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European banks — the regulatory angle: EBA, ECB & SRB on supervisory priorities

Crédit Agricole CIB hosted a web conference on the theme "European banks: the regulatory angle" in December 2021, with delegates hearing from ECB supervisory board member Edouard Fernandez-Bollo, Sebastiano Laviola, board member and director of strategy and policy coordination at the SRB, and Isabelle Vaillant, director of prudential regulation and supervisory policy at the EBA.

The European Banking Authority and European Central Bank representatives both opened their presentations by commending the health of the European banking sector.

"Fortunately, the banking system has shown its resilience," said the ECB's Fernandez-Bollo, "not only to the shocks of the last year, but also its capacity to absorb further shocks. In the troubled situation we find ourselves in, we do believe in the structural resilience that has very much improved in the European banking system."

Indeed, Vaillant at the EBA said that key to the European banking sector's ability to navigate and weather the "unbelievable shock" of the pandemic "with no definitive hurt" was its capital and liquidity position going into the Covid crisis. Compared with a fully-loaded CET1 ratio of less than 11% at the start of the Great Financial Crisis, EU banks entered the Covid crisis with a level of 14.7%, and this rose to 15.3% at the end of 2020, she noted, while they had a liquidity coverage ratio of 173% at the end of 2020, up from 148% at end-2019. NPLs declined further in 2020, from 3.1% end-2019 to 2.5%.

"But also as regulators and supervisors, we could react in a different way than we could have ever done in the past," added Vaillant. "The adaptive changes that we took were quite quick and well coordinated."

She cited, for example, the postponement of stress tests, moratoria guidelines and the regulatory relaxation, containing both temporary and permanent measures, known as the CRR Quick Fix.

Vaillant also hailed the functioning of capital instruments during the crisis, even if the EBA continues to scrutinise developments to weed out unduly complex practices.

Isabelle Vaillant, EBA: 'There is no longer doubt about the quality of capital of European banks'

"One of the best achievements we have in Europe is that there is no longer doubt about the quality of capital of European banks," she said.

"When I entered the EBA 10 years ago, this was quite a problem. It's not anymore."

Fernandez-Bollo meanwhile pointed to the 2021 stress test results, which he said offer additional comfort. These showed a system level fully-loaded CET1 ratio depletion of around 5.2 percentage points (from 15.1% to 9.9% under the adverse scenario).

"It was a significantly more adverse scenario than the previous one in 2018," added Fernandez-Bollo, "but the losses were still really manageable, so we can see that banks' capacity to absorb losses is good."

Basel III: speedy, fair, loyal

Implementation of the final Basel III reforms (previously referred to by market participants as "Basel IV") in line with international standards was cited as a priority by both the banking authority and the central bank to ensure continued stability of European banks.

"The regulatory package that is on the way will consolidate the resilience of the European banking system," said Fernandez-Bollo, "so we will very much welcome that."

Vaillant called for the "speedy and fair" adoption of the Basel III package to maintain the strength of the banking sector. She acknowledged the importance of "no significant increase" in capital requirements, but noted this constraint is valid on an average level: thus, certain banks and business types will see material increases in risk-weighted assets.

"We are quite happy with the proposal as it is now," she said.

"It's very important for us that we remain loyal to the global standards," added Vaillant. "It's such a great asset to have global standards that we should not deviate from them."

And Fernandez-Bollo stressed that banks should be able to grow into the new Basel requirements.

"They can fully absorb it just by continuing the path they are on in terms of risk-weighted assets and CET1 with their current distribution policies," he said. "We can thereby have a very smooth transition to finalising the new regulatory environment."

Still lagging on profitability

European banks' profitability was, however, flagged by the EBA and ECB as a cause for concern, as it has been for many years since the Great Financial Crisis of 2008.

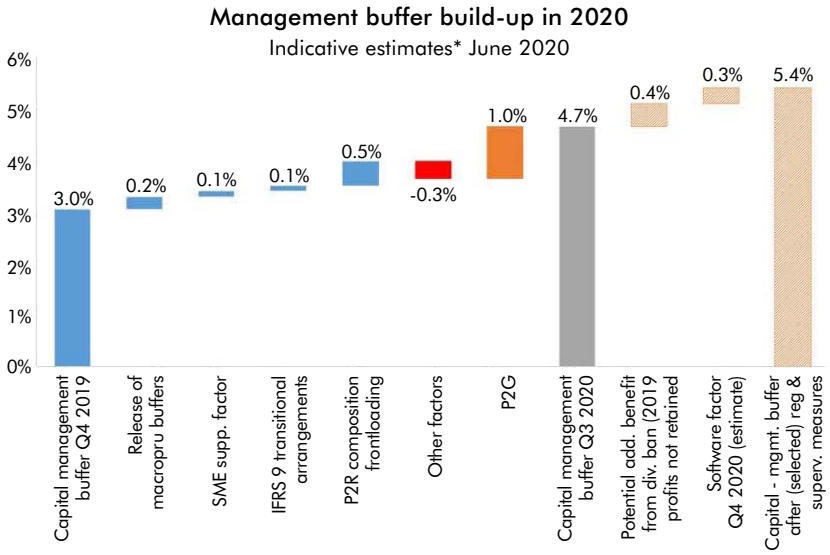
"This post-pandemic situation should be used by the banks of the Eurozone to tackle in particular the structural challenge to profitability," said Fernandez-Bollo. "Profitability has now rebounded to pre-pandemic levels, but it's still lagging behind the peers, and the cost-to-income ratio is still really high."

He acknowledged that the latter may partly be the result of banks investing heavily to transform themselves and prepare for the future.

"And we think that the [Covid] crisis has really been a big driver for M&A," he added.

"But some are moving, and some are not, so we are really in a mixed situation, and we think that at system level we really need very important steering action."

Vaillant also cited overcapacity and cost reductions as issues to be addressed, as well as improving confidence in group supervision in order to tackle capital and liquidity trapping at Member State level (also referred to as the Home-Host issue).



Source: Supervisory reporting data (preliminary data for Q4 2020), EBA calculations and estimates.
**Based on a reduced sample of 116 banks.*

Fernandez-Bollo at the ECB said preparations for the challenges of the post-pandemic era now need to be made, particularly a likely delayed increase in non-performing loans (NPLs).

"We have had the paradoxical situation of a very, very strong economic crisis without, for the time being, seeing the pandemic fallout materialising in the position of banking clients," he said.

Asset quality going forward is also high on the EBA's agenda, according to the priorities for supervision that it released in November, noted Vaillant.

"What I would like to highlight is that we will need now to manage the long exit path from this crisis," she said. "The longer the crisis goes on, the greater attention we have to pay to structural effects on the economy, with some sectors declining while others strengthen.

"So we will stress that there is a need for banks to conduct comprehensive risk assessments. Early recognition and having good provisioning policies are very important, as is proactive engagement

KEY TAKEAWAYS

- Overall, the three regulators agree that the European banking sector is in good shape. with a strong balance sheet (high capital, low NPLs, abundant liquidity) but **structural challenges remain** (even if profitability is back to pre-crisis level, it remains low, there is material overcapacity)
  - The regulators underline that the banks did not get there entirely by themselves — e.g. the EBA has an interesting chart outlining how banks increased distance to MDA from c. 300bp prior to Covid to c. 540bp — it is almost entirely due to regulatory forbearance *(see above chart)*
- The EBA and the ECB put priority on the management by banks of (i) "classic" risks (there will be scrutiny on NPLs following the end of the moratoria/state guarantees, and focus also on the management of richly-valued assets by banks, e.g. real estate, leveraged finance and, beyond that, the general rich valuation of all asset classes — stocks, bonds, credit) and (ii) "emerging" risks
- The EBA and ECB expect banks to **strengthen their governance/risk management, including strategic thinking** on emerging risks
  - Climate risk: too few banks have started tackling the issues (90% of banks are not aligned or only partly aligned with ECB expectations) => expectation of material progress next year (90% of banks to be aligned with ECB expectations on climate risk as a target?) => the ECB will first act on qualitative basis and laggards may be penalised via increased P2R charges in the 2022 SREP
  - Cyber risk, digital resilience, crypto, DeFi
  - Competition from BigTechs, FinTechs and digital banks/third country banks
- Implementation of Basel III in line with international standards is a priority for the EBA and the ECB, as well as reducing the variability in IFRS 9 modelling practices (e.g. via benchmarking)

with individual borrowers — this is what we think is always the best solution."

Fernandez-Bollo highlighted pockets of risk building up in certain sectors. He said that the environment of abundant liquidity and search for yield had let to the loosening of underwriting standards, for instance, in the leveraged loan market, while the pandemic situation had contributed to greater risks in real estate.

"We have seen the return of very traditional risks that stem from the fact that the financial cycle has not, in fact, been broken by the crisis," he added. "We can see from equity prices and stresses in fixed income that we are in a traditional high phase of a cycle, even if we are in a non-traditional situation.

"This cycle at some point will reverse, and we need to be prepared for the downturn phase of this cycle."

In the context of credit risk management, the Vaillant mentioned the report it issued in late November on the benchmarking of IFRS 9 implementation by banks. She said that banks have made significant efforts in implementing the standard, while noting that although the regulator found variations in the way banks have been implementing IFRS 9, this was only to be expected, given the high level of judgement embedded in the standard.

Limited use of the Significant Increase in Credit Risk (SICR) collective assessment is nevertheless one aspect that warrants further scrutiny, noted Vaillant.

Edouard Fernandez-Bollo, ECB: 'We need to be prepared for the downturn phase of this cycle'

Buffers need reviewing post-crisis

The EBA and ECB representatives both acknowledged that regulatory buffers had not operated as intended during the crisis, and Vaillant said the situation definitely has to be reviewed.

"During the crisis, we called many times, as regulators and supervisors, for the buffers to be used, because this is indeed the right moment to dip into the buffers and continue lending to the economy," said Vaillant. "But there was no such use of the buffers, despite the good capital and liquidity positions that I highlighted.

"There are many possible causes for this," she added. "Sometimes it may mean that we have not yet built sufficient space for these buffers to be used without too high a stigma. There is obviously the role of the macro-prudential buffers [e.g. the counter-cyclical and systemic risk buffers; these buffers are releasable], which were quite lean in Europe — probably too lean — but also various types of buffers that are individual to banks [e.g. the G-SII/O-SII and Pillar 2 buffers and requirements], where we need to gain a little bit of space for the market to accept the moment they have to be used."

CACIB notes that some of the early ideas around enhancing buffer usability consist in having a larger share of releasable buffers in "normal times" or reviewing the automaticity of MDA application upon buffer breach (e.g. the UK recently modified its rules such that a pending buffer breach does not mean automatic MDA, as long as there is a credible path to buffer restoration and buffers are breached for the "right reasons", such as avoiding deleveraging in a recession).

Fernandez-Bollo echoed Vaillant's thoughts, noting that any enhancements in the usability of buffers must be made without the need for any significant deviations from international standards.

He also underlined that the ECB is not seeking new exceptional or system-wide legally binding powers in respect of stopping dividends or other variable payments outside of the MDA zone, such as AT1 coupons/redemptions and variable compensation. (Note: this matter is the subject of a review article in the CRR Quick Fix).

