

Identifying CRD V / CRR II Requirements and Impact on Regulatory Reporting for Banks

*Regulatory challenges for
the next three years*

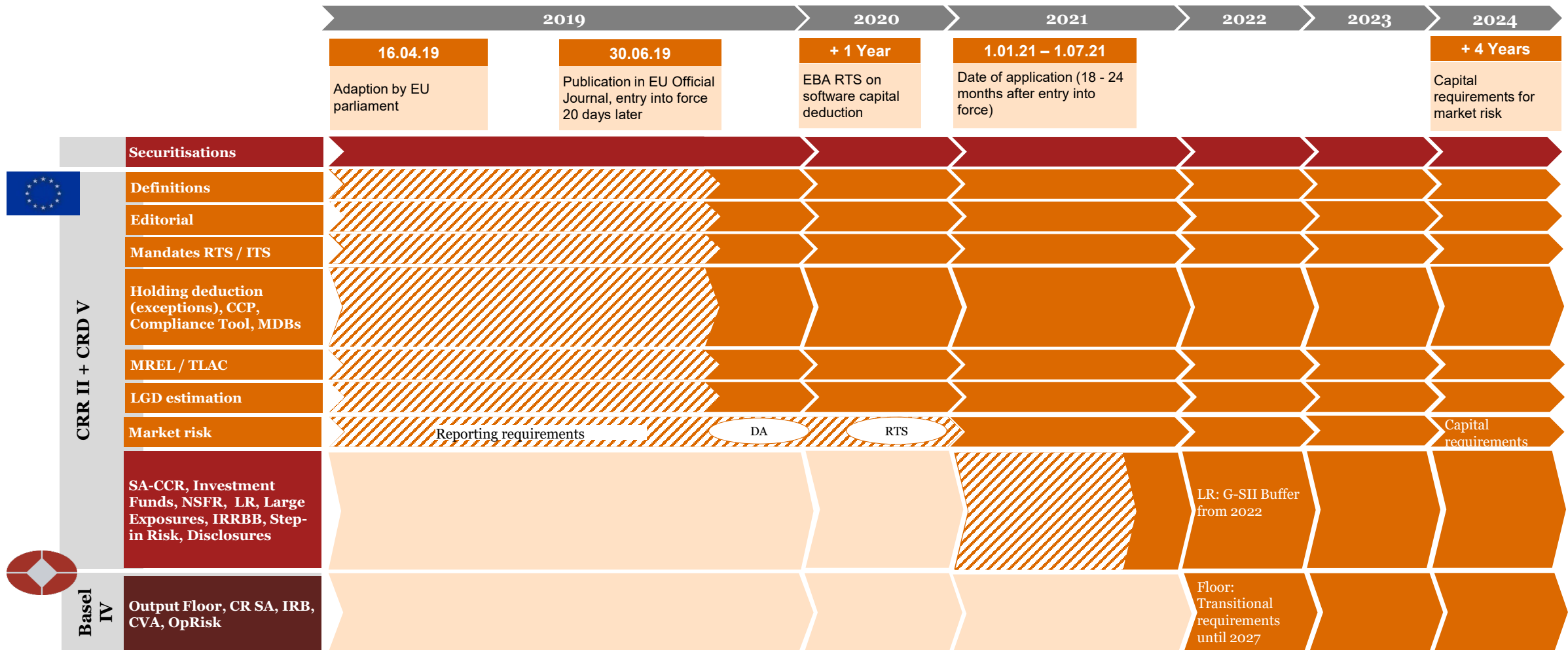
London, 13 June 2019



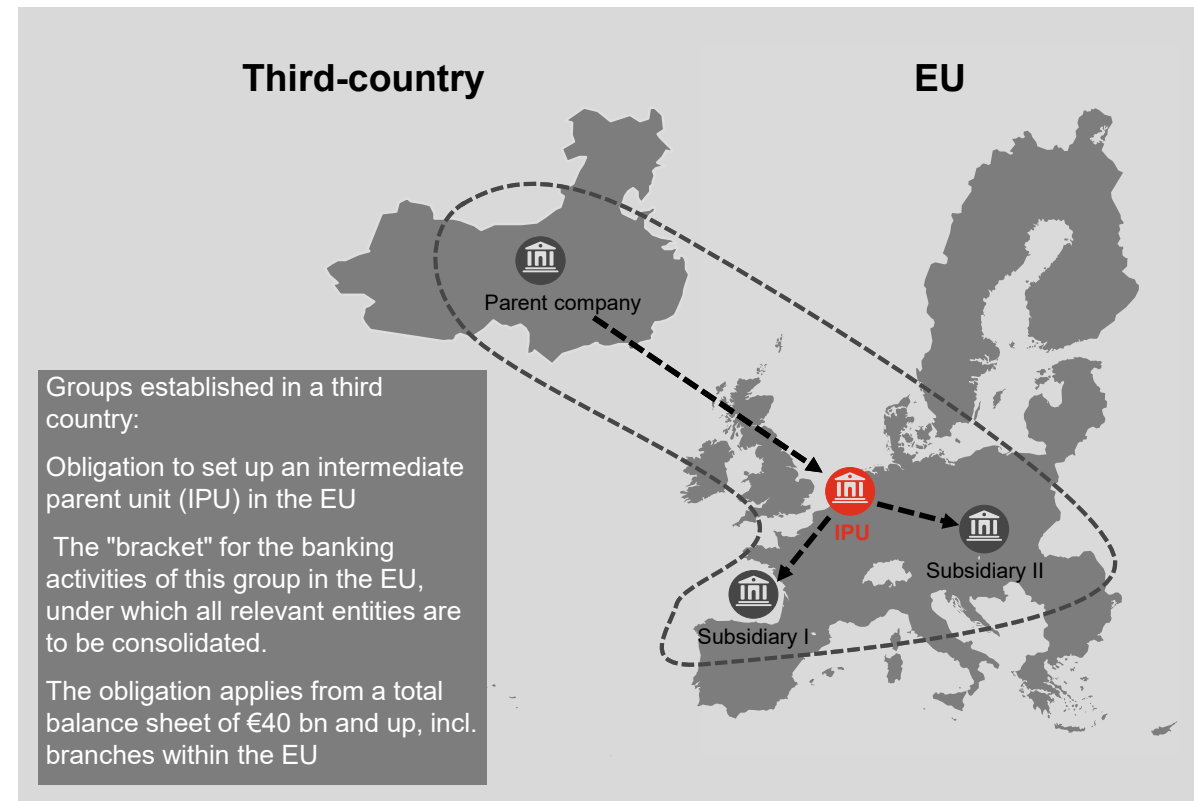
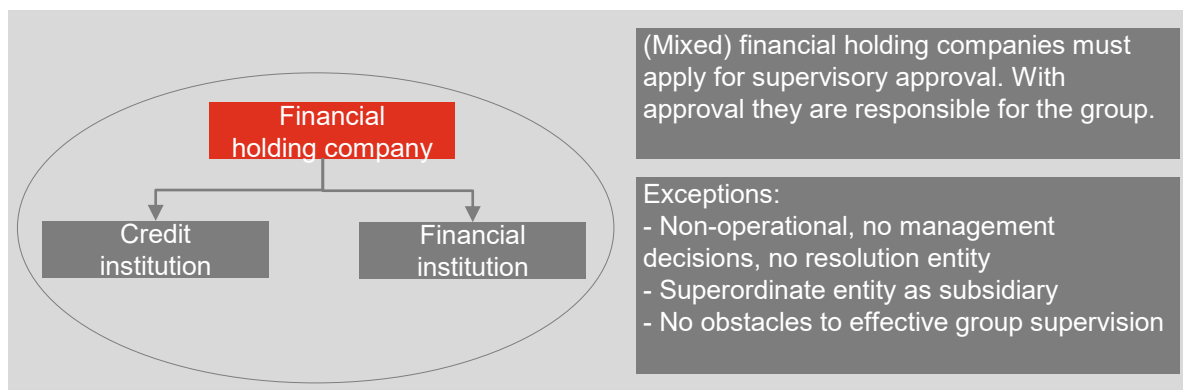
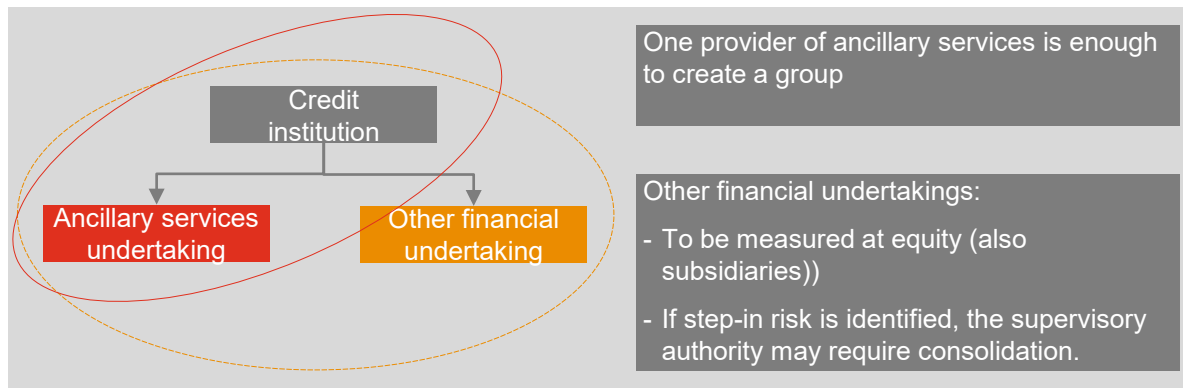
Agenda

- 1 Introduction and overview
- 2 Capital, MREL and TLAC
- 3 The next Generation of RWA
- 4 The CRR II compromise: Is the BCBS done on FRTB?
- 5 What else? Liquidity, Leverage ratio, Large Exposures, Disclosure
- 6 So what? The beginning of an end: Outlook and strategic implications

The new requirements of CRR II will apply gradually, starting in 2019



Supervision on consolidated level



Requirements for own funds instruments and deductions

Criteria for CET1 instruments

- In case of **subsequent issuances**, institutions do not need permission of competent authorities, but a **notification** is sufficient.
- **Profit and loss transfer agreements** are applicable under certain conditions (at least 90% of voting rights, same EU Member State, loss compensation obligation, discretion to decrease amount by allocating a part to funds for general banking risk, limited cancelability).

Deductions of CET1

- **Exceptions from the deduction** are possible **for software**. Requirements: Prudently valued and not negatively affected by resolution, insolvency or liquidation of the institution. EBA-mandate for developing an RTS
- A general deduction obligation for **negative goodwill** (badwill) was **not adopted**
- New deduction for **minimum value commitment** on CIUs
- New deduction in form of **minimum loss coverage for new Non-Performing Exposures (Prudential Backstop)**
- Temporary exemption from deduction of equity holdings in insurance undertakings without prior authorisation

