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Financial Regulation Outlook

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From Basel III to Basel IV?

Comprehensive ongoing review of Risk Weighted Assets. The BCBS is currently undertaking an ambitious revision of RWAs (denominator of capital ratios) that could impact significantly on both minimum capital requirements and disclosed capital ratios. The new global rules are due to be completed by end-2016 and expected to come into effect in 2019.

The end of the zero risk weight for sovereigns?

Under the spotlight. A significant review of the prudential treatment of sovereign risk, as a result of which it may lose its privileged status of zero risk weight, has started at a global level. The Basel Committee is already working on this issue, but no formal outcome is expected before the second half of 2016. In Europe, this topic is beginning to gain importance although no measures are expected in the short term.

Main challenges in the resolution framework

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Shadow banking: the pending issue of the financial reform

Time to come out of the shadows. Transforming shadow banking into resilient and market-based financing is one of the four core elements of the global financial regulatory reform undertaken by the G20 in 2008 at its first meeting in Washington. But progress towards achieving this goal is uneven and there is still work to be done. The implementation of the agreed measures is in an incipient phase. The most significant advances have been in improving transparency and aligning incentives in securitisation.

Micro- and macro-prudential supervision

The perfect duo. Even the best of regulations would not have been efficient without adequate and effective supervision in place. Until the crisis, banking supervision was primarily focused on the individual situation of each entity without paying due attention to risks accumulated at an aggregate level of the system. The global financial crisis showed that most of the time, banking supervisors lacked an overall picture of the whole financial system. Both micro- and macro-prudential supervision have now been reinforced.

Ethics, culture & governance: *the importance of being earnest*

The essentials for restoring trust and reputation. Ethics, culture and governance are the pillars of a resilient banking industry in the current paradigm. Evolving from ethical declaration into action is essential and has to be achieved through a solid culture along with robust governance encompassing the entire organisation. This self-regulation of banks has to be backed up by external regulation and supervision, deterring agents from engaging in undue practices via enforcement actions and sanctions as required. The final goal is an efficient, open and dependable financial system acting as a catalyst for bolstering the banks' role of enhancing the welfare of society.

Digital regulation

The EU agenda will stand out amid little international initiatives in 2016. Despite its global implications, the digital transformation of financial services is mostly regulated at the national level, and there has been little international coordination so far. In this context, the European Union agenda stands out, with several initiatives expected this year.

Regulatory impact analysis: a compelling need

The regulatory tsunami. Since the start of the financial crisis, authorities have created a 'regulatory tsunami' in response to financial turbulences. National, European and global economies have introduced a plethora of uncoordinated measures to cover diverse aspects of banking activities with two main objectives: making the next crisis less likely (strengthening banking solvency) and mitigating its potential consequences (moderating systemic risk, minimising the cost to the taxpayer and improving banks' resolvability).

European regulatory priorities for 2016

From global to local: 10 hot topics for the New Year. The regulatory priorities of the EU institutions for 2016 reflect Europe's new motto of promoting investment, growth and a deeper Single Market. Many resources will also be devoted to finalising key open initiatives and to setting in motion the institutional architecture built up in response to the crisis. We highlight the key issues that will mainly influence the EU's agenda during 2016.

1 What to expect from China's G20 presidency?

Implementation of the global financial sector reform remains of importance

The theme of the G20 Summit to be held in Hangzhou, China, in 2016 *is Towards an Innovative, Invigorated, Interconnected and Inclusive World Economy.*[1] This clearly states the objectives of China's G20 presidency and shows a degree of continuity with Turkey's G20 2015 strategy of Inclusiveness, Implementation and Investment for Growth (Three I's strategy).

During 2016 China wishes to enhance **innovation** at a global level as it believes it is the main driver to guarantee sustained long-term growth. Cyclical policies have been fundamental during the past years, especially after the financial crisis, but their limitations have recently become visible. More ambitious policies need to be implemented now in order to return world economic growth to an improved trajectory.

An **invigorated** world economy is understood as one which needs the participation from all stakeholders. But in order to achieve this, the Chinese presidency states that greater structural reforms are needed, international cooperation must be enhanced and global economic governance must be improved. **Interconnectivity** refers to the sense of a global community that must be strengthened so that cooperation among countries can be improved. As stated by China's G20 Presidency "… the interconnectivity between growth and development in different countries has become so close that we either stand or fall together".

The importance of **inclusiveness** is reconfirmed and is a clear follow-through on one of Turkey's G20's priorities. Furthermore it affirms the importance that emerging markets have gained since the establishment of the G20. The search to reduce inequalities and imbalances in global development will continue to be of the utmost importance and one of the key issues during China's presidency.

Finally, continuing with the financial sector reform is one of the elements that will allow the G20 to pursue a more effective and efficient economic and financial governance during 2016. The implementation of standards and rules already agreed upon will continue at a robust pace, so that the stability and resilience of the global financial system is enhanced. During 2016 there will be a **greater focus on the emergence of new risks and vulnerabilities, for which improved macro-prudential regulation** will be essential. However, China believes it will be important to ensure that further progress is achieved on inclusive finance so that the benefits of financial development are more broadly shared on a global scale. Policies related to financial sector reform will most certainly be addressed by one of the five taskforces, in particular for Financing Growth.

Figure 1.1
B20 Taskforces[2]

B20 Turkey 2015	B20 China 2016
1. Trade	1. Financing Growth
2. Infrastructure and Investment	2. Trade and Investment
3. Financing Growth	3. Infrastructure
4. Employment	4. SME Development
5. Anti-corruption	5. Employment
6. SMEs and Entrepreneurship	Anti-corruption Forum

Source: BBVA Research

1: China's G20 2016 priorities document and statement by Xi Jingpin, President of the People's Republic of China in December 1st, 2015
2: G20 taskforces have yet to be announced; however the B20 taskforces tend to replicate those of the G20.

