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Risk and Regulation Monthly

February 2018

CENTRE *for* REGULATORY STRATEGY EMEA

The New Year brought a number of significant regulatory developments.

David Davis, Mark Carney and Sam Woods provided remarks or evidence on **Brexit**. In particular, David Davis spoke on the UK government's views for a transition period, which he called a "bridge to the future" in the UK-EU partnership. Mark Carney noted that he expects to see a "pick-up" in investment in the UK economy in 2019.

Andrea Enria, European Banking Authority (EBA), and Stefan Ingves, Basel Committee on Banking Supervision, spoke on the finalisation of **Basel III**. They both highlighted that the agreement in December was a major milestone.

Finally, following the introduction of the **Packaged Retail and Insurance-based Investment Products** (PRIIPs) Regulation and the **Markets in Financial Instruments Directive II** (MiFID II) on 1 and 3 January 2018, respectively, the Financial Conduct Authority (FCA) and the European Securities and Markets Authority (ESMA) provided a series of updates and statements. On PRIIPs, the FCA acknowledged firms' concerns that, for a minority of PRIIPs, the performance scenario information may appear "too optimistic and so has the potential to mislead consumers". On MiFID II, both the FCA and ESMA provided statements on transitional arrangements for trading venues. Furthermore, ESMA published a call for evidence on its proposals to restrict or prohibit the provision of contracts for difference and binary options to retail investors, in accordance with its powers under MiFID II/ the Markets in Financial Instruments Regulation(MiFIR).

Brexit

The European Union (Withdrawal) Bill – to repeal the European Communities Act 1972, adopt the EU acquis from the date of the UK's exit, and make other provision in connection with the withdrawal of the United Kingdom from the EU – passed its second reading in the House of Lords. The Bill stipulated that EU-derived domestic legislation, as it has effect in domestic law immediately before exit day, will continue to have effect in domestic law on and after exit day. Furthermore, UK Parliament announced that "committee stage" – a line by line examination of the Bill – will begin on 21 February.

David Davis, Brexit Secretary, spoke on the UK government's views for a **transition period**, which he called a "bridge to the future" in the UK-EU partnership. He stated Britain will remain on "current terms" with the EU and that there should be little difference between the standards and regulations in the UK and the EU immediately after withdrawal from the EU.

Mr Davis also gave evidenceto the House of Lords Select Committee on the European Union, and pointed out that there is currently no explicit plan to publish a **paper on financial services**. He noted again the UK government's intent that both the withdrawal agreement and the future agreement – the substance of the deal with the EU27 – would be agreed by the end of this year.

Mr Carney, Governor of the Bank of England, gave evidence at the House of Lords Economic Affairs Committee. He explained that he expects to see a **"pick-up" in investment** in the UK economy in 2019, once firms receive greater certainty on Brexit.

Sam Woods, Chief Executive Officer of the Prudential Regulation Authority (PRA), spoke on **supervisory cooperation** at the House of Commons Treasury Committee. He said that if there were no transition deal agreed by the end of Q1, the PRA's approach to European Economic Area branches would still hold. However, the PRA would need to take a decision on contingency planning regarding more systemic firms. If there were no cooperation with EU supervisors at all, then subsidiarisation could be considered.

The draft EU supplementing negotiating directives on the **transition period** were endorsed at the EU's General Affairs Council. The directives proposed that a transition period should apply from the date of entry into force of the Withdrawal Agreement and not last beyond 31 December 2020, and that during the transition period the UK continue to preserve the full competences of the EU institutions but lose its voting rights.

Capital (including stress testing)

The PRA consulted on changes to **insurance reporting requirements**, relevant to all UK Solvency II firms, and intended to reduce the reporting burden on firms. The PRA proposed a number of changes, including to PRA National Specific Templates and in quarterly reporting waivers.

