Deloitte.

Printable version of the e-mail alert
sent on 13 November 2014

Banks and investment firms
Regulatory update

Topics covered in this issue

AIFMD

1. ALFI Questions and Answers on AIFMD reporting and guidance AIFMD reporting to investors and annual reports

The Q&A document proposes answers to technical questions on AIFMD reporting, complementing both **ESMA's Q&A document on application of the AIFMD** and the **FAQ document on AIFM** published by the CSSF.

In order to meet the deadline and to comply with the EU requirements, **ALFI has issued guidance** to assist regulated AIFs (mainly UCI Part II and SIFs) in preparation of their annual report. This guidance is more particularly designed for Luxembourg AIFM managing Luxembourg AIFs on the basis of Luxembourg GAAP and IFRS.

The guidance focuses also on:

- The annual report to investors pursuant to Article 20 of the **Law of 12 July 2013 on Alternative Investment Fund Managers**; and
- The periodic disclosure to investors pursuant to Article 22 of the AIFMD Law.

EMIR

2. EMIR Clearing Obligations

On 1st October 2014, ESMA published its **final draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives**.

The Regulatory Technical Standards ("RTS" hereafter) define those types of IRS contracts which will have to be centrally cleared according to Article 5 of EMIR, the types of counterparties covered by the obligation and the dates by which central clearing of IRS will become mandatory for them.

ESMA proposed to create one class of OTC derivative per product type, when product types are defined as follows:

Float-to-float swaps (basis swaps)	Forward Rate Agreement (FRA)
Fixed-to-float interest rate swaps (IRS)	Overnight Index Swaps (OIS)

Class of OTC derivatives subject to the clearing obligation are referred to Class+.

Phase in implementation as per the category of counterparties

ESMA's technical standards also set out the implementation schedule for market participants for whom central clearing will become mandatory as per four categories:

Category	Foreseen Implementation (*)
Category 1: Clearing members for any of the Class+ of any CCP authorised to clear at least one of the Class+.	6 months after the RTS enter into force (estimated to be August 2015).
Category 2: Financial Counterparties (FCs) and Alternative Investment Funds (AIFs) that are non-financial counterparties above the clearing threshold (NFCs+), which are not included in Category 1, and which belong to a group for which the aggregate month-end average notional amount of non-centrally cleared	12 months after the RTS enter into force (estimated to be February 2016)

derivatives for (*) November 2014, December 2014 and January 2015 is above €8bn	
Category 3: FCs and other NFC+ AIFs that have a low level of activity in uncleared derivatives and which are not included in Category 1 or 2	18 months after the RTS enter into force (estimated to be August 2016)
Category 4: non-financial counterparties (NFCs)	36 months after the RTS enter into force (estimated to be February 2018).

(*) assuming the RTS enter into force in February 2015

Key Notes :

- Where a contract is entered into between two counterparties included in different categories of counterparties as defined in Article 2 of EMIR, the date from which the clearing obligation takes effect for that contract shall be the latest of the two.
- Intragroup transactions concluded between an EU and a third-country entity can benefit from an exemption from the clearing obligation under some conditions. One condition is that the non-European entity is established in a third-country in respect of which the European Commission has adopted an implementing act (an “equivalent third-country”)

Next Coming Technical Standards

Further to the consulting papers - Clearing Obligation under EMIR (no. 2) dated 11 July 2014/ESMA/2014/800 and Clearing Obligation under EMIR (no. 3) dated 1st October 2014/ESMA/2014/1185, we expect final reports on draft technical standards related to certain credit OTC derivative classes and foreign-exchange non-deliverable forward (FX NDF) OTC derivatives.

