

The logo features the letters 'GLC' in a bold, black, serif font. A thick, light blue swoosh curves across the letters, starting under the 'G', passing through the 'L', and ending under the 'C'.

GLC

CAPITAL, COMPLIANCE &
COMPETITIVE EDGE (REGULATORY
CHANGE MANAGEMENT)

CATHERINE KEANE

KEY POINTS

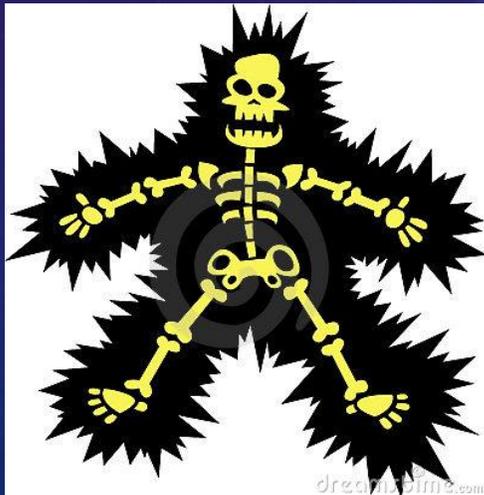
- Setting the context
- Update on where we are with Basel reforms
- Expectations on general thrust of Regulatory Focus – per S&P
- 2025 Changes to Internal Models Rules
- Implications
- Conclusions

REGULATORY BACKDROP - 2017/18 - AFTERMATH OF GFC

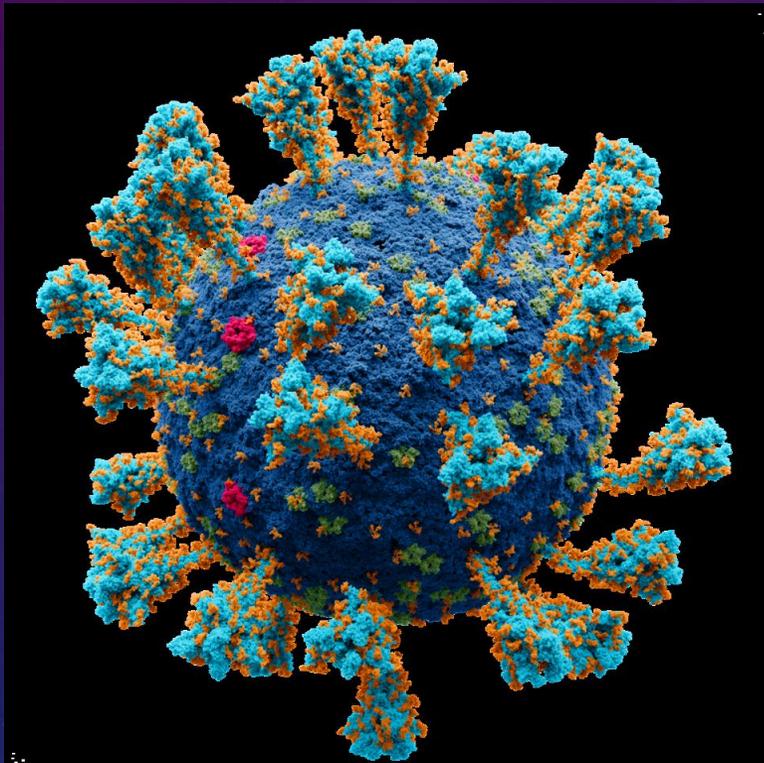
- Banks were struggling with ongoing changes in regulation
 - IFRS 9
 - Basel 3 - 4
 - EMIR/MIFID
 - TRIM
 - Ana Credit



INDUSTRY RESPONSE?



COVID 2020-2022



SURVIVAL → NORMALITY

- All of us struggled through COVID
- Huge shift to remote working
- Regulator recognised the challenges many banks had
- Extended deadlines for implementation of a number of regulatory matters
- Now - Business As Usual!

S&P ARTICLE – KEY THEMES FOR BANKING RISK

- Global regulatory priorities will shift from tightening regulations to improved supervision.
- Regulators in advanced economies are likely to adjust their focus towards increasing supervision of nonbank financial institutions



PRIORITISING GROWTH

Regulators starting to prioritize growth over financial stability-marginally

- slower deployment of macroprudential measures like countercyclical capital buffers,
- higher loan to value ratios and
- lower risk weights for priority sectors, particularly within emerging European banking sectors.