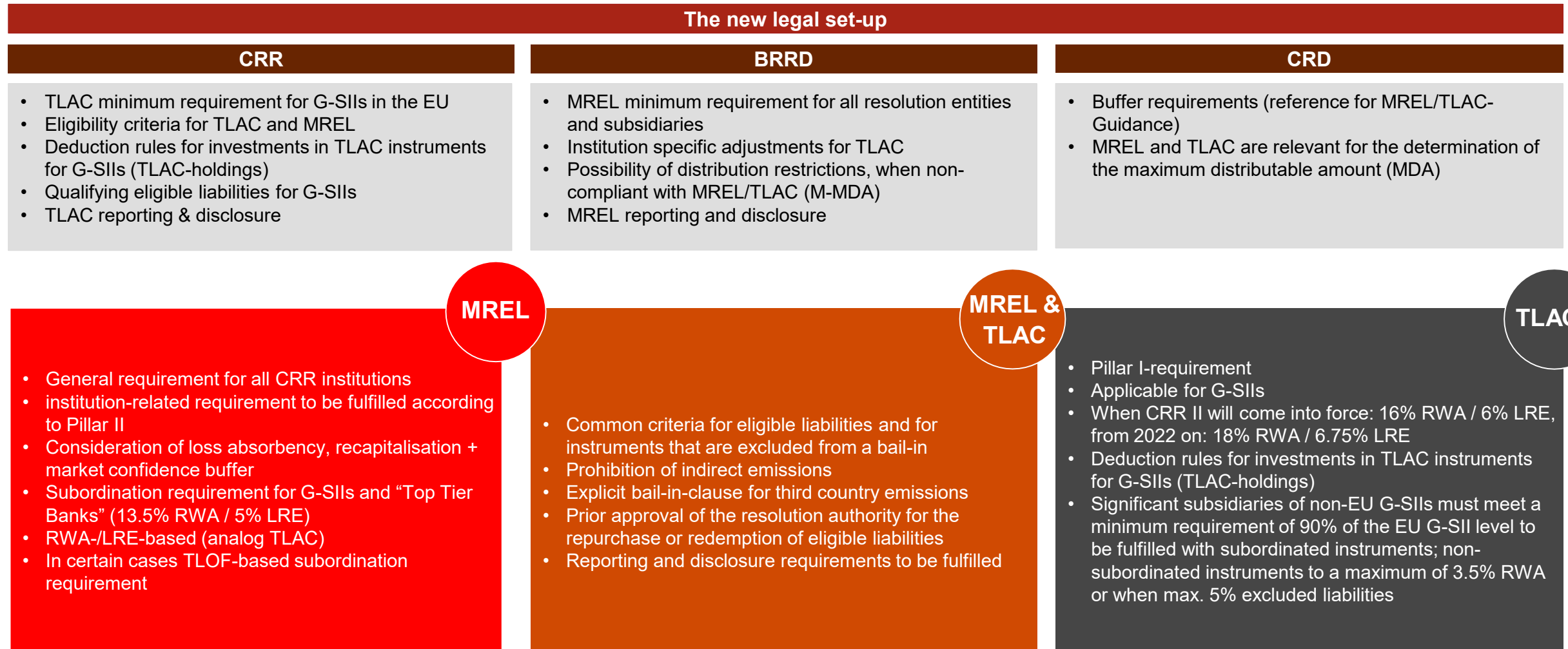
Criteria for AT1- and T2-instruments

- **Indirectly issued capital instruments** are no longer accepted
- PONV-clause required: Option to reduce repayment claims in whole or in part on the basis of regulatory requirements (**regulatory “bail-in”**).
- Prohibition of netting or set-off agreements
- **Grandfathering** for not directly issued instruments (until end of 2021) and for instruments, that do not contain a bail-in clause or are subject to a netting agreement (up to 6 years after the date of entry into force of CRR II).

Minority interests

- Instead of the previous individual enumeration Art. 81 (1) CRR II refers to CET1 items. Therefore **OCI should be eligible in the future**. Minority interests in equally supervised intermediate holding companies in third countries will be eligible in the future.
- For “**Qualified eligible liabilities**” of G-SIIs, a regulation similar to the calculation for qualified AT1/T2 is introduced

MREL & TLAC - overview



RWA calculation for investment funds

		Regulated funds (UCITS or AIF that are allowed to be marketed in the EU)	Unregulated funds
<div>Granularity</div> <div>Conservatism</div>	Look-through approach (LTA)	<ul style="list-style-type: none"> “Look-Through” to underlying assets, under IRB including PD (LGD and EAD, if applicable) Requires steady and sufficient information about the composition, confirmed by third parties Calculation performed by the institution Exclusion of derivatives from the RWA calculation for CVA risks under certain conditions 	Not applicable
	Modified standard approach (IRB only)	<ul style="list-style-type: none"> Determination of underlying assets' risk weights based on Standardised Approach (except for equities and securitisations) Third party calculation possible if the third party complies with the requirements of Art. 152 (7) a CRR II and the correctness of the third party calculations is confirmed by an external auditor (as in the Standardised Approach) CVA adjustments as in LTA 	Not applicable
	Mandate-based approach (MBA)	<ul style="list-style-type: none"> The CIU's investment guidelines and maximum limits are used to derive the SA risk weights. Exceptions for participations, securitisations and other underlying risk positions as in the LTA (→ Mod. Standardised Approach) Conservative treatment (i.e. highest possible risk weights) 	Not applicable
	Fallback approach (FBA)	<ul style="list-style-type: none"> A general risk weight of 1,250% is assigned to the total risk position. 	

Hierarchy of approaches

Counterparty Credit Risk - Thresholds introduced by CRR II

	Size of gross on- and off- balance sheet derivative business (relative)		Size of gross on- and off- balance sheet derivative business (absolute)
SA-CCR	> 10 % of total assets	or	> EUR 300 mln.
Simplified SA-CCR	≤ 10 % of total assets	and	≤ EUR 300 mln.
Revised Original Exposure Method	≤ 5 % of total assets	and	≤ EUR 100 mln.

Requirements for calculating the Thresholds

- The **key date** for calculating the derivative volume is the **last day of the month**
- The absolute value of long and short derivatives shall be summed
- **All** derivative positions shall be included, except credit derivatives that are recognized as internal hedges against non-trading book risk exposures
- Institutions may not enter any transactions which are only intended to comply with the thresholds




→ Hierarchy for calculating the derivative volume

- a) market values
- b) fair values
- c) most recent market value or fair value of this position

Exemptions on individual level

- Institutions that exceed the threshold on an individual level may use the simplified approaches given that the threshold is not exceeded on a consolidated level
- Approval by competent authorities necessary

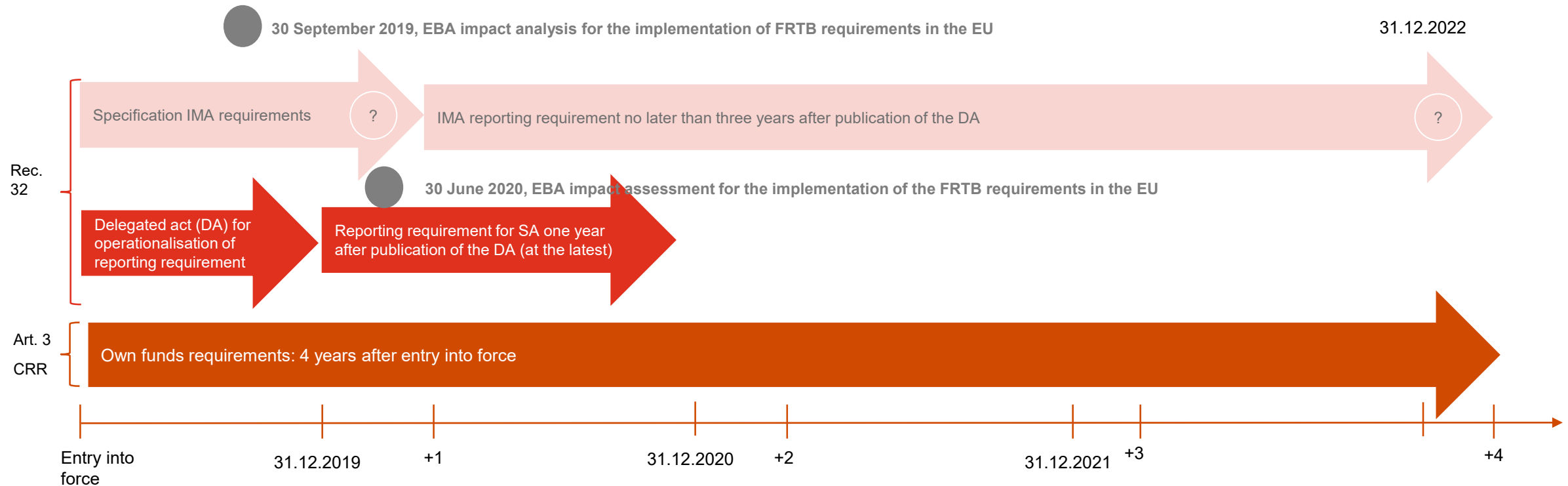
Counterparty Credit Risk - New methods for EAD calculation