"We were quite happy with how things evolved, because the banks understood

Buffer framework, dividends and share buy-backs:

- **Buffers:** Both the EBA and the ECB admitted that buffers did not work in the crisis as intended. The ECB mentioned that some "enhancement" of the buffer usability could be envisaged, such as the use of more releasable buffers (i.e. CCyB and SyRB), but that everything should be agreed on "international level" (read: Basel Committee), unless the changes are within the current framework and concern application in the EU
- **Dividends:** Asked whether stakeholders should assume that in the event of any future crisis the first reaction of regulators will be to ban dividend payments irrespective of the distance above MDA, the ECB was very explicit that this is exactly not the case. In the future, general dividend bans should not be expected and the role of capital conservation will be performed by the MDA mechanism, which was put in place for this purpose
  - Interestingly, the ECB also underlined that it is not asking for any additional legal power to ban dividend payments from banks also when they are above their MDA
- **Share buy-backs:** Although the ECB looks at each bank on a case-by-case basis, share buy-backs are seen as better tailored to absorb capital surpluses (whether due to dividend ban, divestments or organic capital generation), while the ECB expects dividend policies to remain stable over time

and followed the [dividend retention] recommendation, even if they were not particularly happy about that," said Fernandez-Bollo. "It was the prudent thing to do at a time of unprecedented uncertainty and it contributed very much to the build-up of the capital base, at the same time that we relaxed some other regulatory standards. But then you've seen, once the uncertainty come back to, I would say, normal levels, we were also very happy to withdraw, because we don't think this should become a regular crisis measure and we are not asking for that.

"Why? Because we think this will give the wrong message, that now, in each crisis, you could expect a general ban on dividends. Dividend measures should be related to the specific situation of a bank — in past crises, it was a quid pro quo for receiving help from the state. In a future crisis, we hope there will never be help from the state, and what has replaced this quid pro quo is the MDA."

Climate, cyber challenges in focus

Alongside these "classic" risks, the EBA and ECB flagged "emerging" risks — even if they noted that these are already upon us.

"The first one, unsurprisingly, is how to address climate change risks," said Fernandez-Bollo.

He noted that more than 90% of banks are not aligned or only partially aligned with the ECB's supervisory expectations on climate risk, and furthermore over 10% of banks neither expect plans to implement these supervisory expectations to be ready by the end of next year, nor have short term deliverables in place.

"We will be taking very important action next year to see that those with plans really go ahead with implementing these, and that the others really start to do something in 2022," said Fernandez-Bollo. "This is really one of the biggest priorities for next year.

"We don't expect to find all the answers next year, but we surely should be on track to find them."

The ECB's first climate stress tests next year will be a tool in this regard, he noted, although this is unlikely to result in higher capital charges under Pillar 2R or 2G.

"If there is a credible plan, there is no reason why there should be a capital charge," said Fernandez-Bollo. "As for more traditional risk management issues, we normally ask for qualitative improvements, and it's only when we are not happy with the path in the qualitative improvements that we go for the quantitative.

"So we hope we will not have to have any quantitative effects next year — this would be a good result."

Vaillant said the EBA is on board to better define and measure climate risks, and agreed with the ECB that banks need to adopt specific strategies in this regard, noting that the EBA has a mandate to measure the potential impact on Pillar 1 capital charges of climate risk.

"This will be quite a difficult task, because we lack data," she said, "but intuitively it's clear to everybody that this risk is growing, so there would probably be a need to better consider the capital charges against it."

Vaillant meanwhile reiterated the EBA's cautious stance on banks issuing loss-absorbing instruments in sustainability-linked bond formats (e.g. with step-up features upon ESG KPI breach).

"It's obvious to everyone that there can be contradictory objectives in such green instruments," she said, "between their greenness and their loss absorbency. We have to be clear that loss absorbency is the top priority when it comes to capital, and we will never sacrifice that."

Cyber and IT challenges were the other key emerging risks cited by the EBA and ECB, whether operationally or in terms of competition.

Fernandez-Bollo said that although banks have reported slight improvements with respect to IT, they see potential disruption as the number one operational risk and have reported both an elevated number of incidents and issues with end-of-life systems and greater outsourcing.

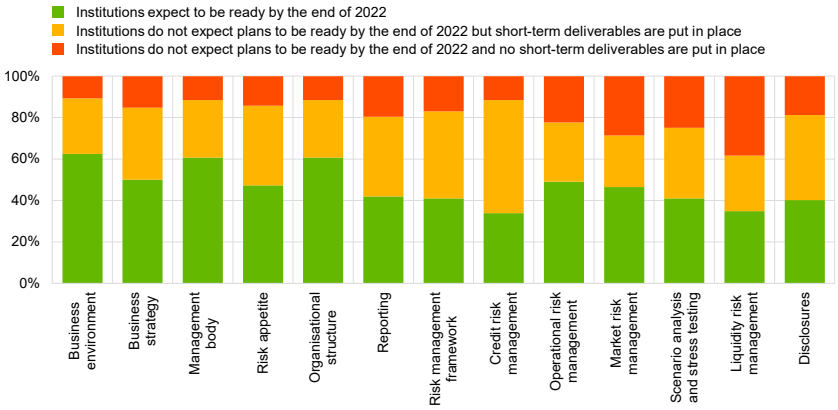
"I'm not completely sure the banks are currently identifying the challenges that are arising," he said, "so this will really be a key factor in our actions in the next years."

Vaillant also flagged digitalisation as a factor in the profitability issue, although she noted positive changes and investments, alongside the impact of the EBA's software RTS, and the Digital Operational Resilience Act (DORA).

"Increasing competition from FinTech and BigTech firms require regulators to ensure the level playing field and banks should streamline their digital capacities," she said.

Vaillant and Fernandez-Bollo both highlighted their institution's work to enhance "fit and proper" governance, with the EBA keen to facilitate a database that authorities can refer to in respect of board appointments, and the ECB seeking to improve internal governance. ●

Timeliness of banks' plans to implement the 13 supervisory expectations set out in the ECB Guide



Source: European Central Bank

On the way to resolvability — SRB 2022 priorities: Separability, sources of resolution funding, data quality from IT systems

Sebastiano Laviola, board member and director of resolution policy and cooperation at the Single Resolution Board (SRB), laid out its priorities for 2022, which aim at ensuring banks' full compliance with the Expectations for Banks (EfB), by the end of 2023.

In 2021, the banks were asked to identify key entities, drivers and quantum of liquidity and funding needs in resolution. In 2022, the banks will be asked to identify the sources of liquidity and collateral necessary to cover funding needs in resolution.

Banks will also be requested to demonstrate the capabilities of their Management Information Systems to produce the necessary data for bail-in valuation and execution, building further on the work undertaken in 2021.

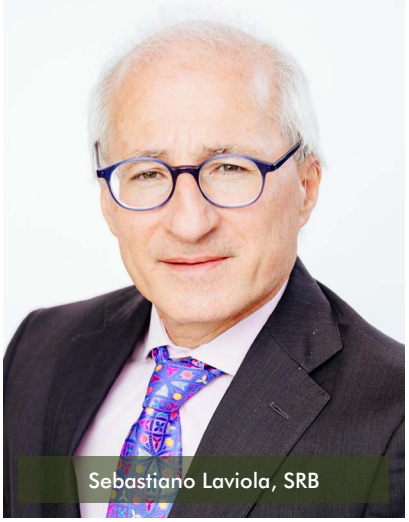
A new focus for the SRB in 2022 will be to assess banks' work on separability and reorganisation after bail-in.

"Separability is particularly important for resolution cases where you have a partial asset sale as part of the resolution strategy," said Laviola, "but also for banks with an open-bank bail-in, because they have to work on credible reorganisation measures and demonstrate capability to support the restoration of the bank's long term viability post bail-in. It is very likely that in a reorganisation plan, after the bail-in, you will have to spin-off some assets and sell some legal entities, and therefore, again, an asset transfer system needs to be in place."

Depending on the use of a partial transfer tool as either preferred ("Plan A") or variant ("Plan B") resolution strategy, the SRB expects either an advanced separability analysis report (SAR) (and a transfer playbook), or a preliminary SAR.

The SRB will also enhance the MREL policy for resolution strategies involving transfer tools.

"Today, if you use a transfer strategy and certain balance sheet indicators indicate a certain degree of marketability of the separated part, there is essentially a


Sebastiano Laviola, SRB

reduction in the MREL requirement," said Laviola. "However, we would like to better link the recapitalisation amount of MREL to the overall assessment of resolvability."

MREL policy: modifications on NCWO calculation and discretionary bail-in exclusions

In respect of MREL more generally, after the overhaul of the policy determined by the introduction of the banking package (CRR-CRD-SRMR-BRRD), the general framework is now relatively clear and stable.

The SRB will reflect more elements in the assessment of the "no creditor worse off" (NCWO) risk, in particular the methodology will take into account that in the run-up to resolution banks' balance sheets do not remain stable but change; in addition, the SRB aims instead at introducing in the methodology the potential impact of discretionary exclusions of classes of liabilities from bail-in (discretionary exclusions are decided by the SRB with a view towards preserving financial stability (or for other reasons) and can potentially include corporate and retail deposits, retail-held debt in securities format, etc).

"It is clear that when you approach the point of resolution, normally the balance sheet doesn't stay constant, it develops, and therefore we have to anticipate — to the extent possible — what type of balance sheet we might face when the bank is coming close to the Point of Non-Viability (PONV) and how this impacts the NCWO calculation," said Laviola.

"The other part is the potential impact of the discretionary exclusions. We all know that in the hierarchy of the liabilities it is possible for the resolution authority, for a number of reasons, to discretionarily exclude some liabilities. Of course, this means that other liabilities pay more, or there has to be compensation ex post from the resolution fund, and this may impact the NCWO calculation. So, what are these discretionary exclusions? What are the constraints? What is the impact?"

He said an update to the SRB MREL policy reflecting the evolution of the bank's balance sheet in the run-up to resolution and NCWO calculations will likely be introduced in 2022, and changes relating to discretionary exclusions may be introduced in 2023.

M-MDA applies, but is different to classic MDA

Laviola then took the opportunity to discuss the MREL Maximum Distributable Amount (M-MDA), highlighting that — in contrast to prudential MDA — the M-MDA regime is not automatic, but subject to a discretionary decision of the resolution authority, following specific procedural steps and assessment criteria.

Where the combined buffer requirement considered on top of the MREL requirement is breached — or expected to be — banks should notify the SRB immediately and then, in stage one, provide the SRB with monthly information while it assesses the criteria in Article 10a(2), in consultation with the ECB, whether to impose a M-MDA restriction. If the breach continues, nine months later, under stage two, the M-MDA is, in principle, applied —

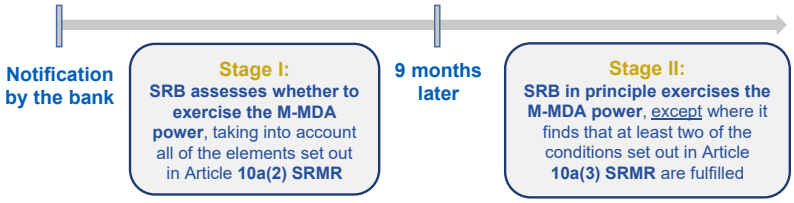
unless, Laviola noted, at least two of five exceptional conditions set out in Article 10a(3) SRMR are fulfilled.

"For example, if there is general financial turmoil, so that the reason why the bank cannot issue is not idiosyncratic to the bank but a generalised condition," he said. "Another condition is that exercising the powers would lead to negative spillover effects in other parts of the banking sector, meaning there could be a financial stability impact."