The PRA sent an interim response to the Treasury Committee's report on **Solvency II and the impact on the UK insurance industry**. The PRA gave its preliminary views on the cost of capital assumptions in risk margin calculations, the Matching Adjustment and dynamic volatility adjustment.

The European Insurance and Occupational Pensions Authority (EIOPA) published a report to the European Commission on the Application of **Group Supervision under the Solvency II Directive**. It concluded that, overall, the definition of groups within the Solvency II Directive worked well, but that one important practical limitation is consistency between the definition of a group and the scope of supervisory powers: in certain cases, a group might exist, but a supervisor might not be able to take appropriate action against a holding company.

EIOPA published its **Risk Dashboard** for Q3 2017. It showed a relatively stable risk exposure in the EU insurance sector; that improvements in solvency ratios are mainly driven by increases in Eligible Own Funds; that some profitability and underwriting indicators deteriorated owing to the impact of recent observed natural catastrophes; and that some improvements could be observed in the rating outlook.

The EBA published its **Risk Dashboard** for Q3 2017. It concluded that EU banks continued to strengthen their capital ratios; the ratio of non–performing loans (NPLs) kept a modest downward trend; profitability indicators have improved slightly; and the loan-to-deposit ratio for households continued to decrease.

The European Commission released its first **progress report on the reduction of NPLs in Europe**. It found that the NPL ratio declined to 4.6% in the EU in Q2 2017, down roughly 1% year-on-year and by a third since Q4 2014. Furthermore, the Commission stated that it will propose a package of measures to reduce the level of existing NPLs and to prevent a build-up in thefuture.

European Commission Vice-President, Valdis Dombrovskis, spoke on the **Economic and Monetary Union**. He observed that immediate priorities include completing the Banking Union and developing the European Stability Mechanism. He highlighted the ongoing work on reducing NPLs, and stated his desire for Europe to lead on tackling tax evasion.

Danièle Nouy, Chair of the Supervisory Board of the European Central Bank (ECB), spoke on the **2018 priorities for banks and supervisors**. She encouraged banks to adapt their business models in light of low profitability and highlighted the work that the ECB is doing to reduce NPLs, noting that an addendum to the ECB's guidance on NPLs, currently subject to consultation, will be finalised in Q1 2018.

The EBA launched its 2018 **EU-wide stress test** and released the macroeconomic scenarios for the test. It said that the adverse scenario implies a deviation of EU GDP from its baseline level by 8.3% in 2020, resulting in the most severe scenario to date. The EBA highlighted that it would publish the results of the exercise by 2 November 2018.

Andrea Enria, Chairperson of the EBA, spoke on the **Basel reform process**. He explained that the package agreed in December was a "major achievement" and that it allayed some of his previous concerns. For example, the agreed restrictions on the scope of loss-given default (LGD) estimation for low-default portfolios reflected evidence that LGD estimation and wholesale portfolios are the most important targets when it comes to risk weighted asset variability in credit risk.

Stefan Ingves, Chairman of the Basel Committee on Banking Supervision (BCBS), spoke on the **finalisation of Basel III** as an important milestone. He noted, however, that work still remains in three key areas: to implement Basel III nationally, evaluate its effectiveness in reducing the excessive variability of risk-weighted assets and continue to monitor and assess emerging risks.

The Bank for International Settlements published a report assessing **structural changes in banking after the crisis**. It found that banks have become more resilient to risks and have strengthened their capital and liquidity buffers since the crisis, but return on equity has declined across countries and business model types since the crisis, in part because of lower leverage.

Liquidity

The European Commission published a Draft Delegated Regulation amending the Delegated Regulation on the **liquidity coverage requirement for credit institutions**. It proposed changes to align the calculation of the expected liquidity outflows and inflows on repos, reverse repos and collateral swaps transactions with the international liquidity standard developed by the Basel Committee; alter the treatment of certain reserves with central banks and non-EU Public Sector Entities; introduce a waiver for the minimum issue size for certain non-EU liquid assets; and introduce the new standardised criteria for securitisation.