	Revised Original Exposure Method (OEM)	Simplified SA-CCR	SA-CCR
Method adequate for	<ul style="list-style-type: none"> Institutions with small derivative-portfolios below the defined thresholds 	<ul style="list-style-type: none"> Institutions with derivative volumes within given thresholds Simple portfolios or portfolios without excessive independent collateral amounts 	<ul style="list-style-type: none"> Institutions above the thresholds of the simplified SA-CCR Less complex portfolios below the SA CCR threshold for which the full SA CCR application is economically beneficial
Data requirements	<p>Low / Medium</p> <ul style="list-style-type: none"> Replacement cost: Simplified calculation, consideration of variation margin only Data requirements and calculation method in line with existing Current Exposure Method (CEM) 	<p>Medium</p> <ul style="list-style-type: none"> Replacement cost: Simplified calculation, consideration of variation margin only Constant multiplier of 1 Simplified calculation of Add-on's 	<p>High</p> <ul style="list-style-type: none"> Replacement Costs: Advanced consideration of collateral Add-On-Multiplier can be reduced by 95% (over-collateralization; negative MV) Add-on's take various risk factors into account
Complexity of calculation			
Outstanding points	-	Regulatory Technical Standards (RTS): <ul style="list-style-type: none"> RTS on the identification of material risk drivers RTS on corrections to supervisory delta 	

- **Simplified SA-CCR causes a higher EAD with no noticeable reliefs**
- **The application of the full SA-CCR can also be profitable for institutions with a simple derivatives portfolio**



FRTB implementation by CRR II - Overview

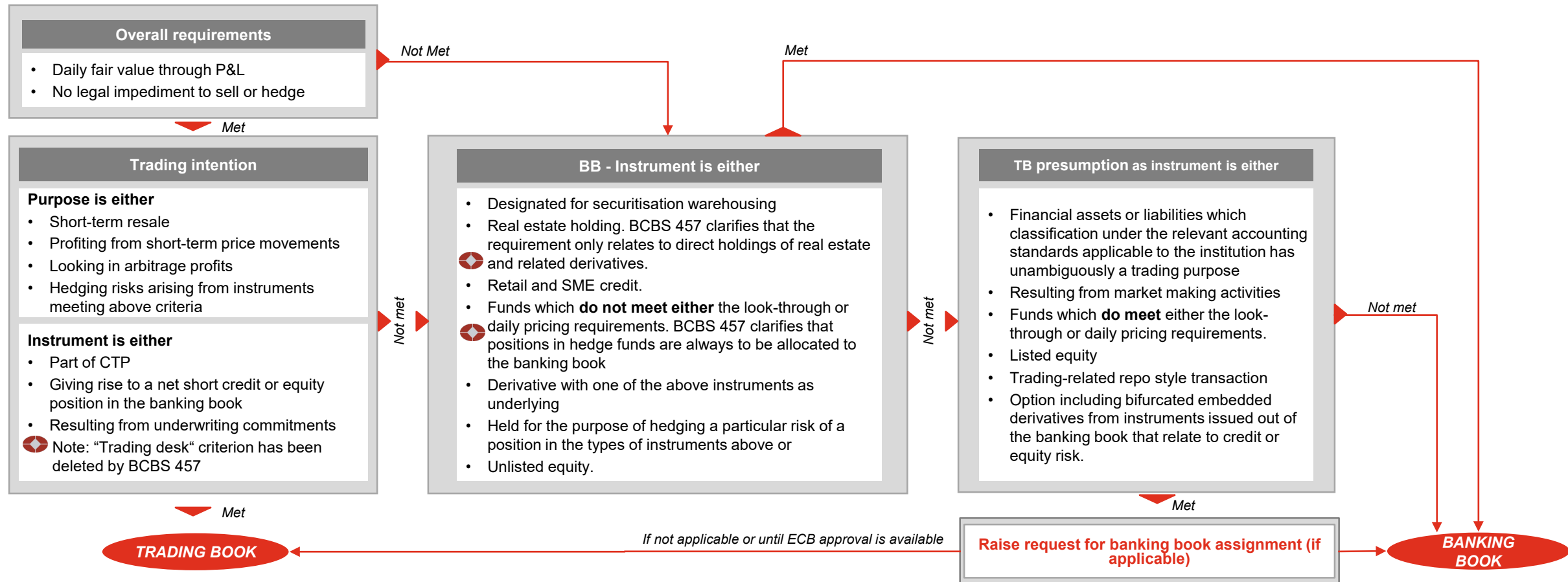


- The publication of CRR II does not come with a new binding capital requirement for market risk.
- Further specifications are conducted through delegated acts, RTS or ITS.
- A reporting requirement will enter into force that requires the calculation of the new standardised approach.
- The capital requirement is not expected to enter into force until four years after the publication of CRR II.

