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RESEARCH

Global & EU Regulatory Update

Presentation in PwC

Santiago Fernández de Lis

Chief Economist, Financial Systems and Regulation

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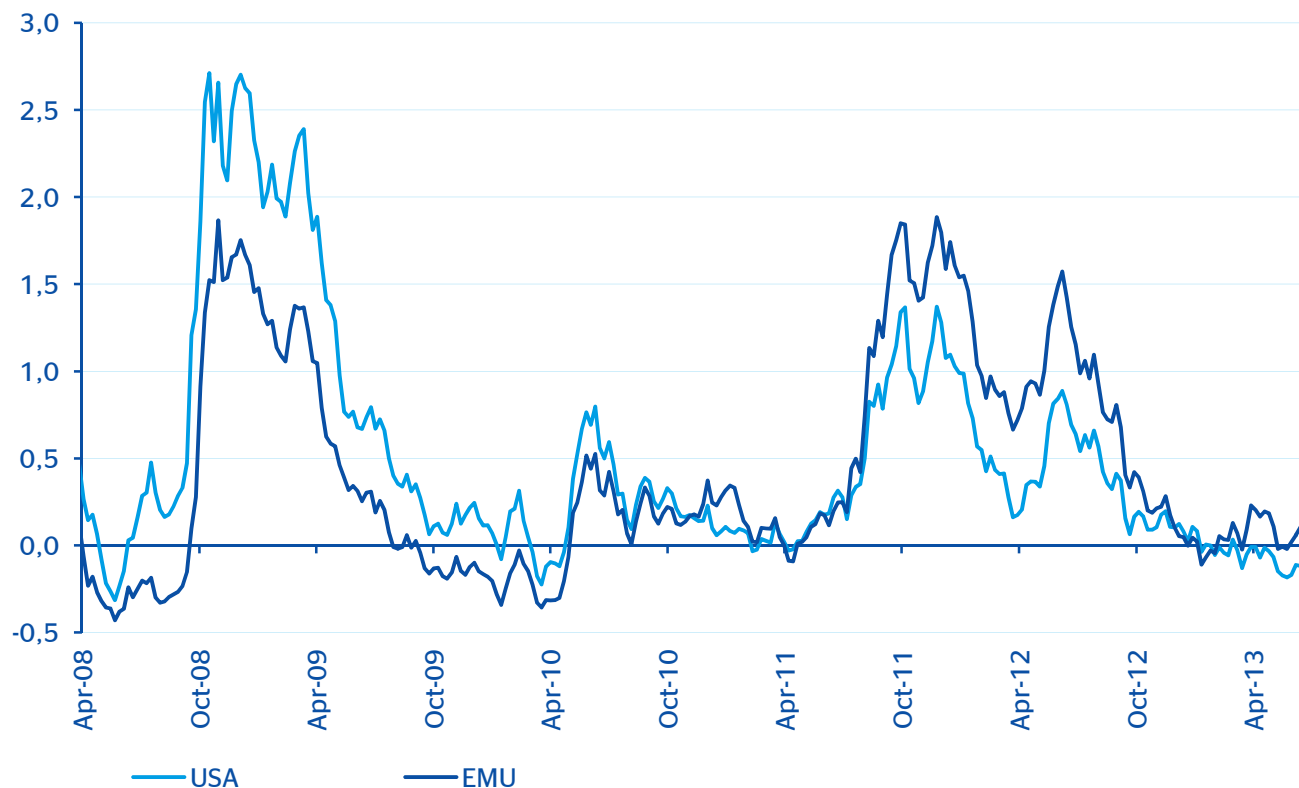
The regulatory reform: 3 main objectives

	Increase banks solvency/safety	Mitigate system complexity/risks	Minimize taxpayers cost
Basel III	●	●	
SIFIs	●	●	
OTC derivatives	●	●	
Shadow banking	●	●	
Effective supervision	●	●	
Macroprudential		●	●
Credit Rating Agencies		●	
Crisis Management		●	●
Structural reforms		●	●
Financial Taxes (FTT)		●	●

