



Risk and Regulation Monthly

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December's biggest news on the banking side was the release of the Basel Committee's final rules for Basel 3, the culmination of a decade of effort to revise banking regulation in response to the Financial Crisis. Elsewhere, the European Council confirmed that discussions on the future relationship between the EU and the UK could commence, and the PRA issued consultations on its approach to authorising third country banks and insurers.

Brexit

On 15 December, the European Council **confirmed** that "sufficient progress" had been made in the **Brexit negotiations**, and that discussions could now move on to the future relationship including the negotiation of a **implementation period** during which firms could continue to carry out cross-border activity under present arrangements.

Following the Council's announcement, Philip Hammond, Chancellor of the Exchequer, issued a **statement** stating that the Government was confident that an implementation period would be agreed. Nevertheless, the statement set out the Bank of England's (BoE) plans to ensure **continuity in financial services** in the "unlikely event" of no deal with the EU. If necessary, the Government will legislate for a temporary permissions regime. The Treasury also proposed to give the BoE functions and powers relating to non-UK central counterparties (CCPs) and non-UK central securities depositories (CSDs), and similarly to empower the FCA in relation to UK and non-UK credit rating agencies and trade repositories.

The Financial Conduct Authority (FCA) **released** a statement **welcoming the intention to provide for an implementation period**, saying it was anticipated this would mean firms will be able to continue to benefit from passporting between the UK and EEA after the point of exit and during the implementation period. In the event of a "no deal" scenario, firms that are solely regulated in the UK by the FCA will need to notify it before exit day of their desire to benefit from the temporary permissions regime. This notification will not require the submission of an application for authorisation. The FCA added that firms based in the UK servicing clients in the EEA should continue to prepare for a range of scenarios and should discuss these arrangements and the implications of an implementation period with the relevant EU regulator.

Sam Woods, CEO of the Prudential Regulation Authority (PRA), **wrote** a letter setting out its views on **planning assumptions for firms' preparations for the UK's withdrawal** from the European Union. In the absence of continued passporting rights post-Brexit, firms currently exercising those rights to establish a branch or provide services into the UK ('inbound firms') will need to seek PRA authorisation to carry on PRA-regulated activities in the UK. Firms are encouraged to submit applications for authorisation from January 2018. The PRA will consider the use of a temporary permissions regime only as a fall-back.

The PRA also published two consultation papers containing draft supervisory statements setting out its proposed new **approach to authorising and supervising international bank branches** and the **factors** it considers relevant for the **authorisation of branches or subsidiaries of internationally-headquartered insurance firms**.

The European Insurance and Occupational Pensions Authority (EIOPA) issued an **opinion** reminding EEA supervisory authorities and **insurers (including UK insurers) that they need to take steps to ensure that existing contracts can continue to be fulfilled by firms after Brexit.** The options envisioned by EIOPA for UK firms with EU27 policyholders include transfer of insurance contracts to an EU27 legal entity; establishment of third-country branch in the EU27 Member State of the policyholder; or change of domicile of a company to an EU27 member state. EIOPA plans to monitor the development and implementation of contingency plans to ensure service continuity, in conjunction with national supervisors.

Verena Ross, Executive Director of the European Securities and Markets Authority (ESMA), **gave** a keynote address at the ICI 2017 Global Capital Markets Conference in London. She presented on the **key developments in the asset management sector in 2017**, as well as ESMA's main work streams on Brexit and money market funds. She also highlighted some of the authority's priorities for 2018 in the sector, notably on costs and charges of investment funds.

Capital (including stress testing)

The Basel Committee on Banking Supervision (BCBS) **published** the **finalised Basel III framework.** The framework calibrates a standardised output floor at 72.5% of RWAs, which will be phased in between 2022 and 2027. Other elements of the framework, including revisions to the standardised approaches for credit and operational risk and constraints on the use of IRB approaches, will apply from January 2022. The Committee established a programme to evaluate its post-crisis reforms and will actively participate in the Financial Stability Board's (FSB) efforts to evaluate their effects.

The BCSB also **published** the results of a **cumulative quantitative impact study (QIS)** to provide stakeholders with a benchmark for analysis and an estimated impact of the Committee's finalisation of the Basel III reforms. The study concluded that the finalisation of Basel III results in no significant increase in overall capital requirements, although effects vary among banks.

The EBA **published** a **cumulative impact assessment of the finalised Basel III framework.** The analysis showed that, under the revised international standards, total minimum required capital (MRC) would increase by 12.9% in weighted average terms.

