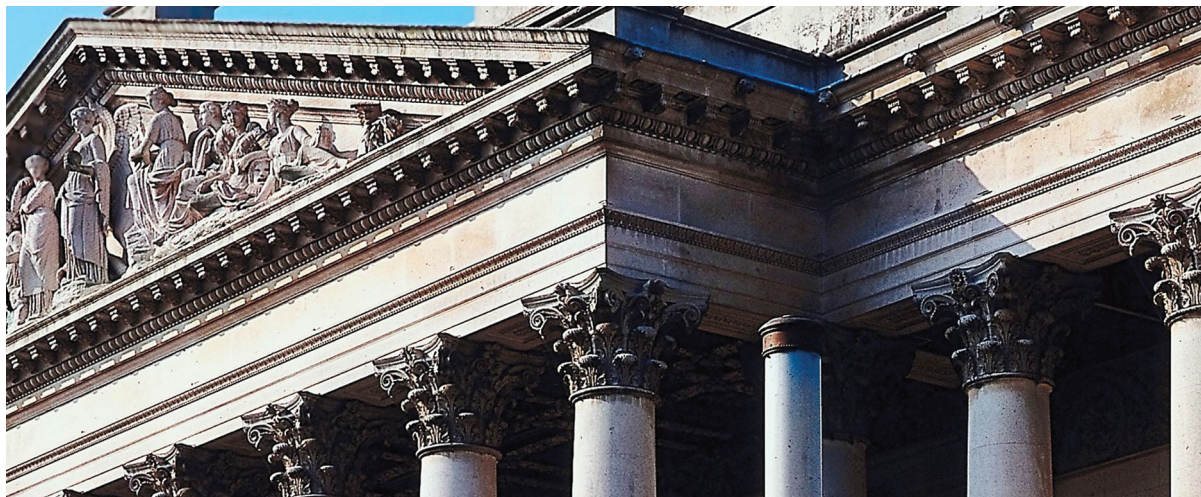


Risk and Regulation Monthly



August was busier than expected. Highlights included the ECB's manual on its **Comprehensive Assessment**, the PRA's third consultation on **Solvency II transposition**, and the FCA's statement that 2.5 million **PPI claims** needed to be reassessed.

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Capital (including stress testing)

The **European Central Bank (ECB)** published a manual on the Comprehensive Assessment of Eurozone banks being undertaken in preparation for the Single Supervisory Mechanism (SSM). The manual provided details on how the ECB will "join-up" its asset quality review (AQR) and the European Banking Authority's (EBA) 2014 stress test. The manual also described the stress test quality assurance process. In parallel, the **EBA** issued the final stress test template.

Both the *Prudential Regulation Authority (PRA)* and *HM Treasury (HMT)* consulted on transposing the Solvency II and Omnibus II directives into UK law. HMT set out changes in PRA powers over use of the volatility adjustment, and de-authorisation. The PRA covered the long-term guarantees package in Omnibus II, transitional measures, and disclosure requirements for groups. It also set out some changes to its supervisory approach, related to the use and definitions of capital add-ons, and exemptions from quarterly reporting, and highlighted a number of upcoming consultations, including possible amendments to the approved persons regime for insurers.

Later in August, the **PRA** published an update on Solvency II implementation, aimed at firms intending to use internal models. The note clarified two areas: (i) the relationship between the risk margin and the calibration of non-hedgeable risks; and (ii) assessing credit risk for matching adjustment portfolios. In a *Director's update*, the PRA also issued a timetable for upcoming Solvency II publications.

The **European Insurance and Occupational Pensions Authority (EIOPA)** issued several Solvency II-related papers, including an *update* on Data Point Model and XBRL taxonomy design, and on *submission* of information to National Competent Authorities (NCAs).

The **PRA** issued its supervisory statement on valuation risk for insurers, following its consultation in May. It covered expectations on valuation uncertainty and prudent valuation, as well as on client-supplied prices.

The **PRA** also issued a supervisory statement on subordinated guarantees and the quality of capital for insurers. The statement addressed the supervisor's concerns that guarantees provided to capital providers can undermine the quality of the capital, and gave guidance on how these should be treated under different scenarios.