Overlapping measures and lack of cumulative impact analysis

Financial tensions index: Europe vs US

Initially the crisis started in the US, but later spread over EU where the recovery is more complicated



Main European Regulatory Initiatives

	ISSUE	STATUS	TYOLOGY	SCOPE
CRD IV Capital Requirements	Transposition of Basel III into EU law	Published in the OJEU Implementation date: 01/2014	REGULATION* & DIRECTIVE **	EU27
RRD Recovery & Resolution	Harmonization of national R&R frameworks	Council: APPROVED Under Trilogue negotiations Parliament: 1 st reading 11/2013	DIRECTIVE**	EU27
DGSD Deposit Guarantee Scheme	Harmonization of national DGS Framework	Under Trilogue negotiations	DIRECTIVE**	EU27
SSM Single Supervisory Mech.	Establishment of a Single Supervisory Authority	Parliament final vote 09/2013 Fully operative: 09/2014?	REGULATION*	EZ 17 (open to UE 27)
SRM Single Resolution Mech.	Establishment of a Single Resolution Authority	COM presented proposal (10/07/2013)	REGULATION*	EZ 17 (open to EU 27)
SDGS Single DGS	Establishment of a Single Deposit Guarantee Scheme	On hold	To be defined	EZ 17 (open to EU 27)

(* Applies directly; ** requires country level transposition)

Main European Regulatory Initiatives

	ISSUE	STATUS	TYOLOGY	SCOPE
FTT Financial Transaction Tax	Establishment of a financial transaction tax	Under negotiation High impact / Big changes expected (enhanced cooperation)	DIRECTIVE**	11 EZ MS (Spain included)
LIIKANEN Separation of activities	Proposal for ring-fencing of risky investment activities	Open consultation: 07/2013 Exp. COM Proposal: 3Q/2013	DIRECTIVE/ REGULATION	EU27 (country level transposition?)
MIFID II/ MIFIR Markets in Financial Instruments	Reform to promote competition and investor protection	Parliament final vote: 10/2013 Exp. Implementation: 2015	DIRECTIVE REGULATION	EU 27
EMIR European Market Infrast.	Reform of OTC derivative markets	Apply since 03/2013	REGULATION	EU 27
CRAs Credit Rating Agencies.	Reform of rating's procedure	Apply since 20/06/2013	REGULATION	EU 27

(* Applies directly; ** Requires country level transposition)

CRD IV

Transposition of Basel III: FSB peer review found EU non compliant on 2 aspects out of 14: (i) capital definition and (ii) IRB models

Systemic Risk

- **Into flexibility package**
- Two buffers:
 - Systemic risk buffer (macroprudential). From 1% to 3% for all exposures & up to 5% for domestic and third country exposures could be higher than 5% of CET1.
 - SIFI buffer (institutions). Global Systemically Important Institutions (G-SIIs, FSB methodology). From 1% to 3,5%. BBVA subject to 1% of CET1 (can be increased by 0,5%).
 - Not cumulative, only the highest buffer applies (unless systemic risk buffer aims at domestic exposures)

Positive elements

- **Minority interests:** All local minority interest could be incorporated up to local minimum
- **Sovereign debt:** 0% in RWAs for MS when denominated in local currency
- **SMEs:** Reduced capital requirements (reductive factor of 0,7619 in RWAs)

Liquidity

- Definition of LCR pending, under the responsibility of EBA
- Differences with BIS proposal: earlier phase-in, minority run-offs, etc.

Leverage

- Slightly stricter than BIS: repos netting cannot be applied

Disclosure

- More demanding reporting requirements on financial information, corporate governance, remuneration, etc.

