



Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

**Feedback to CP110 on the Implementation of Competent Authority
Options and Discretions in the European Union (Capital
Requirements) Regulations 2014 and Regulation (EU) No 575/2013**

1. Introduction

Consultation paper CP110 on *the Implementation of Competent Authority Options and Discretions in the European Union (Capital Requirements) Regulations 2014 and Regulation (EU) No 575/2013* was published on 23 June 2017. The consultation period closed on 4 August 2017 and one response was received by that date.

CP110 outlined the Central Bank of Ireland's (Central Bank's) proposed approaches and perspectives in relation to certain provisions where the competent authority can or must exercise its discretion within:

- The European Union (Capital Requirements) Regulations 2014 ('the CRD Regulations'), transposing Directive 2013/36/EU (CRD IV);
- Regulation (EU) No. 575/2013 (CRR); and
- European Commission Delegated Regulation (EU) No. 2015/61 ('the LCR Regulation').

The Central Bank proposed to update its 2014 Implementation Notice in this regard, particularly in view of subsequent harmonisation initiatives within the Single Supervisory Mechanism with respect to options and discretions (O&Ds) in CRD IV and CRR. CP110 encompassed competent authority O&Ds that may apply to credit institutions and firms authorised under the Markets in Financial Instruments Directive (MiFID), as well as those specific to credit institutions or MiFID-authorised firms, and falling within the Central Bank's supervisory competence.

The Central Bank is grateful to the party which responded to the consultation for their time and effort. Their response to the consultation is available on our website at the following address: <https://www.centralbank.ie/publication/consultation-papers>

Having considered the submission received, the Central Bank has:

- Taken note of areas where the respondent disagreed with a proposed approach;
- Clarified the key questions raised;
- Provided further guidance on its proposed approach, where necessary; and
- Issued a revised Implementation Notice.¹

¹ <https://www.centralbank.ie/regulation/industry-market-sectors/credit-institutions/regulatory-requirements>

2. Summary

The respondent commented upon the following areas of CP110:

- i. Transitional arrangements (liquidity); and
- ii. Credit risk.

3. Main Issues Highlighted

3.1. Transitional Arrangements (Liquidity)

Article 415(3)(b) CRR contains a discretion for competent authorities to continue to collect information through monitoring tools for existing national liquidity standards until the LCR is fully introduced in accordance with Article 460 CRR. In CP110 the Central Bank indicated that it was minded to continue exercising the discretion in Article 415(3)(b) CRR. It was therefore proposed that existing liquidity regulatory reporting would continue under Article 415(3)(b) CRR until 1 January 2018.

Submission

The respondent indicated that they had contacted the Central Bank to query whether the Central Bank's 'Liquidity Return' (Requirements for the Management of Liquidity Risk 2009) would no longer be required from 1 January 2018. The respondent understood that the Central Bank would stop collecting the Liquidity Return after the 31 December 2017 reference date but some of the requirements around liquidity management may be retained.

The respondent also pointed out that, in addition to the existing Central Bank liquidity standard, institutions also submit supplementary liquidity related MI via additional monitoring metric templates, the internal liquidity adequacy assessment process, the short-term exercise and additional ancillary liquidity reports in respect of wholesale funding, depositor portfolios, etc. The respondent thus stated that industry is of the opinion that an opportunity exists to review the suite of liquidity MI provided in an effort to minimise duplication whilst ensuring the requirements of the Central Bank are met. The respondent observed that this would also be in keeping with the move towards the standardisation of liquidity risk reporting across the EU.

Central Bank Feedback

The Central Bank's "Requirements for the Management of Liquidity Risk 2009" ('the National Requirements'), including the reporting requirements contained therein, will be discontinued on 1

January 2018 in accordance with Article 412(5) CRR. The Central Bank intends to conduct a review of the broader liquidity reporting framework in due course.

Although the National Requirements will be discontinued, the Central Bank nonetheless expects credit institutions to maintain an Asset and Liability Committee (ALCO) as part of their compliance with, *inter alia*, Regulation 64(4) of the CRD Regulations and paragraph 13.1(c) of the Central Bank's Corporate Governance Requirements for Credit Institutions. This will be reviewed in the course of regular supervision.