2 From Basel III to Basel IV?

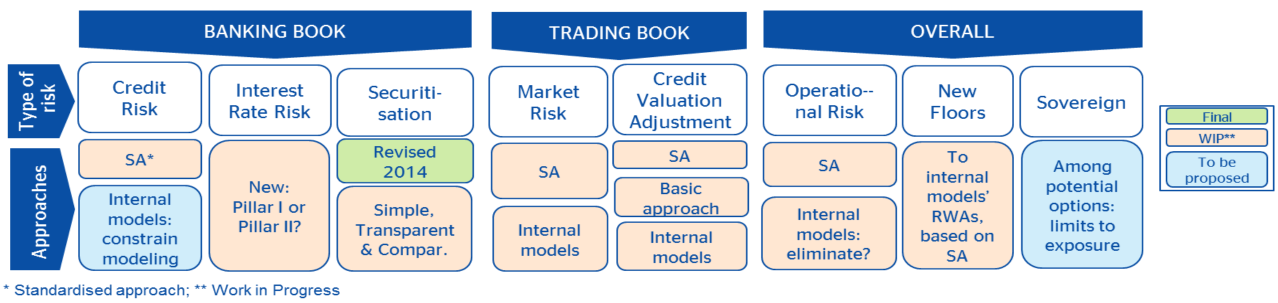
Comprehensive ongoing review of Risk Weighted Assets

The BCBS is currently undertaking an ambitious revision of RWAs (denominator of capital ratios) that could impact significantly on both minimum capital requirements and disclosed capital ratios. The new global rules are due to be completed by end-2016 and expected to come into effect in 2019.

After the adoption of the Basel III risk-based capital ratios in all 24 FSB jurisdictions, and with all internationally active banks already meeting the fully phased-in capital requirements, bank solvency has been considerably strengthened in recent years.

When Basel III saw the light of day in 2010 it was recognised that the framework was not definitive regarding the RWAs of some exposures (e.g. securitisation and trading book) and a revision was envisaged for a later stage to improve risk-sensitivity, reduce reliance on credit ratings and prevent regulatory arbitrage. But subsequently the review of Basel III has gone much further than was initially intended, extending its scope to include practically any type of risk and any approach used to calculate RWAs. A second wave of revisions is associated with BCBS's strategic review of the risk-weighted capital framework to assess whether it strikes the right balance in terms of simplicity, comparability and risk sensitivity. This was a reaction to the questioning of the capital framework on the grounds of its excessive complexity and lack of comparability, particularly when internal models are used. Following this and with the aim of addressing the excessive variability in RWAs observed across institutions, the BCBS set out a multifaceted plan to the G20 in 2014 and during 2015 has made substantial progress towards finalising the new rules. A report to the G20 in November 2015 revealed the intention to complete the revision by end-2016.

Figure 2.1
Revisions to Basel III framework with potential future impact on RWAs



Source: BBVA Research

The impact of these revisions is difficult to assess in advance due to the fact that it is on top of that derived from the Basel III framework, implemented in 2014 and subject to phase-in provisions until 2019. In addition, the cumulative impact is difficult to assess, given the multiplicity of changes being introduced at the same time. Despite global regulators' declaration of no intention to significantly increase overall capital requirements, which reflects the growing awareness that the objective of financial stability should be combined with the goal of not impeding economic growth, the industry is greatly concerned about the potential additional tightening of capital requirements due to the conservative bias in the calibration of the proposals so far published. Furthermore, even if at a global level the impact were neutral, it would not prevent entities from having a significant impact at a credit entity or business line level. To conclude, a significant change in solvency standards is underway; discussion on whether we call it 'Basel IV' or 'revised Basel III' should not overshadow what is really important, which is its impact on the financing capacity to sustain growth. This is particularly relevant in the case of Europe given the importance of the banking sector in financing the economy.

3 The end of the zero risk weight for sovereigns?

Under the spotlight

A significant review of the prudential treatment of sovereign risk, as a result of which it may lose its privileged status of zero risk weight, has started at a global level. The Basel Committee is already working on this issue, but no formal outcome is expected before the second half of 2016. In Europe, this topic is beginning to gain importance although no measures are expected in the short term.

The current regulatory framework grants sovereign exposures a beneficial treatment both for credit risk (with a 0% risk weight in the standardised approach for sovereigns meeting certain requirements and, in the case of Europe, also through the so called “permanent partial use” when using internal models) and also under the large exposure regime, which exempts sovereign exposures that are assigned a 0% risk weight in credit risk.

The global perspective

In 2012, the Basel Committee highlighted[3] sovereign exposures a cause for variability in risk weights across banks and also pointed to Europe as non-compliant with BIS III because of the “permanent partial use”. Lately, the Committee has included in its work programme for 2015 and 2016 the review of the regulatory treatment of sovereign exposures and has been working on this issue for over a year. A global proposal that could change the regulatory treatment is expected to be issued in the second half of 2016. The Bank for International Settlements also included this topic in its 2015 annual report. The BIS considers that a systemic and comprehensive approach is needed and that this work must be developed without delay or hesitation.

The European stance

From a European perspective, there are three main references of the authorities on this issue:

- In March 2015, the European Systemic Risk Board issued a report on the regulatory treatment of sovereign exposures. The report included six potential approaches to recognise the risk of sovereign debt: i) to impose a Pillar 1 capital requirement, ii) diversification through a large exposure limit, iii) coverage of sovereign exposures in macro prudential regulation, iv) enhanced Pillar 2 requirements, v) enhanced disclosure on sovereign exposures, and vi) changes in liquidity risk regulation.
- The 5 presidents’ report released in June 2015 includes as a recommendation for the medium term, a potential revision of the sovereign exposures treatment, possibly through a large exposure limit.
- In November 2015, the Commission released a proposal for a European Deposit Insurance System (EDIS) and accompanied it with a communication setting out several measures for reducing remaining risks in the banking system in parallel. Among these measures was included the revision of the prudential treatment of sovereign exposures.

