



Risk and Regulation Monthly

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EMEA

April saw a number of significant regulatory developments: Asset Management was an area of some focus, particularly in relation to charges; non performing and forbore loans were the subject of new proposed guidelines, following the high level of focus on this issue in recent months; and crypto-assets and crypto-currencies were the subject of a number of speeches and comments by senior regulators in the UK and the EU.

Brexit

Andrew Bailey, Chief Executive of the Financial Conduct Authority (FCA), [spoke](#) on Brexit at City Week UK. He said "now is the time for the UK and EU authorities to come together and work on the **solutions to reduce the risks to financial stability** that Brexit could pose". He called for an approach that supports mutual recognition of each other's standards to support cross-border business.

Valdis Dombrovskis, European Commission (EC) Vice-President, [reiterated](#) the message that **firms need to continue their work to prepare for all Brexit scenarios**. He said that equivalence had proven to be a pragmatic solution that works in many different circumstances, and that it could work for the UK after Brexit as well.

The European Commission [published](#) a notice on the withdrawal of the UK and EU rules for **Institutions for Occupational Retirement Provision (IORPs)**. IORPs members and stakeholders were reminded of legal repercussions to be considered when the UK becomes a third country, which may have consequences on registration and authorisation, sponsoring undertaking, and contract continuity. UK IORPs should contact the competent authorities of the relevant host EU-27 member states to determine the conditions to allow their continued activities.

Michel Barnier, European Chief Negotiator for the UK Exiting the EU, [spoke](#) on Brexit at the **Eurofi High-level Seminar 2018**. He described Brexit as a 'lose-lose situation'. He said that Brexit would come at a cost, substantially higher for the UK than for the EU. In financial services, he emphasised there was no intention of discriminating against the UK, and that the equivalence system for third countries was continually improving.

The EC and HM Treasury (HMT) [asked](#) the **ECB and the BOE to convene a technical working group** on risk management in the period around 30 March 2019 when Brexit is due to take effect, focused on financial services. The EC and HMT will act as observers, and other relevant authorities will be invited to issue-specific meetings. The working group is separate from the negotiations on the Withdrawal Agreement and those on the framework for the future relationship between the EU and the UK.

Capital (including macro prudential and stress testing)

The Prudential Regulation Authority (PRA) [finalised](#) its expectations as to the **model risk management principles firms should adopt when using stress test models**. The principles centre on the definition of a model and model inventory; governance frameworks; model development and implementation processes; and validation and independent review activities.

The PRA [updated](#) its supervisory statement on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP). Changes include **altering the definition of double leverage** so that it is accounting-based and clarifying the level of application of the double leverage formula.

The PRA [published](#) a policy statement on its **groups policy and double leverage**. The PRA will require firms to assess and mitigate the risks to group resilience due to the use of double leverage and the risks highlighted by prudential requirements applied by local regulatory authorities on overseas subsidiaries of UK consolidated groups. It will further require improved monitoring of the distribution of financial resources across different group entities. The changes come into effect from 1 January 2019.

The PRA [published](#) a Consultation Paper on modelling of the volatility adjustment, potentially allowing insurers to **apply the dynamic volatility adjustment (DVA) in internal models** when calculating the solvency capital requirement (SCR). It proposes that firms treat the DVA as a new element of the model. This means any extension of a model to reflect the DVA would require PRA approval, requiring firms to demonstrate that the statutory approval conditions for applying the volatility adjustment would also be met in stress and that consideration had been given to the Prudent Person Principle and the system of governance requirements relating the adequacy of a firm's liquidity plan in the PRA Rulebook.

The PRA [published](#) a “Dear CEO” letter on **capital extractions by insurance firms in run-off**. The PRA emphasises that since firms in run-off have limited ability to generate new capital, it expects firms to be prudent and ensure that an adequate level of protection for policyholders would be maintained following any suggested capital extraction. The PRA expects firms to demonstrate clearly in their application how the board has satisfied itself that the capital extraction request is appropriate, and meets the policyholder protection expectations set out by the PRA.