CAPITAL – BASEL 1V – CRR3

Basel 1V Implemented in EU from January 2025 via CRR3

Responding to increasing levels of variability in banks calculation of RWA

Aim is to restore credibility

- Changes to AIRB – no longer permitted to use AIRB for large corporates with T/O >€500m
- Additional restrictions on internally modelled parameters for Credit Risk
- Introduction of Output Floors – RWA calc. by Internal Models cannot be less than 72.5% of standardised RWA
- Floor will be phased in from 50% in 2025 to 72.5% by 2030 – plus some transitional arrangements until 2032

IMPACTS

Maximum benefit of internal models is 27.5% of RWA – will impact banks who invested very heavily in internal models

Globally expected impact on bank capital will be quite limited – some European Banks will be impacted more

Return on capital in the banking sector estimated to have decreased by 1/3 since GFC

May impact large Corporates with T/O > €500m – lending may become more expensive

JULY 25

UPDATES TO THE ECB'S GUIDE TO INTERNAL MODELS

Key Sentence

As clarified in Preambles 25 and 34 of the CRR, an institution that adopted the IRB approach for one exposure class is no longer required to adopt that approach for all of its non-trading book exposures



WHY IS IT IMPORTANT?

Cost of maintaining models for some asset classes exceeded any capital benefits

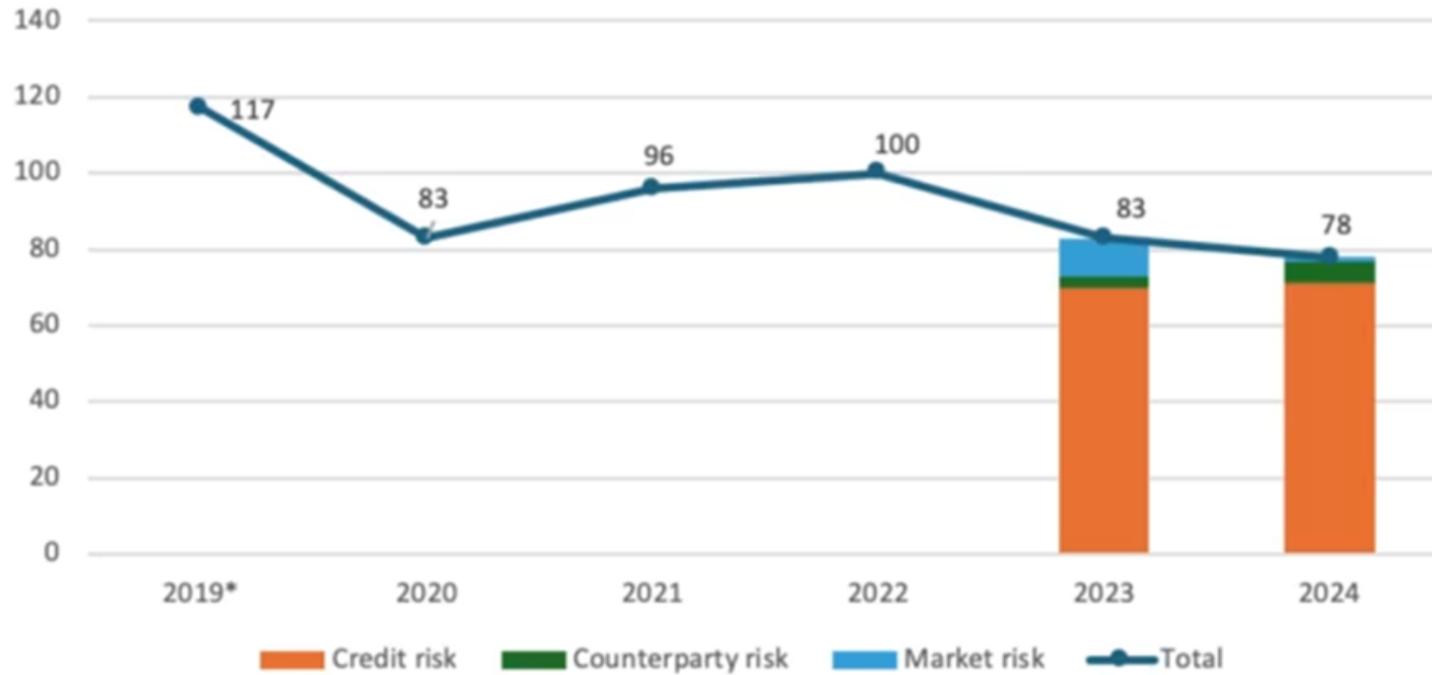
Requirements to obtain approvals for change made it difficult to adapt models to changing environments

- In principle should reduce compliance costs



ECB HAS LIMITED CAPACITY TO REVIEW MODELS

Number of internal model investigations launched per year



Source: ECB Annual Report on Supervisory Activities

* 2019 also had 49 on-site investigations launched as part of the Targeted Review of Internal Models, but this project is now over and its resources have been reallocated.