There were two publications related to technical standards for the revised Capital Requirements Directive (CRD IV/CRR). The **EBA** published final draft regulatory technical standards (RTS) on the treatment of equity exposures under the internal ratings-based (IRB) approach, which allow NCAs to grant institutions a temporary exemption from the IRB treatment for certain equity exposures. The **European Commission** published a draft delegated act on the identification of the geographical location of the relevant credit exposures for calculating institution-specific countercyclical capital buffers.

Liquidity

No new developments.

Governance and risk management (including remuneration)

No new developments.

Conduct of Business (including MiFID)

The **Financial Conduct Authority (FCA)** published an update on progress in redressing mis-sold payment protection insurance (PPI). "Too many complaints" were rejected between late 2012 and early 2013, and so firms had agreed to reassess 2.5mn PPI claims, which had either been rejected or where redress might be too low. However, the overall process for consumers to claim PPI redress was "working well". The FCA hopes to be in a position to scale down PPI work to a "business as usual" level of supervision during 2015.

Following a review of over 1,500 financial promotions for consumer credit products since April 2014, the **FCA** issued a statement that "firms in this sector can do more to ensure financial promotions meet the standards [it] would expect". The FCA has opened 227 cases about non-compliant promotions, with a quarter relating to high-cost short-term credit.

The **FCA** consulted on guidance on how firms can ensure their financial promotions are compliant when using social media, providing examples of unclear risk warnings, how to remain compliant when using character-limited social media (for example, Twitter), and how to use images. The FCA plans to commission qualitative research on how consumers use financial promotions that arrive through social media.

Following a statement by the European Securities and Markets Authority (ESMA) on the potential risks of contingent convertible securities (CoCos), the **FCA** announced it will use its product intervention powers to restrict firms from distributing CoCos to retail investors from 1 October 2014 to 1 October 2015. A consultation on permanent rules on CoCos is expected in September.

The **FCA** published a policy statement on final capital rules for Self-Invested Personal Pension (SIPP) operators. In light of industry feedback, the FCA introduced a sizeable reduction in the capital requirement for a significant number of firms. The new prudential rules do not differentiate by product, but rather by type of provider. However, the vast majority of firms affected by these rules market themselves as SIPP operators. The rules will come in to force on 1 September 2016.

The **FCA** consulted on guidance following the Financial Policy Committee's (FPC) recommendation that major lenders put a 15% limit on new residential mortgages made at loan to income (LTI) ratios of 4.5 times or more. The FCA guidelines apply to firms not subject to the PRA's June rules, but with residential mortgage lending of more than £100mn per year. The FCA will monitor new lending through Product Sales Data returns. It said that from quarter to quarter, 'unused' high LTI mortgage capacity could not be carried over. If a firm breaches the 15% threshold, the FCA may require it to stop high LTI lending. The guidance will become effective on 1 October.

The **FCA** asked firms to provide it with examples of when it (or its predecessor, the Financial Services Authority) applied its rules retrospectively, in the sense of holding firms to a stricter standard than had been applied at the time of an incident, with the benefit of hindsight. The request follows the FCA's publication on the 'expectations gap' between regulators and industry, as part of which the FCA asked industry whether regulation was hindering market developments, and aligns with the FCA's 'Project Innovate'.

The **Payments Council** announced that a same-day retry process will be extended to help customers avoid late payment charges on their account. All participating banks and building societies should give customers until at least 2pm to pay cleared funds into their account. The Payments Council also produced a new consumer guide on the retry process.

The **EBA** consulted on criteria for use of its intervention powers in relation to structured deposits under the Markets in Financial Instruments Regulation (MiFIR). These were based on the criteria already proposed by ESMA for financial instruments. However, some were considered not applicable to structured deposits (e.g. those related to the price formation process), and others were modified (e.g. those related to the degree of complexity).

The **European Commission** published a request to EIOPA for technical advice on the proposed Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs). This covered the criteria and factors to be taken into account in determining when there is a significant investor protection concern or a threat to financial stability.

ESMA updated its guidelines on exchange-traded funds (ETFs) and other undertakings for collective investment in transferable securities (UCITS). These modified the original provision on diversification of collateral received by UCITS in the context of efficient portfolio management techniques and over-the-counter derivative transactions.

ICE Benchmark Administration (IBA), the administrator for LIBOR, consulted on its policy for handling errors identified subsequent to the publication of ICE LIBOR rates. IBA noted that the incidence of errors could be reduced by reducing the number of decimal places to which LIBOR is calculated – currently five – and invited comments on whether this change should be made.