Permissions regime: banks make limited use of the General Prior Permission

The SRB Permissions regime for early reductions of MREL-eligible liabilities (e.g. calls, repurchases, etc) has been refined, with changes valid from 1 January 2022, and at CACIB's event Laviola said that, according to a preliminary assessment, more than 40 applications for General Prior Permission (GPP) to reduce eligible liabilities instruments by a predetermined amount for a specific period had been received.

How will the SRB assess whether to impose M-MDA?



A formal consultation with the ECB will run during each stage.

Source: Single Resolution Board

Following the publication by the EBA of its final report on the draft RTS on own funds and eligible liabilities in May 2021, the European Commission was expected to publish a delegated regulation by the end of 2021. Since the publication has been delayed and this is now expected around the middle of 2022, the SRB has updated the provisions of its transitional regime to reflect the final report on the draft EBA RTS. Banks were thereby requested to apply for General Prior Permissions until 1 October 2021, so that they could be effective on 1 January 2022 and remain in place when the delegated regulation will come into force, unless it contains substantial changes from the draft RTS.

According to the legislative framework, banks are requested to respect a margin above the MREL requirement after deducting the GPP predetermined amount, and according to the draft RTS, the predetermined amount cannot exceed 10% of the total amount of outstanding eligible liabilities.

"This represents normally a substantial amount," said Laviola, "and in fact, the banks have not used the full envelope; rather, half of it, except for a few cases."

In addition to being able to call, redeem, repay or repurchase eligible liabilities under a GPP, banks can also request ad hoc per-

KEY TAKEAWAYS

The **SRB** will focus on **operational resolvability in 2022**:

- Finalisation of bail-in play-books, focus on operationalisation of partial asset transfer processes and playbooks, liquidity in resolution (How much? At which entities? Where to find and mobilise collateral?), Valuation at Resolution and Management Information Systems

On the **MREL methodology**:

- Modelling of balance sheets in the run-up to resolution (Moody's modelling of the resolution balance sheet under their Loss Given Failure methodology provides interesting parallels in this context)
- Based on the above, refinement of the NCWO determination methodology and of discretionary exclusions from bail-in (CACIB view: possible impact of limited amount of additional SNP issuance to be required)
- MREL needs for transfer strategies to be refined based on the operationalisation of the partial transfer resolution strategy
  - The SRB noted that, as of now, the RWA discount applied for the determination of the RA and MCC components of MREL in relation to partial transfer resolution strategies is well within the 15%-25% corridor defined by the SRB
  - It remains unclear at this stage whether the operationalisation of the partial transfer strategy will yield materially different MREL requirements

On MREL requirements and resources, the SRB does not expect any banks to have a shortfall versus their binding intermediate target

General prior permissions regime: The SRB also noted than only 42 banks applied for the general permission regime (on average 5% of the permitted maximum envelope of 10% of the sum of MREL Eligible Liabilities has been asked for, although some banks asked for the full envelope)

CMDI/BRRD 3/depositor ranking: The SRB is openly in favour of depositor preference (e.g. as a way to help smaller institutions than can only access senior preferred cost efficiently for MREL compliance purposes)

- General depositor preference should be accompanied by a single tier ranking of all deposit types so that the DGS can intervene once resources below junior deposits have been written off -> this is in order to breach the gap between lower ranking resources and the 8% TLOF, at which point the SRF can intervene
- In order not to overburden individual DGSs, there should be EDIS or re-insurance EDIS in place

missions to redeem specific instruments, in accordance with Art.78a CRR.

Final MREL shortfall reduced by €23bn in a year, to €40bn

The average final 2024 MREL overall target is 26% of total risk-weighted assets (RWAs) including the CBR, and the average subordination target 17.6%, while the average MREL and subordination binding intermediate targets, effective 1 January 2022, are 25.2% and 17.5%, respectively. According to the SRB's MREL dashboard, as of June 2021, the aggregate shortfall of 77 banks versus their binding intermediate targets (including the CBR) was €5bn — "not very big," according to Laviola — with 20 banks in shortfall. The overall shortfall versus final 2024 MREL targets meanwhile fell by 37% (around €23bn) with respect to the previous year, to about €40bn.

Laviola said banks had been helped by "very buoyant" market conditions and very low rates.

"Therefore, we expect almost all banks to respect the binding intermediate target," he added.

Is senior preferred debt a funding or MREL instrument? It is always bail-in-able, but bigger banks have more subordinated liabilities

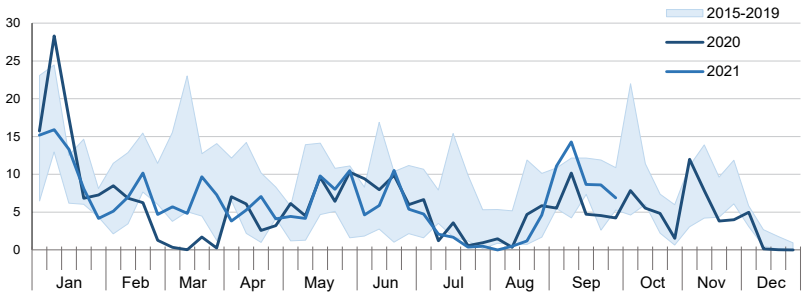
Laviola then addressed a question from the audience on whether senior preferred debt can be seen as a funding instrument, or whether it is always a bail-in-able and MREL-eligible instrument. He began by making a clear distinction between senior preferred debt in securitised format (bonds, certificates, etc) and pari passu debt in non-securitised format, such as deposits, operational liabilities, etc. Laviola reminded the audience that when BRRD 1 was introduced, it preceded the TLAC term-sheet and that, outside of own funds instruments, senior preferred debt constituted the majority of bail-in-able resources of the banking system.

In the wake of statutory preparations for the banking system to meet TLAC, the European legislator introduced senior non-preferred (SNP) debt. This is a good innovation as it ranks below liabilities that are, or can, be excluded from bail-in and therefore helps in addressing the NCWO issue. However, SNP comes at an extra cost given its enhanced loss absorbency.

Laviola then made the link to the liabilities structure and hierarchy of banks' liabilities that is the critical determining factor for which types of liability are subject to bail-in and which get excluded. And the liabilities structure of a bank is closely linked to its size and international reach.

- On one side, large international banks tend to have all types of liabilities on their balance sheet and therefore resolution, in CACIB's understanding, may be carried out by using largely own funds and SNP debt.
- At the other end of the spectrum, there may be banks which have a balance sheet size of below €30bn and may still be earmarked for resolution, in which case also a full MREL requirement will apply. However, such banks tend to have predominantly only capital and deposits. In such cases, senior unsecured debt that such banks may raise will serve predominantly for MREL purposes.

Weekly euro-banks' issuances (EUR bn)
(weeks start on Wednesday and end on Tuesday)



Source: Dealogic, ECB calculations

Are deposits and debt sold to retail really bail-in-able? Legislation says, yes, with caveats

This then prompted a question as to whether MREL-eligible deposits and debt sold to retail and SME investors is really bail-in-able or should the market assume that it will be subject to discretionary exclusion from bail-in? Laviola first reminded the audience that according to the legislation such liabilities are bail-in-able. However, there are certain caveats:

- The first caveat is the discretionary exclusion itself, which is decided by the resolution authority. However, in order for the resolution authority to decide, it needs full information on the liabilities side of the bank as to instruments and their exact ranking — this would then enable the resolution authority, when drafting the resolution scheme, to decide which liabilities cover losses and in what order. This is then complemented by an analysis as to the depletion in the run-up to resolution and financial stability and confidence effects of the bail-in of certain debt types.
- The second caveat is that the regulation provides certain restrictions as to what type of retail investor can be considered as a "bail-in-able" counterparty: the retail investor must have a well-diversified financial portfolio of a certain size, must be documented as well-versed in financial matters, and must be able to invest in material minimum sizes [CACIB: this serves to ensure that a natural person investor can actually afford the loss due to bail-in without having to face financial ruin].

CMDI review can substantially enhance resolvability, but needs deposit ranking and DGS reform

Beyond the current legislation, Laviola then stated that the bail-in-ability of certain deposits and debts sold to retail/SME clients is one of the core debates on the Crisis Management & Deposit Insurance (CMDI) legislative review (covering the BRRD and DGSD and their interactions).

Clearly, there may be issues as to the

resolvability of banks at the low end of the size scale that are earmarked for resolution (the "middle class" banks: too large for liquidation and "too small" for resolution) — these issues relate to whether there is a sufficient amount of liabilities that can be truly bailed in without triggering considerable adverse effects. In this case, the SRB's position on solving this issue consists of introducing up to four elements:

- Introduce a general depositor preference in the EU, meaning that large corporate deposits rank senior to senior preferred debt uniformly throughout the EU rather than the current mixed situation — such a ranking would largely resolve the NCWO issue created in situations where certain pari passu debts are excluded from bail-in in a resolution, but would be included in the insolvency waterfall of a hypothetical liquidation.
- Abolish the super-preference for DGS as per current legislation and let all deposits rank pari passu.
  - What is "super-preference" of DGS and role in resolution? Outside of secured debt and certain liabilities that may be preferred by law, such as the liquidation expenses, employees' salaries, etc, DGSs subrogating to the rights of covered depositors have the most senior liability ranking and rank above SME and large corporate deposits, making their potential contribution in a resolution scenario rather difficult and limited.
  - This would contribute to enhancing the Least Cost test that limits DGS's intervention in resolutions to the maximum final loss the DGS would suffer in a liquidation of the bank (which is today rather limited, given the DGS super-preference in liquidation, after having reimbursed covered deposits).
- Harmonise the criteria for the Least Cost Test throughout the EU.
- In this context, the introduction of a European Deposit Insurance Scheme (EDIS) would be a game-changer.
  With such a scheme in place, upon entry into resolution the DGS could intervene once the bank's own funds and "side effect free" bail-in-able debt are consumed and there remains a shortfall to be covered until the achievement of the liquidation or resolution plan target.

The DGS could be further supported through SRF contributions once the 8% TLOF threshold is met, whilst the introduction of EDIS would mean that there would be no danger that national DGS's can run out of resources.

Finally, DGS intervention is fully compatible with the BRRD, as it does not represent public money, but contributions from the banking industry.

MREL calibration and transparency: here for TLAC, MREL to come in 2024

At the end of the CACIB event, the question of MREL calibration and transparency was addressed — the legislation and its own MREL methodology provide the SRB with various options to customise the MREL quantum to resolution plans, with the result that the final MREL may be different from the MREL determined on the basis of the default MREL formula. At the same time, there is no compulsory standardised disclosure on MREL, which means there is a rather mixed picture in terms of bottom-up MREL transparency. The whole situation may be rather frustrating for investors.

Here, Laviola reminded the audience firstly that TLAC disclosure is already mandatory and has to be disclosed in a pre-determined format, whereas MREL disclosure will become mandatory from the 1 January 2024 date from which the final MREL has to be met.

Laviola clarified some of the general adjustments to MREL that the SRB undertakes:

- Pillar 2 adjustments are mostly limited to the banks with higher Pillar 2, as here it can be assumed that many of the potential losses in the run-up to resolution will be covered by the Pillar 2 setting — hence, a lower Pillar 2 can be justified in the recapitalisation amount element of MREL under certain conditions, and depending on the riskiness profile of the bank post-resolution. But this adjustment is not material.
- The adjustment for transfer strategies is much more important as it impacts the RWA amount used to calibrate the recapitalisation amount and market confidence charge. Here, the SRB uses currently a corridor of 15%-25% of assets calibrated based on balance sheet characteristics capturing the overall marketability of the entity. The adjustment estimates the lower perimeter and recapitalisation needs of the entity post-resolution.