Assessment

A review of the prudential treatment of sovereign exposures could have widespread repercussions, as it implies a change of paradigm (sovereign debt is no longer a risk-free asset). The impact on public-sector funding and the spillover effects on the economy should be properly considered.

Europe should not prejudge the BIS proposal. It is essential to ensure that any measure adopted is globally implemented. Coordination in the adoption of such a change is essential to avoid fragmentation of financial markets and an unlevel playing field with a competitive disadvantage for European markets. Indeed, beyond the analysis of the default risk, there are other types of financial repression which cannot be ignored when dealing with sovereign risk such as artificially low interest rates, capital controls or inflation which also reduce the real value of debt.

3: Basel Committee Report to G20 Finance Ministers and central Bank Governors on Basel III implementation.

4 Main challenges in the resolution framework

Priorities for 2016

Great progress has been made to setup efficient bank resolution frameworks. However the task is not yet complete and several important topics have to be taken care of such as guaranteeing liquidity and operational continuity in resolution for banks. Also, bail-in will have an important role in 2016: MREL will come into force in Europe at the beginning of the year and will be reviewed in October. Finally, resolution needs to be applied to other non-bank players that could originate systemic risk in the financial industry.

Following the recent publication of the final term sheet paper of the Total Loss Absorbing Capacity (TLAC), the FSB's work on bank resolution is now focused on two important topics: funding in resolution and operational continuity of critical shared services. Both subjects were identified in the first round of the FSB's Resolvability Assessment Process (RAP) as material impediments to the resolution of G-SIBs. Banks need to make sure they have enough liquid resources that are, in order of preference: internal, from the private sector or, if insufficient, from a public-sector backstop mechanism. The role of Central Banks as Lenders of Last Resort (LOLR) has been critical during the recent crisis and it will continue to be analysed in the definitive resolution framework. Also, banks need to ensure that critical shared services and functions will continue to be provided even if the entity enters into resolution. As a result, three different models (which can be combined) to provide critical services are under discussion: service provision within a regulated entity, by an intra-group service company, or by a third-party provider. After the close of both consultations during 2016, the FSB is expected to publish a set of principles that will then need to be implemented into national laws by the corresponding authorities.

The publication of the TLAC requirements represents a major step towards ending "too big to fail" entities but it does not mark the end of the road for loss absorbing capacity regulation. Next year the focus will shift to implementing these requirements on a national level. Several jurisdictions have already published proposals in this context such as the Federal Reserve TLAC proposal in the United States (the consultation ends in February and its subsequent approval is expected shortly afterwards) and the PRA's Minimum Requirement on Eligible Liabilities and own funds (MREL) in the UK. Indeed, under the BRRD, the bail-in mechanism will be in full force from 1 January 2016 in the EU, which means that, when a bank enters into resolution, both creditors and shareholders of a failing bank will have to contribute an amount equivalent to at least 8% of the total assets of the bank before being able to access other financial resources such as the Resolution Fund. The MREL will also be binding from 1January 2016 (with a four years phase-in period) and will be determined by the SRB or by the resolution authority throughout the year, on a case-by-case basis. Furthermore, next October the Commission will review the MREL and will most likely take that opportunity to implement the FSB's TLAC requirement for European G-SIBs. Last but not least, the BCBS is considering extending restrictions to investments in TLAC instruments from G-SIBs to other banks and has launched a consultation on TLAC holdings that will end in February. The idea is that all banks, not only G-SIBs, deduct from their capital (Tier 2), investments that they have in TLAC instruments. For all these reasons, 2016 will be the starting point of a significant change in the balance sheet structure and management of financial entities worldwide.

The resolution framework for G-SIBs and other banks is well underway. From now on, it is expected that regulators will concentrate their efforts on other financial industry participants and other types of G-SIFIs such as Central Counterparties (CCPs), insurance companies and asset managers among others. Following the implementation of mandatory central clearing of derivatives, the importance of CCPs has increased substantially to the point that they are becoming players of systemic importance. This is due to their interconnections with other market participants and to the fact that the critical services that they provide cannot be stopped without generating systemic risk and without spreading contagion on a wide scale. Their resilience, recovery planning, resolvability and interdependencies will be analysed during this year.

5 Shadow banking: a pending issue

Time to come out of the shadows

Transforming shadow banking into resilient and market-based financing is one of the four core elements of the global financial regulatory reform undertaken by the G20 in 2008 at its first meeting in Washington. But progress towards achieving this goal is uneven and there is still work to be done. The implementation of the agreed measures is in an incipient phase. The most significant advances have been in improving transparency and aligning incentives in securitisation.

Shadow banking is, according to the Financial Stability Board, "credit intermediation involving entities and activities (fully or partly) outside the regular banking system, or non-bank credit intermediation in short"[4]. Those entities and activities have been continuously increasing their importance in the whole financial system since 2010, as showed in the last *Global Shadow Banking Monitoring Report*[5]. For the first time, the report classifies shadow banking activities by their economical functions, indicating the need for a comprehensive analysis of their inherent risks.

The strategy to 'illuminate' the shadow banking sector has two pillars: monitoring non-bank activities and entities to track developments outside the banking system and fostering their oversight and regulation. The final goal is achieving a global, consistent and harmonised regulatory framework for building safer and more sustainable sources of non-bank financing for the real economy, while minimising its sources of systemic risk. In that vein, macro-prudential supervision policies must cover also non-bank entities and activities, to promote a single level playing field for all the actors in the financial system. It has to be based on genuine competitive advantages to avoid regulatory arbitrage and activity shifting towards the less-regulated activities that might have unfair benefits. All in all, alternative sources of financing are welcome but have to be under the same scrutiny as the banking sector.

