3. CRD V: state of play

Resumption of negotiations after the summer break

On 23 November 2016, the European Commission presented a new legislative package aimed at amending the current prudential and resolution frameworks for banking. The proposal is a very ambitious package that covers a significant part of the banking prudential framework. Negotiations in the Council and in the Parliament are underway but might take longer than expected. Efforts seem to have been made to approve the issues that need fast-tracking: i) transitional agreement for IFRS 9, ii) transitional agreement for large exposures and iii) the bank creditor hierarchy.

General overview of the process

Figure 3.1 Milestones in the legislative process of the file so far

Source: BBVA Research

There has been a general delay in negotiation of the file. After the presentation of the proposal by the Commission, both the Parliament and the Council stated their willingness not to delay the negotiation process too much, although they also pointed out that quality was preferred over speed in the process.

- On the one hand, **the Council seems to be advancing faster than the Parliament**. The Estonian Presidency aims to have a final position on the whole Commission proposal by yearend, although this is highly unlikely.

- On the other hand, **the Parliament is focusing on the fast-tracked files** (IFRS 9, large exposures and the creditor hierarchy). The overall report was originally expected for June, but has since been postponed on several occasions.

The focus now is on fast-tracked files. Having reached a general position at both institutions, trilogues for IFRS 9 and Large Exposures are expected to start in late September. Trilogues for creditor hierarchy are expected to start in early October:

- **IFRS 9 transitional period**: ahead of the introduction of the new accounting provisions of IFRS 9 in January 2018, the Commission proposed a transitional period to mitigate the potential impact of the envisaged increase in accounting provisions on banks' own funds. There are two key aspects in the design of this transitional agreement: i) the approach to calculating the amount to phase in and ii) the percentages of the phase-in itself. The main divergences are regarding the envisaged approach. While the Commission has proposed a dynamic approach (which requires recalculating the amount to phase in every year) and the Parliament has backed this, conversely the Council advocates a new "static modified approach"[1].

- **Large exposures**: as the exemption for certain sovereign exposures (those denominated and funded in the currency of any Member State other than that of the issuer) comes to an end, these government bonds will be subject to a non-zero risk weight and will therefore be subject to the large exposures limit. In order to smooth the impact of the introduction of this limit, the Commission has proposed a three-year phase-out. Both the Parliament and the Council have agreed positions that do not differ from the Commission's proposal in terms of content.

As negotiations resume after the summer break, apart from the fast-tracking, the main issues to discuss are:

- **Pillar 2**. The design of the new Pillar 2 is one of the issues subject to most discussion. One of the main concerns is the trade-off between maintaining a certain flexibility for supervisors and aiming for further homogenisation in applying Pillar 2. The microprudential nature of the Pillar 2 included in the Commission's proposal is also being discussed, as is whether targeted amendments to the macroprudential toolbox would be advisable.

- **Market risk**. The main concerns relate to the difficulty of implementing these new standards. Moreover, the US report recommending a delay in the implementation of the new market risk rules has also been raised as a concern. To soften the application of the FRTB, the Commission has proposed a 3-year phase-in, and in addition to this consideration is being given to allowing a little more time for implementation of the rule (beyond the two-year period for the rest of the rules) to ensure that there is enough time for the transition, especially for the new internal models regime.

- **Proportionality**. This is also a key issue in the negotiation of the file. The Commission proposal already included several features to increase proportionality, which have been met with a high degree of acceptance. The discussion mainly focuses on the thresholds to determine which entities can benefit from this proportionality. The main areas affected by these proposals are: i) disclosure requirements, ii) reporting requirements and iii) targeted remuneration rules.

Next steps

After the summer break, negotiations are resuming in both the Parliament and the Council. Even though the priority is to have the fast-tracking ready for yearend, the rest of the file needs to keep up momentum. The Parliament is expected to issue its report in September.

1: The static modified approach is based on a static approach that requires one only calculation of the amount to be phased-in at the time of implementation of the new standards. Only if macroeconomic circumstances envisage an increase in expected loss, could the amount to be phased-in be increased up to a fixed level.

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This report has been produced by the Regulation Unit:

Chief Economist for Financial Systems & Regulation

Santiago Fernández de Lis
sfernandezdelis@bbva.com

Maria Abascal
Maria.abascal@bbva.com

Santiago Muñoz
santiago.munoz.trujillo@bbva.com

Arturo Fraile
arturo.fraile@bbva.com

Victoria Santillana
mvictoria.santillana@bbva.com

Matías Daniel Cabrera
matiasdaniel.cabrera@bbva.com

Pilar Soler
pilar.soler.vaquer@bbva.com

Javier García Tolonen
javierpablo.garcia@bbva.com

Álvaro Romero Mateu
alvaro.romero.mateu@bbva.com

With the contribution of:

Financial Systems

Ana Rubio
arubiog@bbva.com

Digital Regulation team

Lucia Pacheco Rodriguez
lucia.pacheco@bbva.com

BBVA Research

Economista Jefe Grupo BBVA

Jorge Sicilia Serrano

Macroeconomic Analysis
Rafael Doménech
r.domenech@bbva.com

Global Economic Situations
Miguel Jiménez
mjimenezg@bbva.com

Global Financial Markets
Sonsoles Castillo
s.castillo@bbva.com

Long term Global Modelling and Analysis
J. Julián Cubero
juan.cubero@bbva.com

Innovation and Processes
Oscar de las Peñas
oscar.delaspenas@bbva.com

Financial Systems And Regulation
Santiago Fernández de Lis
sfernandezdelis@bbva.com

International Coordination
Olga Cerqueira
olga.gouveia@bbva.com

Digital Regulation
Álvaro Martín
alvaro.martin@bbva.com

Regulation
María Abascal
maria.abascal@bbva.com

Financial Systems
Ana Rubio
arubiog@bbva.com

Financial Inclusion
David Tuesta
david.tuesta@bbva.com

Spain and Portugal
Miguel Cardoso
miguel.cardoso@bbva.com

United States
Nathaniel Karp
Nathaniel.Karp@bbva.com

Mexico
Carlos Serrano
carlos.serranoh@bbva.com

Middle East, Asia and Geopolitical
Álvaro Ortiz
Alvaro.ortiz@bbva.com

Turkey
Álvaro Ortiz
alvaro.ortiz@bbva.com

Asia
Le Xia
le.xia@bbva.com

South America
Juan Manuel Ruiz
juan.ruiz@bbva.com

Argentina
Gloria Sorensen
gsorensen@bbva.com

Chile
Jorge Selaive
jselaive@bbva.com

Colombia
Juana Téllez
juana.tellez@bbva.com

Peru
Hugo Perea
hperea@bbva.com

Venezuela
Julio Pineda
juliocesar.pineda@bbva.com

CONTACT DETAILS: BBVA Research: Azul Street. 4. La Vela Building – 4th and 5th floor. 28050 Madrid (Spain). Tel.:+34 91 374 60 00 and +34 91 537 70 00 / Fax:+34 91 374 30 25 - bbvaresearch@bbva.com www.bbvaresearch.com