Turning then to the disclosure of individual MRELs and its components, there is a trade-off to be made in the run-up to the final MREL target in 2024, with potentially market sensitive information that may adversely impact legitimate interests of the impacted bank.

Laviola sees this matter as also linked to the disclosure of resolution plans or elements thereof.

The disclosure of resolution plans that exists in the US and is about to be introduced in the UK cannot be compared to the situation in the EU. If one looks at the US, the banks are required to produce their own resolution plans under Title I of the Dodd Frank Act — these are the plans that are partially disclosed. Under Title II of the same act, the FDIC as US resolution authority may draw up its own resolution plan and it is free to deviate from the bank's resolution plan. Resolution plans in the EU are prepared by the SRB and therefore are more similar to Title II plans in the US that are not disclosed.

The SRB clearly acknowledges the positive effects of more transparency: one of the ways in which the SRB considers enhancing disclosure is the yearly publication of resolvability heatmaps — overviews of the progress of the European banking system towards achieving resolvability in anonymised format. Such disclosure is expected in the near future.

The publication of the heatmap would allow each bank to position itself, and all stakeholders to understand how the system is progressing towards full resolvability of each risk profile and dimension. ●

Regulatory updates from CACIB

EC consultation on the macroprudential framework

The European Commission on 1 December launched a consultation on improving the EU's macroprudential framework for the banking sector, which includes a review of the design and functioning of the buffer framework. The consultation is open until 18 March 2022. Below is a summary of the topics addressed in the document *(link here)*.

Background to the consultation

- Article 513 CRR requires the Commission to complete a review of the macroprudential provisions in CRR and in CRD by June 2022 and, if appropriate, to submit a legislative proposal to the European Parliament and the Council by December 2022.
- The Covid-19 crisis has highlighted some macroprudential issues, notably in terms of releasability of buffers and banks' willingness to use them.
- The consultation is launched after the banking package proposal published on 27 October 2021. This should allow respondents to take into account the implications of the proposal for the macroprudential framework, in particular regarding the output floor.

Four topics covered in the consultation and key points raised by the European Commission

1 Overall design and functioning of the buffer framework

- According to the Commission, the review of the framework should focus on the following aspects:
  - a Stigma related to MDA: incentive for banks to deleverage to avoid the MDA trigger and market stigma attached to it
  - b Capital buffer usability: interplay and overlap with parallel requirements (MREL, Leverage)
  - c Balance between structural (fixed) and releasable buffers: making a larger share of buffers releasable in a crisis. One option is a CCyB >0 even in the absence of a credit boom
  - d Procyclicality of risk weights: buffers are expressed in % RWA, i.e. the amount varies with the risks. The Commission notes that the output floor can be expected to mitigate the risk weights variation over the cycle
  - e Banks' willingness to use buffers depends on expectations regarding the speed of replenishment
  - f Buffer framework complexity and consistency of use of buffers across Member States

2 Missing or obsolete instruments, reducing complexity

- Potential introduction of Borrower-Based Measures in the macroprudential framework to mitigate systemic risks, e.g. real estate
- Introduction of a supervisory power to impose a system-wide restriction on the distribution of capital. The Commission notes that during the Covid-19 crisis banks were recommended to refrain from capital distributions as the current legislation only allows supervisors to impose restrictions on a bank-by-bank basis

3 Internal market considerations

- Assessment whether the current voluntary reciprocation of certain macroprudential measures should be made mandatory

4 Global and emerging risks

- Potential threats to financial stability identified in the consultation:
  - Non-bank financial intermediation
  - Climate risks
  - Cyber risks
  - Exposures to third countries
  - Crypto assets
- The Commission is asking various questions on the potential enhancement of the macroprudential framework to address these risks

ESRB on capital buffer usability

Phase out AT1/Tier 2, 33%+ of MREL to be met with debt, increase buffers and RWAs, no CET1 double counting for buffers and MREL/LR, more LR buffers

The European Systemic Risk Board's (ESRB's) Analytical Task Force on 17 December published a report *(link here)* on the usability of banks' capital buffers and their overlap with minimum requirements.

The background is the European Commission work on the redesign of the macroprudential regulatory framework, which includes the capital buffers. CACIB assumes that this ESRB report will feed into the formal ESRB answer to the Commission's Call for Advice on the macropudential topic (response due by 31 March 2022, with contributions also expected from the EBA and the ECB).

The reference to buffer "usability" means the amount by which banks are able to deplete buffers without triggering a breach of any parallel LR/MREL minimum requirements. This is best explained via a short example:

- A bank has a Pillar 1 requirement of €8 and a Combined

Buffer Requirement (CBR) of €3.5 (CCoB and D-SIB buffers) on RWAs of €100

- The bank has a leverage exposure of €300, so the minimum Leverage Ratio (LR) is €9
- The minimum LR exceeds the Pillar 1 requirement by €1, therefore it becomes the binding CET1 constraint. Actual buffer usability is reduced by €1 out of €3.5 or by 28.6% (actual usable buffer space amounts to 71.4% (€2.5 out of €3.5))

The report examines the overlap and interaction between buffers and minimum requirements based on the Leverage Ratio (with and without LR G-SIB buffer) and MREL (RWA and LR basis). The sample covers 95 banks from 21 EU countries, is based on 2019YE data from supervisory/resolution reporting and is enriched by the 2019 EBA Basel IV QIS inputs and outputs. Banks exhibiting shortfalls versus the final LR or MREL requirements are simulated to have covered them by maxing out regulatory buffers with the cheapest-to-deliver instruments (plus keeping 1% management buffer on top of all requirements). The 2019 EBA QIS serves to simulate the Basel IV impact.

The report estimates that the weighted average CBR usability drops to 29% in the 2024 baseline scenario with final MREL targets met, from 65% at mid-2021 when considering only interaction with the LR. The analysis finds a large degree of heterogeneity in buffer usability across banks in the sample, often either 100% or 0%, with a wide dispersion of usability across the sample. Banks using the internal ratings-based (IRB) approach and D-SIBs/G-SIBs are more constrained than banks using the standardised approach (SA), as average risk weight density is a key determinant of buffer usability and that of IRB banks tends to be lower. Also, banks in core Europe (including France and Germany, the Benelux) and Nordic banks tend to have a lower buffer usability than southern or central/eastern European banks.

The report sets out a number of options to increase the usability of buffers, including ideas that may be considered fairly radical changes:

- Options within the current regulatory framework:
  - Increasing the Combined Buffer Requirement (CBR), particularly via a more active use of the Countercyclical Capital Buffer (CCyB). The report calculates that a setting of the CCyB to 2.5% in "normal" times from Q4 2019 levels for all banks would increase CBR usability to 45% from 29% in the 2024 baseline scenario (and require additional capital and eligible liabilities of 1.27% of RWAs from the banks in the sample).
  - Increasing RWAs through macro- and microprudential measures (LGD and RWA floors, TRIM, EBA IRB repair roadmap) and general regulatory requirements such as full implementation Basel IV leads to an increased average RW density and thus higher buffer usability (e.g. 49% of buffers usable in this scenario vs. 29% in the baseline scenario)

- Options necessitating legislative changes:
  - Mirroring all risk-weighted buffers with parallel leverage ratio (LR) buffers, as is the case for the G-SII buffer (with e.g. 50% conversion factor)
  - Restricting the simultaneous use of capital to meet both buffers and minimum requirements (i.e. MREL and LR)
  - Stacking LR buffers on top of non-risk-based MREL (the report points out that at present the EU G-SII LR buffer falls within the LR MREL, as per EC)
  - A higher minimum requirement for eligible liabilities to meet MREL to reduce overlap between the CBR and non-risk-based MREL. The report calculates that requiring G-SIBs, top-tier banks and "fished" banks (banks designated by their regulator to respect the same MREL rules as top tier banks) to meet at least 33% of their MREL requirement with eligible liabilities (a shortfall amounting to 1.08% of aggregate RWAs) would increase CBR usability to 42% from 29% in the 2024 baseline scenario. It calculates that the alternative of requiring the full recapitalisation amount to be met with eligible liabilities would increase CBR usability further, to 53%, while also increasing the shortfall.
  - Requiring the G-SII leverage buffer and potentially other leverage buffers to be met with CET1 only
  - Increasing the CET1 component of minimum capital requirements in the risk-based framework to reduce overlap with non-risk-based minimum requirements (primarily the LR measure). The report suggests, for example, that a greater share of CET1 in risk-weighted Pillar 1 or 2 requirements would reduce the overlap of the CBR with the minimum LR, or requiring that the minimum leverage ratio is met with CET1 only would improve the usability of leverage buffers
  - Phasing out AT1 and Tier 2 to simplify the framework by making only CET1 eligible for going concern requirements, and a wider class of MREL resources for gone concern requirements

EBA annual risk assessment of the European banking system

The European Banking Authority (EBA) on 3 December released its annual risk assessment of the European banking system accompanied by the publication of the 2021 EU-wide transparency exercise, which provides detailed information, in a comparable and accessible format, for 120 banks across 25 EEA/EU countries.

The key figures are summarised in the table below.

Overall, the EU banking system is the best-capitalised, most liquid, and with the lowest NPL ratios it has ever been, whilst profitability, driven by the release of provision reserves, is back to pre-pandemic levels.

- Risk areas of concern raised by the EBA and which banks should focus on in terms of priority:
  - Vulnerability to increasing NPLs due to expiring moratoria/state support schemes. Cf. increasing Stage 2 loan share
  - Very high prices in a number of asset classes that make them vulnerable to corrections: residential real estate, bond and stock markets
  - Lower impairment costs have increased profitability, but profitability remains structurally challenged
  - Increasing operational risks, mainly due to IT and cyber risks, require banks to further prioritise IT and cybersecurity
- Beyond the above priority risks, the EBA makes the following points of interest to banks and their supervisors (non-exhaustive list):
  - ESG: Banks have made progress on ESG risks. Banks' ESG bonds totaled around 20% of banks' total issuance in 2021. Banks have started integrating ESG risk considerations into their risk management. However, there is significant progress to be made, including in areas such as data, business strategies, governance arrangements, risk assessments and monitoring.
  - Funding: Amidst increasing rate volatility, banks should carefully evaluate the risk profile of their funding plans. Banks may take advantage of low yields to accelerate the build-up of their MREL buffers. They should, however, ensure that they are able to substitute current central bank funding with other funding, not least to prevent a material deterioration of the NSFR or sharp increases in funding costs. Amid decreasing covered bond issuances, commonly considered as a reliable source of funding, including in times of increased market volatility, banks should ensure they have access to covered bond markets and investors.
  - Dividends: Banks should not pursue overly generous dividend and share buy-back policies. Regulators and supervisors should provide clarity on the period and approach to restore capital buffers released during the pandemic.

	CET1 ratio (transitional)	CET1 ratio (fully-loaded)	Liquidity Coverage Ratio	NPL ratio	Share of Stage 2 loans	RoE	Leverage Ratio (fully phased-in)
Q2 2021	15.8%	15.5%	174.5%	2.3%	8.8%	7.4%	5.7%
Q2 2020	15.0%	14.7%	166.2%	2.9%	8.2%	0.4%	5.1%

Source: EBA

ECB supervisory priorities 2022-2024

The European Central Bank Single Supervisory Mechanism (SSM) on 7 December published its supervisory priorities for 2022-2024 *(link here)*.