On the one hand, shadow banking has some advantages: it contributes to liquidity generation and market making activity, which are two essential elements for the proper functioning of financial markets. It also contributes to risk diversification (because it allows risk transference from the banking industry to other areas of the financial system), and it is a complement to the bank lending in financial intermediation. Furthermore, shadow banking simplifies the loss absorbency process because in case of default of a non-bank entity investors are the ones who have to absorb the losses. It also allows cost-reduction due to lower intermediation and more competition.

On the other hand, it has significant disadvantages: shadow banking could lead to significant systemic risk if it is not properly regulated and supervised as the last crisis might suggest. It generates uncertainty because, in global terms, it is opaque and there is still some lack of information. Moreover, it reduces market discipline and promotes regulatory arbitrage. Finally, it can increase hidden leverage, maturity transformation and pro-cyclicality due to short-term wholesale funding dependence.

There are four main levers in the implementation of the shadow banking reform that have progressed unequally: i) assessing and mitigating risks from the interaction between banks and non-bank **and among non-banks** (more analysis and a deeper understanding is required); ii) decreasing money market funds' run risk (the implementation of policies is on track); iii) improving transparency and aligning incentives in securitisation (the implementation is uneven), and iv) diminishing procyclicality and other financial stability risks in securities financing transactions (the *global regulatory framework* is already released).

4: FSB. Transforming Shadow Banking into Resilient Market-based Finance. An Overview of Progress. 12 November 2015.
5: 12 November 2015.

6 Micro- and macro-prudential supervision

The perfect duo

Even the best of regulations would have not been efficient without adequate and effective supervision in place. Until the crisis, banking supervision has been primarily focused on the individual situation of each entity without paying due attention to risks accumulated at an aggregate level of the system. The global financial crisis showed that most of the time, banking supervisors lacked an overall picture of the whole financial system. Currently both the micro and the macro prudential supervision have been reinforced.

Micro-prudential supervision

In recent years, there have been several international initiatives worth commenting on related to the need to improve supervisory practices. For instance, the Financial Stability Board (FSB) explored the tools and methods that are used by supervisors with a particular focus on systemically important financial institutions (SIFIs). In the same vein, the Basel Committee in 2012 reviewed the Core Principles of Banking Supervision originally launched in 1997. In this regard, the launch of the Single Supervisory Mechanism (SSM) was also built on these practices, adopting the EBA supervisory methodology. Even if there is still some room for improvement, current supervisory practices are stronger than those identified in 2008. Among others there is: i) a more fluent dialogue between board members and supervisors; ii) more focus on risk governance including the assessment of the risk appetite framework and risk culture of financial institutions; iii) proportionality in the sense that bigger financial institutions will be subject to higher requirements and more intensive supervision; iv) importance of the assessment of business models as a cornerstone of supervision; v) robust stress testing and stronger resolution planning; and vi) more focus on the quality of supervision.

In a nutshell, more intense and effective supervision represents a core element of the supervisory agenda and it is required to promote best practices among supervisors and ease the identification of risks before they represent a serious problem for financial institutions and for the financial system as a whole.

Macro-prudential policy

In response to the global financial crisis, many countries have developed strong frameworks for macro-prudential supervision following the commitment made by the G20 at their meeting in Seoul in 2010[6]. This supervision should be understood as the policy aimed at identifying and mitigating financial vulnerabilities and bubbles in the whole financial system as the perfect complement to micro-prudential supervision (focused on the prudential situation of individual entities). Over the past few years, the efforts have been devoted to settle the governance and procedures for an enhanced policy with the creation of specific Boards. The ultimate goal is putting in place explicit frameworks to ensure financial stability in the system and pre-empt systemic risk or mitigate the potential subdued effects. It is an increasingly important issue which will still receive much attention during 2016, mainly in the field of the practical experience. The challenges ahead are to gather more knowledge about modeling the financial cycle, to better calibrate tools, to deepen the research made on the spill-over effects between different economic policies (specifically with monetary and fiscal policy) so as to have a clearer idea of the effectiveness of the different tools. It is a rather a new art and authorities are learning as they go along in this field.

The macro-prudential supervision must cover the whole financial system. In that vein, it should be progressively extended to the shadow banking system which operates under a less regulated landscape as new vulnerabilities might be emerging in this sector. In short, both types of supervision, micro and macro, are needed and should be complementary to each other.

6: G20 Leaders concluded that further work on macroprudential frameworks was a priority. Source: *FSB; Macroprudential policy tools and frameworks. Update to G20 Finance Ministers and Central Bank Governors. 14 February 2011*. Link

7 Ethics, culture & governance: *the importance of being earnest*

The essentials for restoring trust and reputation

Ethics, culture and governance are the pillars of a resilient banking industry in the current paradigm. Evolving from ethical declaration into action is essential and has to be achieved through a solid culture along with robust governance encompassing the entire organisation. This self-regulation of banks has to be backed up by external regulation and supervision, deterring agents from engaging in undue practices via enforcement actions and sanctions as required. The final goal is an efficient, open and dependable financial system acting as a catalyst for bolstering the banks' role of enhancing the welfare of society.

Banking conduct and culture is becoming increasingly important in the current challenging environment for the financial industry. It must recover its credibility, which was undermined as a consequence of both malpractices in the private sector and regulatory and supervisory failures. Re-establishing confidence in the banking sector constitutes a strategic opportunity and is going to be a significant competitive advantage in the long-term. An ethical banking model is an investment in clients' confidence that allows higher returns adjusted to principles. **Principles of integrity, transparency and prudence** combined with strict compliance turn into value-added for all the stakeholders in the medium and long term, contributing to raising the aforementioned returns adjusted to principles, a leading variable in the challenging environment the financial industry has to cope with at present.

In addition to these three principles, there are two other issues worth noting that entities must focus on if they want to attain a solid a durable banking culture: people and cooperation. Banks play an essential role in society, and as such they have the duty of acting as an example to the rest of the community. Cooperation and coordination, together with a clear communication of their commitments, help people to a better understanding of the risks they are taking and to better form their expectations.

