Deloitte. 2019 Regulatory agenda - Top priorities

IN THIS SPECIAL EDITION OF THE TOP 2019 REGULATORY PRIORITIES:

- **Internal governance arrangements – incl. revised guidelines on outsourcing, on ICT and security risk management**
- **CRD V / CRR II/SREP - incl. IRRBB, stress testing and revised guidelines on ICAAP and ILAAP/NPL Management and new definition of default/CRR III: Finalization of Basel reform (Basel IV)**
- **Resolution and recovery BRRD/MREL/TLAC/Bail-in**
- **Investment fund initiatives: Omnibus initiative on cross-border barriers to distribution of funds/Private Placement Regimes (PPR) revision under AIFMD**
- **Packaged Retail and Insurance based Investment Products (PRIIPs)**
- **IFRS 17**
- **IORP II and PEPP**
- **Directive on Administrative Cooperation (DAC 5 and DAC 6)**
- **EU ESG financial strategy**
- **Market infrastructures – Central Securities Depositaries and internalized settlements & settlement discipline**
- **EMIR**
- **Changes of reference benchmarks**

TOPICS / SCOPE

Internal governance arrangements – incl. revised guidelines on outsourcing, on ICT and security risk management

- Credit institutions
- (Large) investment firms
- Payment service providers (PSPs)

CRD V/CRR II/SREP - incl. IRRBB, stress testing and revised guidelines on ICAAP and ILAAP/NPL Management and new definition of default/CRR III: Finalization of Basel reform (Basel IV)

- Credit institutions
- (Large) investment firms

Resolution and recovery BRRD/MREL/TLAC/Bail-in

- Credit institutions

Investment fund initiatives: Omnibus initiative on cross-border barriers to distribution of funds/Private Placement Regimes (PPR) revision under AIFMD

- Investment funds (UCITS & AIFs)

Packaged Retail and Insurance based Investment Products (PRIIPs)

- Investment firms

IFRS 17

- Insurance undertakings

IORP II and PEPP

- Institutions for occupational retirement provisions (pension funds)

Directive on Administrative Cooperation (DAC 5 and DAC 6)

- Investment funds (UCITS & AIFs)
- Credit institutions
- Insurance companies
- PFS (Professionals of the Financial Sector)
- CSP (Corporate Service Providers)

EU ESG financial strategy

- Credit institutions
- Investment firms
- Investment funds (UCITS & AIFs)
- Insurance companies
- Management companies / AIFMs

Market infrastructures – Central Securities Depositaries and internalized settlements & settlement discipline

- Credit institutions
- Settlement internalizers
- CSD member institutions

EMIR

- Investment firms
- Credit institutions
- Management companies

Changes of reference benchmarks

- Credit institutions
- Investment firms
- Investment funds (UCITS & AIFs)
- Insurance Companies

BACKGROUND

Following the entry into force of EBA's revised guidelines on internal governance on 30 June 2018, supervisors are likely to strengthen their review of internal governance arrangements, including "fit and proper" procedures as harmonising institutions' internal governance arrangements, processes and mechanisms across the EU is a key objective of the ECB.

Outsourcing arrangements

Specific attention will be made on outsourcing arrangements with the release of EBA's revised guidelines on outsourcing arrangements that deal with the responsibilities of the management body for the establishment of an appropriate framework for outsourcing, its implementation and application in a group, the due diligence process and risk assessment before entering in such arrangements. The guidelines will also clarify aspects related to the contractual arrangements, the monitoring and documentation of outsourcing arrangements as well as the supervision by the supervisory authorities.

ICT and security risk management

The EBA guidelines on ICT and security risk management will establish requirements for credit institutions, investment firms and payment service providers (PSPs) on the mitigation and management of their information and communication technology (ICT) risks. The guidelines recognise the increasing reliance of financial institutions on ICT and their ever-growing exposure to ICT threats (including cyber-attacks) that can pose significant adverse impacts on their operational functioning. The guidelines outline expectations in relation to ICT governance and strategy, ICT risk management framework, Information security, ICT operations management, ICT project and change management and business continuity management, to mitigate ICT and security risks.

The provisions of the 'Guidelines on the security measures for operational and security risks of payment services' (EBA/GL/2017/17) have been fully integrated in the EBA Guidelines on ICT and security risk management and will be repealed when the latter enter into force.

Following the developments seen in recent years, the following prudential matters should be closely monitored over the coming year:

CRD V/CRR II

A political deal was reached in late 2018 in negotiations on the EU's bank capital legislative package. The stated objective is to further strengthen the resilience of the banking sector by introducing more risk-sensitive capital requirements. At the same time, the new measures should make CRD/CRR rules more proportionate and less burdensome for smaller financial institutions and improve banks' lending capacity to support the EU economy.