(NB: Deloitte's EMEA Centre for Regulatory Strategy has **published** a blog on the **challenges for Banks** during the finalisation and implementation of Basel III.)

Following the publication of a policy statement on **Pillar 2A capital requirements and disclosure**, the PRA has updated its **methodologies** for setting Pillar 2 capital and its **supervisory statement** on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP). The PRA will set Pillar 2A capital as a firm-specific capital requirement rather than as individual guidance and has revised its Pillar 2A disclosure policy, introducing an expectation that firms disclose their total capital requirement. The PRA's disclosure expectations apply from 1 January 2018.

The PRA **published** a final supervisory statement (SS) on **MREL buffers and threshold conditions**. The SS sets out the PRA's expectations on the relationship between MREL and both capital and leverage ratio buffers, as well as the implications that a breach of MREL would have for the PRA's consideration of whether a firm is failing, or likely to fail, to satisfy the Threshold Conditions. The PRA expects firms not to double count CET1 capital towards both MREL and the amount reflecting the risk-weighted capital and leverage buffers.

The Single Resolution Board (SRB), together with the Banking Union and National Resolution Authorities (NRAs), **published** the **2017 Minimum Requirement for own funds and Eligible Liabilities (MREL) Policy**. The SRB will set bank-specific, binding, consolidated MREL targets for the majority of the largest and most complex banks, including G-SIBs and banks with resolution colleges. The MREL policy will include a number of bank-specific adjustments.

The European Commission adopted proposals for a **regulation** and a **directive** to amend the **prudential rules for EU investment firms**. The new rules establish three categories of investment firms, including a category of systemic investment firms which would be subject to the full scope of CRD/CRR and two categories of non-systemic investment firms with more proportionate rules determined by a range of factors.

The European Banking Authority (EBA) launched a **consultation** on amended technical standards on **benchmarking of internal models**, adjusting the benchmarking portfolios and reporting requirements. The proposed changes reduce uncertainties in credit risk portfolios and introduce a new set of market risk benchmarking portfolios.

The European Supervisory Authorities (ESAs) **published** final draft technical standards amending **margin requirements for non-centrally cleared OTC derivatives** with respect to physically settled foreign exchange forwards. The amendment aligns the regulatory treatment of variation margin for these instruments with international standards.

The European Central Bank (ECB) **adopted** four **supervisory priorities for 2018** and **published** an accompanying presentation with **details of the 2017 SREP exercise** and the **approach for the 2018 stress test**. The updated priorities will include business models and profitability drivers, credit risk, risk management, and activities comprising multiple risk dimensions. The 2018 stress tests will follow the same approach as in 2016, and results of the 2018 stress test will inform the 2018 SREP, to be applied in 2019.

The BCBS **released** a report on **supervisory and bank stress testing** which found that, in recent years, both banks and authorities have made significant advances in stress testing methodologies and infrastructure. Given the rapid evolution in stress testing practices, the BCBS also reviewed its current set of stress testing principles and is **consulting** on a proposal to replace this set of principles with a streamlined version.

EIOPA **published** the results of the **2017 Occupational Pensions Stress tests**, finding that European Institutions for Occupational Retirement Provision (IORPs) providing defined benefits and hybrid pension schemes have, in aggregate, insufficient assets to cover their liabilities, that the sponsors of over a quarter of IORPs might face challenges meeting their

obligations, and that these vulnerabilities could spill-over to the real economy either through the adverse impact on sponsors and/or on beneficiaries through benefit reductions.

EIOPA **issued** an opinion setting out its **prudential expectations of internal models making use of a dynamic volatility adjustment (DVA)**. Undertakings should demonstrate that by using a DVA their Solvency Capital Requirement (SCR) is at least as high as if replicating the EIOPA Volatility Adjustment Methodology. Supervisors should also ensure that all tests and standards on internal models are applied and no undesirable risk management incentives are allowed.

EIOPA **published** its annual analysis on the use of **long-term guarantees measures and measures on equity risk**, showing a particularly wide use of the volatility adjustment and the transitional measure on technical provisions.

EIOPA published **information** on firms' use of **exemptions and limitations**, showing that 134 undertakings (and 8 groups) from five Member States were exempted from reporting and limitations from quarterly reporting concerning 703 undertakings and 21 groups.

EIOPA published a **report** on the use of **capital add-ons**. As at year-end 2016, four Member States have imposed a total of 20 capital add-ons at solo undertaking level (UK 15, France 2, Norway 2 and Ireland 1) and one Member State (UK) has imposed a total of 4 capital add-ons at group level.