EIOPA published its 2017 market development report on **occupational pensions and cross-border institutions for occupational retirement provisions** (IORPs). The report showed there was a continuous shift from Defined Benefit to Defined Contribution schemes in the vast majority of Member States, triggering a transfer of financial risks and costs from employers and IORPs to scheme members.

Governance and risk management (including remuneration)

The PRA released a "Dear Chair" letter on **consumer credit**, which detailed weaknesses within firms. In particular, the PRA raised concerns that some Board Risk Committees do not routinely receive sufficient standardised management information on consumer credit to recognise when a shift in asset quality or portfolio performance is taking place.

Conduct of Business (including MiFID)

The FCA released near-final rules for the implementation of the **Insurance Distribution Directive** (IDD), in relation to product governance and additional requirements for insurance-based investment products. The FCA highlighted the European Commission's proposed delay of the application date of the IDD to 1 October 2018, and the Commission's plans to postpone the application of two delegated regulations adopted under the IDD. If agreed by the European Parliament and Council, firms would have until 1 October to implement new IDD rules. The FCA observed that even in the event of a delay, firms may be in a position to comply early; it therefore included a formal transition period in its near-final rules, allowing firms to adopt some or all of the IDD requirements early if they choose. However, it said that if a delay to the IDD is not ultimately agreed by the European Parliament and Council, it will remove this transition provision from its final rules.

The FCA published a policy statement **on depositing client money in unbreakable deposits** (UDs). The FCA confirmed that it had amended its rules to permit a firm to deposit an appropriate proportion of client money in 95-day UDs.

The FCA provided a statement on the **PRIIPs Regulation** which acknowledged firms' concerns that, for a minority of PRIIPs, the performance scenario information may appear "too optimistic and so has the potential to mislead consumers". The FCA stipulated that where a manufacturer is concerned that the scenarios are too optimistic, such that it may mislead investors, it would be "comfortable" with them providing explanatory materials; similarly, where firms selling or advising on PRIIPs have concerns, the FCA stated that they should consider how to address this.

The FCA delivered a summary of its **Institutional Disclosure Working Group** meeting, on supporting consistent and standardised disclosure of costs and charges to institutional investors. Members agreed that the principles of the proposed framework were appropriate and to begin user-testing the current disclosure template.

The FCA consulted on Handbook changes for the **Money Market Funds (MMF) Regulation.** The draft changes included a proposal to dis-apply certain Handbook provisions, which the FCA believes are no longer required in view of the requirement that any MMF structured as an Undertaking for Collective Investment in Transferable Securities (UCITS), non-UCITS Retail Scheme or Qualified Investor Scheme be authorised under the MMF Regulation and comply with its investment restrictions.

The FCA announced that it was content to publish the s166 report into the **treatment of small and medium-sized enterprise customers** transferred to Royal Bank of Scotland's Global Restructuring Group, but that to do so it would require consents from individuals who provided information in the report or who were identified.

The FCA published progress made in the **high-cost credit review**. The report highlighted that there is an emerging picture for possible intervention in a number of markets. In particular, it detailed concerns regarding high costs for unarranged overdrafts, especially compared to the relatively small amounts lent: data from the largest personal current account providers showed that annual revenues, excluding unpaid item fees, were around 200% of the amount outstanding in 2016.

The FCA released a report on the fair treatment of **existing interest-only mortgage customers** and concluded that lenders have, overall, made progress. It highlighted that strategies exist to contact customers, understand their repayment plans and provide appropriate solutions where customers have no plan in place.

The FCA published a statement granting **transitional arrangements to trading venues**, ICE Futures Europe and the London Metal Exchange, under MiFIR Article 54(2). With effect from 3 January 2018, ICE Futures Europe and the London Metal Exchange would not be required to consider open access requests made under Article 36 for exchange-traded derivatives, until the expiry of the transitional period on 3 July 2020.