Implementation

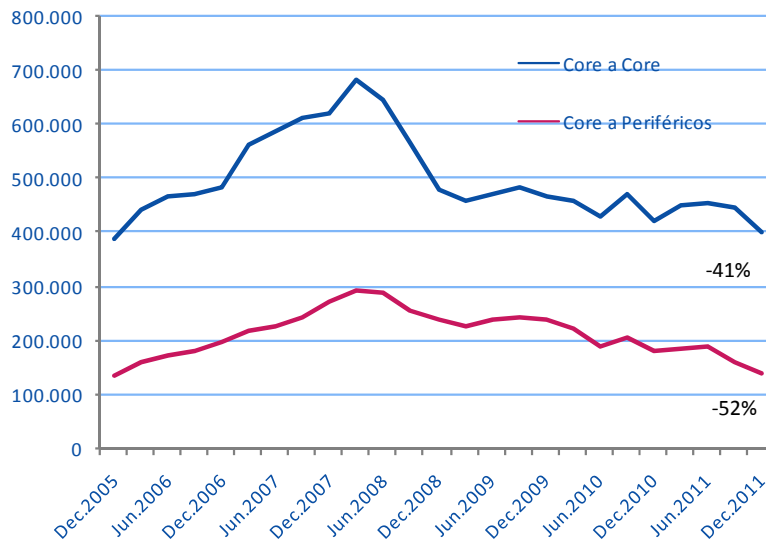
01/01/2014

The trend towards fragmentation

The fragmentation is **more worrying in the Eurozone**: re-nationalization of financial markets puts at risk the euro

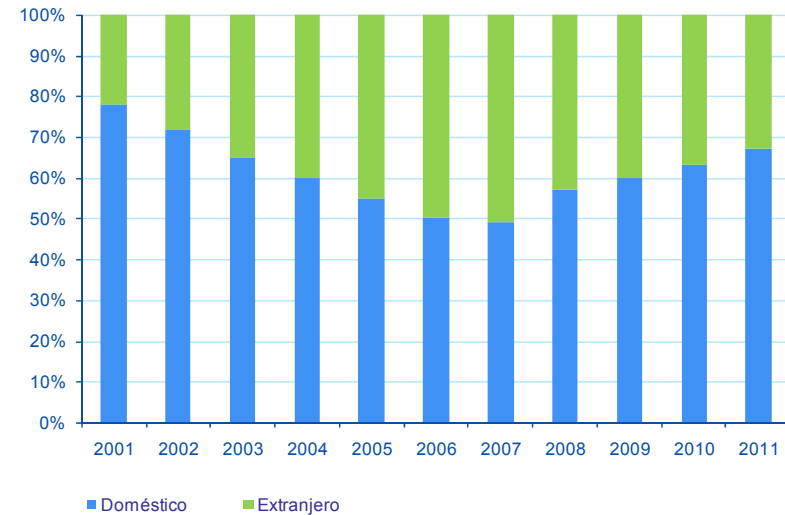
European Banks: Average exposures to EU members (dollars)

Source: BIS



Collateral used in credit operations (Euro system) (%)