The International Association of Insurance Supervisors (IAIS) **published** an interim consultation on an Activities Based Approach (ABA) to **evaluating and mitigating systemic risk** in the insurance sector. The interim consultation paper asks for input into the development of an activities-based approach and feedback on the proposed steps that the IAIS will follow in its work on deriving activities-based policy measures.

Liquidity

ESMA issued three consultations on draft technical standards implementing the **Securitisation Regulation**. The RTS covered the content and format of the simple, transparent and standardised securitisation (STS) **notification**, disclosure requirements, operational standards, and access **conditions** and third-party firms providing STS verification **services**. The consultations set out the requirement for the information to be reported about securitisations to repositories, the additional criteria for STS designation and the authorisation of third-party entities to assess the compliance of securitisations within the STS criteria.

The EBA **published** a discussion paper on **EU implementation of the revised market and counterparty credit risk frameworks**, covering key challenges in implementing the frameworks and preliminary views on how to address them. The paper also proposed a roadmap for the regulatory deliverables included in the Capital Requirements Regulation 2 (CRR2) proposal.

ESMA **issued** technical advice on how to improve the **Short-Selling Regulation**. ESMA proposed specific actions on the exemption for market making activities carried out on a trading venue and OTC, short-term bans

on short-selling in case of a significant decline in prices and the transparency of net short positions and reporting requirements.

The BCBS **issued** a proposed **technical amendment to the Net Stable Funding Ratio**. The amendment proposes to allow reduced required stable funding factors for central bank claims with a maturity of more than six months.

The Governing Council of the ECB **approved** the **consolidation of the real-time gross settlement system TARGET2 and the securities settlement platform TARGET2-Securities**, and the development of a Eurosystem Collateral Management System. Across the Eurosystem, the consolidated system seeks to provide market participants with enhanced liquidity management procedures. The collateral management system will provide a harmonised platform for collateral operations.

Governance and risk management (including remuneration)

The FCA published a package of proposals on how firms and individuals will transition to the **Senior Managers and Certification Regime**. The package covered proposals for **insurance** and **non-insurance firms**. The FCA is also **consulting** on extending the 'Duty of Responsibility' to insurers and firms solely regulated by the FCA. The Duty of Responsibility currently only applies to Senior Managers of banks.

Alongside the FCA's proposals, the PRA consulted on **changes** to forms and administrative amendments related to the extension of SM&CR to insurers.

The PRA **proposed** updating its guidance on the **model change** process, model change policies and the reporting of minor model changes, reducing the frequency at which minor model change accumulations must be reported where they do not trigger a major model change. The PRA also proposed changes to minor model change reporting, such as reporting through BEEDS, and changes to submission deadlines.

The PRA published a **statement** setting out its review of the time it had taken to assess model change applications approved since the implementation of Solvency II on 1 January 2016; how firms had completed the Common Application Package (CAP) when making model change applications; and how firms have defined model changes in model change policies.

Conduct of Business (including MiFID)

The FCA **published** final rules which require providers of personal current accounts and business current accounts to **publish information that will help customers compare services**, including information about the speed of the account opening process, the time taken to replace a lost or stolen debit card, and how often the firm reports major operational and security incidents.

The FCA **published** a further consultation on its **credit card market study** relating to persistent debt and earlier intervention remedies. The FCA updated its draft rules on the content of communications to customers, referrals to not-for-profit debt advice and an extension to the 3-4 year repayment period. It proposed to give firms 6 months to implement the rules.

The FCA **published** feedback from roundtables on the **high-cost credit review**. Key themes emerging from the roundtables included challenges around access to capital for alternative lenders and the need for greater clarity around regulatory boundaries. The FCA will bring forward recommendations in a consultation paper in Spring 2018.

The FCA **published** the trading venue reporting form for **submitting information on the suspension and removal of certain financial instruments** from trading and any subsequent restoration under Articles 32 and 53 of MiFID II. Trading venues will need to send completed forms to the FCA in the format set out in the technical standards.

The FCA **published** a speech by Megan Butler, Director of Supervision in Investment, Wholesale and Specialists at the Financial Conduct Authority (FCA), to the Personal Investment Management and Financial Advice Association in London. Butler highlighted the FCA's current focus on two key topics, namely the quality of advice in relation to **defined benefit to defined contribution transfers and high risk investments**, and insisted on the need for firms and regulators to cooperate on these issues.

