Banks and investment firms
Regulatory update

Topics covered in this issue

AML

1. *Fourth AML Directive published in JO*

Banking structural reform

2. *Council agreed its position regarding the structural reform of the banking sector*

BRRD

3. *Guidelines on recovery plan indicators*

CRD IV

4. *Guidelines on the management of interest rate risk arising from non-trading activities*

CRR

5. *Own Funds requirements: deduction from own funds items of indirect and synthetic holding*
6. *Own Funds requirements: disproportionate drag on own funds and preferential distributions*
7. *Own Funds requirements for market risk: materiality of extensions and changes of internal approaches*

DGS

8. *EBA Guidelines on contributions and payment commitments*

LCR

9. *Reporting of liquidity coverage ratio*

MCD

10. *Mortgage creditworthiness assessment and arrears and foreclosure*

MiFID

11. *ESMA guidelines embedded in CSSF Circular 15/615*

Transparency

12. Notification of major holdings in listed companies

AML

1. Fourth AML Directive published in JO

On 20 April 2015, the Council of the European Union has adopted its position on the rules aimed at preventing the use of the financial system for the purpose of money laundering or terrorist financing. The Directive aims at addressing the threat of money laundering by laying down additional measures; the Directive will repeal Directives 2005/60/EC and 2006/70/EC.

The position of the Council follows the Proposal for a Directive of the European Parliament and of the Council adopted on 05/02/2013. Main observations are as follows:

A. Retailers of high value goods and providers of gambling services

The new Directive broadens its scope to comprise unconventional channels to launder illicit proceeds. Retailers of high value goods and high value service providers apply customer due diligence when dealing with natural or legal persons trading in goods and carrying out transactions in cash of EUR 10 000 or more (whether in one transaction or in multiple transactions which appear to be linked). The Council has raised the threshold originally (in a former draft version) proposed of EUR 7500.

Providers of gambling services (including, but not limited to, casinos) are obliged to carry out customer due diligence. Member States may exempt certain providers of gambling services from these obligations, if the nature and the scale of the activity is at low risk. The use of exemptions should be considered as an exception and applied in a strict manner. Casinos can never be assimilated to a low risk activity. Customer due diligence is carried out when conducting transactions of EUR 2 000 or more (whether in one transaction or in multiple transactions which appear to be linked). The identity of the customer must be linked to the transactions carried out.

B. PEPs

Individuals who hold prominent public functions are exposed to greater risk of money laundering; they may transmit this risk to the financial sector when entering into a business relationship with an entity or professional of the financial sector. As a method of prevention, enhanced due diligence should be applied to politically exposed persons regardless whether they are domestic PEPs or PEPs residing in another Member State or in a third country.

C. Risk assessment

With the aim of identifying the risks of money laundering across Member States, the Council encourages a more centralised approach to risk assessment, which conceives a strengthened role of the Commission in coordinating cross-border risk assessment. A biennial report will indicate the sectors mostly at risk, the associated risks and the means used by criminals to launder illicit proceeds. The Commission will update its report with the intent of encouraging an effective response of national legislators and stakeholders. Similarly, Member States detect the threats of money laundering to which they are exposed and adopt appropriate countermeasures on a national level. This information is shared with the Commission, the European Supervisory Authority and the other Member States.

D. Tax crimes

The extended scope of the directive encompasses tax crimes within the definition of “criminal activity” with the intent of including tax crimes within the predicate offenses to money laundering. The text disregards the amendment of the

European Parliament pointing to “tax offenses” (infractions fiscales pénales). Tax crimes constitute “criminal activity” when:

- Related to direct or indirect taxes;
- Punishable by deprivation of liberty or detention order for a maximum of more than 1 year; or
- Punishable by deprivation of liberty or detention order for a minimum of more than 6 months.

Despite Member States independently designate the conducts constituting tax offenses, differences in national laws cannot hamper cooperation exchange of information between FIUs.