Trading book boundary - Overview

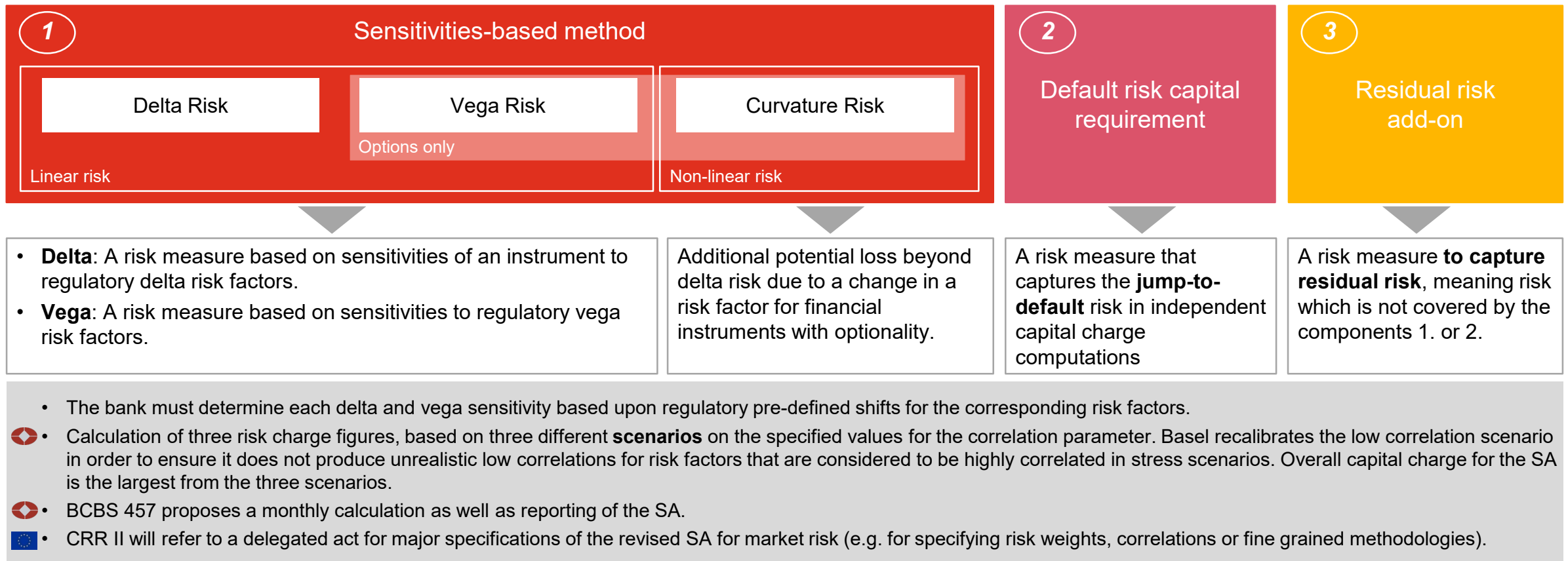
CRR II will not contain the requirements for the discussed FRTB trading book boundary.


- CRR II does not contain the revised trading book boundary requirements and refers to the previous requirements of Art. 104 CRR.
- Further clarifications of the boundary requirements are conducted by the Basel Committee through BCBS 457 (January 2019).
- The exact interpretation within the EU remains unclear.



The new standardised approach for market is an entirely new method not related to the current standardised approach

The new standardised approach consists of 3 components (Art. 325 CRR II)



 New in BCBS 457. Not reflected in CRR II draft yet

For banks having a “large trading book”, the requirements according to CRR II lead to substantial challenges

1

- FRTB is expected to be finalised at EU level by a delegated act (end 2019/ beginning 2020)
- CRR II will not introduce a capital requirement
- After publishing the delegated act, an observation period will be launched in which reporting requirements will exist

2

- Consistent data standards and completeness in risk factor analysis through data strategy and flexible data architecture.
- Creation of synergy effects and challenges across several projects. The FRTB implementation should be used to optimize the internal risk management processes

3

- Early analysis of thresholds and trading book boundary requirements: Evaluation of the need for a SBA implementation and possible adjustments in the area of position management and trading strategy

4

- The recalibration of the requirements leads to renewed RWA effects and, if necessary, to a noticeable reduction in the capital requirement under the standardised approach
- A (renewed) analysis of the impact is necessary in order to be able to estimate the potential effects (e.g. in relation to the capital floor and IMA)

Introduction of a minimum requirement for NSFR

$$\text{NSFR} = \frac{\text{Available stable funding}}{\text{Required stable funding}}$$

- **Minimum Level 100%**
- **Available Stable Funding:**
 - Liabilities and Equity
 - Weighting factors depend on maturity and product type
- **Required Stable Funding:**
 - Assets and off-balance sheet items
 - Weighting factors depend on maturity and market liquidity
- **Minimum requirement has to be fulfilled at any time**
- **Reporting obligation in all major currencies (analogous to LCR)**
- **Simplified NSFR for small, less complex institutions provided they have supervisory approval**

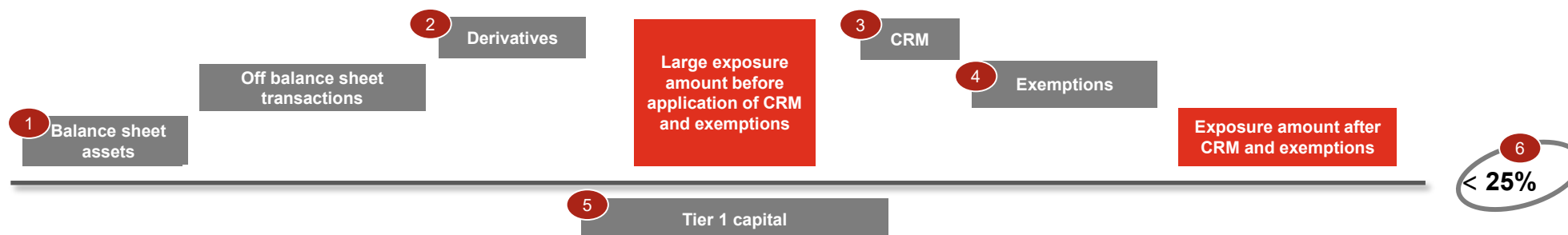
Introduction of a binding leverage ratio

- Introduction of a binding **minimum ratio of 3%** (Art. 92 (1d))
- Exclusion of certain exposures from the **exposure measure**, e.g. exposure against central banks, Clearing Members, QCCPs, pass-through loans, certain promotional loans,... (Art. 429a)
- Introduction of an **adjusted Leverage Ratio (aLR)**, to be satisfied at all times, if exceptions for central bank exposures are being used (Art. 429a (7))
- Changes to the treatment of **credit risk adjustments** for on- and off-balance-sheet positions (Art. 429 (4))
- Netting of **pre-financings and intermediate loans** with the client's deposits in case of building societies (Art. 429 (7))
- Introduction of a **modified SA-CCR** to calculate the exposure value of derivatives (Art. 429c)
- Clarification of the treatment of **written credit derivatives** (Art. 429d)
- Clarification of the treatment of **regular way sale purchase and sale** of financial assets (Art. 429g)
- New **reporting and disclosure requirements** (Art. 99 und 451)
 - Reduced scope for small and less complex institutions
 - Enhanced scope for large institutions to cover window-dressing behaviour