The FCA **published** a **Policy Statement on IDD implementation**, summarising its approach to disclosure to customers, inducements, suitability, conflict of interest, product oversight and governance, the protection of customers' money and other matters. The FCA is expected to publish another Policy Statement in January 2018, containing additional requirements on inducements, suitability and appropriateness.

ESMA **published** key **transitional transparency calculations (TTC) for equity and bond instruments** under MiFID II/MiFIR, making the TTC available to market participants for all asset classes required under the framework. ESMA will now publish reference data, transparency calculations and double volume cap information on a regular basis.

ESMA issued guidance to national competent authorities (NCAs) and market participants on the **continuity of cross-border provision of investment services** in the transition between MiFID I and MiFID II. The updated Q&As cover issues relevant to **secondary markets** and **investor protection**, such as the validity of authorisations and continuity of the provision of services.

ESMA **issued** a statement to support the smooth implementation of **Legal Entity Identifiers (LEI) requirements** under MiFIR. It granted banks and their clients an extra six months to comply with rules that require them to have individual reference numbers in order to continue trading.

The European Commission adopted legislative proposals to delay the application date for **the IDD** and **IDD Delegated Regulations** to 1 October 2018. EU countries, however, are still required to transpose IDD into national law by the original date, 23 February 2018.

EIOPA **issued** recommendations to improve **consumer protection in the unit-linked market**, stating that NCAs will have to issue clarifications to insurers on how to apply the legal principles set out in the Insurance Distribution Directive (IDD) and the Solvency II Directive that apply to conflicts of interest arising from monetary incentives received from asset managers or the management of unit-linked products.

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

The PRA updated its supervisory statement on **ring-fenced bodies** and its supervisory statement on **recovery planning** following the publication of a **policy statement** setting out final expectations on the content of recovery plans and on the **approach to recovery planning for groups containing a ring-fenced body (RFB)**. The PRA stated that ring-fencing requirements are “likely” to act as constraint on the recovery options available to the group and that RFBs must ensure they can take decisions independently of other members of the group.

The BoE **published** a record of the Financial Policy Committee (FPC) Meetings held on the 22nd and 27th November 2017. The committee agreed that the 2017 stress test demonstrated the UK banking system was resilient to deep simultaneous recessions, large falls in asset prices and a separate stress of misconduct risks, and **raised the UK countercyclical capital buffer to 1%**, with binding effect from 28 November 2018.

The European Banking Authority (EBA) **published** technical standards to reduce divergent practices in the application of **simplified obligations and waivers in recovery and resolution planning**. The RTS will increase harmonisation of the application of simplified obligations by national authorities.

EIOPA **published** its **Financial Stability Report of the (re)insurance and occupational pensions sectors** which found that prolonged low yield environment and low market volatility, coupled with high levels of economic and political uncertainty, continue to represent major challenges for European insurers and pension funds.

Regulatory perimeter

The FCA **revealed** the **third round of successful firms in its Regulatory Sandbox**. Successful applications came from a range of sectors and their propositions covered areas including Distributed Ledger Technology, RegTech, anti-money laundering, biometric digital ID and Know Your Customer (KYC) verification. The fourth cohort of applications is currently open until 31 January 2018, and applicants should be ready to be tested by June 2018.

Rethinking the domestic and international architecture for regulation

The FCA published its approach to **authorisation** and its approach to **competition**. The documents are the second and third in a series explaining its **approach to regulation** and follow on from the **approach to consumers** which was published in November.

(NB: Deloitte’s EMEA Centre for Regulatory Strategy has **published** a blog on the FCA’s approach to authorisation and competition.)

The European Commission **published** a roadmap for **deepening Europe’s Economic and Monetary Union**, setting out steps to be taken over the next 18 months. These include plans to adopt all remaining proposals on the Banking Union and to propose an enabling framework for European Sovereign Bond-backed securities for the euro area by 2018. By mid-2019,

The Commission expects to have a fully functional backstop to the SRF, to implement EDIS, and to finalise all pending legislative initiatives for the Capital Markets Union (CMU).

The SRB **published** its first Multi-Annual Programme document, including its **Work Programme 2018**. In 2018, the SRB plans to set binding MREL targets, to develop a policy on removing impediments to resolvability, and to alter the timeline for drafting annual resolution plans. By 2020, the SRB expects to develop complete resolution plans for all banking groups in its remit.

