank data on interest rate risk in the banking book

In August, the EBA published its Decision to run an ad-hoc data collection of institutions' interest rate risk in the banking book ("IRRBB") data. This data collection will provide competent authorities and the EBA with timely and necessary data and tools to monitor risks arising from interest rate changes and the implementation of the IRRBB scrutiny plan. The ad-hoc collection follows a proportionate approach, as it will apply only to those institutions that are already providing IRRBB data in the context of the QIS exercise and include the same templates that these institutions will have to report once the final Implementing Technical Standard ("ITS") on IRRBB reporting starts applying.

» EBA consults on amendments to the Guidelines on the specification and disclosure of systemic importance indicators

In August, the EBA launched a public consultation on amendments to its Guidelines on the specification and disclosure of systemic importance indicators. The proposed changes aim primarily at updating the annex which replicates the data template issued by the Basel Committee on Banking Supervision (BCBS) on a yearly basis. The consultation ended on 1 September 2023.

» EBA updates timeline for the implementation of the IRB roadmap and publishes its final supervisory handbook for the validation of IRB rating systems

In August, the EBA updated its roadmap for the implementation of internal ratings based ("IRB") model requirements to limit compliance costs for institutions. The EBA also published its final supervisory handbook for the validation of IRB rating systems to clarify the role of the validation function as part of corporate governance.

» EBA launches 2023 EU-wide transparency exercise

In September, 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. The EBA expects to publish the results at the beginning of December, together with the annual Risk Assessment Report ("RAR").

Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts

ESG



The EBA consults on draft templates and template guidance to prepare its one-off Fit-for-55 climate risk scenario analysis

In July, the EBA launched a public consultation on draft templates for collecting climate related data from EU banks. This effort is part of the one-off Fit-for-55 climate risk scenario analysis, which the EBA will carry out together with the other ESAs and with the support of the European Central Bank (“ECB”) and the European Systemic Risk Board (“ESRB”). The draft templates are accompanied by a template guidance, which includes definitions and rules for compiling the templates.

The consultation ended on 11 October 2023.



The EBA is collecting institutions' data on environmental, social and governance risks to set up a monitoring system

In July, the EBA published the Decision on an ad hoc data collection of institutions' ESG data. The Decision will provide competent authorities and the EBA with the necessary data and tools to fulfill monitoring functions and ESG-related mandates by collecting the information that is already available to institutions as part of their Pillar 3 disclosure obligations with respect to ESG risks.



ESAs analyse the extent of voluntary disclosure of principal adverse impacts under the SFDR

In September, the Joint Committee of the three ESAs (EBA, EIOPA and ESMA) published their second annual Report on the extent of voluntary disclosure of principal adverse impacts under the Article 18 of the Sustainable Finance Disclosure Regulation (“SFDR”).

Three ESAs launched a survey of National Competent Authorities to assess the current state of entity-level and product-level voluntary principal adverse impact (“PAI”) disclosures under the SFDR, and have developed a preliminary, indicative and non-exhaustive overview of good practices and areas that need improvement.

Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts



Investment firms



The EBA consults on Guidelines on the application of the group capital test for investment firm groups

In July, the EBA launched a consultation on the draft Guidelines on the application of the group capital test for investment firm groups. These Guidelines aim at setting harmonised criteria to address the observed diversity in the application of the group capital test across the EU.

In particular, the Guidelines identify criteria to assist Competent Authorities in their assessment of the simplicity of the group structure and the significance of the risk posed to clients and the market.

The consultation ended on 25 October 2023.

Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts



Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts

Other updates

EU/EEA banking sector shows rising profitability, but asset quality and profitability related risks are looming

In July, the EBA published its Q1 2023 quarterly Risk Dashboard (“RDB”). The publication presents the results of the EBA’s latest risk assessment questionnaire (“RAQ”), which was conducted among 85 banks in spring this year. It also includes information on MREL. Banks’ profitability continued to increase, and their capital, funding and liquidity ratios remain strong. Bank debt issuance has resumed after a temporary halt due to the Silicon Valley Bank (“SVB”) and Credit Suisse (“CS”) induced turmoil. A downward trend in liquidity and funding ratios is expected due to repayments of the ECB’s TLTRO.