3.2. Credit Risk

3.2.1. Article 178(2)(d) CRR (materiality of credit obligations past due)

Article 178(2)(d) CRR specifies that the materiality of a credit obligation past due shall be assessed against a threshold, defined by the competent authorities. This threshold shall reflect a level of risk that the competent authority considers to be reasonable. In CP110 the Central Bank acknowledged that the European Banking Authority (EBA) is mandated to develop draft regulatory technical standards (RTS) to specify the conditions according to which a competent authority shall set the threshold referred to in paragraph 2(d). The Central Bank also indicated that, notwithstanding the RTS, relevant entities are required to have an appropriate and documented materiality policy; where thresholds are set based on the distribution of exposures and taking into consideration product and obligor characteristics.

Submission

The respondent submitted that the setting of thresholds "based on the distribution of exposures and taking into consideration product and obligor characteristics" by each institution conflicts with the harmonisation the RTS sets out to achieve. Once the RTS is in effect, institutions will follow the requirements therein. In addition, the respondent stated that the setting of materiality thresholds is not expected to be documented in a distinct policy; rather it should be considered within the institution's documentation of the definition of default.

Central Bank Feedback

The EBA is mandated to develop draft RTS to specify the conditions according to which a competent authority shall set the threshold referred to in Article 178(2)(d) CRR. Pending the application of the European Commission regulation adopting that RTS, relevant entities are required to have an appropriate and documented materiality policy; where thresholds are set based on the distribution of exposures and taking into consideration product and obligor characteristics.

3.2.2. Article 115(2) CRR (exposures to regional governments or local authorities)

Article 115(2) CRR specifies that exposures to regional governments or local authorities shall be treated as exposures to the central government in whose jurisdiction they are established where there is no difference in risk between such exposures because of the specific revenue-raising powers of the former, and the existence of specific institutional arrangements the effect of which is to reduce their risk of default. Article 115(2) CRR further specifies that EBA shall maintain a publicly available database of all regional governments and local authorities within the Union which relevant competent authorities treat as exposures to their central governments.

In CP110 the Central Bank indicated that it does not consider that any Irish local authorities currently meet the criteria in this provision. The Central Bank further specified that institutions would require prior written approval from the Central Bank in order to avail of this treatment for any European Economic Area (EEA) regional governments or local authorities. In addition, the Central Bank indicated that institutions should continually monitor the relevant EBA list of eligible EEA regional governments and local authorities.

Submission

The respondent was of the view that the prior approval requirement appears to be an error since no option or discretion is available to the Central Bank under the legislation. The respondent noted that no reference was made to this requirement under the Central Bank's 2014 Implementation Notice. The respondent submitted that if the Central Bank identifies entities which fall within this category, its obligation is to advise the EBA, to facilitate the publicly available database. If an institution has an exposure to an entity included on the database, then that exposure can be treated as an exposure to the central government of the entity's jurisdiction. The respondent was of the opinion that no prior written approval from the Central Bank is required in this regard.

Central Bank Feedback

The Central Bank is of the view that there is a discretion for the competent authority in this provision to determine whether exposures to regional governments and local authorities are eligible for treatment as exposures to the central government, which will in turn inform competent authority submissions to the EBA database.

Therefore, in circumstances where a regional government or local authority is not already listed in the EBA database an institution may nonetheless make an application to their competent authority that such a regional government or local authority meets the conditions for preferential treatment. Should a competent authority, in consultation with any other relevant competent authorities, make a positive determination on foot of such an application, then that competent authority would notify the EBA of same and request inclusion of that regional government or local authority in the EBA database.

Accordingly, the Central Bank confirms that:

- a) No Irish local authorities currently meet the criteria in this provision and should not be treated as such by institutions; and
- b) For exposures other than a) above, institutions should continually monitor the relevant EBA database and if they intend to apply the preferential treatment to any EEA regional government or local authority not presently listed in that database, a prior detailed application to this effect must be submitted to the Central Bank.

3.2.3. Article 116(4) CRR (exposures to public sector entities)

Article 116(4) CRR specifies that, in exceptional circumstances, exposures to public-sector entities (PSEs) may be treated as exposures to the central government, regional government or local authority in whose jurisdiction they are established where in the opinion of the competent authorities of that jurisdiction there is no difference in risk between such exposures because of the existence of an appropriate guarantee by the central government, regional government or local authority.

