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Printable version of the e-mail alert
sent on 17 December 2014

Banks and investment firms
Regulatory update

Topics covered in this issue

PRIIPS

1. Discussion paper on consumer-friendly KIDs

On 17 November 2014, the Joint Committee of the three European Supervisory Authorities (EBA, EIOPA and ESMA) published a Discussion Paper on Key Information Documents (KIDs) designed to help retail investors in the EU better understand and compare packaged retail and insurance-based investment products (PRIIPs) across the EU.

PRIIPs regulation has mandated the three European Supervisory Authorities "ESA" (EBA, EIOPA and ESMA) to develop draft Regulatory Technical Standards (RTS) on the content and presentation, as well as on the timing of delivery of the KIDs for PRIIPs.

For that purpose, the **ESAs Discussion Paper on consumer-friendly Key Information Documents on investment products across the EU** has been published on 17 November 2014 by ESAs on how these standardised KIDs should be developed and for which a feedback is requested by 17 February 2015.

Criteria for assessing options for presentation:

1. Engaging
2. Understandable
3. Comparable
4. Compatible
5. Balanced presentation
6. Coverage of types of PRIIPS

The Joint Committee is expected to submit the RTS to the Commission at the beginning of 2016 and the new KIDs will start to be used at the end of 2016. Undertakings for collective investment in transferable securities (UCITS) are not subject to this regulation for five years.

2. PRIIPS Regulation published in JO

On 9 December 2014, the Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) ("PRIIPS Regulation") has been published in the Official Journal of the European Union.

You are fund manager, insurance undertaking, credit institution or investment firm, then you are most probably a PRIIPS manufacturer or advising on or selling PRIIPS to retail investors.

As PRIIPS manufacturer you must be willing to take your responsibilities from 31 December 2016; in essence, it means to be ready for:

- drawing up the KID before the PRIIP is made available to retail investors or monitoring the service provider to which KID production is outsourced;
- publishing the KID on its website;
- designing and implementing appropriate procedures and arrangements in relation to complaints handling.

To know more about:

- what is a PRIIP ?
- what are the responsibilities and liabilities of a PRIIPS manufacturer ?
- what challenges PRIIPS manufacturer or distributor is currently facing ?
- what are the issues that remain outstanding regarding PRIIPS ?
- how **Deloitte KID factory** can help you meeting your three main challenges: content creation, industrialisation and, life cycle management ?

We invite you to go through our **Deloitte KID factory service brochure**.

Asset emcumbrance

3. CSSF Circular 14/597 - Update of CSSF Circular 12/552 on the central administration, internal governance and risk management

CSSF Circular 14/597, published on 25 November, introduces a new Chapter in Part III of the CSSF Circular 12/552, related to sound risk management to be implemented and performed on assets encumbrance. This Chapter implements in Luxembourg a recommendation issued in December 2012 by the European Systemic Risk Board on funding of credit institutions (**ESRB 2012/2**). It is applicable only to banks.

Policies, procedures and controls

Credit Institutions shall set-up and implement risk management policies defining their approach in relation to asset encumbrance, as well as procedures and controls that ensure that risks associated with collateral management and asset encumbrance are adequately identified, monitored and managed.

Business model, host countries, specificities of the funding markets and macroeconomic situation shall be considered and factored in the monitoring program ensuring adequate oversight and risk management on assets encumbrance.

Policies are subject to proper validation by the Board of Directors; procedures and controls shall be duly validated by the Authorised Management.

They shall also implement a general monitoring framework that provides timely information to the management and the relevant management bodies on:

- the level, evolution and types of asset encumbrance and related sources of encumbrance, such as secured funding or other transactions; and
- the amount, evolution and credit quality of unencumbered but encumberable assets, specifying the volume of assets available for encumbrance.

Stress testing and contingency plans

Institutions have also to include in their contingency plans strategies to address the contingent encumbrance resulting from relevant stress events.

These stress events shall be simulated and reported as part of the overall stress testing program of the institutions (and main conclusions disclosed in the ICAAP report). In particular, the amount, evolution and types of additional encumbrance resulting from stress scenarios (contingent encumbrance) should be timely reported to the authorised management.