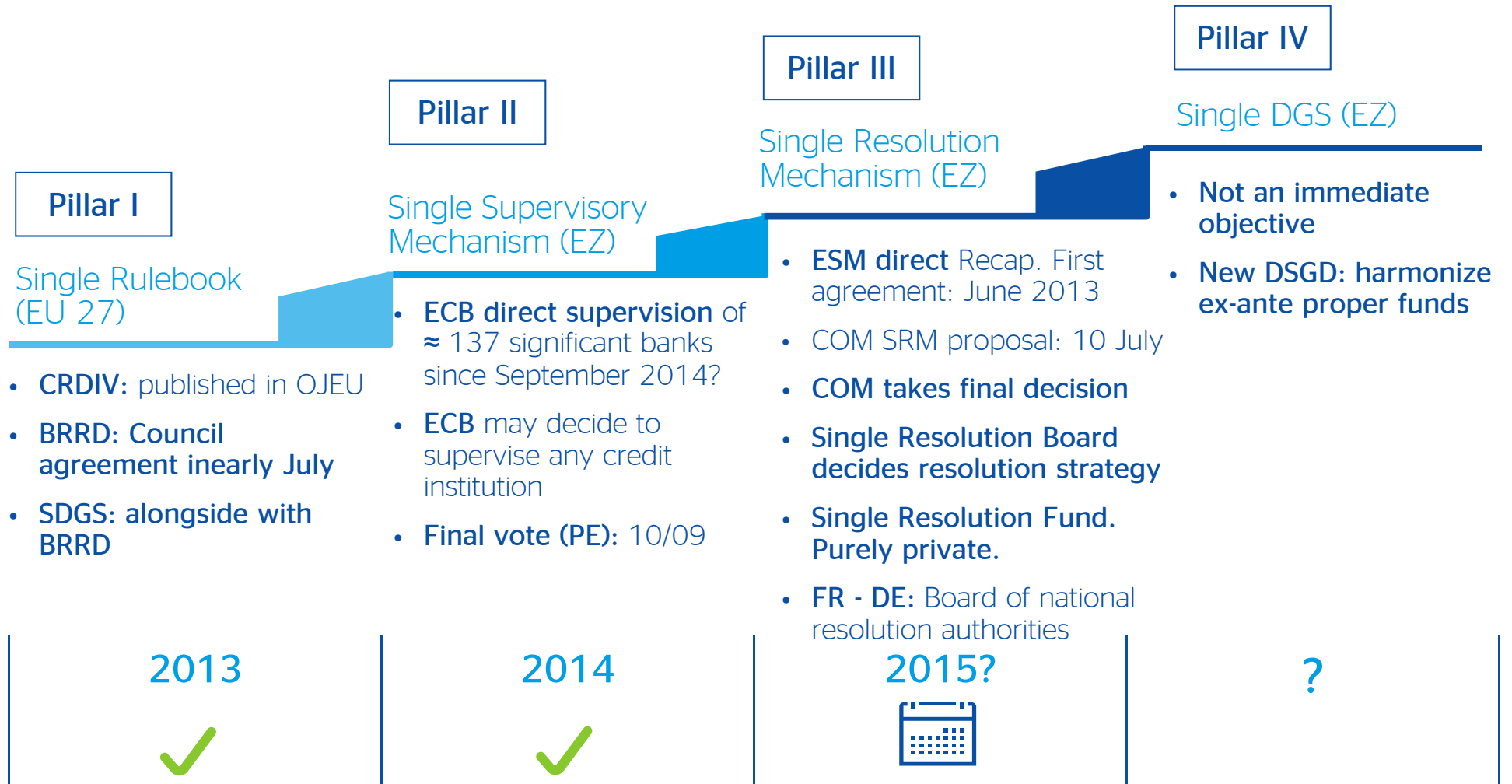
Source: ECB



3 Triggers

- 1 Market-driven segmentation
- 2 Rating agencies
- 3 Regulation (mostly moral suasion)

Banking Union



RRD Council Agreement

8% Internal Loss Absorption

- **8% of total liabilities** to be absorbed by shareholders & creditors

Use of Resolution Fund (RF)

