Deloitte.

Challenges related to coordination among UK and EU banking supervisory and resolution authority *after Brexit*

December 2017

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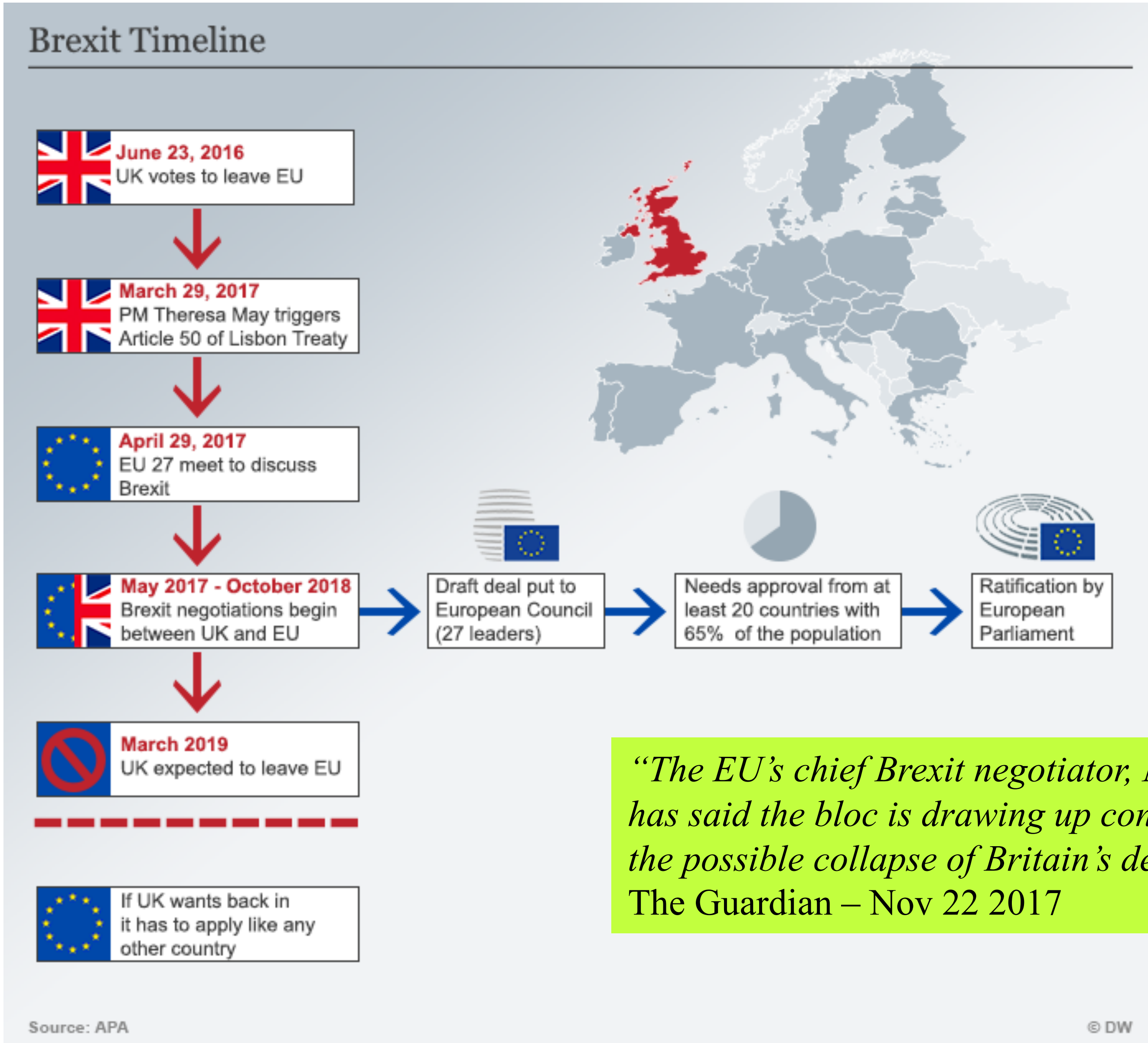
Brexit : Indicative timeline

Indicative timeline pending bilateral negotiations



"The EU's chief Brexit negotiator, Michel Barnier has said the bloc is drawing up contingency plans for the possible collapse of Britain's departure talks",
The Guardian – Nov 22 2017

The reaction of the sector

Banks and EU Institutions are activating Plan B

Financial Times-Nov 21, 2017
EU foreign ministers meeting in Brussels on Monday voted for the EBA to shift its headquarters from London to Paris after Brexit.