The Bank of England (BoE) [published](#) a speech by David Rule, Executive Director, Insurance Supervision, on **risks for insurers active in the bulk annuities market**, which include: data due diligence; longevity and its reinsurance; and asset selection, rating and valuation. In the context of internal asset rating, he talked about equity release mortgages and that the PRA may commission an opinion from a credit rating agency in the form of a skilled person review if they have continued concerns over the internal rating of a particular asset.

The FCA [sent](#) a “Dear CEO” letter to listed companies with **irredeemable preference shares** and other similar capital instruments. The FCA required that companies need to ensure that certain information, such as the terms and conditions of those instruments, is readily accessible so that all holders and potential holders can properly assess the risks and rewards associated with such shares.

Andrew Bailey, chief executive of the FCA, gave a [speech](#) on **challenges for the asset management market**, and outlined regulatory developments in the sector. Challenges he identified included a shift in the balance of assets under management from accumulation-orientated products to decumulation products as a result of the growing number of people reaching retirement.

The European Banking Authority (EBA) [published](#) its **Risk Dashboard for Q4 2017**. It found that European banks have strengthened their capital ratios, with CET1 ratios now above 11% for all institutions. However, it noted that profitability and high levels of nonperforming loans (NPLs) continue to be a challenge for the European banking sector.

The European Central Bank (ECB) [published](#) a report on **how competition and regulation drive bank and investment fund risk profiles** and their market shares. Findings included that an increase in an asset's credit risk is associated with a decline in bank holdings of that asset, while the opposite is true for banks' holdings with respect to liquidity risk. Findings also suggest that higher capital requirements make the banking sector as a whole more reluctant to hold risky assets and thereby contribute to increases in banks' holdings of safe assets.

The Committee on Payments and Market Infrastructures (CPMI) and the International Organization of Securities Commissions (IOSCO) [issued](#) guidance on **supervisory stress testing of central counterparties (CCPs)**. The guidance set out a detailed framework to support supervisory stress tests, and covered various components of the exercise such as governance arrangements, the development of stress scenarios, data collection and protection, the development of analytical metrics and the use of results and disclosure.

Andreas Dombret, Member of the Executive Board of Deutsche Bundesbank, [spoke](#) on the **challenges of regulating the financial markets in Europe**. Two key challenges include the finalisation of global post-crisis regulation and the regulatory challenges to be met in a digital financial world.

The IAIS [published](#) an issues paper on **climate change risk in the insurance sector**. The paper describes the climate risk landscape, how climate change might affect the insurance sector and strategies for insurer climate resilience. The bulk of the paper explores supervisory approaches and observed practices in selected jurisdictions, and the IAIS has said it may follow up with Application Papers to explore the subject further.

Liquidity

The PRA published its [approach](#) to **supervising liquidity and funding risks** for firms to which CRD IV applies, effective from 1 January 2019. Areas covered include the Internal Liquidity Adequacy Assessment Process, the Liquidity Supervisory Review and Evaluation Process, drawing down Liquid Asset Buffers, collateral placed at the Bank of England, and daily reporting under stress.

The BoE [implemented](#) its **reforms to the Sterling Overnight Index Average (SONIA) interest rate benchmark**, which now captures bilaterally negotiated transactions as well as brokered transactions, and is based on volumes of circa £50 billion daily. The publication time was also moved so that the SONIA rate for a given London business day is now published at 09:00 on the following London business day.

The Bank for International Settlements (BIS) published its Fourteenth progress report on [adoption of the Basel regulatory framework](#). The report focused on ensuring Basel III standards are transformed into national law or regulation according to the internationally agreed timeframes, and includes for the first time the finalised Basel III post-crisis reforms. Findings show the leverage ratio is in force in most member jurisdiction, 24 members have issued draft/final rules for the Net Stable Funding Ratio (NSFR), and 19 have issued draft/final rules for the revised securitisation framework.

Conduct of Business (including MiFID)

The FCA [published](#) a finalised guidance which sets out the **expectations from firms involved in the transfer of fund investors from pre-Retail Distribution Review (RDR) unit classes to post-RDR unit classes**. Under the recast guidance, a fund manager who has the power to carry out a mandatory conversion will be able to make a simple, one-off notification to each holder at least 60 days ahead of the conversion.