Among the most remarkable challenges identified by the industry in implementing the cultural and behavioural changes, according to the progress report on *Measures to reduce misconduct risk* released by the Financial Stability Board on November 2015, are: i) the integration of appropriate behaviour and ethics in business decisions; ii) the achievement of consistency between messages and facts; and iii) the achievement of a homogeneous taxonomy for conduct risk for the whole industry.

The self-regulation of the banking industry has to be underpinned by financial regulation and supervision. *Belt and braces are needed*[7] because all companies make mistakes and it is difficult to provide advice from the inside. Therefore, an efficient supervision and a robust regulation, with the empowerment to enforce and to apply sanctions that are a credible deterrent[8], will contribute to make individuals and entities accountable and to avoid misconduct, also helping to restore public confidence in the banking industry.

In conclusion, being earnest is going to be what makes the difference for the banking industry in the present challenging post-crisis environment because malpractices and inappropriate behaviour are no longer tolerated. Last but not least, it must be heavily emphasised that an ethical banking model does not reduce profitability and that being profitable does not mean doing business at any price.

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7 Mark Carney. *Some current issues in financial reform*. Remarks by Mr Mark Carney, Governor of the Bank of Canada and Chairman of the Financial Stability Board, to the Canadian Club of Montréal, Montréal, Quebec, 8 November 2012.
8 There are seven key elements to consider: legal certainty; co-operation and collaboration to eliminate safe havens; investigation and prosecution of misconduct; sanctions; public understanding, transparency and caution and good regulatory governance. Source: IOSCO. *Credible Deterrence in the Enforcement of Securities Regulation*; 2015.

8 Digital Regulation

The EU agenda will stand out amid little international initiatives in 2016

Despite its global implications, the digital transformation of financial services is mostly regulated at the national level, and there has been little international coordination so far. In this context, the European Union agenda stands out, with several initiatives expected this year.

Given the inherently cross-border nature of the digital ecosystem, there should be a coordinated international response to the regulatory challenges posed by cybersecurity, the use and transfer of personal data, the applications of the blockchain technology, etc. However, regulations often take place at the national level and there has been little coordination at international bodies so far. For instance, the **Bank for International Settlements (BIS)** has only released some initial reflections on the possible implications of digital currencies for central banks. Regarding **cybersecurity**, obviously a global and interconnected problem, international coordination has mostly focused so far on increasing the use of standards such as NIST, ISO 27001 and COBIT.

Amid little international initiatives, the European Union's regulatory agenda will stand out in 2016. The European Commission is working on several initiatives to make best use of new technology to strengthen the Single Market. As digital technologies facilitate transactions between geographically dispersed agents, they are a powerful tool to overcome the existing EU market fragmentation in different economic sectors. Yet regulatory and administrative obstacles still limit cross-border transactions, fragmenting the internal market.

In May 2015, the Commission launched the **Digital Single Market (DSM) strategy**, aiming to remove the technical and legal barriers that prevent the European Union from constituting a single market for digital activities. As well as scaling up the market where digital business operates, the DSM strategy aims to address competition concerns – arising from the entrance of new market players and the role of online platforms and intermediaries – and to reinforce trust and security in digital services.

Despite the broad name of the strategy, most of its 16 initiatives target just a few sectors: e-commerce, the content and audiovisual industries and the telecoms sector. The EC is carrying out public consultations to gather views from all stakeholders before turning the DSM initiatives into concrete legislative and non-legislative proposals before the end of 2016. Along with more sector-specific initiatives, the Commission plans to establish a contractual public-private partnership on cybersecurity, to tackle restrictions on the free flow of data within the European Union and to launch a European Cloud initiative covering the certification of cloud services and the switching between providers. These initiatives will complete the Network and Information Security (NIS) Directive and the General Data Protection Regulation (GDPR), the formal adoption of which will take place in early 2016.

Regarding the financial sector, the EC launched in December a **Green Paper on retail financial services**, aimed at overcoming the existing market fragmentation across countries. To that end, the EC states that digital channels offer a great opportunity to foster cross-border activity without requiring banks to physically establish in other member states. Making the best use of new technology is therefore highlighted by the EC as one of the ways to address the specific barriers that consumers and firms face in making full use of the Single Market for retail financial services. For instance, cross-border e-identification is one of the areas where the EC sees considerable potential for improvement. As a first step in the roadmap for the Green Paper, the Commission will gather views from all relevant stakeholders in a public consultation open until 18 March 2016. Then, taking account of the identified barriers to cross-border activity and the proposed solutions, the Commission envisages releasing an Action Plan around the summer of 2016. Specific legislative and non-legislative measures to strengthen the Single Market for retail financial services are expected in the following years.

9 Regulatory impact analysis: a compelling need

The regulatory tsunami

Since the start of the financial crisis, authorities have created a 'regulatory tsunami' in response to financial turbulences. National, European and global economies have introduced a plethora of uncoordinated measures to cover diverse aspects of banking activities with two main objectives: making the next crisis less likely (strengthening banking solvency) and mitigating its potential consequences (moderating systemic risk, minimising the cost to the taxpayer and improving banks' resolvability).

Most of new regulatory pieces can be classified in seven broad categories: capital requirements, leverage ratio, liquidity rules, reform of banking structures (ring-fencing), resolution and clearing of over-the-counter derivatives (such as EMIR in Europe). Some of these rules have had unintended consequences.

Analysing the total implications of all these new regulations is difficult for a variety of reasons. First, the regulatory reform is not complete, as new rules in aspects as diverse as Basel IV, the treatment of sovereign debt holdings for capital purposes, shadow banking or macro-prudential policies are still to be published. Second, different regulations can have opposite effects on the same banking activity. For example, retail banking assets are fostered by capital regulation as they usually carry a low risk weight, while liquidity regulation penalises them as they are not considered high-quality liquid assets. Third, we are still in a transition period of the regulatory reform, when new rules have to be implemented. Therefore, assessing the long-term benefits of new regulation is a complicated exercise.