Automatic Exchange of Information

3. Automatic Exchange of Information Directive on administrative cooperation politically agreed - Luxembourg to become an early adopter

Introduction

Automatic exchange of information has become the standard way of administrative cooperation. The legal framework regarding automatic exchange is evolving rapidly:

- In the current situation, the EU Savings Directive, already in place since 2005,applies regarding certain interest income. While Luxembourg still appliedsavings withholding tax under this Directive, as from 1 January 2015 theswitch to automatic exchange of information under this Directive will bemade. Additionally, the Administrative Cooperation Directive in its currentversion will apply as from 1 January 2015, in a first phase regardinginformation available in the hands of tax authorities on salaries, director’sfees, pensions, life assurance and real estate income (with, in a secondphase, mandatory exchange of information on certain of these categories ofincome). Finally, under the Luxembourg-US Intergovernmental Agreement,FATCA reporting will apply as from 2015 regarding 2014;
- While the amended version of the EU Savings Directive should have becomeapplicable as from 1 January 2017, the (amended) EU Savings Directive willlikely be repealed by the EU Commission in view of the application of theCommon Reporting Standard (CRS) as from 2016. Political agreement on thedraft amended

Administrative Cooperation Directive, integrating the CRS intothis Directive, was indeed reached during the ECOFIN of 14 October 2014,and will introduce the CRS reporting amongst all EU Member States as from 1January 2016 (Austria may benefit from an extension of this deadline up to 1January 2017)

- It is therefore likely that the last reporting under the EU Savings Directive willbe due in 2016 regarding calendar year 2015, since the much broader CRSreporting will be due in 2017 regarding calendar year 2016. Alongside,FATCA reporting will of course continue to apply as well. As not only EUMember States will apply the CRS, but also many other OECD Members, it islikely that additional legal instruments will soon impose CRS reportingamongst additional (clusters of) jurisdictions.

The European Council agreed on 14 October 2014 on a draft Directive amending the existing Directive 2011/16/EU on administrative cooperation in the field of taxation.

Automatic exchange of information obligations based on the OECD Common Reporting Standard (CRS) are integrated in this amended Directive, which will considerably extend the scope of the mandatory automatic exchange of information between EU tax administrations.

Based on the “political agreement” reached at the ECOFIN meeting, the automatic exchange of information included in the amended Directive should apply as from calendar year 2016, meaning a first automatic exchange of information between EU tax administrations would take place in 2017. Austria may benefit from an additional year to apply the new rules regarding 2017 (first reporting in 2018).

The new scope of the exchange of information is based on FATCA reporting and covers account balances, interest, dividend, capital gains and all types of income derived from financial assets (investment funds, insurance products, derivatives….).

Following these recent developments, the Commission is now considering to repeal the amended EU Savings Directive 2014/48/EU adopted on 24 March 2014 (which would normally have to be applied as from 1 January 2017).

CRS

The OECD developed a new standard for automatic exchange of financial account information in tax matters which has been approved by the OECD Council on 15 July 2014, released on 21 July 2014 and formally presented to the G20 Finance Ministers in September 2014.

The CRS (the template of Convention released by the OECD to implement the CRS) is based on the intergovernmental agreements (IGA) transposing FATCA reporting obligations, and will allow governments to obtain detailed account information from financial institutions and exchange that information automatically with other jurisdictions on an annual basis.

Before the October ECOFIN meeting, over 65 jurisdictions (including G20 countries) already committed to implement the Common Reporting Standard, out of which more than 40 jurisdictions as “early adopters”, aiming at an implementation date of 1 January 2016 with a first automatic exchange of information by September 2017.

Other financial centres

Most Dependent and Associated Territories applying the current EU Savings Directive through agreements with the EU Member States already committed to apply the CRS as from 2016 as early adopters (U.K.'s Crown Dependencies of Isle of Man, Guernsey and Jersey; the U.K.'s Overseas Territories of Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Montserrat, and the Turks & Caicos Islands).

