5. New package of banking reforms

Content and timing of the proposal

The European Commission presented on 23th November a new comprehensive package of reforms to further strengthen the resilience of European banks. The package of measures includes the implementation of outstanding international standards and, at the same time, certain amendments to take into account European specificities or unintended consequences identified in the Call For Evidence. This is in line with the defined roadmap for completing the Banking Union which established that bank's risk reduction was needed before moving forward. The spirit of the Capital Markets Union is also present as the Commission wants to ensure that strong banks continue to play a key role in supporting growth and financing the economy.

The scope of this revision is double:

1. **Prudential framework**: the Capital Requirements Regulation (CRR) and the Capital Requirement Directive (CRD IV) are amended to introduce international standards and technical improvements.

    a) Main changes in CRR include:

    - A mandatory **leverage ratio** of 3% of Tier 1 aimed at preventing excessive leverage and at acting as a backstop to internal model-based capital requirements. No buffer for GSIBs has been included.
    - Implementation of the **Net Stable Funding Ratio** (NSFR), to promote a sustainable funding structure, with some adjustment from Basel so as to adjust to European specificities.
    - Specification of the **Minimum Requirement for Own Funds and Eligible Liabilities** (MREL) for global systemically important banks (G-SIBs). It will be determined on a case-by-case basis for the rest of entities.
    - A new standardized approach for measuring **counterparty credit risk exposure**, that replaces the Current Exposure Method and the Standard Method, aimed at increasing risk-sensitivity in non-internal models.
    - Implementation of the **Fundamental Review of the Trading Book** (FRTB), including modifications to both the standard and internal approaches and a new definition of trading desk.
    - New rules for exposures to **central counterparties** (CCPs) and the treatment of default funds in both qualifying and non-qualifying CCPs.
    - New framework for **equity investment in funds**, with revised conditions for the use of the different methods allowed.
    - Implementation of the new **Large Exposure Framework**, which includes: i) a new capital base (Tier 1 instead of eligible capital), ii) a hardened requirement for exposures of a G-SIB to another G-SIB (limit set at 15% of Tier 1) and iii) a final provision requiring that sovereign exposures incurred from November 2016 are subject to this framework (with a phase in period of three years).

- New **disclosure requirements**, to enhance consistency with the new Pillar 1 and ensure a proportionate application of these requirements.

b) Main changes in CRD IV include:

- Implementation of a new framework for measuring the **interest rate risk in the baking book**, which remains as a Pillar 2 risk.
- Update of the criteria and powers of the Commission to **exempt entities** from the compliance of the CRR and the CRD IV.
- Inclusion of **financial and mixed financial holdings** under the scope of CRD IV. A provision is introduced so that third country banking groups, which are G-SIBs or have total assets above EUR 30 billion and two or more subsidiaries operating in the EU, have to establish an intermediate parent undertaking in the EU.
- **Remuneration rules** have been adapted to ensure their proportional application. Small and non-complex institutions will not be subject to deferral rules and pay-out requirement in their variable remuneration.
- **Pillar 2 framework** is clarified, differentiating between Pillar 2 requirement and guidance. Also light is shed regarding the stacking order for the activation of **capital conservation measure**.