Introduction of a non-risk-based ratio to restrict the build-up of excessive leverage in the banking sector as a main lesson learned from the global financial crisis

$$\text{LR} = \frac{\text{Tier 1 - Capital}}{\text{On-balance sheet exposure} + \text{Off-balance sheet exposure} + \text{Derivatives} + \text{SFTs}} \geq 3,0\%$$

Significant Changes to the Large Exposure Framework



Exposures in the trading book

- Long and short positions in different financial instruments are to be off-set only where financial instruments are of the same seniority or where the short position is junior to the long position
- Allocation of financial instruments into buckets based on different degrees of seniority

Derivatives

- Consideration of indirect exposures from (credit) derivatives not directly entered into with the client but underlying a debt or equity instrument issued by the client

Counterparty credit risk

- Mandatory application of the (simplified) SA-CCR or the OEM to determine the risk exposure amount of derivatives
- Application of IMM not permitted for derivatives (for SFT still applicable)

Credit risk mitigation techniques (CRM) / collaterals

- Obligation to use CRM for large exposures, if applied for calculation of own funds requirements
- Application of substitution approach, regardless of the collateral type used, provided that the CRM was also applied for the calculation of RWA
- Application of the Simple Method or the Comprehensive Method, except for institutions that are allowed to use the IMM for repo transactions
- Exemptions of mandatory application of the substitution approach for tri-party repo transactions and collaterals or guarantees provided by eligible protection providers or export credit agencies under specific conditions
- Consideration of real estate property for the calculation of exposure values allowed, except where prohibited by applicable national law

Exemptions

- Gradual elimination of exemptions for exposures to EU central governments (neither in EUR nor EU national currency) by 2022
- Exemptions for MREL-related risk exposures
- Exemptions for clearing members' trade exposures and default fund contributions to qualified central counterparties

No consideration of Tier 2 capital

- Tier 1 capital as the sole reference for the definition of large exposures and the determination of the large exposure limit
- No longer consideration of Tier 2 capital instruments for the determination of large exposure limits

Overshooting of large exposure limit in exceptional cases

- Obligation for institutions to submit a plan for a timely return to compliance with large exposure limits
- EBA will issue guidelines specifying how competent authorities determine the "exceptional cases" for allowed overshooting large exposure limits as well as the appropriate time to return to compliance with large exposure limits and the measures to be taken for compliance

Decreasing large exposure limit

- G-SIIs shall not have risk exposures to other G-SIIs greater than 15% of Tier 1 capital

New proportionality requirements for reporting and disclosures

New Definitions

“Small and non-complex” institution” (Art. 145)

“Small and non-complex” institution means an institution meeting **all** of the following conditions:

- ❖ **total assets** on individual or consolidated basis, is on average **equal to € 5bn or below**, over the 4-year period preceding the reporting period;
- ❖ **simplified obligations** (or no obligation) for recovery and resolution planning
- ❖ **small trading book business**
- ❖ the total value of **derivative positions held with trading intent** does not exceed **2% of its total on- and off-balance sheet assets**; the total value of its **overall derivative positions does not exceed 5%**
- ❖ **more than 75% of both the institution's consolidated total assets and liabilities**, excluding in both cases the intragroup exposures, **relate to activities with counterparties located in the EEA**;
- ❖ **does not use internal models -> except for** subsidiaries using internal models developed at the group level
- ❖ **no objection** to being classified as a small and non-complex institution either from institution's or supervisor's view

“Large institution” (Art. 146)

“Large institution” means an institution meeting **any** of the following conditions:

- ❖ it is a **G-SII**
- ❖ it is identified as an **O-SII**
- ❖ It is **one of the three largest institutions** in terms of total value of assets in the Member State it is established
- ❖ It has **total assets equal to or greater than €30 bn**

“Large subsidiary” means a subsidiary that **qualifies as a “large institution” (Art. 147)**

“Non- listed institution” (Art. 148)












“Non-listed institution” means an institution that **has not issued securities that are admitted to trading on a regulated market of any Member State**, within the meaning of point 21 of Article 4(1) of Directive 2014/65/EU.

“Financial report” (Art. 149)


“Financial report” shall be understood within the meaning of **Articles 4 and 5 in Directive 2004/109/EC** of the European Parliament and of the Council.


Proportionality in disclosures (1/2)


The CRR II contains references to all the new disclosure requirements contained in the Basel Stage II document but also strengthens the principle of proportionality by distinguishing between institutions' size and capital market orientation:

	Listed Institutions			Non- listed Institutions	
	Annual	Semi-annual	Quarterly	Annual	Semi-annual
Large Institutions					
Other Institutions					
Small Institutions					

 Full disclosure according to part 8 of CRR

 Disclosure of selected information, which cover main requirements of part 8 CRR

 Disclosure of selected information, which cover partly requirements of part 8 CRR

