

Banks and investment firms

Regulatory update

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AML

1. CSSF Circular 15/623 on FATF statements

The **FATF** maintains that the AML/CFT regimes of Iran and the Democratic People's Republic of Korea ("DPRK") continues to present substantial and strategic deficiencies, so the FATF maintains the application of counter-measures against Iran and DPRK.

Burma/Myanmar presents strategic failures of AML/CFT and remains on the list of jurisdiction whose progress were deemed insufficient.

Afghanistan, Algeria, Angola, Bosnia and Herzegovina, Guyana, Iraq, Lao People's Democratic Republic, Uganda, Panama, Papua New Guinea, Syria and Yemen are the jurisdictions with strategic deficiencies regarding AML/FT and which have developed with the FATF action plans to correct their failures. Ecuador and Sudan have been removed from the list.

2. ESA's consultation on anti-money laundering and countering the financing of terrorism

The ESAs launched on 21 October 2015 a public consultation on two anti-money laundering and countering the financing of terrorism (AML/CFT) Guidelines.

Risk-Factors Guidelines

On 26 June 2015, Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing (Directive (EU) 2015/849) entered into force.

In line with the FATF's standards, Directive (EU) 2015/849 puts the risk-based approach at the centre of Europe's anti-money laundering (AML) and counter-terrorist financing (CFT) regime.

Article 17 and 18(4) of Directive (EU) 2015/849 require the European Supervisory Authorities to issue guidelines to support firms with this task and to assist competent authorities when assessing the adequacy of firms' application of simplified and enhanced customer due diligence measures.

The Risk-Factors Guidelines set out factors credit and financial institutions should consider when assessing the money laundering and terrorist financing risk associated with a business relationship or occasional transaction but also how they can adjust the extent of their customer due diligence measures in a way that is commensurate to the money laundering and terrorist financing risk they have identified.

These guidelines are divided into two parts:

- Title II is generic and applies to all firms. It is designed to equip firms with the tools they need to make informed, risk-based decisions when identifying, assessing and managing money laundering and terrorist financing risk associated with individual business relationships or occasional transactions.
- Title III is sector specific and complements the generic guidance in Title II. It sets out risk factors that are of particular importance in certain sectors and provides guidance on the risk-sensitive application of Customer Due Diligence measures by firms in those sectors.

These guidelines will help firms identify, assess and manage the money-laundering and terrorist financing risk associated with individual business relationships and occasional transactions in a risk-based, proportionate and effective way.

These guidelines are likely to be finalised in Spring 2016.

Risk-Based Supervision Guidelines

The Risk-Based Supervision Guidelines are addressed to competent authorities and give recommendations on:

- Identification of Money Laundering / Terrorism Financing (“ML/TF”) risk factors, including ML/TF threats and vulnerabilities;
- Risk assessment;
- Acting on the ML/TF risk assessment;
- Monitoring and follow-up action.

These guidelines aim to provide a common European basis for compliance with the FATF's recommendations on risk based AML/CFT supervision.

CMU

3. The Capital Market Union (CMU) action plan

The European Commission has published the much anticipated **action plan** for the Capital Markets Union (CMU). There is no big, bold individual step at the heart of the CMU to capture attention. Instead the action plan includes 33 initiatives across six chapters which individually would not carry much weight, but cumulatively have the potential to turn fragmented pieces of legislation into a cohesive regulatory framework “to mobilise capital in Europe” and understand how regulatory reforms are affecting the financial services industry.

The initiatives of the action plan fulfil many of the commitments made at the outset of the CMU; a limited legislative programme, greater emphasis on revision and calibration, and removing barriers to cross-border flows of capital. In many respects the action plan is restrained, taking a pragmatic view of what measures are achievable to make regulation work more effectively for a growing economy while respecting the concerns of financial stability. While some of the initiatives may come to nothing (e.g. those on tax and insolvency) the majority of the proposed initiatives will be welcome to the market, especially the call for evidence on the cumulative impact of regulatory reforms.

Alongside the action plan the Commission also published a bundle of documents forming the first actions on the CMU:

- a legislative proposal on **securitisation**, including a revision to the capital requirements regulation;
- an amendment to the **Solvency II Delegated Act (annexes)**;
- a **consultation** on venture capital and social entrepreneurship funds;
- a consultation on **covered bonds**; and,
- a call for evidence on the **EU regulatory framework for financial services**.