The proposed legislation implements components of the Basel III framework, including the Net Stable Funding Ratio (NSFR), the leverage ratio, and the Fundamental Review of the Trading Book (FRTB) in part. It also includes provisions relating to proportionality (with a reduced reporting burden and the use of a simplified NSFR), Intermediate Parent Undertaking (IPU), and the introduction of environmental, social and governance (ESG) risks into the risk management process.

SREP Review

To further enhance institutions' risk management and supervisory convergence in the Supervisory Review and Examination Process (SREP), the EBA issued several publications in 2018 as part of its Pillar II Roadmap that will become applicable in 2019. These include the revised guidelines on the Supervisory Review and Evaluation Process (SREP), management of Interest Rate Risk in the Banking Book (IRRBB) and stress testing.

Internal capital and liquidity adequacy assessment processes (ICAAPs and ILAAPs) are key risk management instruments for credit institutions. ECB Banking Supervision reviews the quality of institutions' ICAAPs and ILAAPs as a fundamental part of the SREP. Following an intensive dialogue with banks, the finalized ECB guidelines on ICAAP/ILAAP will be available for use from 2019 onwards. Work will also continue on improving transparency around the risk-by-risk composition of the Pillar II capital requirements.

NPL management and the new definition of default

Management of non-performing and forborne exposures will still be high on the agenda of institutions in 2019 with the entry in force of the EBA guidelines on managing non-performing exposures (NPEs). The guidelines aim to ensure that credit institutions have adequate prudential tools and frameworks in place to effectively manage their NPEs and to achieve a sustainable reduction on their balance sheets. They require institutions to establish NPE reduction strategies and introduce governance and operational requirements to support them.

This should be considered in conjunction with banks' ongoing efforts to align their internal models and IT systems with the new definition of default that will apply from 1 January 2021.

ECB stress test exercise

As in 2017, the annual supervisory stress test in 2019 will be conducted with a focused scope. The 2019 stress test will seek to assess banks' resilience against liquidity shocks. The individual banks' stress test results will inform the SREP assessments.

Prudential requirements for investment firms

The European Parliament and the Council will continue their dialogue on the proposed "Investment Firm Package" adopted in December 2017 by the European Commission. This addresses the view among EU supervisory authorities that the current CRD IV prudential regime is not appropriate for the majority of investment firms.

The proposal will establish three different classes of investment firms:

- Class 1—Full application of CRD IV requirements
- Class 2—Partial application of CRD IV requirements
- Class 3—MiFID II requirements only

Once adopted, an implementation period of 18 months is expected before the application of the new regime.

Transposition of Basel IV in Europe—CRR III

Following the publication of the "finalization" of Basel 3 (referred to as Basel IV) by the Basel Committee in December 2017, the European supervisory authorities will initiate work on its implementation in EU legislation (CRR III). We expect the CRR III package to not be proposed by the European Commission until mid-2020.

Amendments will be made to the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRMR), to incorporate international standards on loss absorption and recapitalization.

The Total Loss-absorbing Capacity (TLAC) set by the Financial Stability Board (FSB) will be integrated into the EU's "minimum requirement for own funds and eligible liabilities" (MREL) rules. In the EU, global systemically important banks (GSIIs) will be required to comply with the TLAC, while non-GSIIs will remain subject to MREL rules.

Other amendments include the following:

- Eligibility criteria and subordinated debt: Amendments to the eligibility criteria for the instruments and items that count towards compliance with MREL rules, to bring them into line with the eligibility criteria provided in the TLAC standard for the TLAC minimum requirement. The new text also defines the level of liabilities that may need to be met by subordinated debt to be "bailed in" before other liabilities and also approves provisions to ensure that a bank that holds more capital is not punished in the calculation methodology.
- Moratorium: Application of a "moratorium power" to suspend payments by banks that are getting into difficulty. The provision says that this power may be activated when it has been determined that the bank is failing or likely to fail (FOLTF) and if there is no private sector measure to prevent the failure. It allows the resolution authority to establish whether it is in the public interest to put the bank into resolution rather than insolvency. The scope of the moratorium would be proportionate and tailored to the specific case in question.
- Protection: New provisions to protect retail investors from holding bail-inable bank debt when it is not a suitable retail instrument for them. Furthermore, any financial contract governed by a third country in the EU would be subject to the resolution rules.

On 3 December 2018, the European Parliament's ECON Committee agreed its position on the cross-border barriers to fund (UCITS and AIFs) distribution.