Financial Times-Nov 24, 2017
The EBA conceded that the risk of a "cliff edge" Brexit was the main cloud hanging over all of Europe's banking system — European banks slash UK-related assets by €350bn after Brexit vote

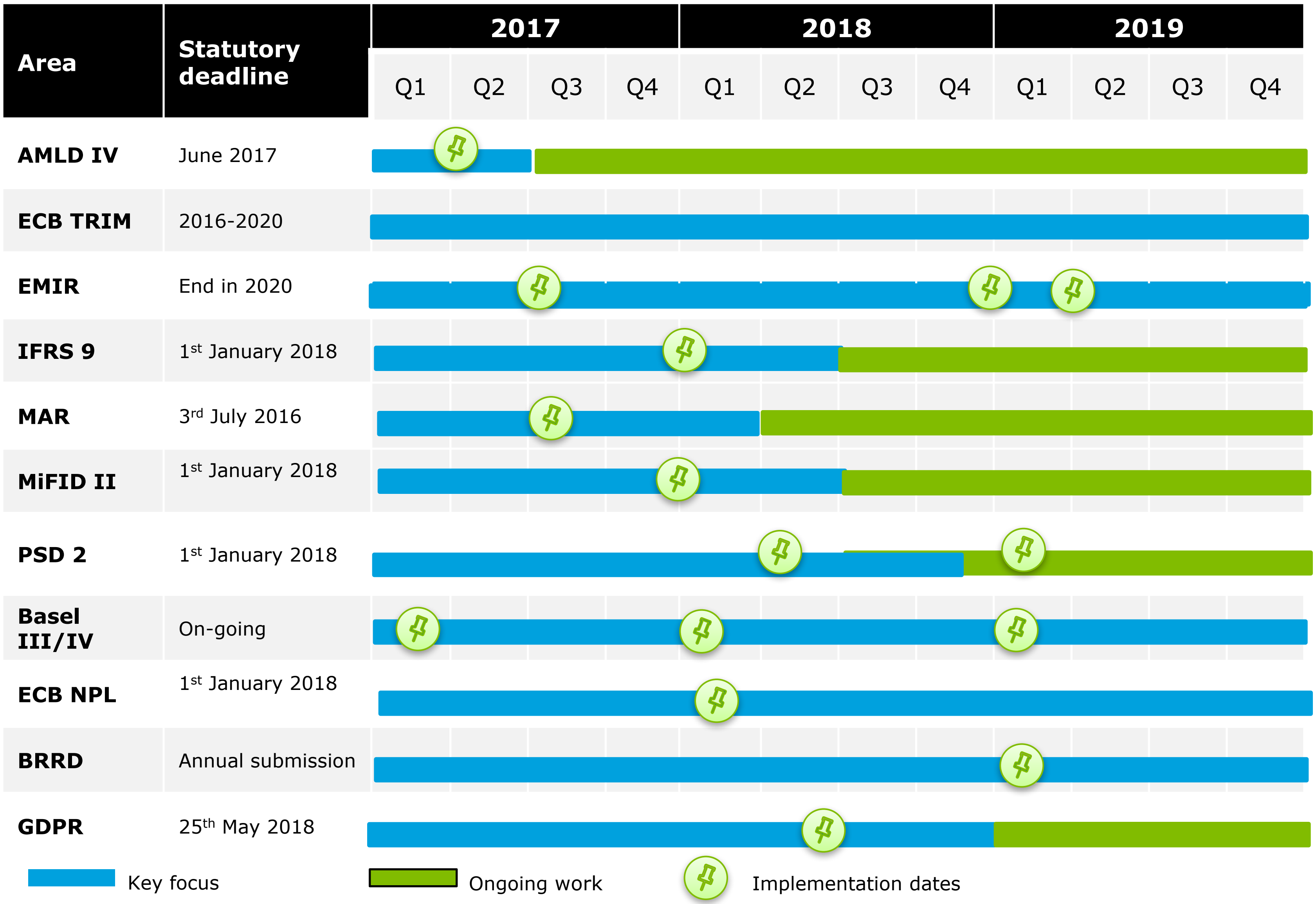
Reuters – Nov 6, 2017
ECB's Nouy says almost 50 banks considering post-Brexit relocation

Bloomberg – Nov 23, 2017
ECB Plans to Add 170 Supervision Staff as Brexit Boosts Workload

Bloomberg – Nov 15, 2017
ECB Blasts Banks for 'Empty Shell' Brexit Plans, Risk Transfers. The European Central Bank demanded changes in banks' plans for relocating from the U.K., saying some are still seeking to set up "letter box" companies in the euro area with no real independence.