In fact, most assessments that have been published focus on partial aspects of new regulation, but fail to estimate an overall impact. This is the case of studies that focus on the impact of higher capital requirements on credit granting. Besides, most of the existing studies provide a qualitative impact assessment, but not a quantitative estimate.

In any case, estimating the global impact of new regulation is a compelling need, as new rules can have a critical influence in aspects as important as the banking models, the geographical scope of entities, average banking size and banks' performance or profitability. Besides, the impact of regulation on banks will have repercussions in other sectors, such as new non-bank players willing to access banking activities, and on the pace of economic recovery.

The proliferation of regulation is not a new phenomenon, as something similar has occurred after all financial crises. In fact, regulation follows the pattern of a pendulum, swinging from efficiency to stability. When turbulence arises, authorities focus on stability, making regulation stricter. In that phase, attention should be paid to avoiding ring-fencing, regulatory arbitrage (and the proliferation of shadow banking) or a delay in the economic recovery. When the situation improves, the focus goes back to efficiency and regulation gets laxer. There is room there for profitability, innovation and financial inclusion. In the long term, we should find an equilibrium midway between these two extremes, as only an efficient financial system can be stable.

In order to find that equilibrium, we should first know where we are. And that is why an overall assessment of the impact of new regulation on banks is so crucial. We are entering a new post-crisis phase in which regulation should foster growth and support the on-going recovery.

10 European regulatory priorities for 2016

From global to local: 10 hot topics for the New Year

The regulatory priorities of the EU institutions for 2016 reflect Europe's new motto of promoting investment, growth and a deeper Single Market. Many resources will also be devoted to finalising key open initiatives and to setting in motion the institutional architecture built up in response to the crisis. We highlight the key issues that will mainly influence the EU's agenda during 2016.

1. **Building a Capital Markets Union,** Europe's new flagship project to create deeper, broader and more integrated capital markets in the EU. Although the project is very broad and essentially long-term, the Commission has identified some immediate priorities for 2016, including revitalising securitisations, deciding on a European framework for covered bonds and analysing the cumulative impact of financial regulation.
2. **Delivering a single market for retail financial services** to address the persistently high level of fragmentation in these markets. During 2016, the Commission will focus on identifying the main barriers and setting a roadmap, and with that aim it has recently published a Green Paper. Also, it is exploring how to take advantage of the benefits of digitalisation while ensuring consumer protection and a level playing field.
3. **Completing the banking union.** In 2015 the Commission tabled a proposal to build a European Deposit Insurance Scheme (EDIS), indispensable to complete the banking union. Considerable work on the technical details, as well as an intense political debate, are sure to follow during 2016. Furthermore, EU institutions will start working on the design of a common fiscal backstop for the SRF in 2016.
4. **Agreement on a Financial Transaction Tax (FTT) under enhanced cooperation in 10 Member States.** In December, they agreed on the scope of the tax in shares and derivatives, although key decisions remain open (tax rates and use of the revenues). Member States are committed to strike a final deal by June 2016.
5. **Bank Structural Reform.** Only the Council had reached an internal agreement so far while the Parliament is still drafting its position, which would allow trilogues to begin in 2016. During 2016 the debate will likely focus on the scope, metrics and use of supervisory discretion, but the final design of the Regulation is still uncertain.
6. **The Single Resolution Board to assume full responsibilities in 2016.** This year it will focus on developing recovery plans, elaborating resolution guides and fostering cooperation within Europe and abroad. It will also face the challenge of operationalising the Single Resolution Fund, setting up internal resolution teams and guaranteeing a consistent implementation of the MREL.
7. **The SSM will continue working to ensure a fully harmonised banking supervision for the euro area**. A priority for 2016 will be reaching an agreement on a common framework for options and national discretions. Other day-to-day priorities of the SSM include: business models and profitability, comparability and quality of internal models, persistent high levels of non-performing exposures, and banks' governance arrangements.
8. **ESAs' priorities for 2016 include consumer protection and the analysis of cross-sectorial risks.** On top of that, EBA will work on completing and ensuring the correct implementation of the CRR/CRD IV and BRRD frameworks, as well as on assisting the Commission in areas such as securitisations, covered bonds or the bank structural reform. Finally, EBA will initiate and coordinate the 2016 EU-wide stress test.
9. **Delivering a Digital Single Market.** During 2016, the Commission will present 16 concrete legislative proposals. Also, significant efforts will be devoted to implement and further develop the new framework on payments. Finally the EU institutions aim to reach a deal on data protection rules during 2016.
10. **The Commission and the EBA will work on assessing the equivalence of third-countries' regulatory regimes.** Under CRR/CRD IV rules, exposures located in third-country regimes deemed equivalent can enjoy preferential treatment. This is regarded as a long-term project, although the process should be speed up.