Revision and calibration rather than new legislation

In launching the CMU Lord Hill stated that there would be no large legislative agenda and he has followed through with this claim. He has proposed new legislation, such as that on securitisation, and some of the proposed initiatives will result in legislation, but the majority of initiatives will, ultimately, lead to the revision or calibration of existing rules.

As examples there are the calibration of the Solvency II delegated act for infrastructure investments and European long-term investment funds (ELTIFs), revising the prospectus directive, and the European venture capital regulation (EuVECA). Scheduled reviews of this legislation are likely to have resulted in revision and calibration; the CMU will also take a holistic view in revising legislation.

Understanding the effect of regulation

The action plan recognises the need to understand the individual and cumulative effect of the post-crisis regulatory reforms, for example the focus on market liquidity as part of the review of corporate bond markets, the call for evidence on the interactions between rules and the cumulative impact of financial reforms, and the comprehensive assessment of EU retail investment products. These initiatives represent a positive change towards understanding how regulation should work as a network. However, this review should not be seen as the Commission putting forward a deregulatory agenda, but about making regulation work effectively.

Focus on barriers

The stated method to build a CMU was to tackle barriers one at a time; the action plan follows through with this commitment. For example revisiting the barriers to cross-border clearing and settlement, reviving plans to tackle issues in the cross-border ownership of securities and the assignment of claims, and the barriers to the cross-border distribution of funds. These measures have the potential to address persistent issues which frustrate cross-border market activity.

The CMU action plan in context

The 33 initiatives in the action plan represent a substantial commitment by the Commission, but the CMU needs to be set in the context of regulatory change as many CMU initiatives will interact with other work streams. For example, the work on corporate bonds will need to be set against the transparency provisions of MiFID II, and strengthening supervisory convergence against ESMA's new work plan for supervisory convergence starting in 2016.

The debate triggered by the Commission green paper acknowledges that bank-based finance will still be the predominant source of finance in the EU, especially for SMEs, and the action plan reflects this. After all the aim of the CMU is not to replace bank-based finance but to complement it with market-based finance.

What next?

The CMU initiatives are not a quick fix and nor will they result in a boost to economic growth in the near-term. CMU is a long-term project, and even if the steps set out in the action plan are followed through it will be some time before the benefits are fully realised.

The action plan is the starting point of the substantive and detailed work which will need to be undertaken over the next four years.

As a first step firms should identify and prioritise initiatives based on the effect on their business model rather than seeking to tackle the initiatives as a whole. CMU will require active and prolonged engagement by the market to ensure the outcomes are targeted, proportionate and ensure financial stability and economic growth for the long-term.

CRD/CRR and LCR

4. Banking supervision – ECB launches consultation on harmonisation the exercise of options and discretions in union law

The European Central Bank (ECB) on 11 November 2015 published the draft ECB Regulation on the exercise of options and discretions available in Union law and the draft ECB Guide on options and discretions available in Union law. These documents lay down how the exercise of options and discretions provided in the CRR/CRD and the LCR delegated act is to be harmonised in the euro area.

The **draft Regulation** is a binding legal act and sets out the framework for the exercise of options and discretions in Union law (CRR/CRD and LCR delegated act) and mandated to competent authorities, concerning prudential requirements for credit institutions. The options and discretions, conferred to national authorities and directly applicable to credit institutions classified as significant, concern provisions for own funds, capital requirements, large exposures, liquidity and transitional provisions of CRR, and the ECB suggests particular ways of interpretation, methodology and

timelines that should be taken into account by the authorities when exercising their discretion. The Regulation should take effect around March 2016.

The **draft Guide** (a non-legally binding document) sets out the criteria which should be taken into account by the supervisory teams in determining the prudential requirements for significant credit institutions. The policies will be used as guidance by the Supervisory Teams when assessing individual requests and decisions that would involve the exercise of an option or discretion. It aims to provide coherence, effectiveness and transparency on the supervisory policies that will be applied in supervisory processes within the Single Supervisory Mechanism. In particular, it aims to assist the Joint Supervisory Teams in the performance of their tasks with regard to the principles the ECB intends to follow in supervising significant credit institutions.