The EU banking regulatory transformation agenda

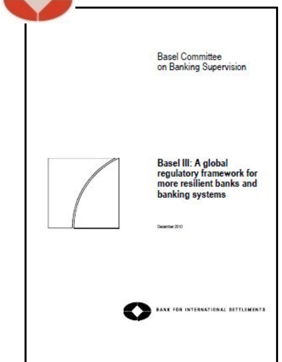
2017-2019 requires a significant effort from the Supervisors to adopt their supervisory framework to regulatory initiatives



What is the new regulatory environment?

CRD and CRR together form the CRD IV package which is the implementing act of Basel III in Europe

Basel III



Single Rulebook

Capital Requirements Directive (CRD)	Capital Requirements Regulation (CRR)
Bank Recovery and Resolution Directive (BRRD)	Deposit Guarantee Scheme Directive (DGSD)

CRD transposed into local law

Refer to Appendix 1 for transposition details

What is Basel III?

- Basel III is a global banking standard developed by the Basel Committee on Banking Supervision that seeks to strengthen the regulation, supervision and risk management of the banking sector;
- Basel III will be fully in force from 1 January 2019;
- The third version of the standard was introduced following the global financial crisis, in order to address certain shortcomings as below:

Shortcomings of Basel II
Low level and quality of banks' capital bases; insufficient loss absorbency
Excessive leverage
Insufficient liquidity buffers
Does not deal with pro-cyclicality

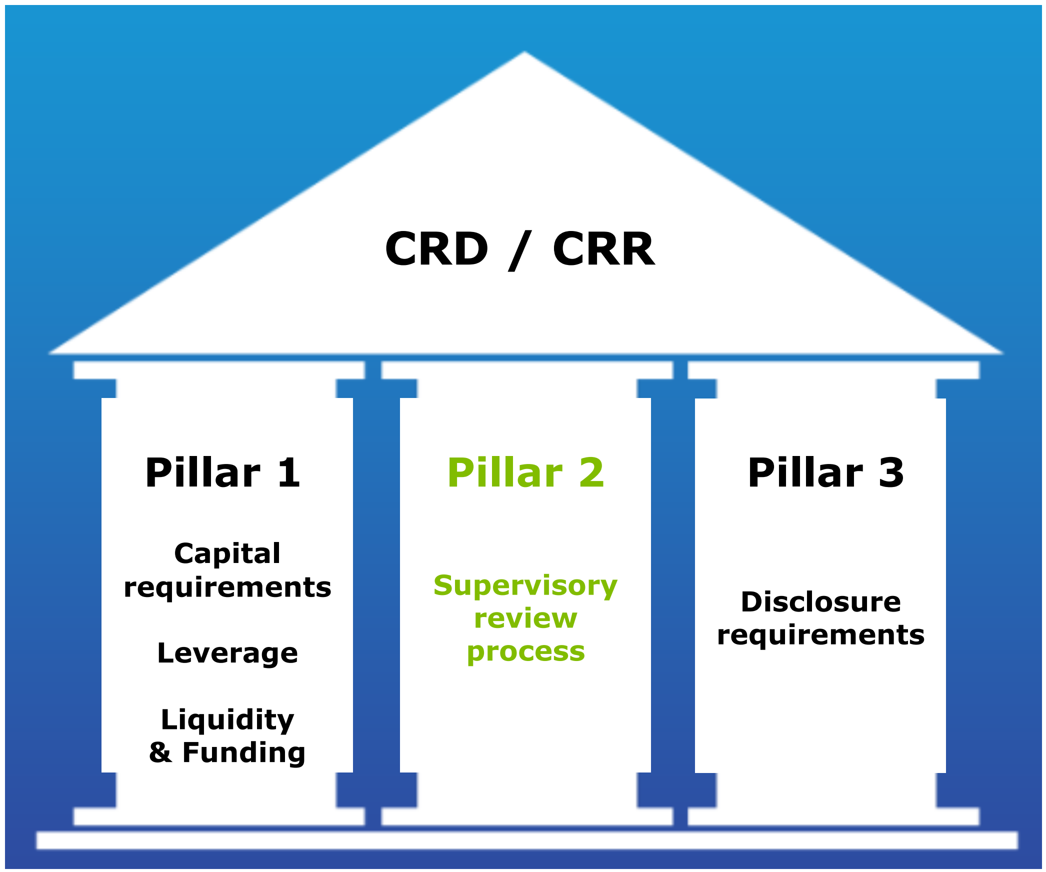
Basel III improvements	
Strengthening the quality and quantity of the capital base	Dealing with procyclicality
Enhancing risk coverage	Addressing Systemic Risk and Interconnectedness
Introduction of an overall Leverage Ratio (LR)	Introduction of Global Liquidity Risk Standards