The FCA fined the Royal Bank of Scotland and NatWest £14.5mn for failings in their advised mortgage business. “Only two of the 164 sales reviewed were considered to meet the standard required overall in a sales process”. The firms agreed to contact around 30,000 consumers who received mortgage advice in the relevant period, although “there is no evidence that the failings have caused widespread detriment to customers”.

The FCA fined Stonebridge International Insurance Limited £8,373,600 for failings in its sales of accident insurance. The telesales scripts designed for its outsourcing companies did not provide clear, fair and balanced information, while Stonebridge’s poor systems and controls and inadequate oversight of its outsourcing companies breached FCA requirements that firms treat customers fairly and have appropriate systems and controls.

The FCA fined Deutsche Bank £4.7mn for incorrectly reporting 29mn equity swap contracts for difference transactions between 2007 and 2013.

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

The FCA consulted on the implementation of the Bank Recovery and Resolution Directive (BRRD) for investment firms. The FCA’s approach will be to apply the legal minimum where possible, as the majority of investment firms supervised by the FCA are smaller than those covered by the PRA. It will also apply the simplified obligations permitted by the BRRD to smaller, less complex firms, with only the largest investment firms subject to the full requirements. The FCA’s test of ‘significance’ will be similar to that under CRD IV for identifying prudentially significant firms. The FCA will not be the resolution authority for firms under its remit, as this role will remain with the Bank of England, but it will be responsible for recovery plans, early intervention, and gathering data for resolution planning purposes. The first dates for submission of data and recovery plans will be June 2015 for the largest of these firms, with phased implementation for the remainder.

The ECB identified four systemically important payment systems (SIPS) – TARGET2, EURO1, STEP2-T and CORE(FR) – to be covered by the new ECB Regulation on oversight requirements. This implements the international Principles for Financial Market Infrastructures (PFMIs), and enables the ECB to take enforcement action in case of non-compliance.

Regulatory perimeter

ESMA published final guidelines on the implementation of the PFMIs. It was “concerned” that differences in language between the European Market Infrastructure Regulation (EMIR) and the PFMIs could prevent the EU from being considered compliant with the PFMIs for Central Counterparties (CCPs), despite the fact that EMIR cites the importance of such international principles. ESMA’s guidance is intended to articulate the relevance of the PFMIs for EMIR in a way that can be incorporated into a PFMI consistency assessment.

The International Organization of Securities

Commissions (IOSCO) launched a public information repository for central clearing requirements for over-the-counter (OTC) derivatives, which provides regulators and market participants with consolidated information on the clearing requirements of different jurisdictions.

The OTC Derivatives Regulators Group (ODRG)

set out its concerns to the Financial Stability Board (FSB) on barriers to reporting to trade repositories. These included data protection laws, blocking statutes, state secrecy laws, and bank secrecy laws.

ESMA issued an opinion on the application of guidelines issued by the Committee of European Securities Regulators (CESR), the predecessor of ESMA, in relation to European money market funds (MMFs). To avoid mechanistic reliance on credit ratings, MMFs will be expected to perform their own assessments of the credit quality of money market instruments, rather than rely solely on recognised credit rating agencies.

The Unique Trade Identifier (UTI) Steering Committee,

acting on behalf of several industry bodies such as the British Bankers’ Association (BBA), the Global Financial Markets Association (GFMA) and the International Swaps and Derivatives Association (ISDA), wrote to IOSCO on developments in the creation of a global UTI, building on the Legal Entity Identifier. Current trade identifiers tended to adopt either a US or EU-based format, and the lack of ESMA endorsement for any European approach meant industry had struggled to develop a coherent approach.

The **Regulatory Oversight Committee (ROC)** of the Global Legal Entity Identifier System (GLEIS) published principles guiding interim decision-making until the Global Legal Entity Identifier Foundation (GLEIF) takes over operational governance of the system.

Rethinking the domestic and international architecture for regulation

The **European Commission** reported on the operation of the *European Supervisory Authorities* (ESAs) and on the mission and organisation of the *European Systemic Risk Board* (ESRB). The ESAs had “performed well” since their creation, despite “difficult circumstances”. However, an increase in their workload had not been accompanied by equivalent increases in budgets or resources, and the Commission would therefore review the existing funding model. Meanwhile, the ESAs should consider increasing their focus on supervisory convergence, and on consumer protection. On the ESRB, while many were satisfied with its work so far, it was too early to form an in-depth opinion of its effectiveness. The Commission said the ESRB could improve its communication strategy and its governance arrangements, and should continue to expand its perspective beyond banking. This was the first review of the European agencies, and further reviews will be conducted every three years.