Switzerland, Monaco, Andorra, San Marino and Liechtenstein are applying measures equivalent to those included in the current EU Savings Directive. The EU Commission is mandated to sign revised tax agreements with those jurisdictions and intends to include the adoption of the CRS in the discussions. Switzerland has recently announced negotiating this new global standard for exchange of information with the EU. Many other financial centres have already agreed the adoption of the new standard (like Singapore), or should do so in the coming months.

Luxembourg

The Luxembourg Finance Minister has committed on 14 October 2014 to be part of the “early adopters” of the CRS through approving the application of the amended Directive as from 2016. This means that the current EU Savings Directive automatic exchange of information applicable with other EU countries as from January 1st, 2015 is expected to be only be in place for a single year. It will be replaced as from 2016 by the automatic exchange of information based on the updated Directive on administrative cooperation and the CRS.

Conclusion

In view of these recent developments, Financial Institutions will need to act rapidly:

- To be ready to apply the automatic exchange of information under thecurrent EU Savings Directive as from 1 January 2015 (presumably forone year, as the Commission is considering to repeal the (amended) EUSavings Directive in view of the application of CRS reporting as from 1January 2016 by (almost) all Member States);
- To be ready to upgrade to the automatic exchange of information underthe revised Directive on administrative cooperation. This meansobligations as to classification of investors and reporting need to be assessed to be ready to go live with the CRS as from 1 January 2016. In this respect, it will be possible to capitalize -to a large extent- on efforts that have been made in respect of FATCA implementation, although

Capital Requirements Regulation (CRR)

4. Capital Requirements Regulation (CRR) - Liquidity Coverage Requirement

Scope, context and entry in force of this Regulation

On 10 October 10 2014, the European commission published a regulation under the delegated act that lays down rules to specify in detail the liquidity coverage requirement provided for in Article 412(1) of Regulation (EU) No. 575/2013 (i.e. CRR).

Having considered the specificities of the EU banking system, the Commission adopted in this regulation a number of adjustments in comparison to the Basel LCR standard to account for the diverse population of entities operating in the EU. Unless the European Parliament and Council issue objections regarding this regulation, the commission suggests an entry into force as from 1 October 2015 with the following transitional provisions:

a. 60% of the liquidity coverage requirement as from 1 October 2015

b. 70% as from 1 January 2016;

c. 80% as from 1 January 2017;

d. 100% as from 1 January 2018;

The scope of application of this detailed LCR regulation has been limited to credit institutions, investment firms being still subject to the general liquidity requirement under article 412(1) of the CRR.

Significant innovations of the Commission Delegated Regulation (EU) of 10 October 2014

List of eligible liquid assets

The commission has enlarged the pool of assets eligible for the LCR calculation, giving recognition to some covered bonds and securitised assets that showed excellent liquidity performance during the liquidity crisis. Shares, corporate debt, restricted-use committed liquidity facilities, units in CIUs or deposits in specific institutions are also eligible as liquid assets, under certain conditions and up to a certain amount.

Composition of the liquidity buffer

Eligible assets are split in three groups: Level 1 (“extremely high liquidity and credit quality”), Level 2A and Level 2B (“high liquidity and credit quality”). The part of Level 2 assets shall not exceed 40% as illustrated below.

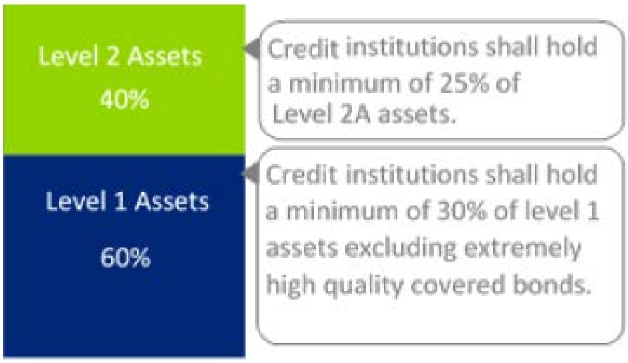

Figure 1 - Composition of the liquidity buffer by asset level

Some further caps have been introduced, limiting the portion of the pool of liquid assets to 70% for covered bonds eligible as Level 1, 40% for each individual category of Level 2A assets and 15% for each individual category of Level 2B assets. Furthermore, haircuts (ranging from 7% to 50%) should be applied to the market value of those various assets.