E. Beneficial ownership

In line with the latest FATF Recommendations, the identification of the natural person, who ultimately owns or controls a legal entity or a transaction, is crucial to the fight against money laundering. A central register in each Member State will collect the information which will be accurate and kept up to date. Member States are responsible for the arrangement of the central register, however they may hold obliged entities accountable for its compilation. Competent authorities, FIUs, obliged entities (and, to a certain extent, any person or organisation that can demonstrate a legitimate interest) will have access to the register. The consultation of the register does not fulfil in itself customer due diligence obligations. The mechanism aims at combating the misuse of legal persons and legal arrangements and at increasing transparency.

F. Sanctions

Competent authorities should impose administrative sanctions of different type and extent; when the infringing conduct is subject to criminal sanctions under national law, Member States can decide if they want to impose also administrative sanctions in addition. However, if no criminal sanction is foreseen, administrative sanctions become mandatory. Sanctions can be applicable to legal persons, to management bodies and to natural persons engaged in the breach.

Future developments

The European Parliament will be able to adopt the directive at second reading at a forthcoming plenary session. Member States will have two years for the transposition into national law.

How can Deloitte help?

Deloitte provides assistance for compliance to natural and legal persons subject to anti-money laundering provisions. We can help organisations to face efficiently the challenge and contribute with:

- **Internal policies** - gap analysis of anti-money laundering internal policies against regulatory requirements
- **On-site assistance** - adoption of a risk-based approach on the job
- **Forensics investigations** - tailor-made inquiries and analyses

Banking structural reform

2. Council agreed its position regarding the structural reform of the banking sector

By protecting the deposit-taking business of the largest and most complex EU Banks from potentially risky trading activities, the aim of this proposal is to enhance financial stability.

The proposed regulation would only be binding for **banks that are either deemed of global systemic importance or exceed certain thresholds** regarding their size (global systemically important institutions, in accordance with directive 2013/36/EU on capital requirements) or trading activities (entities with total assets of at least €30billion over the last three years and trading activities of at least €70 billion or 10% of their total assets).

The draft regulation is intended to:

- reduce excessive risk taking
- avert fast balance sheet growth, as a result of trading activities
- protect institutions providing activities that deserve a public safety net from losses incurred as a result of other activities
- provide for the mandatory separation of proprietary trading.

Trading activities other than proprietary trading would be subject to a risk assessment.

The regulation requires a qualified majority for adoption by the Council, in agreement with the European Parliament.

BRRD

3. Guidelines on recovery plan indicators

On 6 May 2015, the European Banking Authority (EBA) published **its final Guidelines on indicators for the recovery and resolution plans of credit institutions and investment firms across the EU**.

The EBA Guidelines establish the requirements that institutions across the EU should follow when developing their recovery plans.

The minimum list that institutions should include in their plans should be composed of, both qualitative and quantitative, indicators grouped into different categories such as capital, liquidity, profitability and asset quality. The national competent authorities have to ensure that credit institutions have put in place appropriate and consistent dispositions for the regular monitoring of the indicators.

On top of the minimum list of indicators, the EBA Guidelines furnish a list of additional indicators institutions may want to use.

These Guidelines are addressed to competent authorities and will enter into force on 31 July 2015.

CRD IV

4. Guidelines on the management of interest rate risk arising from non-trading activities

On 22 May 2015, the European Banking Authority (EBA) released **its updated version of the CEBS guidelines on technical aspects of the management of interest rate risk arising from non-trading activities (IRRBB) under the supervisory review process**, published on 3 October 2006.

The Guidelines focus on expectations towards institutions regarding the appropriate identification and mitigation of IRRBB risks. They introduce changes to the high-level ‘Principles' laid down in the CEBS Guidelines to:

- clarify expectations towards institutions
- extend the scope to internal governance
- specify the calculation of the supervisory ‘standard shock'

The Guidelines are splitted into two major sections :

1. updated version of the original CEBS text and provides enhanced high-level guidance on the management of IRRBB additional details for the management of IRRBB
2. additional details for the management of IRRBB

This guidance focuses on five areas of interest risk assessment and control:

- scenarios and stress testing
- measurement assumptions
- methods for measuring interest rate risk, governance
- identification of interest rate risk
- calculation and allocation of capital to interest rate risk.

These Guidelines are addressed to Competent Authorities and will apply from 1 January 2016.