Transforming a standard into legislation

- The Basel framework was implemented in Europe via CRD and CRR;
- CRD and CRR have also evolved in line with developments in the Basel standard.

How is the new regulatory environment structured?

The pillar framework introduced by the Basel Accords is mirrored in European banking legislation



What is EBA's SREP?

One single cohesive financial and non-financial risk framework to supervise lenders in EU

Ongoing risk assessment

1. Business model analysis

Viability and sustainability of Business Model (RAS)

=> Score + Rationale

2. Assessment of internal governance & controls

Adequacy of governance and Risk Management (RAS)

=> Score + Rationale

3. Assessment of risks to capital

Assessment of Risk level and Risk Controls for risks to capital (RAS) => Score + Rationale for each risk category

Capital requirement determination => CET 1 add-on

Block 1

RAS - based

Block 2

- ICAAP
- Supervisory proxies

Block 3

- Stressed ICAAP
- Supervisory stress tests/proxies

Capital adequacy assessment => Score + Rationale

4. Assessment of risks to liquidity and funding

Assessment of Risk level for liquidity & funding risk and Risk controls (RAS) => Score + Rationale

Liquidity requirement determination => liquidity buffer

Block 1

RAS - based

Block 2

- Internal Liquidity Determination – ILAAP

Block 3

- Stressed liquidity determination – Supervisory Stress Tests

Liquidity & funding adequacy => Score + Rationale

Overall SREP assessment – Holistic approach
=> Score + Rationale/main conclusions

Supervisory measures

Quantitative capital measures

Quantitative liquidity measures

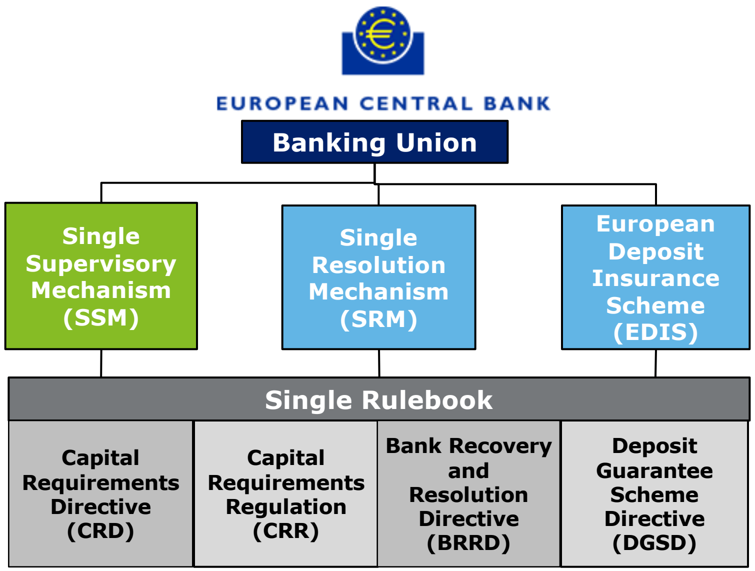
Other Supervisory measures

Supervisory Priorities 2017

Supervisory priorities reflect the dynamic of EU specificities

The Banking Union

- ESAs raise red flag on EU's supervisory convergence
- European Commission urges ESAs to increase their supervisory reach



