



Risk and Regulation Monthly

August 2016

August is usually a quieter month, as many in the financial sectors take time off over the summer period.

Nonetheless, there was some activity in August: the UK Government stated that controls on immigration must be part of the UK's post-Brexit deal with the European Union (EU) – the implications of this for the UK's membership of the EU single market remain unclear; the Financial Conduct Authority (FCA) proposed a 2019 deadline for new complaints about payment protection insurance (PPI) to be made; and the Financial Stability Board (FSB) issued a slew of papers ahead of the G20 meeting in early September, focussing on governance, resolution and CCPs.

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Brexit

The UK Government's Cabinet **met** to discuss their approach towards **negotiations on the UK's exit from the EU**.

The Cabinet decided that controls on the number of people who come to the UK from Europe needs to be part of the deal, although the implications of this for the UK's membership of the EU single market were not made clear. The Cabinet also said that there is no need to hold a parliamentary vote before beginning the formal process for withdrawing from the EU.

Capital (including stress testing)

The Bank of England's Financial Policy Committee (FPC) published a **statement** and the **minutes** from its latest policy meeting during which it decided to allow banks to exclude central bank reserves from the **total exposure measure in their calculation of the leverage ratio**. The measure was announced in the context of maintaining financial stability following the UK's decision to leave the EU.

The Prudential Regulation Authority (PRA) **published** a statement following the FPC's announcement, stating that the measure would be implemented with immediate effect. It also **sent** a letter to firms inviting them to apply for the temporary modification to their total exposure method.

The European Banking Authority (EBA) **published** a report to the European Commission on the **calibration of the leverage ratio**. The report found the introduction of the leverage ratio with a 3% baseline to be "generally consistent" with the objective of providing a backstop to risk-based capital requirements. It judged the impact of the leverage ratio on the supply of finance to the real economy would be "relatively moderate" compared to the overall size of the banking sector. It further found that higher leverage ratio requirements for global systemically important institutions may be warranted due to their potentially elevated risk of excessive leverage.

The EBA **submitted** an amended version of the implementing technical standards on **benchmarking of internal approaches** under the Capital Requirements Directive (CRD) IV to the European Commission. The amended version would be used for the 2017 benchmarking exercise and for reporting by firms to the EBA and competent authorities to allow supervisors to carry out assessments for credit risk and market risk.

The EBA **published risk data** from 36 EU institutions used during the identification and scoring process for global systemically important banks (G-SIBs), in line with the methodologies published by the FSB and the Basel Committee on Banking Supervision (BCBS). The EBA's annual exercise included not only G-SIBs but also other larger EU banks whose leverage ratio exposure measure exceeds 200 billion Euros.

The EBA **published** findings from its **review of the Single Rulebook Q&As on the CRD and Capital Requirements Regulation (CRR)**. The review was targeted at aspects of CRD and CRR that are expected to be the subject of legislative review in 2016, although it does not make specific recommendations for how to address its findings. The review found two errors in the CRD text and seven inconsistencies in the CRR text. The review found that the Own Funds Q&As contained 14 issues that fell into the category of "fundamental issues".

The European Systemic Risk Board (ESRB) **recommended** the EU-wide reciprocation of Estonia's 1% rate for the **systemic risk buffer**. The 1% rate will apply to all EU firms' Estonian exposures.

The European Commission **published** an implementing regulation for the calculation of **technical provisions and basic own funds under Solvency II**. The regulation lays down risk-free rate term structures, fundamental spreads for the calculation of the matching adjustment, and volatility adjustments for each relevant national insurance market.

The European Commission **consulted** on issues relating to the upcoming **review of the EU macroprudential framework**, including the scope and activation of macroprudential policy instruments in CRD/CRR, and the role and organisational structure of the ESRB.

The European Commission also **published a roadmap for the review** of the EU macroprudential framework. It suggested that a legislative proposal would seek to streamline the macroprudential policy instruments, introduce more coherent and less onerous procedures, and facilitate proper policy coordination and peer review processes.

Liquidity

The International Organization of Securities Commissions (IOSCO) **consulted** on its analysis of **liquidity in corporate bond markets since 2004**. It found that there was no substantial deterioration in market liquidity compared to historic non-crisis periods and that regulatory reforms have not caused a substantial decline in liquidity. The study also revealed changes to the characteristics and structure of secondary corporate bond markets, including increased use of technology and electronic trading venues, and changes in the role of participants and execution models.