The consultation period began on 11 November 2015 and ends on 16 December 2015. The ECB will hold a public hearing on 11 December 2015.

CRD IV

5. CSSF Circular 15/622 on higher ratio notification procedure applicable to remuneration policy according to Article 94(1)(g)(ii) of Directive CRD IV

On 21 October 2015, the CSSF published the **circular 15/622 on higher ratio notification procedure applicable to remuneration policy according to Article 94(1)(g)(ii) of Directive 2013/36/EU (“CRD IV”)** following its transposition into Luxembourg law via Article 19(7°)(g) of the law of 23 July 2015.

The law of 23 July 2015 requires that CRR institutions, that do not benefit from a derogation granted by the CSSF, set a ratio between the fixed remuneration and the variable remuneration for persons whose professional activities have a material impact on the risk profile of the institutions. These persons may not receive a variable remuneration that exceeds 100% of their fixed remuneration.

However, in accordance to Member States option, Article 38-6(g) of the Law of 5 April 1993 on the financial sector has set the higher maximum ratio at 200%. This higher ratio shall be subject to annual approval by the shareholders, owners or members of the CRR institutions.

Non-Significant Institutions

Any approval of a higher ratio for **Non-Significant Institutions** shall be notified to the CSSF.

Significant Institutions

Any approval of a higher ratio for Significant Institutions shall, in compliance with Circular CSSF 14/596 on the communication regime under the Single Supervisory Mechanism for Significant Entities be notified to the European Central Bank JST team, with a copy sent to the CSSF.

Notification process

The notification process consists in two different steps:

- the CRR institutions must inform the CSSF without delay once a detailed recommendation requesting the application of a higher ratio has been submitted to the shareholders or owners or members of the CRR institution and should be able to demonstrate to the CSSF that the proposed higher ratio does not conflict with the CRR institution's obligations. The required information shall be communicated through the Notification Form - Part A;

- the CSSF should be informed without delay once the shareholders or owners or members of the CRR institution have taken a decision regarding the approved higher maximum ratio. The required information shall be communicated through the Notification Form - Part B

This process needs to be renewed annually should the CRR institution wish to maintain this higher maximum ratio.

CRR

6. Securitisation initiative: proposal to amend the Capital Requirements Regulation

On 30 September 2015, the European Commission launched its CMU Action Plan which is a medium-term project but with some important early initiatives. Alongside the CMU Action Plan, the Commission has also revealed a first set of measures to relaunch high-quality securitisation. A Proposal to amend the Capital Requirement Regulation is part of the package of the Commission Securitisation initiative.

PSD II

7. Electronic payments services: Council adopts updated rules

On 16 November 2015, the European Council adopted the revised **directive on Payment Services (PSD II)**. The European Parliament adopted its position at first reading on 8 October. The new rules enhance consumer protection, promotes innovation and use of innovative online and mobile payment and improves the security of payment services in Europe.

The revised directive introduces some key changes:

- Enhancing consumers' rights;
- Prohibition of surcharging;
- Opening the EU payment market for companies offering consumer or business-oriented payment services;
- Introduction of strict security requirements regarding electronic payments and the protection of consumers' financial data.

Luxembourg will have two years to transpose the directive into national law and regulations.

SFTR

8. European Council adopts transparency rules on Securities Financing Transactions (SFTR)

On 16 November 2016, the European Council adopted the **Regulation on Transparency of Securities Financing Transactions - (SFTR)**. The European Parliament adopted its position at first reading on 29 October.

The purpose of the new regulation is the following:

- cover all forms of lending, borrowing and re-use of securities in the EU,
- enhance transparency, and
- improve the package of regulations in the shadow-banking sector.

The regulation will enter into force on the 20th day following its publication in the EU Official Journal.

Supervisory reporting

9. CSSF Circular 15/621 – New FinREP on individual basis, IFRS 9 and liquidity ratio

This circular specifies the different application deadlines of the new FinREP reporting on individual basis. It also mentions that IFRS 9 will be applicable as at 1st January 2018, and warns institutions about the preliminary preparation they will have to face in order to comply with IFRS 9 requirements.

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