CACIB summary:

- Top areas for ECB scrutiny in 2022 will be (i) NPE management and provisioning (banks should not aggressively release provisions), (ii) CRE, leveraged finance and prime brokerage, and (iii) IT resilience. Deficiencies in these areas may have adverse impact on capital and/or profitability
- Longer term areas of focus appear to be climate/environmental risk, governance and digitalisation strategies
- In addition, in terms of the significant excess capital over MDA (c. 400bp-500bp), the ECB guides that (i) it considers that it is happy with robustly capitalised banks and (ii) that banks can use the excess capital to expand lending/absorb losses as they come along. Some of this excess capital will also be consumed by banks addressing the supervisory priorities outlined in this briefing.

Detailed considerations

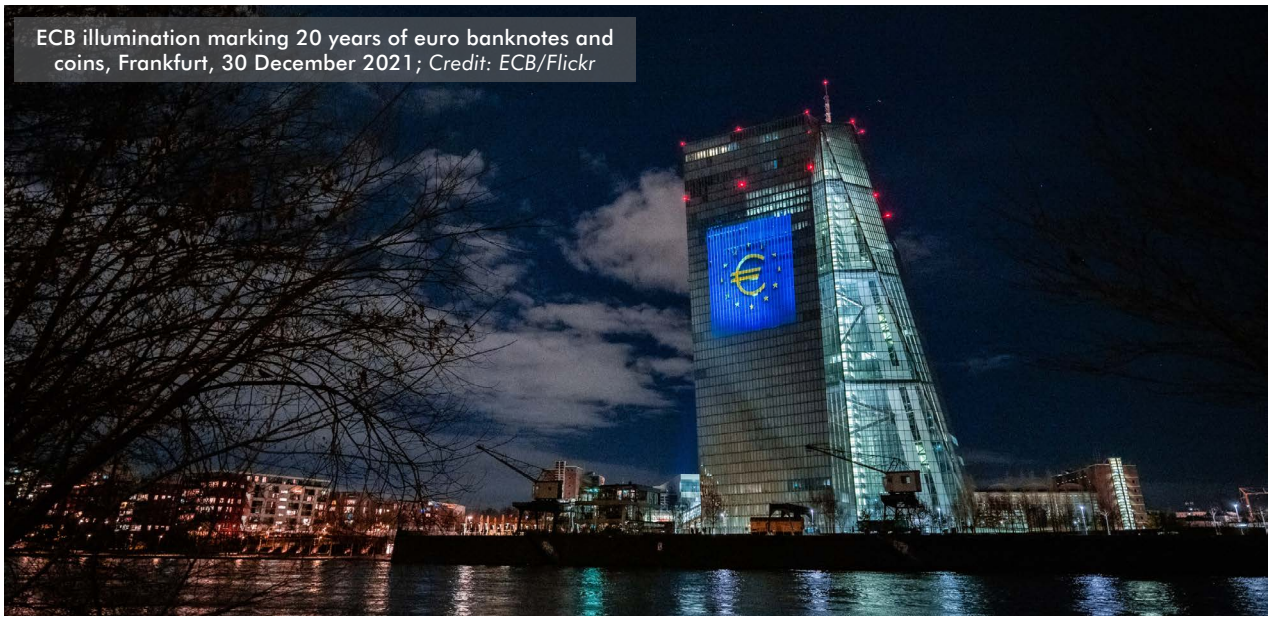
The priorities were identified as the risks that banks are most likely to face over the coming years and reflect (i) the health/economic environment, (ii) continued structural risks that banks are exposed to and potential remedies, and (iii) "emerging" risks.

The supervisory priorities will be tackled through the usual ECB tools of data gathering and benchmarking, targeted reviews and on-site inspections, and follow-ups by the Joint Supervisory Teams.

All identified supervisory priorities will be worked upon starting in 2022 and their conclusions are not expected until 2024.

The following tables detail the supervisory priorities, the areas they cover, the potential ECB SSM actions in respect of each priority, and clarifying comments.

Supervisory Priority 1: Ensure banks emerge resilient from the current pandemic/economic environment				
Credit Risk	Credit Risk Management Frameworks (CMF)	Focus on: • Unlikely-to-Pay UTP) identification/classification • Collateral valuation • Adequacy of provisioning practices	• The ECB is still concerned about remaining deficiencies in the identification of UTPs, e.g. not right data is being collected • IFRS 9 model deficiencies remain, notably in respect of: o Macro model application o SICR triggers • W.r.t provisions, the ECB is concerned about premature provisions releases	Key planned supervisory activities: • *Follow-up by JSTs on credit risk management deficiencies identified during the "Dear CEO letter" exercise in 2020, and targeted on-site inspections* • *Targeted reviews in the area of credit risk identification, monitoring and assessment, as well as the relevant dimensions of the IFRS 9 provisioning framework* • *Follow-up by JSTs with affected banks, and targeted internal model investigations into model changes related to the implementation of the EBA IRB repair programme or triggered by the impact of the pandemic* Possible impacts on banks (CACIB view): • NPE additions • Additional provisions • Both elements above can reduce capital ratios • In case banks do not follow through, possible penalties from the ECB can include fines, P2R add-ons (direct or via SREP), CET1 deductions
	Exposures to COVID-impacted sectors, incl. CRE	• Special focus on Commercial Real Estate • Focus also on other Covid-impacted sectors, e.g. real estate	N.A.	Key planned supervisory activities: • *Regular monitoring of banks' exposures towards vulnerable sectors* • *Targeted reviews and on-site inspections of banks' exposures to CRE* Possible impacts on banks (CACIB view): as above
	Leveraged Finance	*Prevent the build-up of unmitigated risks in the area of leveraged finance and foster banks' adherence to the supervisory expectations laid down in the related ECB Guidance from 2017*	• The ECB wants banks to respect the exposure limits, notably with respect to EBITDA, laid down in its Guide	Key planned supervisory activities: • JSTs continue to assess leveraged finance risks and follow up on significant institutions' efforts to implement the supervisory expectations outlined in the related ECB Guidance • Targeted on-site inspections Possible impacts on banks (CACIB view): • In case banks do not follow through, possible penalties from the ECB can include fines, P2R add-ons (via SREP), CET1 deductions
Market Risk and IRRBB	Sensitivities to interest rate and credit spread risks	The ECB is concerned about banks' abilities to cope with "medium term" IR and credit spread shocks, esp. in the context of rich valuations	• *Banks should have in place sound risk management frameworks addressing the assessment, mitigation and monitoring of such risks and take timely remedial actions whenever deficiencies are identified.*	Key planned supervisory activities: • Targeted review of banks' interest rate and credit spread assessment, monitoring and management, in both trading and banking books • Follow-up by JSTs on banks' remedial action plans whenever material deficiencies are identified, and targeted on-site inspections Possible impacts on banks (CACIB view): • Additional valuation haircuts, provisioning, deleveraging (?) -> adverse impact on capital ratios



ECB illumination marking 20 years of euro banknotes and coins, Frankfurt, 30 December 2021; *Credit: ECB/Flickr*

Supervisory Priority 2: Address structural weaknesses (low profitability) through digitalisation strategies and enhanced governance				
Business Model	Deficiencies in banks' digital transformation strategies	• Part of the Business Model assessment by the supervisor in the context of SREP	• Ensure business model resilience and address low profitability through enhanced digitalisation • More digitalisation will also enable banks to adapt to shifting customer preferences and withstand competitive pressure from FinTechs • Digitalisation strategies must be credible and achievable	Key planned supervisory activities: • *Survey on banks' digitalisation strategies* • *Benchmarking analysis and JST follow-up with banks where material deficiencies in their digital transformation strategies are identified* • *Targeted on-site inspections in areas where the main deficiencies are identified* Possible impacts on banks (CACIB view): • No direct impact on capital of banks from concrete ECB measures expected • However, persistent deficiencies can lead to worse SREP score and thus higher P2R (not expected for 2022) • Short to medium term pressure on costs and Net Income
Governance	Deficiencies in management bodies' steering capabilities	*Supervised institutions should address deficiencies in management bodies' functioning and composition*	• *Regulators keep reporting a high number of structural deficiencies in internal control functions, management bodies' functioning or risk data aggregation and reporting capabilities. The difficulties banks have in remedying these shortcomings in a timely way raise legitimate concerns about the effectiveness of their boards and their strategic steering capabilities*	Key planned supervisory activities: • *Targeted reviews of banks' management bodies' effectiveness and targeted on-site inspection* • *Development and implementation of a policy on diversity and a risk-based approach to fit and proper assessments* o The ECB is planning to implement intrusive Fit and Proper assessments o Achieving diversity of banks' boards is another declared ECB objective Possible impacts on banks (CACIB view): • Possible changes in banks' boards • Bad governance score leads to worse SREP score and increased Pillar 2R

Supervisory Priority 2: Address structural weaknesses (low profitability) through digitalisation strategies and enhanced governance				
Climate and environmental risk	Supervised institutions should proactively incorporate climate-related and environmental risks into their business strategies and their governance and risk management frameworks, in order to mitigate and disclose such risks and comply with the corresponding regulatory requirements	• The ECB recently published its assessment of banks' alignment with its supervisory expectations with respect to climate and environmental (C&E) risk and found the vast majority of banks not to correspond to such expectations • The objective is to move more banks towards compliance with supervisory expectations on C&E risk	• In 2022 the ECB will carry out its C&E stress test which is expected to be a learning experience for both supervisors and banks	Key planned supervisory activities: • *Bottom-up climate risk stress test and development of best practices on climate stress testing* • *Thematic review of banks' strategies and governance and risk management frameworks* • *On-site inspections* • *Follow-up by JSTs on banks' disclosure practices and adherence to supervisory expectations laid down in the related ECB Guide* Possible impacts on banks (CACIB view): • No direct impact on capital of banks from ECB measures • There will be no publication of individual bank results, but only of aggregated data
Market and Credit Risk	Counterparty credit risk, with special focus on exposures towards non-bank financial institutions (NBFI)	*Supervised institutions should have sound governance and risk management frameworks in place to cope with increased exposures to the counterparty credit risk (CCR) stemming from capital market services* • In other words, the ECB is concerned with banks' exposures via e.g. Prime Brokerage activities towards hedge funds, MM funds, family offices and other lightly or non-regulated NBFI entities	• The ECB will focus on understanding banks' expertise in the relevant areas • Investigations will focus on all relevant aspects, but will include: o Client on-boarding o Margining practices o Management of default of counter-parties	Key planned supervisory activities: • *Targeted reviews and on-site inspections on CCR governance and management* • *Finalisation of prime brokerage reviews to clarify supervisory expectations in terms of management of NBFI exposures* • *Follow-up by JSTs with banks that show material deficiencies in these areas* Possible impacts on banks (CACIB view): • Changes to banks' practices in concerned areas • Adverse impact on capital • For banks not following through, potentially worse SREP score and increased P2R/higher capital charges
Operational risk	• IT outsourcing • Cyber resilience	Foster more robust IT outsourcing arrangements and better resilience against cyber threats	• Increased reliance by banks on outsourced IT providers merits a stronger supervisory focus • Increased number of cyber incidents in line with increasing digitalisation	Key planned supervisory activities: • *Data collection on banks' outsourcing registers* • *Targeted reviews and on-site inspections on cyber resilience and IT outsourcing arrangements* • *Follow-up by JSTs with banks that show material deficiencies in these areas* Possible impacts on banks (CACIB view): • Changes to banks' practices in concerned areas • Potentially adverse impact on capital/ profitability • For banks not following through, potentially worse SREP score and increased P2R/higher capital charges

ESMA on AT1/Tier 2 call and buy-back announcements, and P2R and P2G disclosures

The European Securities & Markets Authority (ESMA) on 5 January published its revised MAR Guidelines on delayed disclosure of inside information.