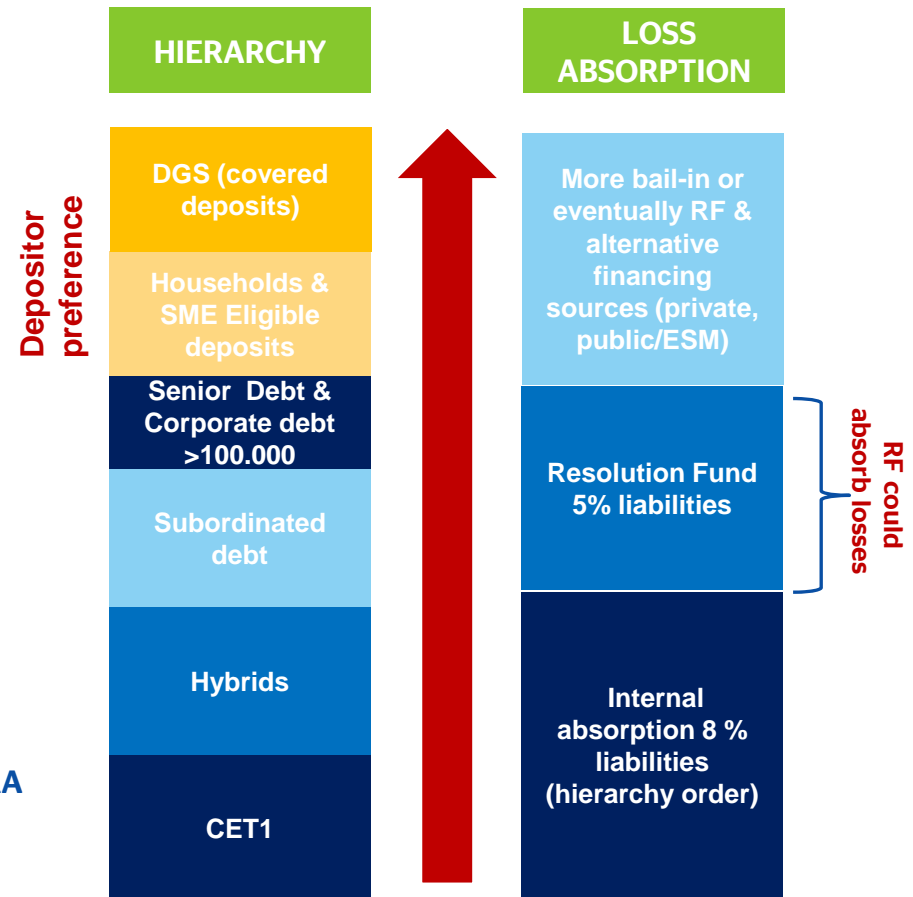
- **Once 8% bail-in is done: RF could be used to absorb losses or recapitalize the bank. This contribution is capped at 5% total liabilities.**

Financing of RF

- Ex-ante contributions
- Ex-post contributions
- If the two previous options are insufficient: Alternatives financing sources (private or public)

Alternative financing sources

- Under extraordinary circumstances, only **after all unsecured and non-preferred liabilities other than eligible deposits have been bailed in**, the **RA will seek funding from alternative financing** (which opens the door to assistance by the ESM).



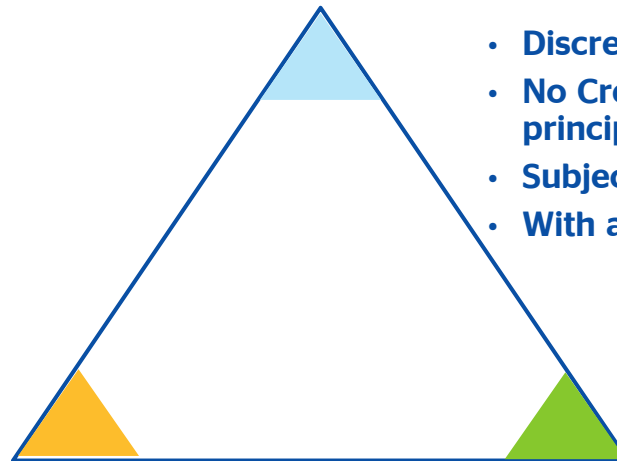
Banks Recovery and Resolution Directive (BRRD): Council Agreement

Bail-in Framed flexibility

- Discretionary exclusion of certain liabilities
- No Creditor Worse Off than in liquidation principle
- Subject to a minimum internal loss-absorption
- With a harmonized hierarchy of creditors