The FCA [released](#) the **occasional paper: "Now you see it: drawing attention to charges in the asset management industry"**. The paper found that the presentation of charges has a significant impact on investors' decision-making and understanding of charges. It also highlighted that an increased focus on charges does not seem to reduce investors' consideration of other factors such as the fund's performance of risk.

Mary Starks, Director of Competition at the FCA, delivered a [speech](#) at the Authority for Consumers and Markets Conference. She highlighted the **risks and benefits that distributed ledger technology can pose to consumers, financial markets and competition**.

The FCA [issued](#) a **warning about loan fee fraud** after it conducted research revealing that over a third of (surveyed) people are not confident about how to check whether a loan provider is legitimate and that they tend to accept what financial firms tell them. The FCA also reported that, in 2017, loan fee fraud took over investment fraud as the most common scam reported to the FCA, and caused borrowers to lose over £3.5 million.

The FCA [warned](#) it will take action against general insurance firms who are failing to comply with transparency and **shopping-around rules**. The FCA found that firms are still failing to comply with these rules, by for example mis-stating previous year premiums, or leaving out the shopping-around message. It expects senior management of these firms to take "immediate action" to ensure they are compliant.

The FCA published a [consultation paper](#) (CP), a [policy statement](#) (PS) and an [overview information sheet on its Asset Management Market Study remedies](#).

The CP proposed to improve clarity where funds are benchmark constrained (i.e. if a fund has benchmarks, their use must be explained consistently in consumer documents). The PS changed rules and guidance for Authorised Fund Managers, including changes to their governance arrangements. The overview document sets out remedies that seek to protect investors and drive competitive pressure on asset managers, as well as proposals to improve intermediaries' effectiveness. You can read our [blog](#) on FCA's asset management market study for further information.

The FCA [published](#) its **2018/19 Business Plan**, with a number of changes in its cross-sectoral priorities: "Consumer vulnerability and access" priority is dropped, although a focus on vulnerability is evident across a number of work streams. The "Technological change and resilience" priority is carried over across two new priorities: "Data security, resilience and outsourcing", and "Innovation, big data, technology and competition". Last year's theme of "Promoting competition and innovation" is also merged into the second of these. There are two new priorities, one on "Long-term savings, pensions and intergenerational differences" and the other on "High cost credit". Notably, "EU Withdrawal" is called out as a standalone priority this year. You can read our [blog](#) on the FCA's 2018/19 business plan for further information.

The FCA [published](#) data showing 3.76 million **complaints about financial services firms** in the second half of 2017. The 13% rise was driven by complaints about payment protection insurance (PPI), which rose by 40% compared to the previous period. PPI redress payments made by banks now stand at £30 billion.

The FCA [responded](#) to the Independent Review of the **Funding of Debt Advice** by Peter Wyman. The FCA said it will look at how it can act on the report's findings, which included a number of recommendations such as face – to-face interactions continuing to be widely available, and all debt advisors having a debt advice qualification before they can offer debt advice unassisted.

The European Commission [published](#) a study on **the distribution of retail investment products across the EU**. The study highlighted the difficulties EU consumers face when trying to buy the most suitable investment fund, life insurance or private pension. The study noted that retail investors have access to a wide range of products through various distribution channels but face challenges in comparing data or getting independent advice on the different products on offer.

EIOPA [published](#) its 2017 **oversight activities report**, highlighting its activities in the past year, which included consistency projects on internal models, and participation in 49 cross-border colleges of supervisors and 14 colleges on internal models. It also set out its 2018 priorities, which include improving supervisory practices in the authorisation process through peer reviews, national engagements and technical assistance, and focusing on “vulnerable business models”.

The FSB [published](#) a report with tools that supervisors and firms can use to **mitigate misconduct risk**. The report looks at the cultural drivers of misconduct, individual responsibility and accountability, and the ‘rolling bad apples’ phenomenon.

The CPMI and IOSCO jointly [published](#) technical guidance on the **harmonisation of critical over-the-counter (OTC) derivatives data elements** reported to trade repositories (other than Unique Transaction Identifier (UTI) and Unique Product Identifier (UPI)). Guidance was provided on wide-ranging elements including dates, counterparties, regular and other payments, valuation and collateral, prices and quantities, packages, links and custom baskets. Firms are also expected to develop a maintenance and governance framework.