Main regulatory actions around the world over the last month

	Recent issues	Upcoming issues
GLOBAL	On **18 Nov FSB** published standards and processes for securities financing transactions (SFTs) to achieve timely risk detection On **24 Nov CPMI/IOSCO** published a consultation on cyber resilience for market infrastructures On **25 Nov IAIS** published a consultation on changes to the 2013 methodology for identifying global systemically important insurers (G-SIIs) On **30 Nov CPMI/IOSCO** published a report on implementation of the Responsibilities for authorities On **02 Dec IAIS** adopted revision to the Insurance Core Principles regarding supervision, corporate governance and risk management On **4 Dec FSB** established Task Force on Climate-related Financial Disclosures (TCFD) On **6 Dec BIS** published its quarterly review focussing on the calm as we await lift-off of the policy rate in USA and calibration of leverage ratio On **7 Dec FSB** published a report on implementation of the Enhanced Disclosure Task Force (EDTF) Principles and Recommendations On **7 Dec FSB** published a report on the impact of expected credit loss approaches On **7 Dec FSB** published a statement by EDTF on the disclosure of emergency liquidity assistance On **10 Dec BCBS** published second consultation on the standardised approach for credit risk that reintroduces the use of external ratings for banks and corporates On **17 Dec CPMI/IOSCO** published a consultation on harmonisation of the Unique Product Identifier (UPI) to facilitate OTC derivative identification On **17 Dec BCBS** published a consultation on identification and measurement of step-in-risk to mitigate potential spill-over effects from the shadow banking to banks On **18 Dec BCBS** published a report on progress in adopting the principles for data aggregation and risk reporting On **18 Dec BIS** issued guidance on credit risk and accounting for expected credit losses	In **Sep** 2016 China will host the **G20** Leaders **summit** in Hangzhou
EUROPE	On **26 Nov Council** published a document setting out the state of play on the proposal for financial transaction tax (FTT) On **02 Dec EC** adopted a third group of three Solvency II Implementing Technical Standards On **02 Dec Council** agreed its stance on proposals to facilitate the development of a securitisation market, as part of capital markets union On **08 Dec Council** published a statement on Banking Union and bridge financing arrangements for the Single Resolution Fund On **08 Dec Council** adopted transparency rules on cross-border tax rulings On **08 Dec EBA** published a comparative report on the approaches on scenarios in recovery plans On **09 Dec EC** reports EP and Council on capital requirement for covered bonds under CRR On **09 Dec Council** confirmed agreement with EP on tougher rules of market benchmarks On **10 Dec EC** launched a consultation on retail financial services On **11 Dec EBA** published a consultation on draft Guidelines on ICAAP and ILAAP information collected for SREP purposes On **11 Dec ESMA** published Implementing Technical Standards (ITS) on reporting, cooperation and suspensions under MiFID II On **14 Dec EBA** published a consultation on assessment methodology on the use of internal models for market risk On **14 Dec ESMA** published a consultation on margin period of risk for CCPs' client accounts On **15 Dec EBA** published final Guidelines on institutions' exposures to shadow banking entities and recommends approach to limiting risks On **16 Dec ESMA** published risk dashboard for the European securities markets covering the third quarter of 2015 On **16 Dec EC** proposed to extend until 31 Dec 2020 the CRR exemption for firms that trade exclusively in commodity derivatives On **16 Dec EP** adopted a Resolution on the legal steps needed to improve corporate tax transparency, coordination and EU-wide policy converge On **16 Dec EBA** published draft Regulatory Technical Standards (RTS) on prudential requirements for Central Securities Depositories (CSDs) On **17 Dec ESMA** published final report on MiFID II Guidelines on assessment and knowledge of competence On **17 Dec EBA** published final draft RTS on the content of business reorganisation plans under the BRRD	In **Oct 2016 EBA** will published reports on implementation of the MREL In **2016 the EC** will present concrete legislative proposals on Digital Single Market In **2016 EU institutions** will start working on the design of a common fiscal backstop for the SRF In **2016 the EC** will bring forward a legislative proposal on TLAC **Member States** are committed to strike a final deal on FTT by **June 2016**

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Main regulatory actions around the world over the last month (cont.)

	Recent issues	Upcoming issues
EUROPE	On **17 Dec EBA** published a report on impact assessment and calibration of the Net Stable funding Ratio (NSFR) and recommending the introduction of the NSFR On **18 Dec EBA** published an opinion on the application of restrictions on profit pay-outs to restore capital adequacy On **18 Dec EBA** published a consultation on draft Guidelines on stress testing On **18 Dec EBA** advises the EC to bring in eligibility criteria that take into account the specificities of synthetic securitisation for SMEs On **21 Dec EBA** published its eighth semi-annual report on risks and vulnerabilities in the EU banking sector	
MEXICO	On **16 Dec the National Banking and Securities Commission (CNBV)** adjusted its provisioning rules for revolving consumer credit (including credit cards)	The **CNBV** is expected to issue its implementation of the D-SIB regime in time for the 2016 international entry date; likewise, it will set its leverage ratio rules (which would be enforceable in 2018, but disclosed by banks during 2016)
LATAM	On **17 Dec in Argentina the Central Bank** freed all restrictions on new flows of exports and imports of goods and services as well as capital movements and unified the FX market In **Dec in Colombia the Ministry of Finance (MoF)** published a decree that makes some modifications to the instruments used for the technical equity computation In **Dec in Colombia Financial Superintendence** published a draft of a decree that will establish the local stress test regulation for financial institutions	**Colombia's Ministry of Finance** is working on two studies that evaluate the implementation of Basel III's capital buffers in Colombia and the composition of regulatory capital and solvency requirement for pension funds, stockbrokers, fiduciary and insurance companies. Publication expected during 4Q15 **Colombian Congress** is studying a legislative reform that forbids charges for ATM withdrawals for accounts with average monthly transactions lower than three minimum monthly wages
USA	On **6 Nov Agencies** issued guidelines on investments in covered funds to clarify the interaction between capital rules and the Volcker and avoid overlapping Tier 1 capital deductions On **12 Nov Fed** announced the annual indexing of reserve requirements of depository institutions On **18 Nov SEC** proposed rules to enhance transparency and oversight of Alternative Trading Systems (ATSs) On **24 Nov Fed** proposed rule on disclosure by large institutions of several measures that relate to their Liquidity Coverage Ratio (LCR) and high-quality liquid assets (HQLA) On **24 Nov Fed** announced minimum standards for improving the oversight of large and complex banking organizations On **24 Nov CFTC** approved proposed rule on automated trading to enhance risk controls and transparency measures On **25 Nov Fed** approved final rules to modify its capital plan and stress testing rules On **30 Nov Fed** approved final rule on emergency lending that broadens the definition of insolvency to improve eligibility of the right entities On **4 Dec Fed** announced final rule on how to apply the Board's revised capital framework to depository institution holding companies that are not organised as traditional stock corporations	Regulators are working to **complete some of the pending reforms outlined by the Dodd-Frank Act** before the next administration takes office (2017) The **Consumer Financial Protection Bureau** expects to issue final rules on **consumer protection for prepaid cards** in the spring of 2016 and on mortgage servicing by mid-2016 The **SEC** will publish a notice of proposed rule-making for **fiduciary standard** in October 2016
TURKEY	In **Dec CBRT** raised the remuneration rate of the USD-denominated required reserves, reserve options and free reserves held at the Bank from 0.24% to 0.49%	**Central Bank of Turkey** stated that Financial Stability Committee will study regulations in CAR so as to prevent the negative impacts on banks of the new regulation and to conserve FX liquidity reserves
ASIA	On **11 Dec PBOC** indicated that the RMB will be loosely pegged to a basket of 13 currencies On **17 Dec Reserve Bank of India** decided to adopt the marginal cost of funds methodology to calculate interest rates on advances, replacing the current methodology based on average costs of funds On **18 Dec China Securities Regulatory Commission** signed a cooperation memo with Hong Kong Securities and Futures Commission to launch a programme of mutual recognition of mutual funds between mainland China and Hong Kong On **19 Dec China Securities Regulatory Commission** announced the approval of the "stock issuance registration system" reform by the State Council	**China's central bank (PBOC)** will introduce a new system to assess macro-prudential risks in the financial system in 2016