Governance and risk management (including remuneration)

The PRA **published** a letter reminding all CRR firms that they are required to comply with PRA rules to put in place a **policy promoting diversity in their management body**. The letter cited the EBA's Report on the Benchmarking of Diversity Practices of July 2016, which showed that just 15% of firms surveyed had a policy on promoting diversity.

The PRA **published** a policy statement on **remuneration requirements under Solvency II**, along with a **supervisory statement** and a **remuneration policy statement reporting template**.

The supervisory statement clarifies the PRA's expectations of how Solvency II firms should comply with the key Solvency II remuneration requirements. The focus is on the identification of Solvency II staff, deferrals, and performance measurement.

The FSB **launched** a peer review on the implementation of the G20/Organisation for Economic Co-operation and Development (OECD) **principles of corporate governance**. The review will take stock of how FSB member jurisdictions have applied the principles to publicly listed financial institutions, inform the update of the OECD's Assessment Methodology and provide input to governance-related aspects of the FSB's broader work on conduct for financial institutions.

Conduct of Business (including MiFID)

The FCA **consulted** on rules and guidance on **PPI complaints**. The FCA proposed a 2019 deadline on new complaints about PPI and a campaign to raise awareness in 2017. It also provided additional information on proposed guidance for the calculation of redress for complaints affected by the Plevin judgement.

The FCA **published** a report on the **equality issues relating to the FCA's PPI proposals**. The report provided evidence on the impact of the proposals on vulnerable consumers and those from protected groups. It set out suggestions to ensure that the FCA's proposed consumer communication campaign will effectively reach specific "vulnerable groups".

The FCA **published** an alert highlighting the potential **risks to authorised firms that accept business from unauthorised introducers**, lead generators and other authorised firms (introducers). The FCA expressed concern at the increase in cases in which an introducer has had inappropriate influence on how the authorised firm carries out its business, such as influencing the final investment advice given to customers. The FCA reiterated that authorised firms need adequate control over the advice they are ultimately responsible for giving to customers.

The FCA **announced** an upcoming consultation on updating the methodology used to calculate **redress for unsuitable advice on transfers from defined benefit occupational pension schemes to personal pensions**. It said that firms should not settle currently outstanding complaints on a "full and final" basis until the outcome of the consultation is known.

The Competition and Markets Authority (CMA) **published** the final report on its **retail banking market investigation**. The CMA said that it will require the largest banks to implement "open banking" by 2018, which will enable customers to manage accounts with multiple providers through a single digital "app". All personal current account providers must also introduce and publicise a monthly maximum charge for use of an unarranged overdraft facility by Q3 2017.

The FCA **published** a policy statement on increasing **transparency and engagement at renewal in general insurance markets**. It said that insurers and intermediaries must disclose last year's premium at each renewal, encourage consumers to check their cover, and encourage consumers who have renewed their policies on four consecutive occasions to "shop around".

The FCA **published** a statement relating to their consultation on **client money rules for insurance intermediaries**. It concluded that it would not be proportionate to proceed with the proposed rule changes at this time owing to the industry's increased focus on protecting client money and engagement with the FCA's policies in this area. The FCA confirmed it will not pursue rule changes without further consultation.

The FCA **published** minutes of its latest **MiFID II implementation roundtable**. The FCA confirmed that the European Securities and Markets Authority (ESMA) is expected to provide clarification for firms to help determine if they are a systematic internaliser and is also likely to provide guidance on investment research. The FCA also clarified that the Treasury statutory instruments are being revised and a feedback statement is expected later this year.

The FCA **added** the ICE Benchmark Administration Limited's London Interbank Offered Rate (**LIBOR**) **code of conduct** to its list of 'confirmed' industry guidance. This means that the FCA will not take action against a firm for behaviour that it considers to be in line with guidance.

The FCA **published** an occasional paper looking at whether it is possible to predict which **consumer credit users** will suffer **financial distress**. The research concluded that the risks of financial distress vary predictably depending on an individual's circumstances, and in particular their debt-to-income ratio. It suggested that consumer credit lenders should take this into account when evaluating whether lending to an individual was affordable.

The European Insurance and Occupational Pensions Authority (EIOPA) **consulted** on implementing technical standards on the standardised presentation format of the **Insurance Product Information Document** (IPID) under the Insurance Distribution Directive. EIOPA discussed the length of the IPID, the use of visual aids, and the use of digital formats. It clarified that multi-risk policies should be presented in a single IPID. The European Commission adopted two sets of regulatory technical standards under the revised Markets in Financial Instruments Directive (**MiFID II**) and Regulation (**MiFIR**), one on **transaction reporting** and one on **organisational requirements** for investment firms engaged in algorithmic trading.