Governance and risk management (including remuneration)

The European Supervisory Authorities (ESAs) Joint Committee [published](#) its **Risk Report for the second half of 2017**, finding that the sudden repricing of risk premia (as witnessed by the recent spike in volatility and associated market corrections), uncertainties around the terms of the UK's withdrawal from the EU, cyber-attacks, and climate change affecting the sustainability of investments were potential sources of instability for EU financial markets.

The EBA [consulted](#) on its Guidelines on the **types of exposures to be associated with high risk** under Article 128 (3) of the CRR, including specifications around speculative investments. The proposed Guidelines further clarify the notion of investments in venture capital firms and private equity. The consultation closes on 17 July 2018.

Danièle Nuoy, Chair of the Supervisory Board of the ECB, [spoke](#) on **risk appetite frameworks**. She highlighted the areas in which she considers banks need to improve, including: the inclusion of non-financial risks; governance; the application of risk limits; and the embedding of risk appetite frameworks in the strategic decision-making process.

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

The PRA [published](#) its 2018/19 business plan, outlining its **strategic priorities for the coming year**. The PRA will shift its focus from implementation of post-crisis reforms to the day-to-day supervision of firms. It will continue to improve Solvency II implementation and will develop its supervisory approach to operational resilience. You can read our blog on the PRA's 2018/19 business plan for further information.

Sabine Lautenschläger, Vice-Chair of the Supervisory Board of the ECB, [contributed](#) to the Eurofi Newsletter. She discussed the need to **refine the regulatory framework in the banking union**, including the need to remove the overlap between standard supervisory measures and early intervention measures.

Steven Majoor, Chair of ESMA, [spoke](#) on **CCP resilience, recovery and resolution**. He welcomed the European Commission's proposal for a CCP recovery and resolution regulation and proposals to enhance the recognition regime for systemically important third-country CCPs. He spoke on how to strengthen CCP resilience through supervision, and ensure that recovery and resolution arrangements support strong CCP resilience. He reflected that the resolution framework should be considered in conjunction with the regulatory and supervisory framework for CCPs.

Elke König, Chair of the SRB, [spoke](#) at the SRB press breakfast. She discussed the **SRB's priorities for 2018**, including: determining binding MREL targets at the consolidated level; identifying substantive impediments to resolution, including the lack of adequate availability of data; and adopting resolution plans for the majority of banking groups under its remit.

Elke König, also [spoke](#) on **resolution in Europe**. She noted several areas in which she considered banks need to improve, including: building up MREL; addressing inadequate IT systems; and ensuring that the necessary data is instantly available during a crisis situation. She stated that further work is needed to help ensure liquidity in resolution and harmonise national insolvency procedures.

Elke König further [published](#) an article in Eurofi on MREL. She stated that the SRB will develop guidance on **solo/internal MREL and MREL calibration under transfer strategies** and will conduct further work on defining the need for subordination. The SRB will strive to implement internal MREL for banking groups with resolution colleges during the 2018 planning cycle.

Mauro Grande, SRB Board Member, [spoke](#) at the European Parliament on **money laundering in the banking system**, noting that reputational risks can cause a bank to fail in a short period of time. He further stated that key relevant information on AML risks should be communicated to supervisors, and that supervisory dialogue should better assess business models that are more susceptible to reputational risks.

The IMF [launched](#) the **Global Financial Stability Report**. This noted that economic recovery remained resilient despite market volatility. Also that short term risks to financial stability have increased, and medium-term risks remain elevated. The report discussed three main vulnerabilities: stretched valuations across many asset classes; borrowing by emerging markets and low-income countries; and bank dollar liquidity mismatches.

Dietrich Domanski, Secretary General of the FSB, gave a [speech](#) on the **FSB work plan 2018**. Planned work includes completion of the outstanding G20 reforms (including whether further guidance on CCP resolution is needed), evaluation of these reforms (such as looking at the effects of reforms on financial intermediation), and monitoring of new and emerging risks (such as assessing crypto-assets).

