



Trading Compliance Limited

What do I need to do about: CRD IV and the Capital Requirements Regulations?

Disallowed Capital:

From 1st January 2014, the following items will not be allowed as regulatory capital:

- Unaudited trading book profits (unless approved by your auditors).
- Deferred tax assets which rely on future profits.

Changes to some other types of Capital:

Ordinary share capital and premium, and audited reserves are unaffected. However, if you have other forms of capital such as preference shares or subordinated loans, you will need to check their validity under the new regime.

Gearing Limits:

CRD IV introduces new absolute gearing limits. In particular, your shareholders' funds must be at least 3% of your gross balance sheet BEFORE any form of netting. This is unlikely to present a problem for derivatives businesses but may impact firms active in the repos / stock borrowing and lending / deliverable foreign exchange etc. These are generally subject to netting provisions and have hitherto attracted relatively modest regulatory capital requirements.

Internal Models.

There are significant changes to the use of internal models for both market and credit risk. If you are using any form of internal model, you need to check how you will be affected.

Standard Approaches to Market Risk and Credit Risk.

The standard approaches for credit and market risk in the trading book remain largely unchanged. You should note, however, that there are changes to the list of diversified stock indices which are exempt from a specific market risk requirement. This appears to arise simply from a change in the authority responsible for maintaining the list. The regulatory capital requirement for positions in indices removed from the list may increase, although conversely the capital requirement for indices added to the list can be reduced.

Foreign Exchange Risk.

You may be able to reduce your capital requirement on certain FX exposures. The new rules provide for a lower capital charge on:

- Exposures to ERM2 currency pairs (formed of DKK, LTL, LVL) at 1.6%
- Exposures to low risk currency pairs (see appendix 1) of 4%

There is no case for capital requirements to rise here, so you will not be in breach if you do not implement this change.

Options without model approval.

The new rules provide for capital requirements on option portfolios to be calculated on the basis of the net delta, gamma and kappa/vega exposures. This is subject to regulatory approval but the rules suggest that approval will be given provided the maths is reliable.

New financial returns.

From 2014, certain financial returns will be replaced by new 'COREP' and 'FINREP' returns. These will be submitted through Gabriel. However, they will have to be submitted in XBRL format.

The FCA is hoping to update firms' reporting schedules during the first quarter with the first COREP returns due in May.

Our services

We can provide assistance with your preparations for the new requirements. Please get in touch with either:

Jude Bahnan
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or

David Dudeney
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to discuss how we can help you.

Or call us 020 3301 4545