Retail banking products

4. Product oversight and governance - EBA consultation

On 10 November 2014, EBA published a consultation paper **Draft Guidelines on product oversight and governance arrangements for retail banking products** on these guidelines, which require the establishment of internal arrangements for the design, marketing and life cycle maintenance of products and are aimed at ensuring that products are designed to meet interests, objectives and characteristics of the target market.

The guidelines apply to:

- Manufacturers's internal control functions, identification of the target market, product testing, disclosure, product monitoring, remedial actions and the selection of distribution channel and distributors of retail banking products.
- Distributors's internal arrangements, identification and knowledge of the target market, and information requirements.

EBA is waiting for comments on all proposals put in this paper by 10 February 2015.

Banking supervision

5. CSSF Circular 14/596 on Communication Regime under the SSM for Significant Entities

Repeal of the VISA procedure for published annual accounts

On 28 November 2014, the CSSF published Circular 14/596 in order to draw the attention to the new communication regime for Significant Entities and decided to abolish the VISA procedure for published annual accounts for all credit institutions.

Communication Regime under the SSM for Significant Entities

According to the Article 95 of the SSM Framework Regulation, Significant Supervised Entities shall address to the European Central Bank all its requests, notifications or applications, relating to the exercise of the tasks conferred on the ECB.

This Circular lists exceptions, fixed by the SSM Framework, for which the communication continues to take place directly between the bank and the CSSF:

- Article 11 on the right of establishment of credit institutions with the SSM;
- Article 12 on exercise of the freedom to provide services by credit institutions within the SSM;
- Article 17 on right of establishment and exercise of the freedom to provide services in relation to non-participating member states;
- Article 73 to 79 on cooperation with regard to an application for an authorisation to take up the business of a credit institution;
- Article 85 to 87 on cooperation with regard to the acquisition of qualifying holdings;
- Article 93 to 94 on compliance with fit and proper requirements for persons responsible for managing credit institutions.

The above applications must be submitted to the ECB authorisation and direct communication between the ECB and the credit institution may take place.

SFTs

6. Transparency of securities financing transactions - Council agrees transparency rules

The Council of the European Union agrees on transparency rules regarding **Securities Financing Transactions on 20 November 2014** Securities Financing Transactions: Council agrees transparency rules, the Commission presented its proposal in January 2014.

The aim of this draft regulation is to enhance financial stability by ensuring that information on so-called securities financing transactions is efficiently reported to trade repositories and investors in collective investment undertakings.

Improved transparency would prevent financial intermediaries, including banks, attempting to circumvent regulation by shifting parts of their activities to the less-regulated shadow Banking Sector.

The draft regulation introduces measures to improve transparency:

- the monitoring of the build-up of systemic risks
- the disclosure of information
- rehypothecation activities

For more information please read more in our Deloitte regulatory news alert: **EU proposal to bring transparency to SFTs**.

CSR

7. Disclosure of non-financial and diversity information

On 15 November 2014, the **Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups** ("The Directive") has been published in the Official Journal of the European Union.

The objective of the Directive is to increase European companies' transparency and performance on environmental and social matters and, therefore to contribute effectively to long-term economic growth and employment. More transparency will help companies to better manage the opportunities and non-financial risks.

This Directive seeks to ensure equal rules for all, to reduce the costs for companies operating in more than one Member State and ensure that investors are well informed. Indeed, investors are nowadays more interested in non-financial information in order to have a comprehensive understanding of a company's development, performance, position and impact of its activity. They thoroughly analyse this information in their investment decision process.

Targeted companies

The new rules will only apply to large public-interest entities. Smaller companies will have no new requirements.

<table>
<tr><td rowspan="4">Large Companies *</td><td rowspan="4">Public-interest entities **
("PIEs")</td><td>Listed companies</td></tr>
<tr><td>Credit institutions</td></tr>
<tr><td>Insurance undertakings</td></tr>
<tr><td>Other public-interrest entities
So designated by Member States because of their activities, size or number employees</td></tr>
</table>

** having an average number of more than 500 employees and exceeding either a total balance sheet of EUR 20 million or a net turnover of EUR 40 million in the meaning of Art.3 (7) of the Directive 2013/34/EU*
*** defined by Art. 2 a, b, c, d of the Directive 2013/34/EU*