Regulatory perimeter

The BoE [allowed](#) TransferWise, a FCA-regulated firm, to become **the first non-bank payment service provider (PSP) participating to the UK's Faster Payments System**. This is part of the BoE's project to extend to non-bank PSPs settlement account access. Wider access to BoE's Real-Time Gross Settlement (RTGS) system for non-banks is expected to bring financial stability benefits through increasing the proportion of settlement in central bank money, diversifying the number of settlement firms, and driving greater innovation in risk-reducing payments technologies.

Rethinking the domestic and international architecture for regulation

Mark Carney, Governor of the Bank of England, [spoke](#) on **climate-related financial risks**. Carney took stock of the actions to mitigating climate – related risks taken by governments, insurers, banks and financial policymakers. He particularly emphasised that insurers' risk modelling for increasing physical risks posed by climate change must be "unrelenting", and that some banks have begun to treat climate-related risks like other financial risks relevant to their business models.

Valdis Dombrovskis, the European Commission Vice-President, [spoke](#) at the first informal ECOFIN press conference in Sofia. He encouraged Ministers to agree on a **general approach on the 2016 Banking package at the May ECOFIN**. He further stated that at the June summit ECOFIN should make progress on a European deposit insurance scheme (EDIS) and strive for a clear mandate for a workable backstop for the Single Resolution Fund.

Ignazio Angeloni, Member of the ECB Supervisory Board, [presented](#) on Europe's Banking Union. He noted a number of **remaining hurdles to completing the Banking Union**, including an incomplete macro prudential policy framework; an underdeveloped framework for resolution and crisis management; and the lack of progress on EDIS.

Danièle Nuoy, Chair of the Supervisory Board of the ECB, was [interviewed](#) for the Eurofi Newsletter. She discussed the causes of **low levels of cross-border consolidation**, including national-level ring-fencing and a lack of regulatory harmonisation. She further stated that cross-border waivers on capital should be introduced.

Pentti Hakkarainen, Member of the Supervisory Board of the ECB, [delivered](#) a speech on "**Financial Integration, Competition and Efficiency**".

He highlighted that financial integration and an international level playing field are necessary to achieve a truly competitive banking market. In this regard, at the EU level, the creation of a common deposit insurance system and regulatory cooperation will be needed to increase the integration of European markets.

Valdis Dombrovskis, the European Commission Vice-President, [presented](#) the **Economic and Monetary Union (EMU) package**, including four key initiatives: (i) proposal to establish an EMF, (ii) proposal to integrate the substance of the Treaty on Stability, Coordination of Governance into the Union legal framework, (iii) communication on new budgetary instruments for a stable euro area and (iv) communication on the possible functions of a European Minister of Economy and Finance.

The Single Resolution Board (SRB) identified the **obstacles to the defragmentation of the Banking Union**, and a way forward. Observing that once the banking union is completed, member states would have little reason to maintain ring-fencing practices. The SRB strongly encouraged legislators to harmonise national insolvency laws, in order to create a level – playing field.

Disclosure, valuation and accounting

The BoE finalised an update to its reporting requirements for Pillar 2, including a final [policy statement](#) and updated [supervisory statement](#). The changes **introduce a new data item, PRA111, to capture stress testing data currently included in firms' ICAAP documents** and reduce the frequency of reporting of Pillar 2 data items for some firms. The changes take effect from 1 October 2018.

The PRA [published](#) a Consultation Paper on the **external audit of the Solvency and Financial Condition Reporting**. It proposed to remove the external audit requirement for certain smaller firms, and certain groups, defining what "Small Insurers" are for the purpose. The definition is based on a score which applies a risk factor to gross written premium and best estimate liabilities.

The PRA [published](#) a Consultation Paper on the **regulatory reporting of internal model outputs and the ORSA and ultimate time horizon for non-life firms**, proposing to amend the life, counterparty and non-life templates. Changes include requesting a 'biting scenario' (a scenario which gives rise to losses equal to the SCR for any given entity) to provide insight into the interactions between calibrations of individual variables when determining the SCR, and enabling non-life firms to submit one-year losses when one-year and ultimate losses are the same.

The PRA [published](#) a Consultation Paper on **changes to the file type and reporting format** for insurance reporting submissions. The changes would alter the format from Microsoft Excel workbooks to XBRL for the national specific templates, internal model outputs, market risk sensitivities, and standard formula reporting for firms with an approved internal model.