The European Commission **adopted** an implementing decision **classifying Euro Interbank Offered Rate (EURIBOR) as a critical benchmark** for the purposes of the Benchmark Regulation, which imposes requirements ensuring integrity and robustness of critical benchmarks.

The International Association of Insurance Supervisors (IAIS) **published** a paper on **cyber risk to the insurance sector**, citing data safety, consumer protection and confidence in the industry as primary global concerns. The paper analysed the different levels of awareness of cyber threats, risk management frameworks, and supervisory approaches across jurisdictions and regions.

The Committee on Payments and Market Infrastructures (CPMI) and IOSCO **published** a second consultation on the **harmonisation of the unique product identifier** (UPI), whose purpose is to uniquely identify reportable OTC derivatives products. It focused on the product classification system, specifying the principles and high-level business specifications for a UPI that would meet authorities' needs, including characteristics relating to uniqueness, persistence and consistency. CPMI and IOSCO seek to publish final guidance on a UPI by the end of 2016.

IOSCO **published** final good practices for **fees and expenses of collective investment schemes** (CIS). This sets out international standards for permitted or prohibited costs, disclosures to investors, remuneration of the CIS operator, performance-related fees, transactions costs, hard and soft commissions on transactions, fees for CIS that invest in other funds, fee differentiation in multi-class CIS, and changes to the fees and expenses of a CIS.

IOSCO **consulted** on the good practices for the voluntary **termination of investment funds**.

These covered disclosure at the time of investment, the decision to terminate or merge, the termination process, and issues relating to funds with assets which are illiquid or hard to value.

The FCA **fined** Cenkos Securities Plc £530,500 for representing a client as eligible for a Premium Listing when it had **failed to perform adequate due diligence** for the client. The due diligence was part of its sponsor obligations under the UK's Premium Listing regime.

The Financial Conduct Authority (FCA) **revoked the permissions** of **Performance Tuning UK Limited, Jay Bee Automotive Limited, Hallbrooke Ballymena Limited**, and **Generate Green Limited** for failing to meet the threshold conditions, specifically for breaching Principle 11, which requires regulated firms to deal with the regulator in an open and cooperative way.

Crisis management (including special resolution, systemically important firms, and business continuity)

The FSB finalised its guidance on **operational continuity** and **temporary funding** in resolution which are largely the same as the proposals issued last November. The FSB said it would **consider the need for further work in relation to funding** over the course of the next year.

The FSB is **seeking** input on **aspects of Central Counterparty (CCP) resolution** that are considered core to the design of effective resolution strategies. The discussion note covers areas such as the governance of risk management, stress testing, margining systems, and the coverage of credit and liquidity exposures. The FSB's **work on CCPs** will continue into 2017, including in relation to supervisory stress testing of CCPs, CCP risk management practices, and resolution regimes.

The CPMI and IOSCO **consulted** on further guidance on how CCPs should implement the CPMI-IOSCO principles for financial market infrastructures, to improve their **resilience and recovery planning**. The guidance focuses on five key aspects of a CCP's financial risk management framework: governance, stress testing for both credit and liquidity exposures, coverage, margin, and a CCP's contribution of its financial resources to losses.

The CPMI and IOSCO **reported** on the **financial risk management and recovery practices of ten derivatives CCPs**.

They found the CCPs have made “important and meaningful” progress in meeting regulatory expectations, but identified several gaps and shortcomings, with the absence of a full set of recovery rules and procedures at some CCPs labelled a “serious issue of concern”.

Regulatory perimeter

The Treasury Select Committee (TSC) published responses from the **FCA** and **PRA** to its questions regarding the **regulation of crowdfunding**. The FCA is interested in the market, writing that growth in crowdfunding provides potential benefits to consumers, businesses and investors, but that this comes with increased levels of risk to those groups. The PRA, by contrast, said that it judged the crowdfunding sector to be currently too small to be systemically important to the UK financial system.

The FCA **published** a policy statement on the Payment Accounts Regulations, which implement the EU **Payment Accounts Directive** in the UK and will come into force on 18 September 2016. Alongside this, it published finalised guidance in relation to the definition of a **payment account** and disclosure requirements for **packaged bank accounts**.