The EBA and ESMA assess the implementation of the revised Shareholder Rights Directive and identify areas for progress

In July, the EBA, jointly with the ESMA, published a Report assessing the implementation of the Shareholder Rights Directive 2 (“SRD2”). This assessment, carried out in response to a European Commission’s request, identifies areas for further progress and provides detailed suggestions for policy action, in relation to the Directive’s effectiveness, difficulties in practical application and the appropriateness of the scope of application.

EBA encourages timely preparatory steps towards the application of MiCAR to asset-referenced and electronic money tokens

In July, the EBA published a statement for the attention of financial institutions and other undertakings who intend to commence, or have commenced, asset-referenced token (“ART”) or electronic money token (“EMT”) activities prior to 30 June 2024 (the application date for the relevant provisions of the Markets in Crypto-assets Regulation - MiCAR) and for competent authorities. The statement is intended to encourage timely preparatory actions to MiCAR application, with the objectives to reduce the risks of potentially disruptive and sharp business model adjustments at a later stage, to foster supervisory convergence, and to facilitate the protection of consumers.

The EBA updates guidance on reporting of Financial Soundness Indicators to the International Monetary Fund

In August, the EBA published an updated guidance on how to compile and report to the International Monetary Fund (“IMF”) the Financial Soundness Indicators (“FSI”) based on EBA data. FSIs provide insight into the financial health and soundness of countries’ financial institutions as well as corporate and household sectors, thus supporting the economic and financial stability analysis.

The EBA publishes follow-up Report on the use of machine learning for internal ratings-based models

In August, the EBA published a follow-up Report presenting the feedback received during the consultation on machine learning (ML) used in the context of IRB models. This follow-up Report summarises the main conclusions from the consultation and provides an overview of the current use cases of ML techniques for IRB models.

Executive summary

Prudential regulatory developments

Capital and liquidity

Recovery and resolution

Supervisory reporting

ESG

Investment firms

Other updates

Contacts

The EBA's recent mystery shopping exercise shows the value this tool adds to the supervisory tasks of national authorities

In September, the EBA published a Report on its mystery shopping exercise into personal loans and payment accounts. The exercise confirmed that mystery shopping is a tool that adds immense value to the supervision of national competent authorities and is complementary to other more conventional tools or approaches. It delivers first-hand information about, and insight into, the conduct of financial Institutions towards consumers visiting a branch or using a digital channel.