CRR

5. Own Funds requirements: deduction from own funds items of indirect and synthetic holdings

On 17 June 2015, the Official Journal of the European Union published **its Commission Delegated Regulation (EU) 2015/923 of 11 March 2015 amending Delegated Regulation (EU) No 241/2014 supplementing Regulation (EU) 575/2014 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions**.

The purpose of the Regulation is to ensure that there is a uniform approach concerning the deduction from own funds items of indirect and synthetic holdings in institutions' own own funds instruments and indirect and synthetic holdings in financial sector entities.

The Delegated Regulation (EU) 241/2014 is amended by the insertion Articles 15a to 15j.

15 a	Indirect holdings for the purposes of Article 36(1)(f),(h) and (i) of Regulation (EU) No 575/2013
15 b	Synthetic holdings for the purposes of Article 36(1)(f),(h) and (i) of Regulation (EU) No 575/2013
15 c	Calculation of indirect holdings for the purposes of points (f),(h) and (i) of Article 36(1) of Regulation (EU) No 575/2013
15 d	Default approach for the calculation of indirect holdings for the purposes of points (f),(h) and (i) of Article 36(1) of Regulation (EU) No 575/2013
15 e	Structure-based approach for the calculation of indirect holdings for the purposes of points (f), (h) and (i) of Article 36(1) of Regulation (EU) No 575/2013
15 f	Calculation of synthetic holdings for the purposes of points (f),(h) and (i) of Article 36(1) of Regulation (EU) No 575/2013

15 g	Calculation of significant investments for the purposes of Article 36(1)(i) of Regulation (EU) No 575/2013
15 h	Holdings of Additional Tier 1 and Tier 2
15 i	Order and maximum amount of deductions of indirect holdings of own funds instruments of financial sector entities
15 j	Goodwill

Article 24a and 34a are also inserted:

24a	Distribution on own funds instruments - broad market indices
34a	Minority interests included in consolidated Common Equity Tier 1 capital

This Regulation will enter into force on 7th July 2015.

6. Own Funds requirements: disproportionate drag on own funds and preferential distributions

On 2nd June 2015, the Official Journal of the European Union published its **Commission Delegated Regulation (EU) 2015/850 amending Delegated Regulation (EU) No 241/2014 supplementing Regulation (EU) 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for Own Funds requirements for institutions**.

The Regulation deals with disproportionate drag on own funds and preferential distributions.

The Delegated Regulation (EU) 241/2014 is amended by the insertion of four new articles. The first one is Article 7a which establishes the multiple distributions constituting a disproportionate drag on own funds.

Article 7b and 7c are also inserted and sets out the preferential distributions regarding preferential rights to payments of distributions and the calculation of the pay-out ratio for the purpose of point (b) of Article 7b(8).

The last Article is Article 7d that presents the preferential distribution payments.

The Regulation entered into force on 22 June 2015.

7. Own Funds requirements for market risk: materiality of extensions and changes of internal approaches

On 19th June 2015, the Official Journal of The European Union published its **Commission Delegated Regulation EU) 2015/942 of 4 March 2015 amending Delegated Regulation (EU) No 529/2014 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards regulatory technical standards for assessing the materiality of extensions and changes of internal approaches when calculating Own Funds requirements for market risk**.

The amended Delegated Regulation (EU) No 529/2014 lays down the condition for assessing the materiality of extensions and changes to the Internal Rating Based approaches, the Advanced Measurement Approaches and the internal Model Approach permitted in accordance with Regulation (EU) No 575/2013, including the modalities of notifications of such changes and extensions.

This Regulation will enter into force on 9th July 2015.

DGS

8. EBA Guidelines on contributions and payment commitments

On 28 May 2015, the EBA published its **final Guidelines on contributions to deposit guarantee schemes (DGSs) and on payment commitments**. These Guidelines will help ensuring consistent application of the new funding requirements provided for in the new Deposit Guarantee Schemes Directive (DGSD).

These Guidelines will provide with calculation methods in order to capture the main dimensions of the risk profile of credit institutions, they specify also the option for DGSs to authorise credit institutions to contribute, up to 30% of the required contributions, in the form of secured commitments to pay upon request.