Context:

- The MAR Guidelines have been amended in the context of the interaction between the bank regulatory framework and MAR transparency obligations concerning inside information
- The topics addressed are when to disclose CET1/AT1/Tier 2 calls/repurchases and disclosures on P2R and P2G

Disclosing CET1/AT1/Tier 2 calls/repurchases:

- Banks do not need to disclose to the market intentions to carry out redemptions/repurchases of CET1/AT1/Tier 2, as long as regulatory authorisation has not been given
  - *In CACIB's view, at first read, it appears possible to not to have to disclose to the market a call on an AT1/Tier 2 instrument where the regulatory authorisation is contingent on the successful pre-financing of such call with a new market issuance*
    - *This is based on the assessment that the regulatory authorisation cannot be deemed to have been given without the pre-financing AT1/T2 issuance having first been placed in the market*
    - *This remains a key point of clarification for capital management and funding teams of banks and may require further confirmation*

Disclosing draft SREP decisions and P2R/P2G:

- Draft SREP decisions or information related to them do not need to be disclosed
- P2R is to be disclosed in any case, as soon as possible
- P2G disclosure may be avoided, unless it is "price sensitive". Price sensitive P2G could be present in the following situations:
  - the difference between the P2G and the bank's capital level is not minor and is likely to involve a major reaction by the bank, such as a capital increase
    - This covers the case where the bank's capital is below the level required by its P2G and the bank must implement capital restoring measures
  - the bank's P2G is not in line with market expectations, so a price impact can be expected
    - This covers the case where the bank's capital is above its P2G, but the P2G itself is materially different from market expectations

      Example: the market generally assumes that P2G is at c. 1%. A bank has a P2G of 2% and significant excess CET1. The P2G is materially different to market expectations and it reduces significantly the scope for pay-out of excess capital and therefore it is price sensitive => the actual P2G level must be disclosed

- *In CACIB's view, with a general market expectation that P2G levels are set at c. 1%, banks with listed instruments on EU markets (debt and equity) and significantly different P2G settings will have to disclose such P2G levels, based on this ESMA decision*
  - *The increased transparency on P2G levels will then provide the market with much better visibility on this metric (banks not disclosing will be in line with the market expectations)*

Link to detailed ESMA Final Report

SRB on Public Interest Assessment and Bank-Insurance linkages

The Single Resolution Board (SRB) on 26 January published a blog on the Public Interest Assessment (PIA) and the application of the PIA framework to banks and insurance companies *(link here)*. Below we first summarise the key takeaways and then provide a briefing on what the PIA is.

What is changing in this year's PIA analytical framework? Impact on insurance companies as the new critical element

- This year the SRB is evolving its PIA framework by integrating the analysis of the fall-out of bank failures on insurance companies as (i) counterparties/investors and (ii) subsidiaries, where applicable.
- The SRB is working together with EIOPA, the European insurance supervisor, on testing a methodology for assessing contagion on the EU insurance sector arising from bank failures.
  - Initial results were presented in the December 2021 EIOPA Financial Stability Report, pages 12-21.
  - Two findings: (i) the share of bank assets on the balance sheet of insurers is material (c. 14% of EEA insurers' investments) and (ii) the direct loss impact of a bank failure on insurers appears limited — the harshest scenario, implying the write-down of 15% of TLOF's of individual banks, required that 18 banks fail in order for three insurers to have SCRs fall below 100%. In the lightest scenario, however, implying only 5% TLOF write-off per bank, the failure of one bank resulted in one insurer having its SCR fall below 100% (page 19).
- The SRB is with EIOPA considering how to further strengthen this analytical approach.

Cécile Bidet, Michael Benyaya, Doncho Donchev *(pictured left to right)*, Alpesh Varsani, Szymon Wypiorczyk, James Aber
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- Finally, the SRB is focused on building up expertise in the case of financial conglomerates (banks owning insurance or vice versa), focused on the intra-group linkages and potential for contagion (quantum and transmission). The SRB appears to be at the beginning of this particular strand of work and it also indicates that it will work with insurance supervisors in this context.

What is the PIA?

- The PIA is a tool that determines whether a bank upon failure will be subject to resolution or liquidation as per national insolvency proceedings.
- A resolution must be assessed as being in the public interest in order to be chosen over liquidation.
- The public interest is deemed as given when a resolution contributes to achieving one or more of the five resolution objectives as per Art. 31(2) BRRD*, whilst winding up a failing bank under national insolvency proceedings (without state aid contributions) would not meet those resolution objectives to the same extent.
- When a PIA is positive (i.e. there is public interest at stake), (i) resolution is selected over liquidation and then (ii) the resolution tools to be employed are decided upon. In the resolution planning phase, the PIA is a key determinant for the MREL requirements that will be imposed on banks, i.e. a positive PIA will imply a fully-fledged MREL requirement, combining both a Loss Absorption Amount (LAA) and Recapitalisation Amount (RCA).

**Note: the five resolution objectives as per Art. 31(2) BRRD are: ensuring continuity of critical functions; preventing adverse effect on the financial system; protecting public funds; protecting depositors/other protected investors; protecting client funds/assets*

How has the PIA evolved?

- The PIA is carried out annually as part of the annual resolution planning cycles by the SRB and then once a bank is failing — at that point the PIA may change from the one determined in resolution planning.
- The PIA consists, as per CACIB's understanding, of holistic qualitative and quantitative analysis, including scenarios and war-gaming, of bank failures and resolution/liquidation.
- Initially, the PIA focused on the failure, fall-out and resolution of individual banks (idiosyncratic scenario) — this helped to determine (i) whether resolution or liquidation is the preferred way for dealing with a failing institution and, if resolution, (ii) which is the preferred resolution strategy/tool (Plan A) and which is the variant resolution strategy/tool (Plan B).
- In May 2021, the SRB published an addendum to its PIA that integrated so-called System-Wide Events (SWE, i.e. systemic economic/markets/bank crisis) into its PIA analysis
- The SWE analysis helps determine and calibrate better the selected resolution strategy and tools.
  - The SWE analysis takes the adverse stress test of the EBA/ECB as a starting point.
  - In such circumstances, for certain banks it could be considered that resolution over liquidation must be selected as the preferred resolution strategy and possibly also the scope for transfer strategies may be more limited, meaning less transfer strategy and more open bail-in, up to and including the replacement of the partial transfer strategy with complete bail-in.
- In the blog announcing the SWE analysis, the SRB also commented that it will look at (i) the pay-outs by DGSs in the event of bank failure as potential source of instability and (ii) as to whether a critical function must be assessed only at the EU/national level or also at more regional level.

Other December-January bank capital regulatory updates

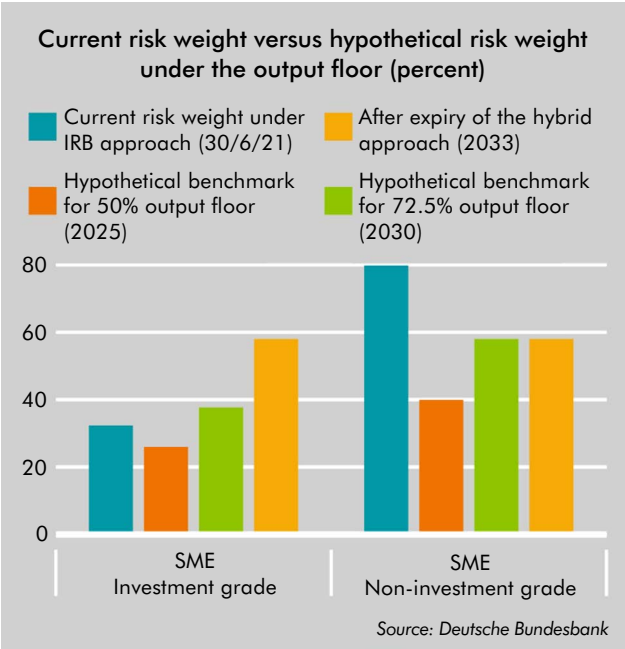
EU: CRR3 DEVELOPMENTS

Bundesbank: Commission Basel III proposal will 'hardly affect' SME funding

The Bundesbank on 21 January published an analysis of the impact of the European Commission's proposal for transposing Basel III into EU law on funding for small and medium-sized enterprises (SMEs, defined in the CRR as firms with an annual turnover below €50m, inter alia). The Bundesbank finds that the roughly 1,300 German institutions that mainly fund SMEs and used the standardised approach (SA) will hardly be affected by rising capital requirements, as the Commission is proposing to leave the existing SME supporting factor (SF) unchanged.

For institutions using the internal ratings-based (IRB) approach, the introduction of the output floor limits the extent to which they can lower their capital requirements compared to those using the standardised approach, but the Bundesbank suggests that the transitional period before the fully-loaded 72.5% output floor comes into force in 2030 means that the supply of credit to the economy is not at risk. The Bundesbank presents the accompanying chart of changes in risk weights for SME exposures: the average currently reported by IRB institutions at 1H21, and maximum values for 2025 (assuming initial application of the output floor at 50%), 2030 (assuming full introduction of the output floor at 72.5%), and 2033 (assuming the end of the transitional hybrid approach).

For investment-grade SMEs, risk weights rise from the current 32% to a maximum of 38% at 2030 and then 58% at the expiry of the transitional hybrid approach. For non-investment-grade SMEs, the maximum possible risk weight falls from the current 80% to 40% at 2025 and then 58% from 2030. *(Link here.)*



CRR/BRRD: ECB Opinion on MPE/Daisy Chain legislation fast-track — in support of proposed regulation, regulatory arbitrage between MPE and SPE resolution to be avoided

The ECB on 13 January published a brief Opinion *(link here)* on the legislative fast-track relating to three resolution-related aspects contained in the CRR3 package: (i) amendments related to multiple point of entry (MPE) resolution regulations (focus on G-SIIs); (ii) amendments related to indirect subscription of internal MREL (iMREL) (lowest rung subsidiary issues MREL to an intermediate subsidiary, which issues MREL to the ultimate legal entity that is the point of entry for resolution — MREL treatment at intermediate subsidiary in focus); plus (iii) eligibility rules for iMREL instruments. The ECB fully supports the proposed amendments in all three areas and proposes only a few limited technical amendments to the proposed text. The ECB insists throughout the Opinion on the need to ensure alignment of EU legislation with the FSB's TLAC standard and Key Attributes for Resolution. The ECB invites the European Parliament, Council and Commission to monitor implementation for the interplay between BRRD and CRR and to avoid G-SIIs engaging in regulatory arbitrage between SPE and MPE resolution strategies based on MREL/TLAC target levels.

