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Regulatory Capital Management: Fair Value Measurement and Regulatory Capital Ratios

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Abstract

The calculation of the regulatory capital ratios according to the Capital Requirements Regulation (CRR) is based on the IFRS consolidated financial statements. Therefore, banks are able to influence their regulatory capital ratios through discretionary powers when measuring with fair values according to IFRS 13. This paper analyzes the effects that discretionary fair value changes have on the regulatory capital ratios. Furthermore, the impact of the prudent valuation according to article 105 CRR on the regulatory capital ratios is examined. While the results depend on a multitude of factors and vary from case to case, there are situations in which the same fair value change of an identical financial asset can have opposing effects on certain regulatory capital ratios depending on bank specific factors like its regulatory capitalization or its tax rate. As a result, decreasing fair values can in some circumstances lead to higher regulatory capital ratios and thus, indicate a greater solvency. In order to identify possible conflicts of interest, the effects of fair value changes on the comprehensive income are also included in the analysis because the comprehensive income serves as an important target figure for banks in addition to the regulatory capital ratios.

Keywords: IFRS accounting, fair value, IFRS 13, regulatory capital ratios, regulatory capital management, Capital Requirements Regulation.

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I. Introduction

The Capital Requirements Regulation (CRR)[1] defines uniform minimum requirements for the capitalization of banks.[2] The calculation of the regulatory

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[1] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, OJ No L 176/1, 27.06.2013.

[2] In regard to the scope of the CRR, see *Dürselen* (2016), m. n. 4–6.

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