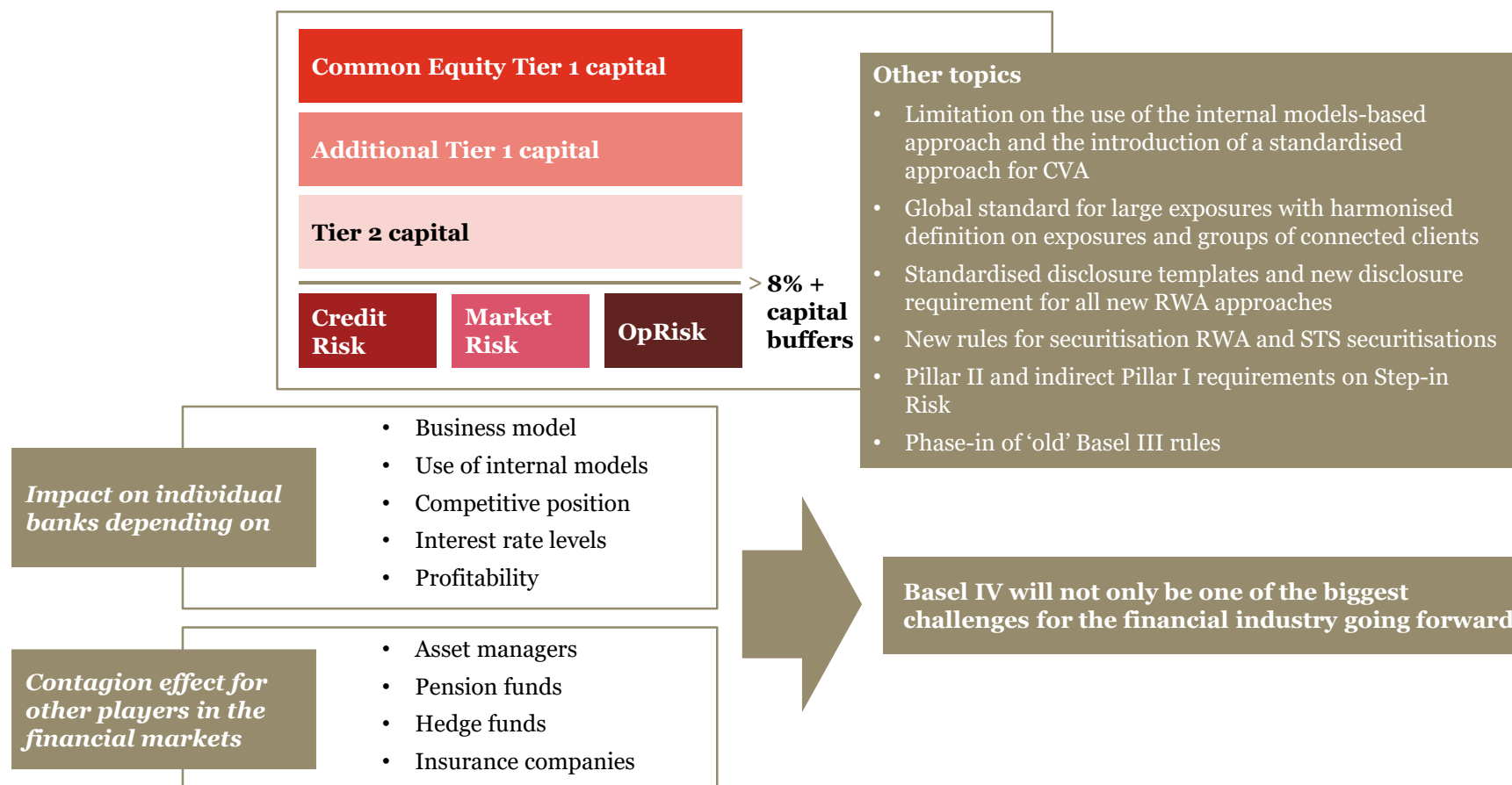
 Solely disclosure of key metrics template.

Proportionality in disclosures (2/2)

Annual disclosure (Listed Institutions)	All information requested under Part VIII of the CRR								Art. 435 (1) points a), f) and g)	Art. 438 point d)	Art. 450 (1) points a) to d), h), i), j)	All information requested under Part VIII of the CRR																																
Annual disclosure (Non-Listed Institutions)	All information requested under Part VIII of the CRR								Key Metrics referred to in Art. 447 CRR	Art. 435 (1) points a), f), g)	Art. 435 (2) points a) to c)	Art. 437 point a)	Art. 438 points c) and d)	Key Metrics referred to in Art. 447 CRR	Art. 450 (1) points a) to d), h), i), j) and k)																													
Semi-Annual disclosure (Listed Institutions)	Art. 437a	Art. 437 point a)	Art. 438 point e)	Art. 439 points e) to i)	Art. 440	Art. 442 points c), e), f), g)	Art. 444 point e)	Art. 445	Art. 448 (1) points a) and b)																																			
	Art. 449 points j) to l)	Art. 451 (1) points a) and b)	Art. 451a (3)	Art. 452 point g)	Art. 453 points f) to g)	Art. 455 points d), e) and g)	Key Metrics referred to in Art. 447 CRR	Key Metrics referred to in Art. 447 CRR																																				
Semi-Annual disclosure (Non-Listed Institutions)	Key Metrics referred to in Art. 447 CRR																																											
Quarterly disclosure (Listed Institutions)	Art. 438 points d) and h)	Art. 451a (2)	Key Metrics referred to in Art. 447 CRR																																									
Large Institution															Small Institution															Other Institution														