EU: ESG-RELATED DEVELOPMENTS IN THE BANK REGULATION SPACE

ECB launches 2022 climate stress test

The European Central Bank on 27 January launched its 2022 supervisory climate risk stress test, which will be conducted in the first half of the year. The exercise aims to complement the economy-wide climate change stress test published in September 2021, the assessment of banks' practices to manage climate and environmental risks published in November 2021, and the 2022 thematic review on the incorporation of climate-related and environmental risks into banks' risk strategies, governance and risk management frameworks and processes. The ECB emphasises that it is not a pass-or-fail exercise and will not have direction implications for banks' capital levels, but is intended as a learning exercise both for banks and supervisors. The results will, however, contribute in a qualitative manner to the Supervisory Review & Evaluation Process (SREP), impacting Pillar 2 Requirements indirectly through the SREP scores, while not directly impacting capital through the Pillar 2 Guidance The exercise has three modules:

1. A questionnaire on banks' climate stress test capabilities
2. A peer benchmark analysis of the sustainability of banks' business models and exposure to emissions-intensive companies
3. A bottom-up stress test

Smaller banks are not required to provide their own stress test projections. The exercise aims to focus on exposures and income

Firmly on the road of "RT" (Regulatory Tightening)

Update on recent Countercyclical Buffer increases in various jurisdictions

Jurisdiction	Highest pre-pandemic level	Current level	Announced/proposed future level
Australia	0%	0%	1% from 1/1/23 (new default level)
Bulgaria	0.5% (1.5% was due 1/1/21)	0.5%	1% from 1/10/22, 1.5% from 1/1/23
Canada	2% Domestic Stability Buffer (2.25% was due 30/4/20)	2.5%	To maintain unchanged as Domestic Stability Buffer
Czechia	1.75%	0.5%	1% from 1/7/22, 1.5% from 1/10/22, 2% from 1/1/23
Denmark	1% (2% was due 30/12/20)	0%	1% from end-Sep 2022, 2% from end-2022, possibly 2.5% in Mar 2023
Estonia	0%	0%	1% from 7/12/22
France	0.25% (0.5% was due 2/4/20)	0%	Possibly 0.5% from March 2023
Germany	0.25%	0%	0.75% from 1/2/23 proposed
Hong Kong	2%	1%	*To be kept unchanged*
Iceland	2%	0%	2% from 29/9/22
Ireland	1%	0%	Gradual rebuilding from 2023
Luxembourg	0.5%	0.5%	*To be kept unchanged*
Netherlands	0%	0%	Targets 2% in a standard risk environment
New Zealand	0%	0%	1.5% from 1/7/27 as part of capital review
Norway	2.5%	1%	1.5% from 30/6/22, 2% from end-2022, probably 2.5% from mid-2023
Romania	0%	0%	0.5% from 17/10/22
Russia	0%	0%	Possible activations from Q1 2023
Slovakia	2%	1%	*To be kept unchanged*
Sweden	3.5%	0%	1% from 29/9/22, possibly 2% in 2023
Switzerland	2%	0%	2.5% sectoral buffer for residential mortgages from 30/9/22
UK	1% (2% was due 2/4/20)	0%	1% from 1/12/22, possibly 2% from Q2 2023

Sources: European Systemic Risk Board, national regulators, Fitch Ratings

sources most vulnerable to climate-related risk, rather than bank balance sheets overall. The exercise uses macro-financial scenarios based on the NGFS (Network for Greening the Financial System) scenarios modelling both physical and transition risks. Banks are required to submit their stress test templates from March and the ECB will publish aggregate results in July. *(Link here.)*

EBA binding standards on Pillar 3 ESG disclosures: quantitative disclosures on climate change physical and transition risks and mitigation; Green Asset Ratio and Banking Book Taxonomy Alignment Ratio from 2024

The European Banking Authority on 24 January published its final draft implementing technical standards (ITS) for Pillar 3 disclosures on environmental, social and governance risks. The ITS set out requirements for large institutions with traded instruments for comparable quantitative disclosures and KPIs for climate-change-related risks as part of the integrated Pillar 3 disclosure framework, covering transition and physical risks and risk-mitigating actions, including KPIs on the alignment of assets with the EU Taxonomy: a Green Asset Ratio (GAR) and Banking Book Taxonomy Alignment Ratio (BTAR). The quantitative disclosures in this first set of ITS concern climate change-related risks, consistent with the first two Taxonomy environmental objectives, climate change mitigation and adaptation, and the EBA intends to extend the ITS to other environmental risks and objectives as the Taxonomy screening criteria are extended. The ITS also set out qualitative disclosures on ESG risks more broadly. The BTAR is the ratio of Taxonomy-aligned exposures to counterparties, including corporates not subject to NFRD (Non-Financial Reporting Directive) requirements, aiming to address concerns about the Green Asset Ratio excluding SMEs and other non-NFRD corporates.

The proposed Regulation would apply from 28 June 2022, with the first disclosures to begin in 2023 with the reference date of 31 December 2022. Disclosure of the GAR begins in 2024, for data as of end-2023, and disclosure of the BTAR begins in June 2024. *(Link here.)*

EU: REGULATION-RELATED DEVELOPMENTS

ECB supervisory blog — limited P2R penalisation expected in 2022 due to under-provisioned NPLs from the mid-2019 and prior vintages

The European Central Bank's Supervision blog on 30 November published a post by Elizabeth McCaul of the ECB Supervisory Board on implementation of the Pillar 2 Requirement (P2R) add-on in the 2021 SREP for banks that have not booked sufficient provisions to cover credit risk on non-performing loans granted before 26 April 2019. McCaul says that the ECB is pleased to see that supervisory dialogues with banks on the subject have shifted practice in the right direction. As of December 2020, the ECB ob-

served a system-wide provisioning shortfall of €13.5bn that decreased during 2021 by €7.7bn to €5.8bn. Roughly half of banks have fully covered their specific shortfalls, mainly via CET1 deductions and NPL disposals. Eliminating the remaining €5.8bn overall shortfall would see banks' aggregate capital ratio drop by around 7bp. The ECB currently expects one in four banks to ultimately show a shortfall and be subject to a P2R add-on in the next SREP decision. *(Link here.)*

ECB ends acceptance of LCR below 100% from January 2022

The ECB on 17 December announced that it would not extend beyond December 2021 the liquidity relief measure introduced in March 2020 allowing banks to operate with a liquidity coverage ratio below the normal minimum threshold of 100%. The ECB expects all banks to maintain a LCR above 100% as of 1 January 2022. *(Link here.)*

EBA Risk Dashboard: CET1 ratios <11% considered to be in the "red" category; 40% of banks identify pricing as main constraint on issuing MREL

Fully-loaded CET1 dropped 10bp in the third quarter of 2021 to 15.4% due to a slight decrease in capital and a slight increase in RWAs, while the leverage ratio remained unchanged at 5.7% on a fully-loaded basis, according to the latest EBA Risk dashboard, published on 10 January. The EBA observes significant variation in CET1 ratios across banks: the interquartile range stretches from 14.1% to 20.0%. In the Dashboard, the EBA divides CET1 ratios among three buckets with "traffic light" colour-coding: the red "worst bucket" (<11%), yellow "intermediate" (11%-14%), and green "best bucket" (>14%).

In the accompanying Risk Assessment Questionnaire (RAQ) results *(link here)*, around 40% of banks identified pricing as the main constraint when issuing MREL and around 35% reported no constraints. 20% of banks (more than double the share in the previous survey) reported that they have already attained enough MREL. For funding over the next 12 months, over 50% of banks reported that they would focus on senior non-preferred or senior HoldCo, and 35% on senior preferred. A smaller share of banks reports their intention to draw secured funding (covered bonds) (25%, from 20% in Spring 2021 and 15% in Autumn 2020). The share of banks stating an intention to access more central bank funding dropped sharply to 5% from 20% in the previous survey, compared with a larger share of analysts (65%, from 40% previously) expecting banks to attain more central bank funding.

Regarding the integration of ESG factors in risk management, 80% of banks reported in the RAQ that they take ESG factors into account in credit risk and more than 70% reported that they consider them for reputational and operational risk. For metrics, the use of carbon or greenhouse gas-financed emissions and of environmental scores or ratings of counterparties were each reported by 45% of banks. 40% of banks reported that they use the share of green exposures; 30% reported they use the share of environmentally harmful exposures. *(Link here.)*


Elke König, SRB

EU: RESOLUTION-RELATED DEVELOPMENTS

SRB priorities for 2022: 'no reason to delay' MREL issuance; SRB to focus on separability for transfer strategies and reorganisation for bail-in strategies, quality of IT systems and data in 2022

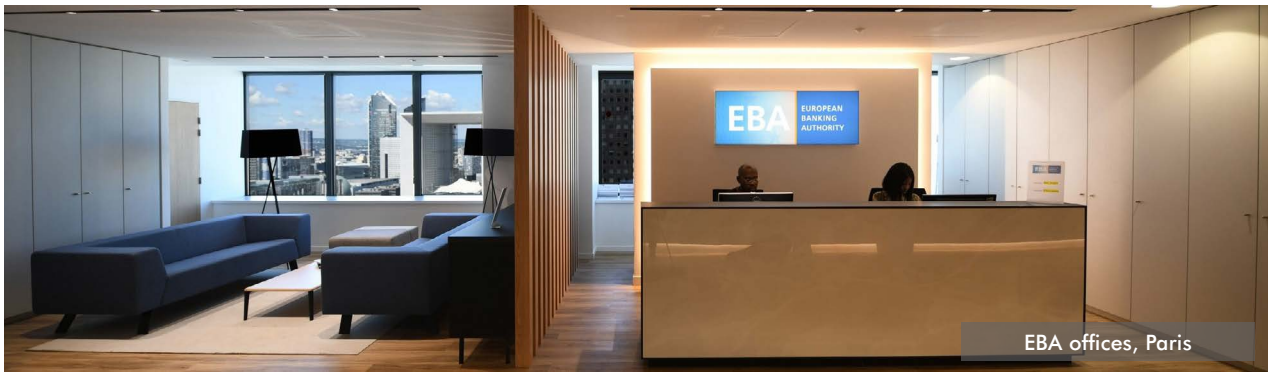
The Single Resolution Board on 10 January published a blogpost by chair Elke König on its priorities for 2022. Three key priorities are highlighted:

1. The most important message is that all banks need to continue to build their MREL resources in good time for the 1 January 2024 deadline: "**Our message to the banks is clear: the market is wide open and they need to continue issuing**. They know the requirements that they must fulfil until 2024 and it is up to them to decide upon buffers to keep them safe. Therefore, **there is no reason to delay**." (Bold and underlining in original.)
2. Separability and reorganisation plans, prioritising work on transfer tools, separability and MREL adjustments for transfer tools for mid-sized banks and continuing work following the guidance note on separability issued in 2021.
3. Information systems and Management Information Systems (MIS)

Another area of focus is the full operationalisation of the single point of entry (SPE) strategy to overcome home-host friction. The SRB is currently working on its first cross-cutting assessment of banks' progress on achieving resolvability to produce a heat-map. *(Link here.)*

SRB to recalibrate MREL in the event central bank exposures are reintroduced in the Leverage Ratio post March 2022

The Single Resolution Board on 22 December announced that



EBA offices, Paris

it will take corrective actions in the final and interim MREL settings by re-recalibrating MREL targets to be based on banks' leverage exposures including deposits at central banks, if competent authorities do not extend the relief measure allowing such central bank exposures to be excluded beyond March 2022. CACIB assumes that any changes will be aimed at keeping the amount of required MREL unchanged, whilst the denominator and the LR requirement are being re-adjusted, solely due to phasing out of the temporary treatment of central bank exposures. *(Link here.)*