The EBA responds to the EU Parliament's 2021 Discharge Report

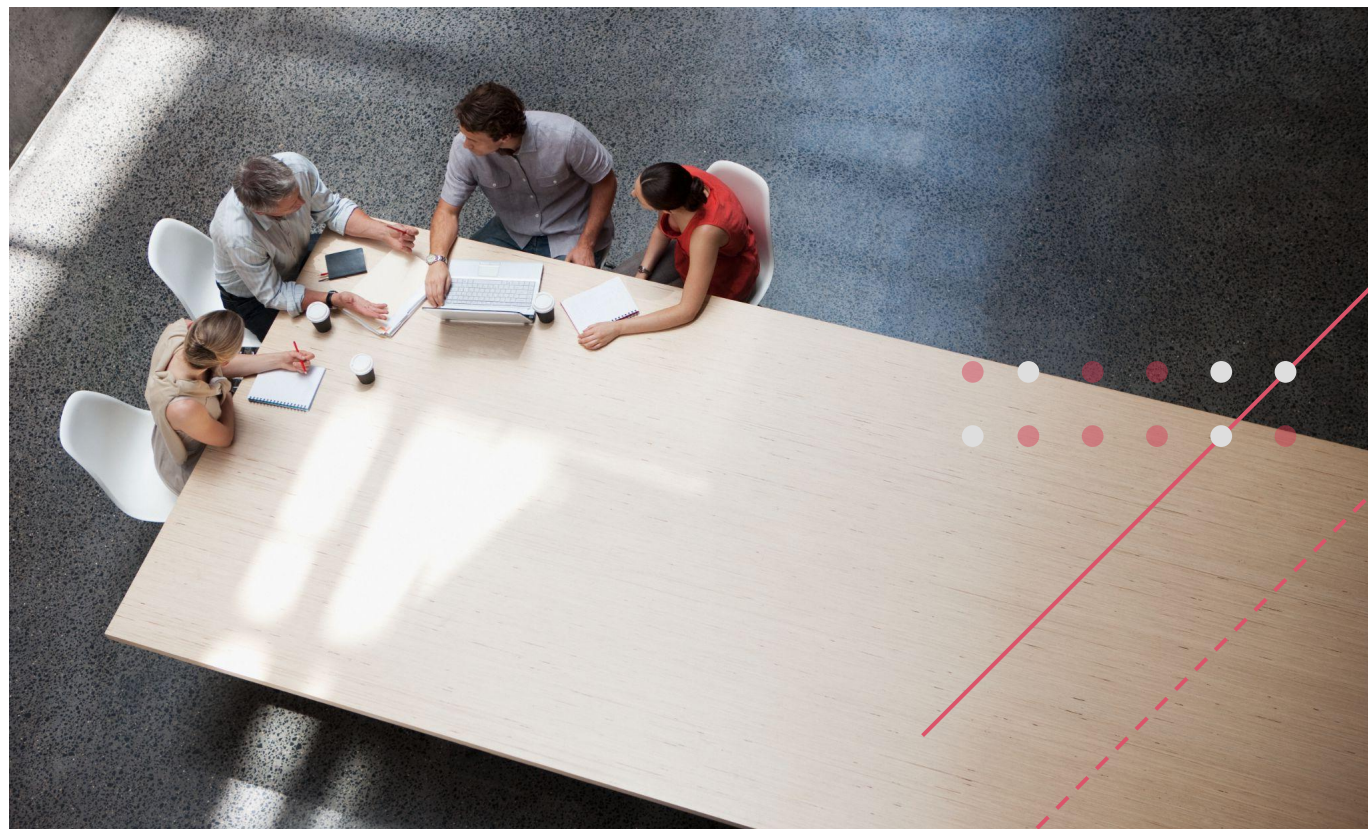
In September, the EBA published an Opinion in response to the observations made by European Parliament in its 2021 Discharge Report. Out of 30 observations, which cover the areas of budget and financial management, performance, staff policy, procurement, prevention and management of conflicts of interest and transparency, internal control, digitalisation and green transition, business continuity along crisis, the EBA considers that 26 have already been implemented or do not require follow-up action. For four observations the follow-up is deemed to be an ongoing consideration.

ESAs specify criticality criteria and oversight fees for critical ICT third-party providers under DORA in response to the European Commission's call for advice

In September, the ESAs published their joint response to the European Commission's Call for Advice on two EC delegated acts under DORA specifying further criteria for critical ICT third-party service providers ("CTPPs") and determining oversight fees levied on such providers.

ESAs publish Report on the landscape of ICT third-party providers in the EU

In September, the ESAs published an indicative overview of information and communication technology ("ICT") third-party providers ("TTP") as part of their preparations for the Digital Operational Resilience Act ("DORA"). The analysis aims to map the provision of ICT services by TPPs to financial entities in the European Union and to support the ESAs' policy making process in light of the European Commission's call for advice to further specify the criteria for critical ICT TPPs and to determine oversight fees.



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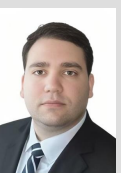
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