The **FCA** published an exchange of letters between *Graham Beale*, the Chairman of the FCA Practitioner Panel, and *Clive Adamson*, FCA Director of Supervision, concerning greater transparency in the use of attestations. In his response, Clive Adamson outlined steps the FCA will take to ensure increased consistency in approach. It would issue revised internal guidance for supervisors, and publish data on attestations on a quarterly basis.

The **Treasury Select Committee (TSC)** published responses to letters sent by Andrew Tyrie, its Chairman, to the FCA and the PRA on 23 June, in which he asked for clarification on the use of their powers to require a report by a skilled person in accordance with section 166 of the Financial Services and Markets Act 2000 (see copies of the original letters to the FCA and the PRA). The FCA’s *Martin Wheatley* and the PRA’s *Andrew Bailey* (see also a *follow-up letter* on cost data) responded with detailed clarifications on the cost and dates of reviews over the past five years and the process by which the decision to require a skilled persons report was taken.

Following an Office of Fair Trading (OFT) report in September 2013 that the buyer side of the market was “one of the weakest” it had analysed recently, the **FCA** consulted on rules to require providers of workplace personal pension schemes to set up and maintain independent governance committees (IGCs). IGCs will have a duty to act in the interests of scheme members, and assess the value for money of the schemes. The FCA will consult later in the year on a charge cap on default funds and on the banning of certain charging practices.

The **ECB** published its third quarterly progress report on implementing the SSM. This confirmed that the ECB will assume prudential supervisory tasks for Eurozone banks from 4 November 2014, as scheduled. SSM governance is now fully operational and almost all coordinators for the 117 Joint Supervisory Teams – the main operational structure for the conduct of supervision – have been selected. Overall, recruitment for the supervisory functions was said to be nearly finalised. The SSM Supervisory Manual is also in its final stages, with approval taking place section by section. In a recent *interview*, Danièle Nouy, Chair of the Supervisory Board of the SSM, said that supervision under the SSM will be “extremely thorough and the rules will be the same for all”.

ESMA published a report on its resource needs, resulting from its supervisory powers under the Credit Rating Agencies Regulation (CRA 3). While ESMA experienced a steep increase of resources in the initial years following the entry into force of the CRA Regulation, the report estimated slower growth in staff numbers in 2015 and 2016.

Disclosure, valuation and accounting

No new developments.

Information security and data privacy

The **Information Commissioner’s Office (ICO)** launched a second round of *consultations* on its privacy seal scheme, asking for views on a set of draft framework criteria for assessing proposals. The ICO intends the privacy seal scheme to act as a ‘stamp of approval’ highlighting an organisation’s commitment to maintaining good privacy standards. The ICO hopes to endorse at least one privacy seal scheme operated by an independent third party in the UK, and will invite proposals in the autumn, with a view to selecting a proposal in early 2015.

Financial crime

The **FCA** published a notice in relation to EU asset freezes against certain members of the former Ukrainian government, certain individuals and entities. The FCA also reminded firms of restrictions on five Russian banks, which prohibit purchase, sale, brokering and assistance in the issuance of or dealing with transferable securities and money-market instruments with a maturity exceeding 90 days issued after 1 August 2014 by these banks.

The **FCA** fined a former Burlington director £350,000 and banned him from involvement in FCA authorised firms for “dishonest involvement” in the sale of Unregulated Collective Investment Schemes (UCIS) to retail customers. Over 800 consumers invested around £30mn in three UCIS, which subsequently failed.

Other

The Bank of England (BoE) *announced* that Julian Adams, Executive Director for Insurance Supervision, is leaving the BoE. Paul Fisher, Deputy Head of the PRA, will take on the role of Executive Director for Insurance until a replacement is appointed. The Bank also *announced* the departure of Spencer Dale, Executive Director for Financial Stability Strategy and Risk. Sam Woods, Director for the same department, will take on the role until a new appointment is made.

The FCA *published* the fifteenth edition of its policy development update, which contained a timetable of forthcoming publications, such as consultation papers on the Mortgage Credit Directive and transfer of second charge mortgages; the review of the client money rules for insurance intermediaries; policy statements on new remuneration rules; individual accountability; and transposition of Solvency II.

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