EBA final report on resolvability guidelines

The European Banking Authority on 13 January published a draft final report on resolvability guidelines, aiming to be the policy point of reference for both resolution authorities and institutions for resolvability in the EU. The EBA resolvability guidelines take the EBA RTS on the content of resolution plans and the assessment of resolvability as a starting point and add more dimensions and specify details, providing a template for resolution authorities to monitor progress towards achieving resolvability:

- a Structure and operations:
  - i Operational continuity
  - ii Access to FMIs
  - iii Governance in resolution planning
- b Financial resources:
  - i Loss absorbing capacity (MREL)
  - ii Funding and liquidity in resolution
- c Information:
  - i Management information systems
  - ii Information systems for valuation
- d Cross-border issues:
  - i Cross-border recognition
  - ii Coordination
- e Legal issues
- f Resolution implementation
  - i Bail-in execution
  - ii Restructuring
  - iii Governance
  - iv Communication
- g Other institution-specific impediments (other than legal issues)

Full compliance with the guidelines is required by 1 January 2024. *(Link here.)*

EBA consults on draft guidelines on transferability

The EBA on 13 January published a consultation paper on guidelines on transferability to complement the resolvability assessment for transfer strategies. The guidelines aim to complement the above guidelines on resolvability by addressing the feasibility and credibility of transfer strategies and requirements related to the implementation of transfer tools when considered as the preferred or variant strategies for an institution. The guidelines address: i) the transfer perimeter definition; ii) separability; and iii) operational transfer of this perimeter. Their scope covers the following resolution tools: i) sale of business tool (SoB, under article 38 of the BRRD); ii) bridge institution tool (BI, article 40 BRRD); and iii) asset separation tool (AST, article 42 BRRD). The EBA will hold a virtual public hearing on 17 March *(link here)* and the consultation will close on 15 April. The EBA aims to publish the final guidelines by 30 September 2022 and expects institutions and resolution authorities to comply in full by 1 January 2024.

UK: RELEVANT REGULATORY DEVELOPMENTS

UK Ring-Fencing and Proprietary Trading Review interim statement: ring-fencing regime is overly rigid; no significant impact on competition

The UK Ring-Fencing and Proprietary Trading Review panel on 19 January published an interim statement on its findings ahead of the final report and recommendations. The review finds that the ring-fencing regime has created unnecessary rigidity in the form of absolute restrictions on ring-fenced bodies' servicing financial institutions, operating in some geographical areas and providing a range of banking services. Otherwise, the interim statement reports that the ring-fencing regime has "contributed to a more resilient banking sector in the UK". While the review finds that the regime has the potential to constrain the competitiveness of UK banks through increased funding costs, additional administrative burdens and balance-sheet constraints, so far there has been no substantial impact. The statement also reports that concerns about "trapped" liquidity caused by the ring-fencing regime are not justified by the evidence, as imple-

mentation coincided with cases of increases in both ring-fenced and non-ring fenced liquidity and current surplus liquidity appears to be a global phenomenon affecting both ring-fenced and non-ring-fenced bodies. The review panel aims to deliver its final report in early 2022. *(Link here.)*

Bank of England 2021 Bank Stress Test: No hurdle breaches, no AT1 conversions, only one bank to stop AT1 payments

The Bank of England on 13 December announced the results of its 2021 solvency stress test of the UK banking system. Major UK banks had a strong end-2020 starting point, with an aggregate CET1 ratio of 15.9% and Tier 1 leverage ratio of 5.7%. In the test, the CET1 ratio fell by 5.5pp to 10.5%, compared to a 7.6% reference rate. The leverage ratio fell to a low point of 4.8%, above the reference rate of 3.7%. The results will not be used for setting UK banks' capital buffers and no individual bank was required to increase its capital as a result. No AT1 loss absorption trigger (in UK: CET1 < 7%) was hit this time and AT1 coupon cancellations appear to have been projected only for one bank. The Bank adjudges the results consistent with its decision to transition back to its standard approach to capital-setting and permitting shareholder distributions, and it intends to revert to the usual annual cyclical scenario (ACS) framework for 2022. Please see the table below for the results. *(Link here.)*

PRA feedback following discussion paper on 'strong and simple' prudential framework for non-systemic banks — most respondents in favour of a (very) slimmed down version of the full regulatory framework

The Prudential Regulation Authority (PRA) on 15 December published a Feedback Statement (FS1/21) providing a summary of responses to Discussion Paper 1/21, "A strong and simple prudential framework for non-systemic banks and building societies". As a reminder, the paper explored options for developing a strong and simple framework fully consistent with the Basel Core Principles, but simpler than the Basel standards applying to large and internationally active banks, for banks and building societies the PRA considers neither systemically important, nor internationally active. The paper proposed two basic approaches for the fundamental set-up of the simplified regulation: a "streamlined" approach (simplifying the elements of the existing framework that appear to be over-complex for smaller firms) and a "focused" approach (using a more narrow but conservatively calibrated set of new prudential requirements).

Most responses were supportive of the Discussion Paper's long term vision of creating a framework of layered prudential regimes with requirements expanding and becoming more sophisticated as the size and/or complexity of firms increases. Some respondents expressed concern that too many layers would make the framework too complicated and a majority supported no more than two or three layers. A majority of respondents preferred the streamlined approach as opposed to the focused approach, expressing concerns about possible increased capital requirements under the latter. Some respondents, however, stated that it may be appropriate to develop a focused approach for the very smallest firms. Certain elements of the focused vs. streamlined approach are detailed below. *(Link here.)*

Quality of capital:

- A simpler capital structure for smaller firms could be based on CET1 and Tier 2 only
  - On AT1:
    - i Excluding AT1 could have a limited impact as only a small minority of smaller firms currently have AT1 (including legacy Tier 1 instruments);

Bank of England 2021 bank stress test results

Institution	CET1 Fully Loaded				Tier 1 leveage fully-loaded			
	Starting point	Low point	Hurdle fully loaded	Buffer to hurdle	Starting point	Low point	Hurdle fully loaded	Buffer to hurdle
Barclays	14.3	8.2	7.0	1.2	5.0	3.6	3.3	0.3
HSBC	15.7	9.8	7.2	2.6	6.2	5.0	3.9	1.1
Lloyds	15.0	7.8	7.7	0.1	5.5	3.6	3.3	0.3
Nationwide	35.6	16.9	8.3	8.6	5.2	5.0	3.6	1.4
NatWest	17.5	10.3	7.0	3.3	6.1	4.4	3.6	0.8
Santander UK	15.1	11.2	8.2	2.0	5.1	4.1	3.5	0.6
Standard Chartered	14.3	10.8	7.1	3.7	5.1	4.9	3.5	1.4
Virgin Money UK	12.9	7.4	6.1	1.3	4.7	3.5	3.3	0.2
Aggregate	15.7	9.9	7.0	2.9	5.6	4.5	3.5	1.0

Source: Bank of England; CACIB

ii But it could also increase the cost of capital for small firms that do want to issue AT1
- Tier 2 could be retained as it is less complex than AT1 and more frequently used by firms that are likely to be in scope of the simpler regime

- Other aspects of the requirements could be modified, such as amending capital deduction rules and simplifying the deduction threshold for equity instruments of financial entities

Calculation of RWAs:
- Choice between:
  - i A simplified but more conservative Standardised Approach with higher risk weights, and potentially with Pillar 2A integrated;
  - ii A more risk-sensitive but more complex Standardised Approach

Leverage Ratio:
- The conclusions of the ongoing review of the Leverage Ratio will be reflected on as the PRA designs the simpler regime

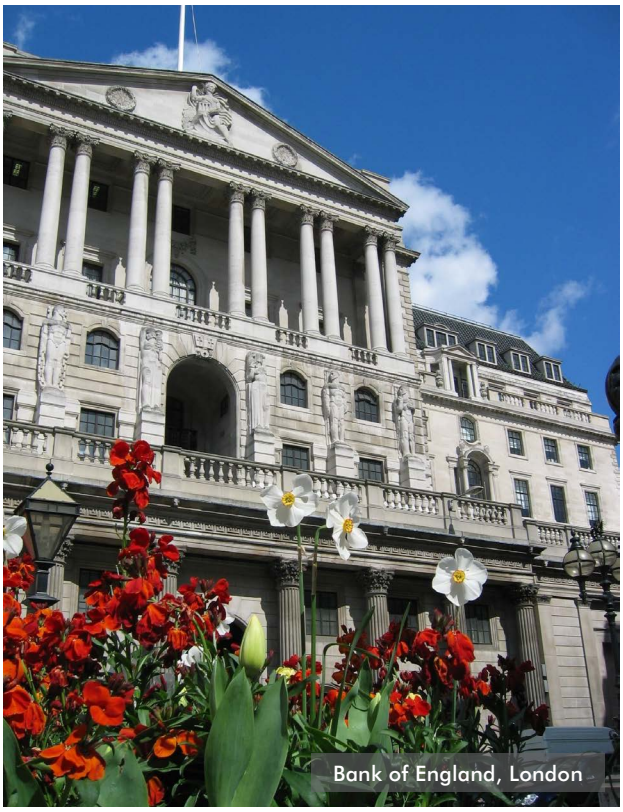
Capital buffers:
- Options under a focused approach:
  - i No buffer requirement;
  - ii A common buffer requirement calibrated conservatively
- Options under a streamlined approach:
  - i Continuing the existing approach, with the 2.5% Capital Conservation Buffer (CCoB) and firm-specific PRA Buffer;
  - ii A single standard CCoB requirement calibrated conservatively;
  - iii Setting only firm-specific buffers

Liquidity and funding:
- Under a streamlined approach, the key design choice would be whether:
  - i To apply both the Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR);
  - ii To apply a simplified LCR and/or NSFR to small firms

PRA 'Dear CEO' letters on 2022 priorities

The Prudential Regulation Authority on 12 January published "Dear CEO" letters setting out its priorities for 2022 for UK deposit-takers, for international banks, and for insurance.

- For UK deposit-taking banks, the 2022 supervisory priorities *(link here)* include:
  1. Financial resilience: business model sustainability in light of Covid-19; the 2022 stress test using the Annual Cyclical Scenario framework; focus on risk management and equity finance/prime brokerage
  2. Credit Risk — more work on IFRS 9 modelling; Model Risk — continued IRB focus
  3. Operational risk and resilience: critical functions mapping, cyber risks, outsourcing and third party risk management


Bank of England, London

  4. Climate-related financial risks
  5. Regulatory reporting accuracy and data quality
  6. Diversity and inclusion
  7. Libor transition
  8. Resolvability
- For international banks active in the UK the 2022 *(link here)*, supervisory priorities include:
  1. Financial resilience: business model sustainability; focus on risk management and equity finance/prime brokerage
  2. Operational risk and resilience: critical functions mapping, cyber risks, outsourcing and third party risk management
  3. Climate-related financial risk
  4. Diversity and inclusion
  5. Libor transition
  6. Regulatory reporting accuracy and data quality
- For insurance, the supervisory priorities *(link here)* include:
  1. Financial resilience: risk management; monitoring risks around economic inflation and the impact on the cost of claims; 2022 Insurance Stress Test (IST)
  2. Operational risk and resilience: cyber risk; firms by 31 March to have identified and mapped important business services, set impact tolerances and begun scenario testing
  3. Climate-related financial risks
  4. Regulatory change: Solvency II review; development of a targeted resolution regime for the insurance sector
  5. Diversity and inclusion

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