BANCO DE ESPAÑA
Eurosistema

Communication Department

PRESS RELEASE

Madrid, 23 May 2019

Financial Stability Review. Spring 2019

As from this edition, the two annual issues of the *Financial Stability Review* will be called Spring and Autumn as opposed to May and November, respectively. The issue 36, published today on the Banco de España website (www.bde.es), contains the following articles:

"The Single Banking Resolution Mechanism", by Antonio Carrascosa

The European authority for banking resolution is the Single Resolution Board (SRB), in collaboration with the national resolution authorities. The resolution of a bank involves its restructuring by this Board, through a series of instruments aimed at ensuring the continuity of the institution's critical functions and financial stability in the Member States involved. This article describes the basic characteristics of the Single Banking Resolution Mechanism: its mission, governance, organisation and the basic elements of a resolution plan. It also explains the setting of a minimum level of eligible liabilities (MREL) and describes the functioning of the Single Resolution Fund. Lastly, the author summarises the SRB's activity since it was established in 2015, and the ongoing legislative reforms under the European resolution framework are set out.

"The FROB in the restructuring of the Spanish banking system. Where it stands after a decade of activity (2009-2019) and considerations for the banking union", by Jaime Ponce Huerta

The chairman of the FROB summarises chronologically the 10 years of activity of the institution, within the context in which the body has developed, and the action involved in Spanish bank restructuring. It also explains the institution's mandate and functions, along with the tools used in the period. Drawing on the FROB's experience, some considerations on the bank resolution environment are presented which may be useful for strengthening the banking union and the current resolution framework. Nearly ten years down the road from the initial outbreak of the financial crisis and from the creation of the FROB, the author acknowledges that, in retrospect, an enormous amount of work has been done to stabilise and resize the Spanish banking sector and boost its resilience to crises.

"Resolution planning for credit institutions in Spain and in the euro area", by Miguel Kruse and Iván Fernández

This article presents the planning process for the resolution of Spanish credit institutions. In particular, it sets out the content of the resolution plans prepared by the Banco de España since 2015, in its capacity as the national preventive resolution authority. Resolution planning does not seek to anticipate when and how future bank crises will arise, nor to estimate the probability of a crisis at specific financial institutions. The main aim of such planning is to have action plans in place for immediate and coordinated action if the time comes for a bank's obligatory resolution. In that way, the adverse effects on financial and economic stability are minimised. The authors explain the key components of resolution plans, the strategies, the tools and the most appropriate measures for eliminating and minimising the problems which may occur during a bank resolution.

"Central counterparties: benefits, costs and risks", by Soledad Núñez and Eva Valdeolivas

This article analyses the functions of a central counterparty (CCP), its risks and the tools available for facing losses. These entities have assumed a key role, particularly since the G-20 required standardised OTC derivatives to be cleared centrally in order to reduce counterparty risk and the systemic risk associated with these markets. However, CCPs could disrupt financial stability due to risk concentration, potential loss mutualisation in the event of one or more members defaulting and the high interdependencies with the rest of the financial system. The Financial Stability Board (FSB), the European Commission and other international institutions are working on initiatives to strengthen their soundness and their capacity for recovery and resolution in the event of crisis.

***"Presentation of the High-level Conference on The new bank provisioning standards: implementation challenges and financial stability implications"*, by Rafael Repullo, Fernando Restoy and Jesús Saurina**

The conference on the new requirements for calculating provisions, jointly organised by the Banco de España, the Centro de Estudios Monetarios y Financieros (CEMFI) and the Financial Stability Institute of the Bank for International Settlements (BIS), was held at the Banco de España's headquarters in Madrid on 18-19 October 2018. It was opened by Pablo Hernández de Cos, Governor of the Banco de España, and the keynote speaker was Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA). It was divided into five sessions and the participants were leading international figures from academia, the banking industry, and accounting, auditing and supervisory institutions. This issue of the *Financial Stability Review* contains two contributions from the conference by Claudio Borio (BIS) and Juan Carlos García Céspedes (BBVA), along with the perspective offered by Jorge Pallarés Sanchidrián and Carlos José Rodríguez García (Banco de España).

"New loan provisioning standards and pro-cyclicality", by Claudio Borio

The adoption of the new expected credit loss provisioning standard (IFRS 9) is a landmark with implications for financial stability. The author thinks that the new standard is likely to mitigate the pro-cyclicality of the financial system to some extent relative to the previous, incurred loss model. However, it falls short of what one would like from a financial stability perspective. This points to broader inevitable tensions between accounting and prudential regulation, and calls for the active use of backstops (or so-called prudential filters) to preserve stability. According to the author, tackling the financial cycle requires a more holistic policy framework, which in addition to sound prudential standards also involves monetary and fiscal policy, and even structural policies.

"Provisioning models vs. prudential models", by Juan Carlos García Céspedes

This article discusses the interaction of and relationship between accounting and capital rules. In 2018 accounting rules adopted IFRS 9, changing the way provisions are calculated from an "incurred losses" to an "expected credit losses" paradigm (ECL). Following a broad description of provisioning and prudential models, the author analyses in greater detail how IFRS 9 affects average capital requirements and their cyclicality. The conclusion is that under current capital requirement rules and the IFRS 9 framework, both average capital requirements and their cyclicality will probably increase. If it is true that ECL is a better predictor than the previous provisions mechanism, supervisors and regulators should conclude that a review of the capital requirement framework is needed in order to include this reduction in unexpected losses in the capital requirement calculation. On the other hand, if ECL does not prove to be a better predictor for real losses than the previous provisioning methodology, accounting regulators should rethink the ECL concept.

"Unveiling the expected loss model in IFRS 9 and Circular 4/2017", by Jorge Pallarés Sanchidrián and Carlos José Rodríguez García

Following the last financial crisis, the G-20 requested that the accounting authorities change the model for estimation of credit losses (or "provisions"). The authors explain that, from a conceptual perspective, the new expected loss model may help to achieve a more accurate and timely estimation of credit losses because it requires them to be recognised from the origination of the transaction and the level of provisions to be increased when the credit quality of the transaction worsens but it has not defaulted. In response to the criticisms of the new standard alluding to its pro-cyclicality, the authors argue that an efficient accounting standard should not overly repress volatility, since this would give a false image of stability. Also, they consider that the greater subjectivity in its application allowed by the new model is a positive factor which helps users to anticipate more accurately future credit losses, not leaving room for earnings management practices.