The FCA **published** minutes of the first meeting of the Payment Services Stakeholder Liaison group, which discussed issues in relation to changes introduced by the **revised Payment Services Directive** (PSD II), including the blocking of funds, the new definition of ‘acquiring’, reporting of data on fraud, and the meaning of ‘accessible online.’

The UK Government **consulted** on a **Pensions Advice Allowance**, which pension savers can redeem against the cost of financial advice. The proposals seek input on specific details of the allowance, such as the age of eligibility and ways to promote awareness, as well as on a number of outstanding policy issues.

The European Central Bank **published** an Addendum to the existing Guide and Regulation on **options and discretions** (O&Ds) available in EU law. The Addendum addressed the ECB’s approaches to assessing and approving or declining applications from banks in relation to eight additional O&Ds, including the exclusion of intra-group exposures from the leverage ratio calculation and the valuation of assets and off-balance sheet items for prudential purposes.

The EBA **consulted** on technical standards for strong customer authentication (SCA) and common and secure communication under **PSD II**. The standards clarify SCA requirements for different types of transactions, such as remote payments, and set out mechanisms for detecting and blocking fraud. The EBA estimated that the standards will apply in October 2018 the earliest.

Rethinking the domestic and international architecture for regulation

The BCBS **published** a progress report on the **implementation of the Basel III reforms**. The report noted that all jurisdictions now enforced the risk-based capital regime and the liquidity coverage ratio regulations, while banks continue to build up capital buffers and reduce leverage. Challenges remain in a number of areas, for example the implementation of margin requirements on non-centrally cleared derivatives and adherence to the revised Pillar 3 framework.

The FSB **published** a progress report on the **implementation and effects of the G20 financial regulatory reforms**. The report found that progress had been made to strengthen the resilience of large internationally active banks and financial markets but some areas of the reform agenda remain “uneven”. Areas for continued attention include: market liquidity, the effects of reforms on emerging and developing markets, and maintaining an open and integrated financial system.

The FSB **published** a progress report for the G20 on its action plan to assess and address the **decline in active correspondent banks** across most regions in recent years. The report said that a number of papers had been published, and the Correspondent Banking Coordination Group had designed a survey to address remaining data gaps, proposed areas where regulatory expectations should be clarified, and was supporting affected jurisdictions.

Disclosure, valuation and accounting

The TSC **published** a letter from Andrew Bailey, former Deputy Governor for prudential regulation at the Bank of England and former chief executive of the PRA, in response to Andrew Tyrie concerning the PRA’s role in the **intrusiveness of regulation, competition and internal modelling and supervisory confidentiality**. The letter discussed the PRA’s role as a statutory authority, the PRA’s work to ensure the robustness of internal models and the Bank of England’s work to improve transparency on bank capital standards.

The BCBS **issued** answers to frequently asked questions on the Basel framework's **Pillar 3 disclosure requirements**. These provided greater clarity on the relationship between financial statements and regulatory exposures, credit risk, counterparty credit risk, securitisation and market risk.

Information security and data privacy

The European Commission **published** preliminary findings from its consultation on the review of the **ePrivacy Directive**. The Directive, which sets out rules on how providers of electronic communications services should manage their subscribers' data, will need to be updated following the recent publication of the new General Data Protection Regulation.

Financial crime

The FCA **published** a policy statement on **financial crime reporting**, detailing the final rules and implementation timescale for the new reporting requirement for firms subject to the Money Laundering Regulations. The new report must be submitted to the FCA annually.

The EBA **welcomed** the Commission's proposal to bring **virtual currency entities in the scope of the Anti-Money Laundering Directive**. The EBA made proposals to clarify various aspects of the amendments, including the transposition deadlines. It also recommended that virtual currency transactions should remain outside the scope of PSD II at the current time.

Other

The Bank of England **published** minutes of the working group on **sterling risk-free reference rates**.

The group discussed a proposal for the introduction of a secured overnight money market benchmark, and a draft letter on high-level principles for relevant market infrastructure providers to promote the development of secured benchmarks.

The Bank of England **published** a **self-assessment of its real-time gross settlement service** against the principles for financial market infrastructures set out by IOSCO and the Committee on Payment and Settlement Systems. The Bank concluded that it observed or at least broadly observed all the applicable principles, including appropriate and robust legal coverage, governance arrangements, credit and liquidity risk management, and settlement finality.

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Designed and produced by The Creative Studio at Deloitte, London. J9392