Net liquidity outflows and exemptions to the inflow cap

The principle for the calculation of the net liquidity outflows remains unchanged. However, the Commission made amendments to and provided further clarifications on some technical features. Of particular interest, the net liquidity outflows are precisely defined, with some inflows being fully or partially exempted from the inflow cap. Subject to the prior approval of the competent authority and under certain constraints, credit institutions may fully or partially exempt the following liquidity inflows from the cap:

- Inflows where the provider is a parent or a subsidiary of the credit institution;
- Inflows from deposits placed with other credit institutions within a group of entities qualifying for the treatment set out in Article 113(6) or (7) of Regulation (EU) No 575/2013;
- Inflows with inter-dependent outflows.

Under specific conditions and subject to the prior approval of the competent authority, specialised credit institutions may be subject to a cap on inflows of 90%.

These exemptions are important for the Luxembourg market place as these inflows are commonly encountered in banks. The possibility to calculate some outflows on a net basis when interdependent inflows exist should be closely analysed and minimum criteria that must be met to benefit from this option should be duly assessed.

5. Capital Requirements Regulation (CRR) - Leverage ratio

The Delegated Act establishes a common definition of the leverage ratio for EU banks which will be the basis for publishing the leverage ratio from the beginning of 2015 onwards. It does not introduce a binding leverage ratio. A decision on whether or not to introduce a binding leverage ratio will only be made in 2016. The Delegated Act amending the methodology for calculating banks' leverage ratio will enhance the uniform understanding of the components of the leverage ratio. It aims to align the leverage ratio as currently included in the Capital Requirements Regulation with the internationally agreed leverage ratio so that there is an international level playing field and true global comparability.

Single Supervisory Mechanism (SSM)

6. Single Supervisory Mechanism (SSM) - SSM launch

While smaller ('less significant') banks will continue to be day-to-day supervised by national authorities, the Single Supervisory Mechanism (SSM) promises a more consistent supervision for all SSM banks. In a joint opinion piece, Danièle Nouy, SSM Chair, and Sabine Lautenschläger, SSM Vice-Chair, once again emphasized the role of harmonized standards for both regulation and supervision; and reminded their readers that "as a true European supervisor", the

SSM's "approach will be to implement best practices for independent, intrusive and forward-looking supervision that will ensure a level-playing field for banks' operations".

They also confirmed that the SSM was to take on board lessons learned during the Comprehensive Assessment, in particular in addressing the inconsistencies that it revealed; one of the SSM priorities will be the review of models banks use for calculating their risk-weighted assets.

7. Single Supervisory Mechanism (SSM) - Comprehensive Assessment

The European Central Bank published yesterday the results of the Comprehensive Assessment conducted on the 130 most important banks of the Euro zone. This assessment was required prior to the effective entry into force of the Single Supervisory Mechanism (SSM) on 4 November 2014. The Comprehensive Assessment includes the Asset Quality Review and the Stress Test.

Key points of the **aggregate report on the Comprehensive Assessment** are:

- Capital shortfall of €25 billion detected at 25 participant banks
- Banks' asset values need to be adjusted by €48 billion, €37 billion of which did not generate capital shortfall
- Shortfall of €25 billion and asset value adjustment of €37 billion implies overall impact of €62 billion on banks
- Additional €136 billion found in non-performing exposures
- Adverse stress scenario would deplete banks' capital by €263 billion, reducing median CET1 ratio by 4 percentage points from 12.4% to 8.3%

The results from the standalone Asset Quality Review confirm that the six Luxembourg institutions' assets are appropriately valued and additional prudential provisions are limited. The Stress Test results show that the six institutions are sufficiently resilient to withstand the two hypothetical Stress Test scenarios.