EBA/SSM Priorities 2017

1. **Business Models and Profitability Drivers**
   - Risk Appetite Framework
   - Profitability
   - Sustainability
   - Peer Group Analysis
   - Investment to support regulatory transformation
2. **Credit Risk**
   - IFRS9
   - NPL Management
   - Credit underwriting process
   - Credit Risk Models (TRIM)
   - Concentration
3. **Risk Management**
   - Governance
   - Data quality BCBS239
   - TRIM
   - Cyber risk

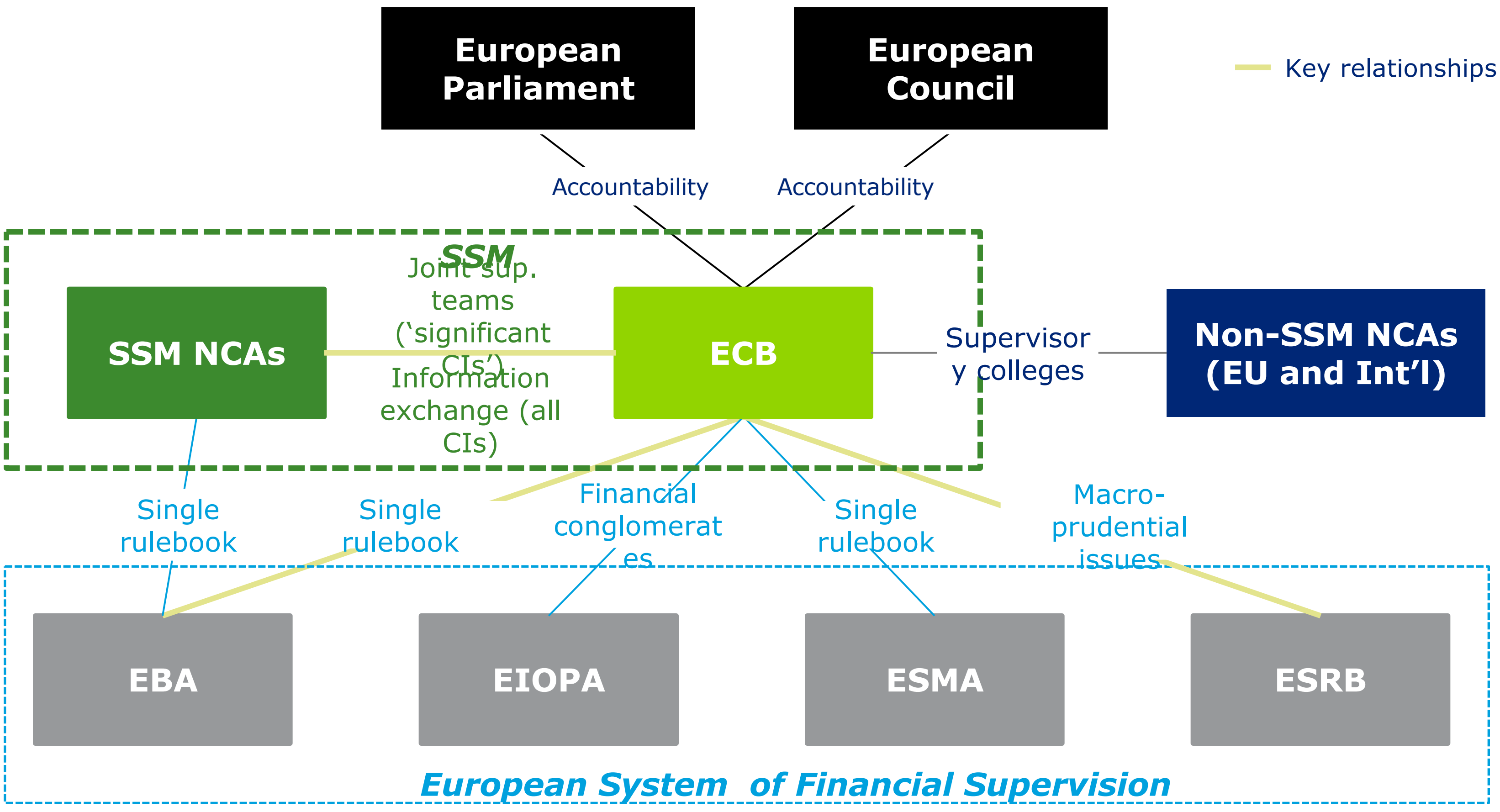
Latest News on Supervisory Approach

ESAs speeding up supervisory convergence in EU and tackle Brexit relocations

- **ECB reinforces its NPL guidance for banks, Oct 2017**
- **ECB publishes for consultation draft guides to bank licensing and fintech bank licensing, Sept 2017**
- **ECB harmonises supervisory rules for less significant institutions, July 2017**
- **EBA publishes final Guidelines on the estimation of risk parameters under the IRB Approach, Nov 2017**
- **ESMA maintains focus on supervisory convergence and risk assessment in 2018**
- **EBA publishes methodology for the 2018 EU-wide stress test, Nov 2017**
- **EBA publishes final guidance on supervision of significant branches, Nov 2017**
- **EBA provides guidance to authorities and institutions on Brexit relocations, Oct 2017**

How does the Single Supervisory Mechanism operate?

How the ECB will work with the UK Supervisor?



Who governs Supervisory Colleges

Should we expect a bilateral agreement between EU and UK?

Basel Committee on Banking Supervision - Consultative document Good Practice Principles on Supervisory Colleges

This paper is designed to **assist supervisors** in running colleges as effectively as possible. **It is not meant to suggest that colleges should replace wider bilateral or multilateral cooperation between supervisors**, nor impede existing national, bilateral or multilateral arrangements in this respect. **Colleges should not be seen as a substitute for effective national supervision**

EU competent authorities have developed a framework of cooperation which is legally binding for all supervisory authorities from the European Economic Area (EEA) (in particular the Capital Requirement Directive-CRD n° 2006/48/EC7)

The potential input from non-EEA host supervisors to the consolidated supervision of international banking groups has to be considered carefully.

Any significant impediments will mean that the parent institution is not able to conduct effective oversight of its consolidated operations or its own operations abroad, and should not be operating in that foreign jurisdiction.

What are the BIS principles of effective collaboration between supervision 1/2

Principle 1: **College Objectives.** Supervisory colleges should **enhance information exchange** and cooperation between supervisors to support the effective supervision of international banking groups. Colleges should enhance the mutual trust and appreciation of needs and responsibilities on which supervisory relationships are built.