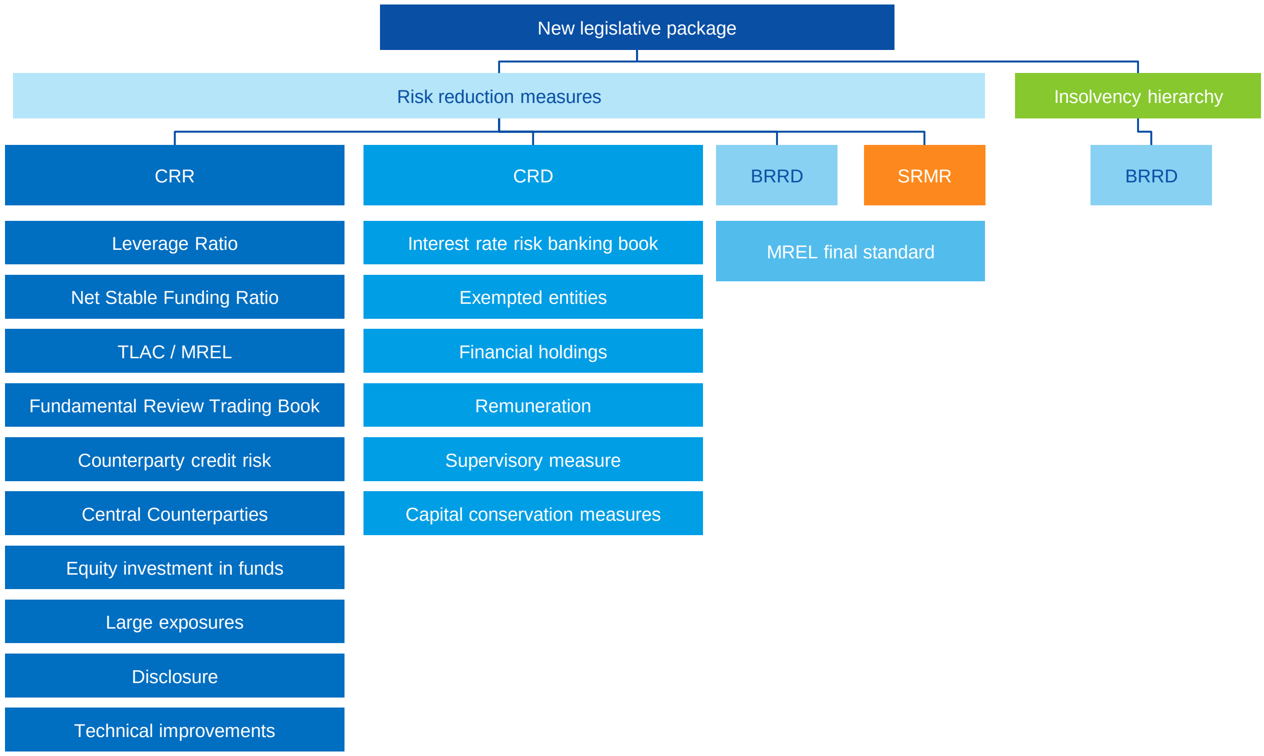
2. Resolution framework: the Bank Recovery and Resolution Directive is also modified to include:

- Clarification of the MREL requirement and a harmonised ranking of unsecured debt instruments in **insolvency hierarchy**.

The Commission's proposal is only the first step in the European legislative process. Negotiations will now begin in the Parliament and the Council, both of which need to reach an internal agreement before trilogues can begin and a final text is agreed. The negotiation process is expected to last approximately one year, and after the approval of the final text, the different measures will have a specific date for their entry into force.

Figure 1

Commission's legislative package



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BBVA Research assessment

- **The Commission's proposals present a wide and comprehensive review**. The implementation of international standards is positive and technical improvements are welcomed. After three years of application of the current prudential framework, we are in a good position to identify issues that are not working as expected.
- **Adjustments made to reflect European specificities are welcome**. Nevertheless, it is also necessary to take into account the specificities of the markets in which European banking groups operate in order not to unduly penalise banking groups with a global footprint.
- **Clarification of the new Pillar 2 framework is very positive**, as legal certainty was needed. Nevertheless, the breach of the MREL requirement should not trigger the activation of the Maximum Distributable Amount (MDA), as this requirement has a different nature than the prudential requirements.
- **This legislative proposal already includes some of the standards that have been discussed under the review of the Basel III framework**, namely: i) the new framework for interest rate risk in the banking book, ii) the revised standardised approach for counterparty credit risk and iii) the fundamental review of the trading book. The rest of the elements of the so-called Basel IV remain under discussion by the group of governors and heads of supervision (GHOS) and will be implemented into the European framework once an international agreement has been reached.

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