The EBA [launched](#) a consultation on its Guidelines on **disclosure by credit institutions of information on non-performing and forborne exposures**. The guidelines specify the information related to non-performing (NPE), and forborne exposures and foreclosed assets, that banks should disclose, and provide uniform disclosure formats. The guidelines seek to allow supervisors to gain a better insight into the features and distribution of firms' problem assets, the quality and value of their collateral, and the efficiency of their recovery function.

EIOPA [published](#) its **supervisory convergence plan**, stating it will focus on implementing a common supervisory culture and addressing regulatory arbitrage. Activities include ensuring that the calculation of technical provisions in cross-border business is consistent, performing comparative studies on the outcomes of internal models regarding underwriting risks, and working on a common basis for the supervisory assessment of conduct risks throughout a product's life cycle.

ESMA [published](#) its 2017 annual report on the **enforcement and regulatory activities of EU accounting enforcers**. ESMA said it will focus on ensuring that issuers are providing sufficiently high quality disclosures in relation to financial performance and financial position, particularly under the new standards (IFRS 9 and IFRS 15).

ESMA [issued](#) the first part of its **technical advice under the Prospectus Regulation**, which covers the format and content of prospectuses, the EU growth prospectus and the scrutiny and approval of prospectuses. In particular, ESMA has developed the content of the new Universal Registration Document (URD), a new shelf registration document for issuers of securities that are listed on a regulated market or a multilateral trading facility.

ESMA [agreed](#) on **position limits** under MiFID II for commodity derivatives regarding feed wheat, jet kerosene and gasoline. The limits set the maximum size of positions which an entity can hold in a particular class of commodity derivatives.

The FSB [published](#) the second consultation on the UPI. It sets out **governance proposals for a global UPI**, and seeks views on fee models and standardisation. The UPI is a key harmonised identifier designed to facilitate aggregation of OTC derivatives transaction reports by regulatory authorities.

The International Organization of Securities Commissions (IOSCO) [issued](#) a final report on **regulatory reporting and public transparency in the secondary corporate bond markets**. The report included recommendations relating to the availability of data reporting in corporate bond markets.

Information security and data privacy

The FCA [published](#) a statement on **requirements for firms offering crypto-currency derivatives to be authorised**. The statement highlights that firms conducting regulated activities in crypto-currency derivatives must comply with all applicable rules in the FCA's Handbook and any relevant EU regulations. The derivatives targeted by the statement include crypto – currency futures, contracts for differences and options.

Karina McTeague, Director of Retail Banking Supervision at the FCA, delivered a [speech](#) at the Pay360 Conference. She emphasised that **customer communications should be balanced**, and not dissuade customers from using third-party providers. She also indicated that the FCA will focus on ensuring that firms' culture prioritises treating customers fairly and doesn't take inappropriate advantage of ill-informed, naïve or vulnerable consumers. You can read our [report](#) on culture in financial services for further information on how supervisors assess culture in practice.

The ECB [published](#) Cyber Resilience Oversight Expectations (CROE), aimed at FMIs and the supervisory authorities responsible for assessing them. At its heart, the CROE creates three levels of **cyber resilience maturity**, and sets its expectations of firms at different maturity levels for different entities based on their importance.

Tobias Adrian, IMF Financial Counsellor and Director of the Monetary and Capital Markets Department at the IMF, delivered a [speech](#) at the IMF FinTech roundtable. He highlighted the **risks that the rise of (and the lack of regulatory coordination on) crypto-assets** may cause in terms of financial stability and market fragmentation. He encouraged the creation of international standards on crypto-assets and argued for the regulation of ICOs and active supervision of crypto-exchanges.

Other

The FCA [published](#) the **final list of the most representative services linked to a payment account and subject to a fee** in the context of the Regulation 3 of the EU Payment Accounts Regulations. Firms will be required to use the terminology presented in the list from 31 October 2018.

ESMA [stated](#) that **the legal and supervisory frameworks of Canada and South Africa** will continue to meet the requirements for endorsement under the Credit Rating Agency Regulation from June 2018. As a consequence, EU registered credit rating agencies' ability to endorse credit ratings from these jurisdictions following the entry into force of new requirements for endorsement will not be disrupted.

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