The **Deloitte interactive tool** provides an overview of results published by the European Central Bank and enables comparisons between countries and institutions.

8. Single Supervisory Mechanism (SSM) - Guide to Banking supervision

This guide is an important milestone in the implementation of the Single Supervisory Mechanism (SSM), the new system of financial supervision comprising, as at October 2014, the European Central Bank (ECB) and the national competent authorities (NCAs) of euro area countries. It was issued in accordance with the inter Institutional Agreement between the European Parliament and the European Central Bank (ECB).

The ECB published this guide before it took over its supervisory tasks on 4 November 2014 to provide practical guidance and to support stakeholders in their preparation. It is a practical tool that will evolve through regular updates to reflect new experiences that will be gained in practice.

The SSM is based on 9 supervisory principles which are:

Principle 1 – Use of best practices

Principle 2 – Integrity and decentralisation

Principle 3 – Homogeneity within the SSM

Principle 4 – Consistency with the Single Market

Principle 5 – Independence and Accountability

Principle 6 – Risk based approach

Principle 7 – Proportionality

Principle 8 – Adequate level of Supervisory Activity for all Credit Institutions

Principle 9 – Effective and timely corrective measures

The SSM guide presents also the conduct of supervision, which is based on the following pillars:

1 Authorisations, acquisitions of qualifying holdings, withdrawal of authorisations

2 Supervision of significant institutions

3 Supervision of less significant institutions

4 Overall quality and planning control

This guide is not a legally binding document and cannot be in any way, substitute for the legal requirements laid down in the relevant applicable EU Law.

Bank Recovery and Resolution Directive and Single Resolution Mechanism

9. Bank Recovery and Resolution Directive (BRRD) and Single Resolution Mechanism (SRM) - Commission adopts detailed rules on contributions of banks to resolution funds

Delegated Act - BRRD

The **Bank Recovery and Resolution Directive 2014/59/EU (BRRD)** published in the Official Journal on 12 June 2014 sets out new resolution rules for all EU banks. These rules include a national, prefunded resolution fund that each Member State has to establish and build up so it reaches a level of at least 1% of covered deposits within 10 years (according to the data provided by the Member States, as of end 2012 covered deposits in the European Union amounted to nearly EUR 7 000 billion).

In the context of BRRD, all institutions (credit institutions and investment firms) authorised in European Member States, including branches of third country financial institutions, have to contribute to the resolution financing arrangements. The Delegated Act determines how much individual credit institutions will have to pay each year to their respective resolution funds according to the bank's size and risk profile.

The risk pillars and risk indicators used in the methodology for the calculation of contributions are:

1. risk exposure
2. stability and variety of sources of funding
3. importance of an institution to the stability of the financial system or economy
4. additional risk indicators to be determined by the resolution authority

The Delegated Act should be applicable by 1 January 2015.

Draft proposal for a Council implementing act - SRM

The Single Resolution Mechanism Regulation establishes the Single Resolution Fund in the Banking Union. It will reach the target level of EUR 55 billion over 8 years (the basis being 1% of the covered deposits in the financial institutions of the Banking Union). Once this target level is reached, in principle, the banks will have to contribute only if the resources of the resolution funds are used up.

The methodology developed in the Delegated Act mentioned above also applies to the calculation of the contributions in the euro area.

CRD IV

10.CRD IV - Remuneration

CSSF Circular 14/594 - Transposition of the EBA guidelines on the applicable notional discount rate for variable remuneration

These guidelines aim to explain the calculation and the rules for applying the discount rate referred to in Article 94(1)(g)(iii) of CRD IV.