To summarize, all compromises, including the extension of the UCITS exemption, were passed with a large majority—a positive sign for the Trilogues discussions with the European Commission and Council that will be required to finalize the text of the regulation.

The final ECON position now reflects the following:

- A broad definition of "pre-marketing" that applies to EU domiciled AIFs to include the definitions already in use in Member States other than the targeted host country.
- ECON has succeeded in introducing a review clause for the UCITS pre-marketing regime with the implicit aim of aligning it with that of AIFs.
- The European Commission will also have to report on the effect of the proposed amendments on the AIFMD third-country regime (as per Articles 35 and 37-41 of the AIFMD) before this comes into effect.
- The numerical thresholds for de-notification envisaged in the original proposal have been removed. However, the trilogue phase still needs to formally confirm this.
- The obligations of host Member State supervisory authorities are clarified vis-à-vis those investors that choose to remain invested in funds for which the national marketing regime has ceased.
- On the extension of the UCITS PRIIPS exemption, the European Commission has given one more year to finalize its Level-1 review (until 31 December 2019) while the UCITS exemption is extended by two years (until 31 December 2021).

In terms of AIFMD II, the European Commission report commencing the review of the framework in line with Article 69 of the AIFM Directive has been published. The review will now continue with the next step being the European Commission preparing a report to the EU co-legislators.

On 18 May 2017, the IASB published IFRS 17 Insurance Contracts, closing a project that has been running for 20 years. It will replace IFRS 4 on accounting for insurance contracts and has an effective date of 1 January 2021.

While the building blocks of IFRS 17's recognition and valuation requirements stem from the same, or very similar, underlying concepts as Solvency II, there are significant issues that must be resolved before IFRS 17 is endorsed.

Implementation of the standard will probably be delayed by two years to allow time to make the necessary improvements and to allow time for the insurance industry to implement the standard.

The European Supervisory Authorities, on 1 October 2018, set out in a letter to the European Commission their intention to make proposals to support legislative changes to tackle key issues that have arisen since the implementation of the IFRS. The consultation paper addresses, in particular, amendments to the information regarding investment products' performance scenarios.

Regulation No. 1286/2014 on Key Information Documents for Packaged Retail and Insurance based Investment Products (PRIIPs) has been applicable since 1 January 2018 and requires PRIIPs manufacturers (e.g., insurance companies, investment banks, asset managers) and distributors (e.g., banking institutions) to provide retail investors with a KID prior to making their investment decision.

The PRIIPs regulation includes an exemption period for UCITS funds or AIFs providing a Key Investor Information Document to their investors drawn up in accordance with the UCITS KIID regulation.

AIFs should have had a PRIIPs KID in place as of 1 January 2018 unless the AIF benefits from the exemption conditions which will allow the AIF to take advantage of the transposition delay until 31 December 2021.

The exemption period, initially until 31 December 2019, has been extended until 31 December 2021. The European Commission is currently undertaking a review of the PRIIPs regulation, assisted by the European Supervisory Authorities, which must be finalized by 31 December 2019.

IORP II

The revised Directive on the activities and supervision of institutions for occupational retirement provision (IORP) was published in the Official Journal of the European Union on 23 December 2016, and Member States must transpose it by 13 January 2019.

This Directive sets common standards that are intended both to guarantee a high degree of security for all future pensioners through the imposition of stringent supervisory standards, and to clear the way for the sound, prudent, and efficient management of occupational pension schemes.

These common standards include new governance requirements, new rules on IORPs' own risk assessment, new requirements to use a depositary and enhanced powers for supervisory authorities.

PEPP

The Pan-European Pension Product (PEPP) is a voluntary personal pension scheme that will offer consumers a new pan-European option to save for retirement. The PEPP could be offered by a broad range of financial institutions such as insurance undertakings, banks, pension funds, certain investment firms and asset managers. In September 2018, ECON adopted a draft regulation to introduce such a product; the final shape of the adopted text will be subject to upcoming negotiations between the European Parliament and the European Commission.

DAC 5

On 6 December 2016, the Council adopted Directive 2016/2258, also known also as DAC 5. This Directive amends EU Directive 2011/16/EU as regards access to anti-money-laundering information by the tax authorities. Following its transposition into Luxembourg legislation by the Law of 1 August 2018, the Luxembourg tax authorities will be able to access the mechanisms, procedures, documents, and information referred to in Articles 13, 30, 31 and 40 of the Council Directive 2015/849. Such information is subject to exchange with the tax authorities of other EU Member States. The following information will be subject to exchange:

- Customer due diligence information
- Beneficial ownership for trusts and corporate entities
- Records of transactions
- Other documents specified in Articles 13, 30, 31 and 40 of EU Directive 2015/849