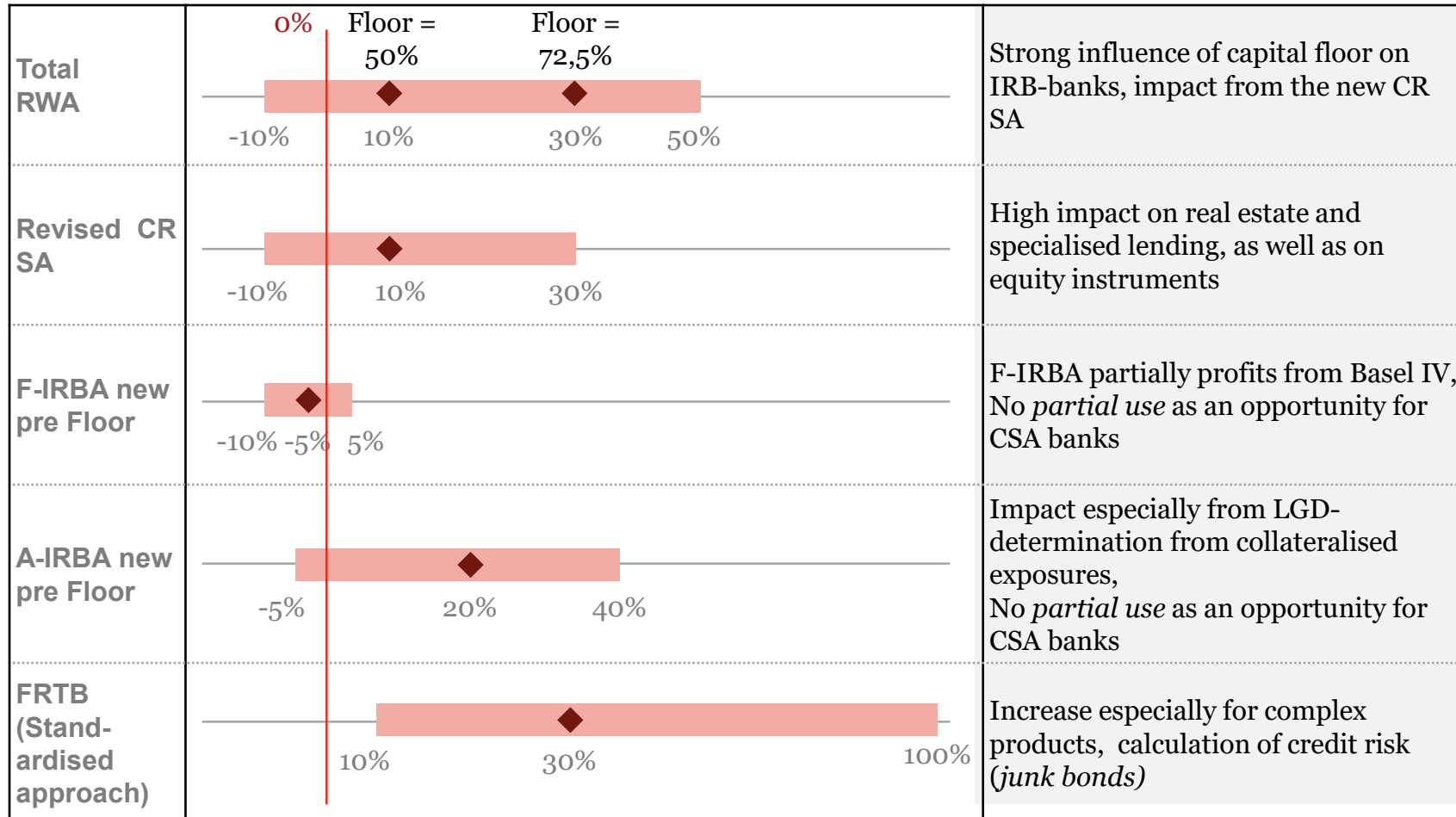
Basel IV in a Nutshell

Calculation of capital ratios under Basel III/CRR...

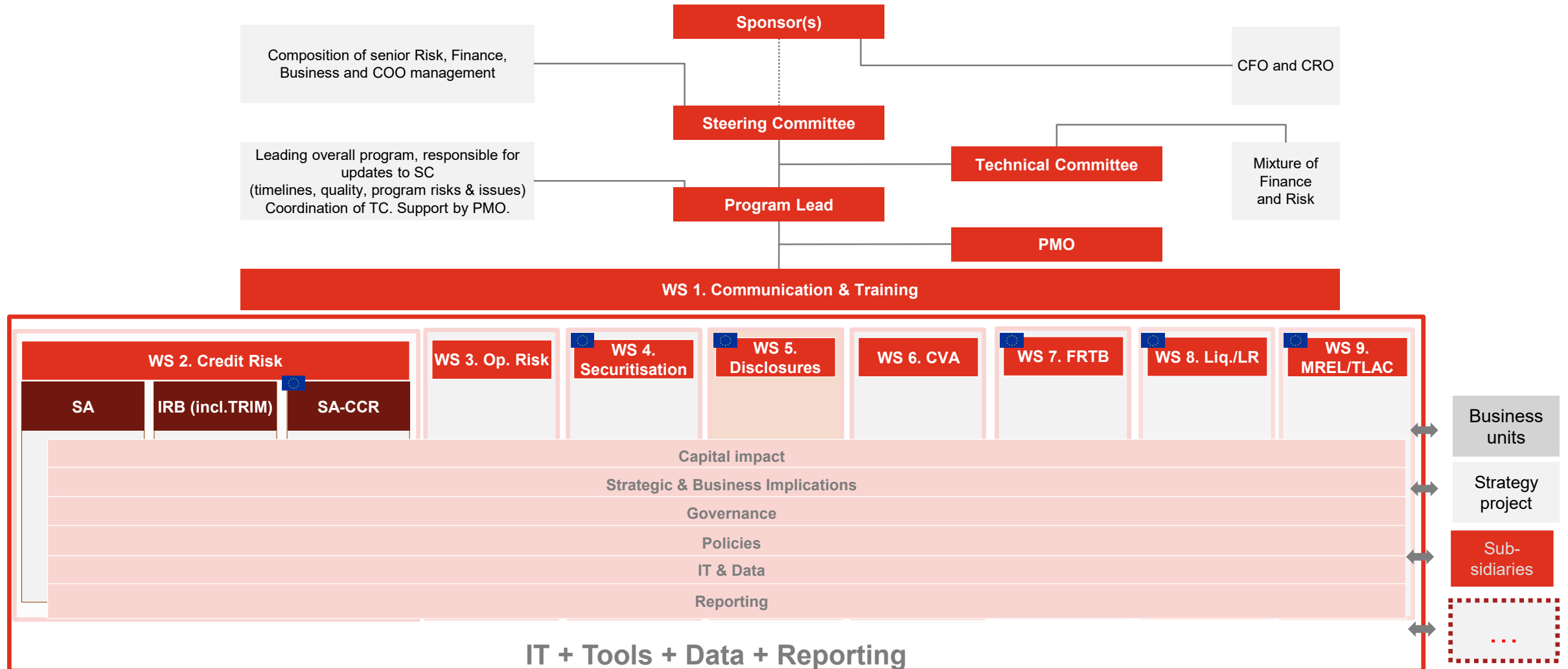


Basel IV: recalibration of Basel III or the next generation of RWA?

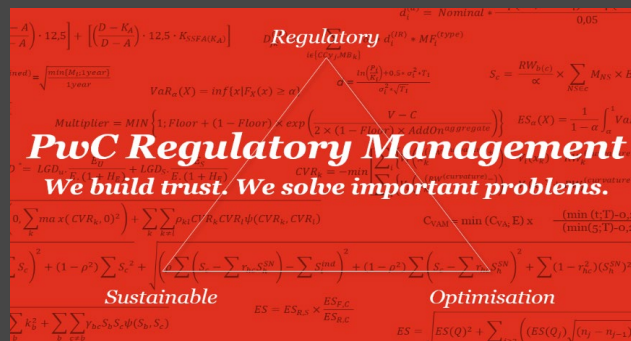
The Impact of Basel IV on RWA is highly dependent on the portfolio composition and business model



CRR II / Basel IV Project governance



Thank you!



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