Content of the non-financial statement/consolidated non-financial statement

Three CSR areas	Type of non-financial information
1. Environmental matters **2. Social and employee-related aspects** **3. Human rights, anti-corruption and bribery matters**	A brief description of the undertaking's business model
	A description of the policy pursued by the undertaking in relation to those CSR matters, including due diligence processes implemented
	The outcome of the above policies
	The principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks
	Non-financial key performance indicators relevant to the particular business

Disclosure at group level/each individual affiliate within a group

If you are a parent undertaking that meets all of the criteria (as specified above), you shall include in the consolidated management report a consolidated non-financial statement in accordance to the reporting obligations.

An undertaking (parent undertaking), which is a subsidiary undertaking, shall be exempted from the reporting obligations, if the undertaking (exempted parent undertaking) and its subsidiary undertakings are included in the consolidated management report or the separate report of another undertaking.

Comply or explain principle

A company that does not pursue a specific policy on one of the non-financial areas is required to provide an explanation for not doing so.

Format of the non-financial statement

The Directive provides companies with significant flexibility to disclose relevant information. The non-financial statement may be published according to one or the other of two ways:

Legal basis	Where	Standards	Check by external expert
Core requirement	Integrated in the management report (or in the consolidated management report)	National, EU-based or international frameworks ***	Required from statutory auditor
Member State option	In a separate report (Sustainability report)	National, EU-based or international frameworks ***	Not required by the Directive - Member State to decide whether verification by an independent assurance services' provider is needed (ISAE 3000 is currently best practice)

***Can be used as long as the relevant framework is specified

Companies that will publish the above listed non-financial information into their management report, may use international, European or National guidelines according to their own characteristics and business environment. The report of the statutory auditor should contain an opinion concerning the consistency or otherwise of the above referred management report with the annual accounts.

Some of the companies and groups within the EU already prepare non-financial reports on a voluntary basis (Sustainability report). If Luxembourg opts for the related exemption, those companies should not be subject to the obligation to provide a non-financial statement in the management report, provided that the Sustainability report is either published together with the management report or is made publicly available within six months period, on the company's website, to which reference is made in the management report.

Guidance on reporting

The EU Commission shall publish non-binding guidelines on methodology for reporting non-financial information, including non-financial key performance indicators, general and sectoral, by 6 December 2016.

New disclosure in the corporate governance statement

Companies should increase the diversification of the Board of directors in order to ensure an efficient control of the direction and strong governance of companies. The description of the diversity policy must be included in the corporate governance statement, together with the objectives and the results achieved. Companies which do not apply a diversity policy will be requested to explain why. This new requirement will not apply to small and medium enterprises.

Transposition

Member States will have two years to transpose the Directive into national legislation. Companies concerned will start reporting for the financial year starting on 1 January 2017 or during the calendar year 2017.

CRD

8. Capital Requirements - Regulation (EU) 1187/2014

Commission Delegated Regulation (EU) No 1187/2014 of 2 October 2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for determining the overall exposure to a client or a group of connected clients in respect of transactions with underlying assets was published in the Official Journal of the European Union on 7th November 2014.

This Regulation shall apply to collective investment undertakings, securitisations and other transactions where there is an exposure to underlying assets.

The Regulation entered into force on 27 November 2014 and set out the following:

1. the methodology for the calculation of the value of exposures to transactions with underlying assets,
2. the procedure used to determine the contribution of underlying exposures to overall exposures to clients and groups of connected clients and
3. the conditions under which the structure of the transaction does not constitute an additional exposure.

One of the key elements of this Regulation is the introduction of a materiality threshold (0.25% of the institution's eligible capital) below which institutions would not need to apply the look-through approach and identify the obligors of the underlying assets.

AML

9. FATF Guidance for a risk-based approach

On 27 October 2014, the FATF adopted a risk-based approach guidance for the banking sector. FATF Guidances assist the interpretation of the FATF Recommendations, which set international standards against money laundering and terrorism financing. The guidance delineates the principles of a risk-based approach and assists the interested parties in the design and implementation of the same. It follows the adoption of FATF International standards on Combating Money Laundering and the Financing of Terrorism and Proliferation in 2012, and it has been adjusted to reflect the experience gained both in the private and in the public sector.