The FCA released findings from its review of 19 providers and distributors of **Contracts for Difference** (CFD) products. Most of the firms reviewed were unable to produce a satisfactory target market definition for their CFD products or explain how they align the needs of this group to the CFD product they offered. The FCA made clear that firms should take action to address this issue, as well as other areas of concern highlighted in its letter.

ESMA published a call for evidence on proposed product intervention measures on **CFDs and binary options to retail investors**. Restrictions on CFDs were proposed, including: leverage limits on the opening of a position by a retail client, a margin close-out rule, and negative balance protection on a per-account basis. ESMA said it would also consider whether CFDs on cryptocurrencies fit within the remit of its proposed restrictions. Furthermore, it proposed a prohibition on the marketing, distribution or sale of binary options to retail clients.

ESMA published a list of trading venues making use of the temporary opt-out from the access provisions for **exchange-traded derivatives** (ETDs) under Article 36 of MiFIR. ESMA noted that the venues on the list, and the central counterparties (CCPs) to which they are connected, do not benefit from any of the access rights under the non-discriminatory access provisions under MiFIR.

ESMA provided a public register for the **trading obligation in respect of derivatives** under MiFIR. The register included a list of swaps subject to the trading obligation, the EU trading venues which trade those swaps, third-country equivalent trading venues which can be used to satisfy the trading obligation, and the date at which the trading obligation takes effect.

ESMA published its first MiFID II position management controls for **commodity derivatives**. ESMA said it would continue to maintain a database of the details of position management controls submitted by investment firms or market operators to their national competent authorities.

ESMA updated the transparency calculations for **equities and bonds** and **tick sizes band assessment** for MiFID II/MiFIR. The extended version of the transitional transparency calculations (TTC) for equity and bond instruments added the applicable TTC for equity instruments traded for the first time on trading venues between 13 September 2017 and 2 January 2018, and bond instruments traded for the first time on trading venues between 1 November 2017 and 2 January 2018.

The European Parliament's Committee on Economic and Monetary Affairs published a briefing on **equivalence decisions under MiFID II/MiFIR**. It detailed the process for adopting equivalence decisions, relevant provisions under the MiFID II/MiFIR framework and recent equivalence decisions, including the Commission's recognition of certain trading venues in the US, Australia, Hong Kong and Switzerland as equivalent to EU venues.

ESMA delayed the publication of data on the **double volume cap (DVC) mechanism** from January to March 2018. ESMA performed an analysis of the quality and completeness of the data received from trading venues to perform DVC calculations, since 3 January 2018, as required under MiFID II/MiFIR. It said that based on its analysis, it realised that the publication of the data would have resulted in a biased picture covering only a very limited number of instruments and markets. ESMA made clear that it intends to publish data in March, covering previous periods in order to ensure full application of the double volume cap as of January 2018.

ESMA consulted on guidelines regarding **anti-procyclicality (APC) margin measures for CCPs** under the European Market Infrastructure Regulation. ESMA proposed that CCPs should define one or more quantitative metrics to assess the efficiency of their APC margin measures, make appropriate adjustments where metrics indicate pro-cyclical effects arise from margin requirements and develop a policy for reviewing their APC requirements.

ESMA published a thematic report on fees charged by **credit rating agencies and trade repositories**. ESMA identified areas for improvement and noted that these will form the core of its future supervisory focus. For example, in relation to transparency and disclosure, credit rating agencies and trade repositories need to ensure sufficiency and clarity of information provided to actual and potential clients as well as to ESMA.

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

The PRA published a consultation paper setting out expectations for reporting on **minimum requirement for own funds and eligible liabilities**. It included draft reporting templates for firms.

Regulatory perimeter

EIOPA published its **updated work programme for 2018**. It announced that it will launch a thematic review of the insurance industry's use of Big Data, undertake further work on a pan-European Personal Pension Product, and continue to develop its stance on macro-prudential frameworks for the insurance sector.