- About 100 per year
- 5% instigated by ECB
- Rest by banks
 - New Model Approval
 - Extension of model to a new asset class
 - Material change

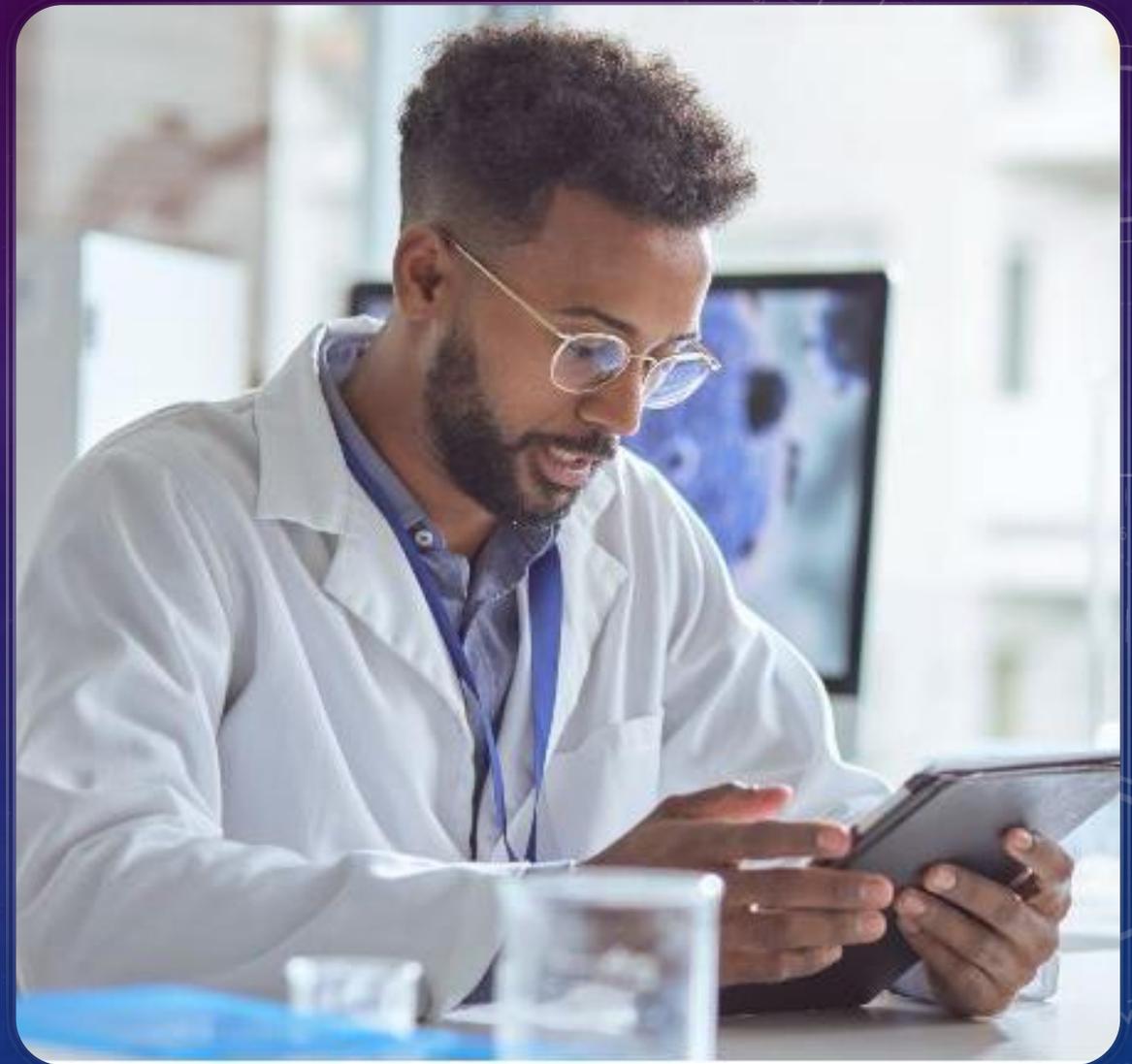
WHAT CONSTITUTES A MATERIAL CHANGE?

- Aware from personal experience how difficult it is to get any change to a model!
- Can be a very inflexible process
- Rules are set by the EBA – feeling that they can be risk averse
- Result is that banks may not be able to respond quickly to market changes
- Some suggestions that the ECB has been lobbying to try and get more flexibility on the rules
- Ability to revert to standardised for some asset classes can be very appealing!
- Also note that permission is required to change from IRB back to standardised for each asset class



PRACTICAL CONSIDERATIONS

- Nothing to prevent banks continuing to use models for internal pricing and risk management purposes – but not for capital calculation
- IRB Models in many banks are now used as basis for IFRS 9 ECL modelling
- Questions around how this would be managed internally in banks to ensure good risk management and modelling practices are maintained.



CONCLUSIONS

- Following multiple years of major regulatory changes things are beginning to settle down
- Regulatory focus likely to be more on increased supervision rather than significant change
- Changes to internal model rules present an opportunity for banks to reduce compliance costs – but there may be practical considerations