The FSB, BCBS, the Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) **launched** joint surveys to review the effects on incentives for the central clearing of **over-the-counter (OTC) derivatives trades** following the implementation of the G20 regulatory reforms.

The BCBS **published** a discussion paper on the **regulatory treatment of sovereign exposures**. The Committee reviewed the main sources, channels, uses and regulatory treatment of sovereign risk in the banking system. As the Committee has not reached a consensus on changes to the treatment of sovereign exposures, it concluded that it will not consult on policy changes for the time being.

Disclosure, valuation and accounting

The ECB published a draft **guide** on the **assessment methodology for the internal model method and the advanced CVA capital charge for counterparty credit risk**, setting out how the ECB intends to assess internal models for counterparty credit risk for directly supervised banks.

The EBA **published** templates targeted at enhancing the **standardisation of data related to non-performing loans** (NPL) transactions across the EU. The templates will provide a common EU data set for the screening, financial due diligence and valuation of NPL transactions, with the aim of widening the investor base, supporting price discovery and facilitating the development of the NPL secondary market.

ESMA **published** the final report on the RTS on the **European Single Electronic Format** (ESEF) in which issuers should prepare their annual financial reports from 1 January 2020. ESMA also **published** a reporting manual and detailed instructions to issuers to facilitate the implementation of the RTS.

Information security and data privacy

The FCA **published** its **feedback statement on Discussion Paper 17/03 on Distributed Ledger Technology** (DLT). The feedback received suggested that the FCA's current rules do not pose any significant barrier to the adoption of DLT, and agreed that the FCA should assess Initial Coin Offerings (ICOs) on a case-by-case basis.

The EBA **published** the **final draft technical standards (RTS) on central contact points under PSD2**. These RTS provide specifications on the appointment and functions of central contact points in host member states. The standards support PSD2's objective of facilitating the supervision of networks of agents used by payment institutions and

electronic payment institutions to provide cross-border payment services under the right of establishment.

The EBA **published** the final **Guidelines on security measures under PSD2**, which seek to ensure that payment service providers have in place appropriate security measures to mitigate operational and security risks. These support PSD2's objective of contributing to an integrated payments market across the European Union.

The EBA **published** the **final draft technical standards (RTS) and Implementing Technical Standards (ITS) on the future EBA register under PSD2**. The RTS specify the procedures that competent authorities should follow when providing information to the EBA, and those that apply to the latter when processing and publishing that information. The ITS specify the information made available on the EBA register. This register seeks to provide transparency on the operations of payment and e-money institutions across the European Union.

The EBA **published** an opinion on the **transition from PSD1 to PSD2**. The EBA is responsible for providing Technical Standards and Guidelines on a number of areas. However, by the application date of PSD2, some of these standards/guidelines will not yet be applicable. The opinion clarifies this issue and a number of other issues identified by market participants and competent authorities.

The EBA **issued guidance for the use of cloud service providers by financial institutions**. The guidance builds on existing Guidelines on Outsourcing developed by the Committee of European Banking Supervisors (CEBS), and specifies supervisory expectations for institutions that intend to adopt cloud computing. The recommendations will be applicable from 1 July 2018 for credit institutions, investment firms and competent authorities.

Financial Crime

The European Union's Presidency and Parliament reached agreement on a **draft directive** to strengthen the rules to prevent **money laundering and terrorist financing**. The draft text is part of the Commission's Action Plan against terrorist financing. It amends the fourth Money Laundering Directive (2015/489), and addresses prepaid cards and virtual currencies, access to beneficial ownership registers, checks on risky third-countries, and the cooperation between member states' financial intelligence units.

The ESAs **published** draft regulatory technical standards (RTS) specifying how credit and financial institutions should manage group-wide **money laundering and terrorist financing** (ML/TF) risks, especially when they have branches, or majority-owned subsidiaries, based in third countries whose laws do not permit group-wide policies and procedures on anti-money laundering and countering the financing of terrorism.

Other

The PRA **published** a Policy Statement on **fees and levies**, introducing a number of new approaches to how periodic fees are determined for designated investment firms, general and life insurers, and a new approach for FSCS levies for certain insurance firms. It also introduced a model maintenance fee for firms with Solvency II or CRR models.

ESMA **issued** its updated **risk dashboard** for EU financial markets in Q3 2017. According to ESMA, the main sources of risk remain “a potential repricing of risk premia and geopolitical events”. ESMA also observed particularly high risk in the securities markets due to a variety of factors including the low interest rate environment and associated excessive risk taking.

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