The European Commission's High-Level Expert Group on Sustainable Finance issued a report setting out strategic recommendations for a **financial system that supports sustainable investments**. It proposed the creation of a taxonomy to provide market clarity on what is "sustainable", as well as an EU-wide label for green investment funds.

Rethinking the domestic and international architecture for regulation

The Basel Committee on Banking Standards held its 13th High-level Meeting for Africa on "strengthening financial sector supervision and current regulatory priorities". Discussions centred on the challenges that sub – Saharan Africa faces in **implementing regulatory reforms**, including adjustments to correspondent banks' business models and stronger regulation around money laundering and the financing of terrorism.

Disclosure, valuation and accounting

The PRA published a "Dear CFO" letter regarding expected credit loss (ECL) accounting requirements under the **International Financial Reporting Standard 9** (IFRS 9). In its letter, the PRA set out its expectations based on discussions with firms regarding core transition disclosures that should be provided to the market at the point of transition to IFRS 9. It highlighted that transition disclosures should include a quantitative assessment of the impact of each of the main differences between International Accounting Standard (IAS) 39 and ECL provisioning models and an explanation of the implications of ECL on governance, risk management, and regulatory capital.

The EBA finalised guidelines on uniform disclosure requirements for **transitional arrangements for IFRS 9**. The guidelines covered, among other things, own funds, the risk-based capital ratio and the leverage ratio. The EBA made clear that competent authorities must notify it that they comply or intend to comply with the guidelines, or otherwise give reasons for non-compliance.

The EBA issued a report on the implementation of its guidelines on methods for calculating contributions to **deposit guarantee schemes**. It found that its guidelines have broadly met the aim of introducing different contribution levels for institutions according to their riskiness. However, it said that the current method may allow for too much flexibility and may need to be reviewed in the future to ensure a consistent approach.

ESMA drew issuers' attention to **IAS requirements on income taxes** following the introduction of new tax legislation in the US. ESMA observed that, in its view, for reporting periods that include 22 December 2017, IAS 12 requires issuers that are affected by changes in US tax legislation to measure current and deferred taxes based on the newly enacted tax law.

Information security and data privacy

Robin Jones, Head of Technology, Resilience and Cyber at the FCA, spoke on "**building cyber resilience**" and stressed that firms should be able to detect attacks that are successful and know how to respond and recover quickly. He emphasised that firms need to understand their key assets, constantly assess where they are vulnerable and establish strong governance.

Financial Crime

The FCA warned of **increased risk of online investment fraud**. It highlighted that over £87,000 is lost to binary options scams every day in the UK. While historically over 55 year olds have been most at risk of investment fraud, the FCA found that those aged under 25 were six times (13%) more likely to trust an investment offer they received via social media, compared with over 55s (2%).

The FCA fined **a brokerage company over £1m** for failing to adequately input into the design and calibration of its post-trade monitoring systems – which were delegated to a team based at another company within the company's group in the US – or to test their operation, to ensure that potential market abuse by its clients would be detected.

The FCA published a "Dear CEO" letter on **authorised push payment (APP) fraud**. The letter referred to the APP Best Practice Standards developed by UK Finance, and asked CEOs to consider how their firms are tackling APP fraud within the context of the Senior Managers and Certification Regime.

The European Supervisory Authorities (ESAs) provided an opinion on the use of **innovative solutions in the customer due diligence** process. They observed that financial innovation can improve the effectiveness and efficiency of Anti-Money Laundering and Countering the Financing of Terrorism controls. Furthermore, the ESAs pointed out that they aim to promote the development of a common approach across Member States.

Other

Charles Randall was appointed the new **Chair of the FCA**. The FCA confirmed that Mr Randall will take up the role on 1 April 2018.

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Designed and produced by The Creative Studio at Deloitte, London. J14949