Source: BBVA Research

Abbreviations

AIFMD	Alternative Investment Fund Managers Directive	**G-SIB**	Global Systemically Important Bank
AQR	Asset Quality Review	**G-SIFI**	Global Systemically Important Financial Institution
BCBS	Basel Committee on Banking Supervision	**IAIS**	International Association of Insurance Supervisors
BIS	Bank for International Settlements	**IASB**	International Accounting Standards Board
BoE	Bank of England	**IHC**	Intermediate Holding Company
BoS	Bank of Spain	**IIF**	Institute of International Finance
BRRD	Bank Recovery and Resolution Directive	**IMF**	International Monetary Fund
CCAR	Comprehensive Capital Analysis and Review	**IOSCO**	International Organization of Securities Commissions
CCP	Central Counterparty	**ISDA**	International Swaps and Derivatives Association
CET	Common Equity Tier	**ITS**	Implementing Technical Standard
CFTC	Commodity Futures Trading Commission	**Joint Forum**	International group bringing together IOSCO, BCBS and IAIS
AMC	Company for the Management of Assets proceeding from Restructuring of the Banking System (Bad bank)	**LCR**	Liquidity Coverage Ratio
CNMV	Comisión Nacional de Mercados de Valores (Spanish Securities and Exchange Commission)	**LEI**	Legal Entity Identifier
COREPER	Committee of Permanent Representatives to the Council of the European Union	**MAD**	Market Abuse Directive
CPSS	Committee on Payment and Settlement Systems	**MiFID**	Markets in Financial Instruments Directive
CRA	Credit Rating Agency	**MiFIR**	Markets in Financial Instruments Regulation
CRD IV	Capital Requirements Directive IV	**MMFs**	Money Market Funds
CRR	Capital Requirements Regulation	**MoU**	Memorandum of Understanding
CSD	Central Securities Depository	**MPE**	Multiple Point of Entry
DGSD	Deposit Guarantee Schemes Directive	**MREL**	Minimum Requirement on Eligible Liabilities and own Funds
DFA	The Dodd–Frank Wall Street Reform and Consumer Protection Act	**MS**	Member States
EBA	European Bank Authority	**NRAs**	National Resolution Authorities
EC	European Commission	**NSAs**	National Supervision Authorities
ECB	European Central Bank	**NSFR**	Net Stable Funding Ratio
ECOFIN	Economic and Financial Affairs Council	**OJEU**	Official Journal of the European Union
ECON	Economic and Monetary Affairs Committee of the European Parliament	**OTC**	Over-The-Counter (Derivatives)
EDIS	European Deposit Insurance Scheme	**PRA**	Prudential Regulation Authority
EIOPA	European Insurance and Occupational Pensions Authority	**QIS**	Quantitative Impact Study
EMIR	European Market Infrastructure Regulation	**RRPs**	Recovery and Resolution Plans
EP	European Parliament	**RTS**	Regulatory Technical Standards
ESA	European Supervisory Authority	**SCAP**	Supervisory Capital Assessment Program
ESFS	European System of Financial Supervisors	**SEC**	Securities and Exchange Commission
ESM	European Stability Mechanism	**SIB (G-SIB, D-SIB)**	Global-Systemically Important Bank, Domestic-Systemically Important Bank
ESMA	European Securities and Markets Authority	**SIFI (G-SIFI, D-SIFI)**	Global-Systemically Important Financial Institution, Domestic-Systemically Financial Institution
ESRB	European Systemic Risk Board	**SII (G-SII, D-SII)**	Systemically Important Insurance
EU	European Union	**SPE**	Single Point of Entry
EZ	Eurozone	**SRB**	Single Resolution Board
FASB	Financial Accounting Standards Board	**SREP**	Supervisory Review and Evaluation Process
FBO	Foreign Bank Organisations	**SRF**	Single Resolution Fund
FCA	Financial Conduct Authority	**SRM**	Single Resolution Mechanism
FDIC	Federal Deposit Insurance Corporation	**SSM**	Single Supervisory Mechanism
Fed	Federal Reserve	**TLAC**	Total Loss Absorbing Capacity
FPC	Financial Policy Committee	**UCITS**	Undertakings for Collective Investment in Transferrable Securities Directive
FROB	Spanish Fund for Orderly Bank Restructuring		
FSAP	Financial Sector Assessment Program		
FSB	Financial Stability Board		
FTT	Financial Transactions Tax		

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