In CP110 the Central Bank indicated that, in accordance with its pre-existing approach under Directive 2006/48/EU, institutions seeking to avail of this provision to treat exposures to EEA PSEs as exposures to the central government, where there is no difference in risk between such exposures, would require

prior written approval from the Central Bank before doing so. The Central Bank also advised institutions to continually monitor the relevant EBA list of eligible PSEs in Ireland and the broader EEA. The Central Bank further indicated that it would also have regard to any list of eligible PSEs which may be issued by the ECB in due course.

Submission

The respondent highlighted that EBA maintains a listing of eligible PSEs in the EEA, which have been identified as representing the same risk as the relevant central government and/or regional government and/or local authority. The respondent observed that if an institution has an exposure to an entity included on the EBA listing, it may treat this exposure in a manner reflecting this risk. The respondent was of the opinion that if the Central Bank identifies entities which fall within this category, its obligation is to advise the EBA so that the entity is included in its listing of eligible PSEs. The respondent was of the opinion that further prior written approval from the Central Bank is not required. The respondent also requested, for the avoidance of doubt, that the Central Bank confirm it would not approve a PSE under this requirement on a case-by-case basis if it had not arranged for the EBA to include the relevant entity in its list of eligible PSEs.

Central Bank Feedback

The Central Bank notes that Article 116(4) CRR refers to the 'opinion' of the competent authorities. Therefore, it is the Central Bank's view that in order to form appropriate opinions in this regard, and keeping in mind that the existence (or not) of 'appropriate guarantees' may differ from PSE to PSE, a prior approval case-by-case approach is necessary and compatible with Article 116(4) CRR. Any approvals granted by the Central Bank will in turn inform the Central Bank's submissions to the EBA's list of eligible PSEs.

The Central Bank may approve a treatment under Article 116(4) CRR for a PSE not previously included on the EBA list, given that the Central Bank may not have had prior occasion to consider the eligibility of that specific PSE for the purposes of Article 116(4) CRR. A prior approval need not be sought by institutions for PSEs already included on the EBA list.

3.2.4. Article 124(4) CRR (exposures secured by mortgages on immovable property)

Unless otherwise decided by competent authorities on financial stability grounds in accordance with Article 124(2) CRR, Article 126 CRR applies a 50 per cent risk weighting to loans fully and completely

secured on commercial property, subject to the fulfilment of specific criteria. Otherwise a risk weight of 100 per cent applies. In CP110 the Central Bank confirmed it is minded to continue with its policy requiring 100 per cent risk weighting for such exposures as a matter of course.

The Central Bank also pointed out that, as per Article 124(4) of CRR, this approach may be subject to a future European Commission delegated regulation on ‘financial stability considerations’. Furthermore, the Central Bank indicated that it would have regard to any future methodology which may be developed by the ECB in this area, as referenced in the ECB Guide for SIs.²

Submission

The respondent submitted that the 50 per cent risk weight for exposures secured on commercial property should be made available on a similar “tiered criteria” basis to the approach taken by the Central Bank in respect of exposures secured on residential property. The respondent was of the opinion that there is no justification for these commercial exposures to attract the same capital as unsecured exposures and the continued application of this discretion results in:

- A lack of risk discrimination; and
- An uneven playing field vis a vis other banks outside the Republic of Ireland and that this is contrary to the regulator’s objective of harmonisation across Europe.

The respondent requested that the Central Bank consider an amendment to its proposal for a continuation of the current approach.

Central Bank Feedback

In accordance with Article 124(2) CRR the Central Bank reviews, at least annually, the appropriateness of, *inter alia*, its policy requiring a 100 per cent risk weighting for such exposures. At this time, the Central Bank remains of the view that this policy is appropriate from a financial stability perspective, taking cognisance of historical loss experience and forward-looking property markets developments. Having regard to any future European Commission delegated regulation and/or ECB methodology in this area, the Central Bank will continue to keep this policy under review and will communicate any future proposed changes.

The Central Bank also notes that this particular discretion is fashioned to facilitate alternative prudential approaches, where appropriate, given the inherent specificities of national property

² ECB Guide on options and discretions available in Union law, consolidated version, November 2016.

markets. The Central Bank further notes that, according to the EBA database,³ a number of other EEA competent authorities have taken similar measures in this respect.

³ EBA, *List of changes to risk weights or stricter criteria for exposures secured by immovable property (Article 124 CRR)*: <http://www.eba.europa.eu/supervisory-convergence/supervisory-disclosure/rules-and-guidance>