A RBA in AML/CFT enables countries, competent authorities, and financial institutions to identify, assess and understand the AML/CFT risks to which they are exposed and therefore to adopt adequate measures in order to reduce those risks. Each country is responsible for allocating supervisory resources into the financial sector, by assessing the related risks and evaluating the adequacy of AML/CFT controls. The legal and regulatory obligations set up by supervisors should reflect the expectations of compliance in the banking sector while at the same time guiding banks to comply with the AML/CFT regulations.

Adopting a risk-based approach to AML/CFT for banks means effectively organising internal compliance resources, internal controls and internal structures. The risk mitigation process within a bank involves several steps:

1. adopting internal policies for the identification and verification of the identity of clients and beneficial owners and of the nature of the business relationships;
2. performing customer due diligence in all cases, but the extent of the due diligence may vary depending on the risk of the business relationship;
3. mitigating the risks through ongoing customer due diligence and monitoring, carried out independently from the risk of the clients;
4. promoting compliance as a core value within the bank.

To this end, the internal control environment should assure compliance and the staff must be well trained to the risks that internal procedures aim at mitigating.

10. FATF Guidance - Transparency and beneficial ownership

On 27 October 2014, the FATF adopted a **Guidance on Transparency and Beneficial Ownership**, which aims at assisting policy makers and practitioners in national authorities in the implementation of FATF Recommendations 24 (Transparency and Beneficial Ownership of Legal persons) and 25 (Transparency and Beneficial Ownership of Legal Arrangements).

The misuse of corporate vehicles for illicit activities can be reduced and prevented if information on the beneficial owners is easily accessible to the competent authorities. In the context of legal persons, the beneficial owner is either the person who ultimately owns the legal entity or the person who can take relevant decisions within the legal entity. In the context of legal arrangements, the beneficial owner is the natural person who ultimately owns or controls the legal arrangement and who exercises control over it. According to Recommendation 24 enhancing transparency of legal entities entails: obtaining basic information on the legal entities and on the beneficial owners of the entities. Beneficial ownership of a legal entity is identified through three main criteria:

1. natural person who may control the legal person through ownership interests;
2. natural person who controls the legal entity through other means;
3. natural person exercising control of the entity by holding relevant positions within the legal entity (residual criterion).

The information on beneficial ownership should be recorded and available for consultation. Three mechanisms ensure that the information is collected and available:

1. company registries obtain this information and keep it up-to-date;
2. companies should obtain and hold information on beneficial ownership;
3. existing information contained in sources already existing (e.g. company registries).

Recommendation 25 defines legal arrangements as "*trusts or other similar legal arrangements*" (fiducie, treuhand and fideicomiso). Countries whose national laws allow and recognise trusts should require trustees to obtain and maintain up-to-date information on the beneficial ownership of the trusts. Countries whose national laws do not contain provisions on trusts or similar legal arrangements are not exempt from obtaining information on beneficial ownership of trust, but they should also arrange additional measures that facilitate the access to information on beneficial ownership.

FTT

11. ECOFIN meeting – discussions on the FTT are still ongoing

At the ECOFIN meeting on 7th November 2014, the Finance Ministers of the 11 participating Member States further discussed the proposal for the implementation of a Financial Transactions Tax (EU FTT) under the enhanced cooperation mechanism.

Although not much progress was achieved in this meeting, the Italian Presidency clearly indicated that work would be intensified to enable an agreement in the near future, with the aim of implementing a first phase of the FTT as from the 1st January 2016.

If, on the one hand, the 11 participating Member States (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain), agree that transactions in shares of companies listed on the stock exchanges should be subject to FTT, on the other, further work will be required on:

- what concerns the taxation of transactions in derivatives;
- how to achieve the application of the "issuance" and "residence" principles;
- the possible methods for allocation of revenues.

In spite of this, neither Germany, France, nor the European Commission have demonstrated to have less enthusiasm in relation to their intention to implementing an EU FTT.

On the way forward, the EU Council was invited to provide indications with a view to resolving the still pending issues and to mandate the Working Party in Indirect Taxation and the Committee of Permanent Representatives to finalise drafting of the compromise legislative text.

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