DAC 6

On 25 May 2018, the Council adopted Directive 2018/822 (DAC 6) to further amend the Council Directive 2011/16/EU. The new Directive aims to establish new transparency rules for intermediaries such as accountants, banks, lawyers, and tax advisors that design and promote tax-planning schemes, or have knowledge of such schemes, for their clients. To achieve this goal, DAC 6 introduces a set of obligations that Member States will have to transpose into their national systems. These obligations include:

- A requirement for intermediaries to identify and report cross-border arrangements that contain specific indicators ("hallmarks") that may suggest that the arrangement has been set up for tax avoidance purposes
- A requirement for Member States to automatically share the information received from intermediaries with all other Member States on a quarterly basis

The ESG financial strategy is composed of several regulations or amendments to existing regulations:

- **MiFID II:** introduction of the ESG component into the investor profile, requiring firms to propose ESG compliant products.
- **IDD:** similarly, to MiFID II, the proposed amendments aim to introduce ESG preferences into insurance/pension contracts.
- **Taxonomy:** a definition of taxonomy should ensure that all references to ESG compliant products/ investments meet pre-agreed standards.
- **Benchmarks positive and carbon neutral:** these benchmarks aim to help the fund industry and asset managers benchmark their investments' compliance to ESG compliant policies comparing them to a benchmark with carbon neutral emissions and a second benchmark that reduces production of carbon dioxide.
- **Long-term:** inclusion of ESG factors in loans (CRD/CRR amendments) and application of ESG goals to individual entities.

CSD-R aims to harmonize the authorization and supervision of Central Securities Depositories (CSDs) across the EU. It also aims to harmonize various aspects of settlement including settlement cycles (mandating a T+2 cycle), settlement discipline regimes (including a buy-in process to remedy settlement failures) and to mandate the adoption of full dematerialization of securities.

CSD-R – Internalized settlement

Under delegated regulation 2017/311, this subset of the CSD-R regulation will require settlement internalizers to report on a quarterly basis, on the internal settlement of transactions they operate between two or more accounts.

The delegated regulation has been complemented by ESMA guidelines (070-151-1258) on the content of the reporting issued in September 2018.

Settlement discipline

Under delegated regulation 2018/1229, CSDs and financial institution members of CSD will have to implement new rules on settlement discipline.

Key obligations would be to enforce settlement, provide underlying financial instruments and/or cash penalties.

Its impact is likely to affect the whole execution value chain in case of settlement failure. The market or relevant CSD might trigger the settlement discipline if a trade fails to settle within the required cycle (usually T+2). The party that fails will have to supply equivalent securities, or in the impossibility to deliver, pay an equivalent sum to its counterpart plus a penalty to the CSD.

The mandatory central clearing of certain OTC trades follows an extended phase-in process, with the European Commission releasing application dates in its Regulatory Technical Standards (RTS). The clearing obligation started to come into force in mid-2016 and will only be complete for all asset classes and counterparties by mid-2019.

EMIR Review (REFIT proposal): In May 2017, the European Commission published a proposal to amend EMIR, following a review of how EMIR has worked since its adoption. The European Commission proposal marks targeted amendments, including amendments to the definition of financial counterparty (FC), introducing a clearing threshold for smaller FCs, placing new duties on firms offering clearing services to do so on a fair, reasonable and non-discriminatory basis, removing frontloading and giving the European Commission powers to temporarily suspend the clearing obligation.

EMIR 2.2. (CCP supervision): In June 2017, the European Commission published a proposal to enhance the supervisory framework under EMIR for EU Central Counterparties (CCP) and systemically important non-EU CCPs. The proposal gives ESMA greater powers to co-ordinate supervision of EU CCPs and to directly supervise systemically important non-EU CCPs. It also gives the European Commission power (upon request by ESMA and in agreement with the relevant central bank) to impose a located requirement for non-EU CCPs that are of such systemic importance that direct supervision is deemed insufficient to mitigate the potential risks.

Under the review of "Principles for financial benchmarks review" by IOSCO, the ECB, FCA and European Commission have started to reflect on the usage of key benchmarks: LIBOR, EURIBOR and EONIA.

The new methodology will be aligned on the Benchmark Regulation switching from judgemental expert contributions to transaction-based data.

As a result, the ECB is mandating a switch from EONIA to ESTER for short term rates, leading to the replacement of all interest rate references to EONIA in products, services and contracts. As regards EURIBOR and LIBOR, their future is currently under discussion.

Therefore, the switch is likely to require adaptation of contracts that refer to one of the EURIBOR, LIBOR or EONIA benchmarks, this includes loans, mortgages, but also derivatives contracts, funds or other assets that use a rate benchmark as reference.