Institutions may apply the discount rate in the calculation of the ratio between the fixed and variable components of remuneration to a maximum of 25% of the total variable remuneration provided it is paid in instruments that are deferred for a period of not less than five years. “Discount ratio” shall mean the value by which a nominal amount of variable remuneration which will be acquired in the future is multiplied to obtain the present value.

The EBA guidelines on the applicable notional discount rate for variable remuneration entered into force on 1 June 2014. The CSSF Circular 14/594 comes into force with immediate effect.

Prudential reporting

11. Prudential reporting: CSSF 14/593 - Supervisory reporting requirements applicable to credit institutions as from 2014

The purpose of the **CSSF Circular 14/593** is to remind and inform on recent and future developments in prudential reporting. The following table present an overview of applicable reporting on individual and consolidated basis.

<table>
<tr><th>Individual basis</th><th>Consolidated basis</th></tr>
<tr><td>FINREP
- B 1.1 and B 1.6 (monthly)
- B 2.1 and B 2.5 (quarterly)
as introduced by CSSF Circular 07/316 and subsequent circulars.
A transition to the harmonised prudential reporting on individual basis is expected. As long as no instruction from the European Central Bank is received in the context of the Single Supervisory Mechanism, these tables are still applicable on an individual basis.</td><td>New FINREP
- Part 1: Information to be reported quarterly (27 tables)
- Part 2: Information to be reported quarterly on threshold basis (10 tables)
- Part 3: Information to be reported semi-annually (4 tables)
- Part 4: Information to be reported annually (13 tables)</td></tr>
<tr><td colspan="2">Expanded COREP
- Own funds requirements (Solvency ratio) (quarterly or semi-annually tables)
- Losses stemming from lending collateralised by immovable property (semi-annually)
- Large exposures (quarterly)
- Leverage ratio (quarterly)
- Liquidity Coverage requirements (monthly)
- Reporting on stable funding (Net Stable Funding requirements (NSFR) (monthly)</td></tr>
<tr><td>Other
- B 1.5 Liquidity ratio (monthly)</td><td>N/A</td></tr>
</table>

- B 2.4 Information on participating interest and subordinated loans (quarterly) **- B 4.4 List of head offices, agencies, branches and representative offices (annually)** **- B 4.5 Analysis of shareholdings (annually)** **- B 4.6 Persons responsible of certain functions and activities (annually)**	

These reporting will be completed by:

- Forbearance and non-performing exposures (first reporting as at 30 September 2014 due on 31 December 2014);
- Asset encumbrance (first reporting as at 31 December 2014 due on 11 February 2014); and
- Additional liquidity monitoring metrics (expected 1st July 2015).

Threshold for notification of large exposures

The CSSF maintains current minimum thresholds for notification of large exposures (10% of own funds or EUR 12.5 million) for tables “Large exposures” (Tables C28.00 and C29.00).

Repealed circulars:

- CSSF 14/586
- CSSF 13/570
- CSSF 11/513
- CSSF 10/461
- CSSF 08/344, only regarding requirements on tables B 6.1, B 6.6, B 6.2, B 6.7, B 1.2, B 1.4, B 6.4, B 2.3 et B 6.3
- CSSF 08/381, CSSF 10/450, CSSF 10/493
- CSSF 07/316, CSSF 07/319, CSSF 07/324, CSSF 07/331, only regarding requirements on tables B 6.1, B 6.6, B 6.2, B 6.7, B 1.2, B 1.4 et B 6.4
- CSSF 07/279
- CSSF 06/251
- CSSF 05/227
- IML 93/92.

AML

12. AML - FATF statements

The CSSF published on 30 October the **Circular 14/595** updating the AML classification of countries according to latest FATF statements.

Contact

Martin Flaunet
Partner - Banking Leader
mflaunet@deloitte.lu

Anne-Françoise Liégeois
Director - Regulatory watch
afliegeois@deloitte.lu

Emmanuelle Caumont
Senior Manager - Regulatory watch
ecaumont@deloitte.lu