Credit institutions will be able to make payment commitments by concluding two types of arrangements:

- Payment Commitment Arrangement

- Financial Collateral Arrangement.

The Guidelines provide for criteria on the eligibility and management of collateral, they also provide that DGSs should limit their exposure to debt, whether public or private, the value of which is highly correlated to events where the DGS would have to use its funds, and therefore might have to call in the payment commitment.

Collateral will be subject to regular marking to market and precautionary haircuts in order to cater for possible losses at the point of failure.

The Guidelines also introduce principles ensuring that the prudential treatment of payment commitments does not encourage procyclicality by incentivising payment commitments over cash contributions.

DGSs and designated authorities should implement these Guidelines by incorporating them in their practices by 31 December 2015.

LCR

9. Reporting of liquidity coverage ratio

On 24 June 2015, the EBA published its **updated Implementing Technical Standards (ITS) on supervisory reporting of liquidity coverage ratio (LCR) for European credit institutions**.

The final draft ITS amending ITS on LCR reporting contains templates and instructions to update the LCR reporting framework for credit institutions. This final draft ITS shall ensure a satisfactory supervisory reporting of the LCR as stated in the Commission's Delegated Act. The ITS also outline all the necessary steps needed for the calculation of the ratio.

These new templates and specifications will **only be applicable to credit institutions** and not to investment firms. In fact, investment firms will continue to use current instructions and templates.

Credit institutions will start using the new specifications and templates for their reporting, only as of the application date of the amended technical standards, which will be specified in their final publication in the EU Official Journal.

MCD

10. Mortgage creditworthiness assessment and arrears and foreclosure

On 1st June 2015, the EBA **published its final Guidelines on creditworthiness assessment and on arrears and foreclosure**. Both Guidelines sustain the national implementation by EU Member States of the upcoming Mortgage Credit Directive (MCD).

The Guidelines on creditworthiness assessment draw up requirements for:

- checking consumers' income
- documenting and retaining information

- identifying and preventing misrepresented information
- assessing consumers' ability to meet their obligations under the credit agreement.

The Guidelines on arrears and foreclosure set up requirements in terms of:

- policies and procedures for the early detection and handling of payment difficulties including staff training
- engagement with consumers, provision of information and assistance to consumers resolution process and documentation of dealings with consumers and retention of records.

The Guidelines will apply from 21 March 2016, the transposition date of the MCD.

MiFID

11. ESMA guidelines embedded in CSSF Circular 15/615

On 7 May 2015, the European Securities and Markets Authority (ESMA) published **guidelines on the application of the definition of commodity derivatives and their classification under C6 and C7 of Annex I of the Markets in Financial Instruments Directive (MiFID).**

In some Member States, the application of MiFID gave rise to different interpretations from the competent authorities regarding what should constitute a financial instrument and what should be classified as a derivative contract. This could lead to an inconsistent application of MiFID, but also of other Directives and Regulations that rely on MiFID like European Markets Infrastructure Regulation (EMIR).

These guidelines should ensure a common and consistent application of the definition of commodity derivatives and their classification under C6 and C7 listed in Section C of Annex I of MiFID.

Some of these guidelines are issued under Article 16 of the ESMA Regulation. In accordance with Article 16(3) of the ESMA Regulation competent authorities and financial market participants must make every effort to comply with guidelines and recommendations.

Competent authorities to whom the guidelines apply should comply by incorporating them into their supervisory practices These guidelines apply from 7 August 2015.

CSSF Circular 15/615 published on 11 June 2015 intends to transpose these guidelines.

Transparency

12. Notification of major holdings in listed companies

On 13 May 2015 the Official Journal of the European Union published **Commission Delegated Regulation (EU) 2015/761 with regard to certain regulatory technical standards on major holdings**.

The aim of the Regulation is to ensure consistent application of the regime for notification of the acquisition or disposal of major holdings and related exemptions. This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission and lays down detailed rules for the implementation of Article 9(6b), Article 13(1a)(a) and (b) and Article 13(4) of amended Directive 2004/109/EC (Transparency Directive).

This Regulation shall enter into force on 26 November 2015.

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