NEXT STEPS

- **Q1 2019:** Expected final revised guidelines on outsourcing arrangements
- **Q2-Q3 2019:** Expected final guidelines on ICT and security risk management

- **1 January 2019:** EBA revised guidelines on SREP and stress testing become available
- **1 January 2019:** ECB guidelines on ICAAP and ILAAP become applicable
- **30 June 2019:** EBA guidelines on NPL management and the EBA revised guidelines on the management of IRRBB become applicable
- **Q1 2019:** Expected finalization of the Council and European Parliament legislative process. At that point, secondary rulemaking by the EBA and national regulators must also occur
- **Q1 2019:** CRD V / CRR II

- **Q2 2019:** Expected finalization of BRRD 2

With this agreement in hand, the ECON Committee will be able to start the Trilogue and reconcile the version of the EU Commission and Council, most likely from January 2019 with a view to reaching a resolution before the European elections in 2019.

- **1 January 2018:** PRIIPS entered into force
- **Transition period for UCITS extended until 31 December 2021**

- **1 January 2021:** Entry into force of IFRS 17 Insurance Contracts to replace IFRS 4; anticipated implementation may be delayed by two years

- **13 January 2019:** Transposition deadline for IORP II by Member States

- **1 January 2018:** DAC 5 in force
- **31 December 2019**: transposition of DAC 6 into local legislation, practical application as per 25 June 2018 with first reporting due by 31 August 2020

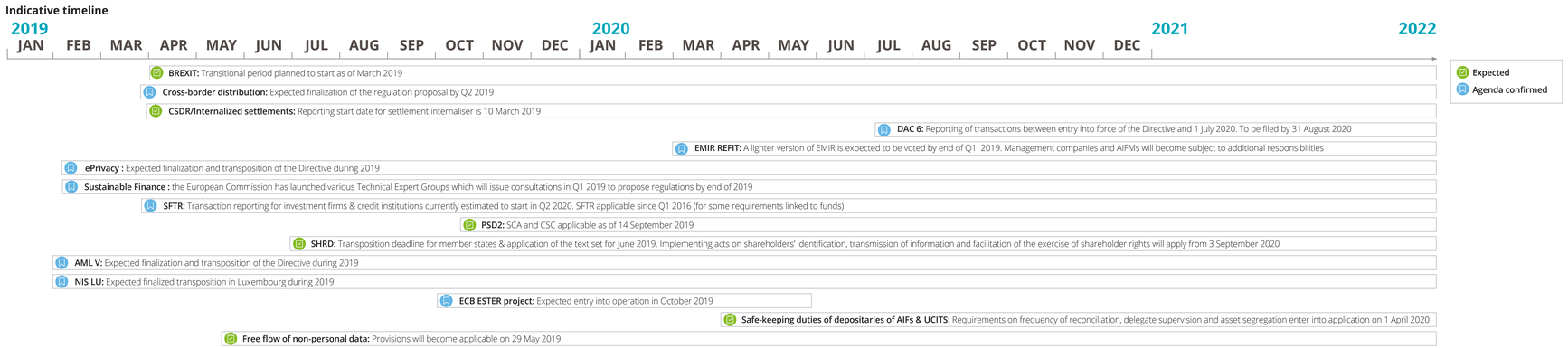
- **By end Q1 2019:** IDD and MiFID II finalisation
- **Estimated finalization by end Q1 2019:** Taxonomy, EU authorities are entering trilogue
- **Expected by end Q1 2019:** Benchmark is entering finalization in trilogue
- **Expected in 2Q 2020:** Application of ESG investment topics

- **10 March 2019:** Technical standards on internalised settlement will apply
- **Q1 2019:** End of March is the start date for internalized settlement reporting which is due in Q2 2019
- **September 2019:** European Commission to review and report on CSDR

- **9 May 2019:** clearing obligation starts for CDS (Category 4 counterparties)
- **21 June 2019:** clearing obligation starts for G4, EEA rates and CDS (Category 3 counterparties)
- **9 August 2019:** clearing obligation starts for EEA rates (Category 4 counterparties)
- ESMA expected to submit draft RTS for REFIT proposal to EU Commission 9 months after in-force date
- **3Q 2019:** EU Commission to adopt delegated act specifying criteria for Tier 2 CCPs 6 months after entry into force

- **By October 2019:** Target date for ESTER (replacement of EONIA)
- Target change for EURIBOR – not confirmed – new benchmark regulations applies from 1 January 2020
- **Scheduled for 2021:** Target date for SOFR (replacement of LIBOR)

Indicative timeline



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