Principle 2: College Structures. Supervisory colleges should be structured in a way that enhances **effective oversight** of international banking groups, **taking into account the scale, structure, and complexity** of the banking group and the corresponding needs of its supervisors. Whilst a college is a single forum, multiple or variable sub-structures may be used as **no single college structure is likely to be suitable for all banks.**

Principle 3: Information sharing College members should make their best efforts to share appropriate information with respect to the principal risks of the banking group. **Mutual trust and relationships are key for effective information sharing**. Nonetheless, formal confidentiality agreements, such as contained in Memoranda of Understanding (MoUs), among college members facilitate this process.

Principle 4: Communication Channels. Communication channels within a college should ensure the efficiency, ease of use, integrity and confidentiality of information exchange. The home supervisor should make sound communication channels available to the college and host supervisors should use them appropriately and continuously.

What are the BIS principles of effective collaboration between supervision 2/2

Principle 5: Collaborative Work. Supervisory colleges should promote collaborative work between members, as appropriate, to improve the effectiveness of the oversight of international banking groups. Collaborative work should be based on agreement between supervisors and should **recognise national legal constraints**.

Principle 6: Interaction with the Institution. Interaction between the college members and the banking group should complement the interaction that individual supervisors (both home and host) have with the specific entity they supervise.

Principle 7: Crisis Management . Supervisory colleges and crisis management structures are distinct but complementary. The work of a banking group's supervisory college should serve as one of the building blocks for crisis management planning.

Principle 8: Macroprudential Work Supervisory colleges can help ensure that the intensity of **supervision** of large, complex, internationally active banking groups is **tailored to their systemic importance**. Supervisory colleges should facilitate the process of identification and dissemination of information relevant to macroprudential analysis.

Potential challenges and in the collaboration of EU and UK Supervisors

- **Delay in UK/EU negotiations over Brexit**
- **Political Pressures on the role of the Supervisors**
- **Weakened influence of the UK sector on an international level**
- **Regulatory deviations (overregulation and deregulation trends, Basel IV)**
- **Different supervisory priorities between the two authorities**
- **Lack of experience of EU supervisors with risk models of US and UK banks**
- **Cultural evolution of the regulatory and supervisory bodies**