Financing Arrangements of Resolution Funds

- Target level of 0.8 % of covered deposits if resolution fund is kept separate from DGS (1.3% if joint resolution fund & DGS)
- Option to resort to alternative financing arrangements (i.e. ESM)



Minimum Requirement of Eligible Liabilities (MREL)

- In Oct 2016 EBA will prepare a proposal for harmonized MREL
- Taking account of the different business models of institution
- 2018: date of application of bail-in

Next steps



- Start trilogue process
- 19 November Plenary Vote EP
- Adoption not likely before December

SRM COM proposal

COM presented a proposal to establish the SRM, covering all banks under SSM scope (≈ 6,000)



SRM Governance

Board: Director, Deputy Director + COM&BCE representatives + MS. Simple majority vote:

- Plenary Session: general nature + budget (all MS)
- Executive Session: resolution strategy (only affected MS)

Single Resolution Fund

Private funding:

- Managed by SRB
- Ex-ante funding (size: 1% covered deposits, €55bn)
- Ex-post funding: Banks, borrowing
- Not explicitly backed by public funds

Public funds?

Implicit role:

- Only after private and Resolution Fund used
- SRM cannot force a MS/ESM to bail out
- Mid-term fiscal neutrality
- Subject to new state aid rules

SRM - Illustrative calendar

Until 01/2015
No BRRD
New state aid rules

2015 - 2019
SRM+BRRD
without bail-in

After 01/2019
SRM+BRRD
with bail-in

	Until 01/2015	2015 - 2019	After 01/2019
Resolution framework	National	BRRD (no bail-in)	BRRD (with bail-in)
Resolution authority	National	SRM	SRM
Private burden sharing	Equity + junior debt	Equity + junior debt	Equity + junior + other creditors (according to seniority)
Resolution fund	National	National	Single Resolution Fund
Public backstop	MS, ESM to MS, [ESM direct recap. if SSM, 09/2014]	MS, ESM to MS, ESM direct recap.	MS, ESM to MS, ESM direct recap.

Revised state aid rules

Will come into effect on 1 August 2013. Important during the transition towards SRM

Use of state aid: Conditions

- Shareholders and subordinated creditors to bear losses first under no creditor worse off clause. Few exceptions (financial stability risks, small aid)
- No burden sharing required for senior or preferred creditors
- Banks must seek to raise capital from private sources before any state aid
- Restructuring plan must be approved before public recapitalization

Use of state aid: Restrictions

- Dividends, capital management transactions, aggressive commercial practices, acquisitions
- Remuneration of executives until bank has repaid state aid/ completed restructuring

Use of DGS and RF

- Payment by DGSs to insured depositors → Not a state aid
- For recovery and resolution purposes if dictated by the MS (unclear whether same treatment would apply to Resolution Fund) → May be considered as state aid

Other

- State aid can be used in orderly liquidation process
- Simplified process for aid to small banks (under €100m balance)

Structural Reforms: Proliferation of initiatives

	Separation of activities		Prohibition of activities
	Europe	UK	US
	Liikanen	Vickers	Volcker
Idea	Ring fencing of investment activities	Ring fencing of retail activities	Prohibition of prop. trading , activities with hedge funds and private equity funds
To be excluded from retail entity	Market making, Prop. trading	Most of investment activities (likely exception for few derivatives)	
Which entities? Threshold	Only banks very active in market making and proprietary trading	Nearly the whole banking sector	

- 1 Other national initiatives in Europe: risks of inconsistency and fragmentation**
 Soft proposals in France and Germany. On-going discussions in other countries
- 2 Volcker is not an alternative to activity separation, but a complementary measure**
 UK authorities are considering a Volcker rule additionally to Vickers (split + prohibition)
- 3 Liikanen is lighter than Vickers and Volcker ...**
 Liikanen is a Vickers solution (ring-fencing) applied to activities prohibited by Volcker (proprietary trading)



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Thank You!

sfernandezdelis@bbva.com