

Risk and Regulation Monthly



As always, December was a busy month. The Financial Conduct Authority (FCA) published its first consultation on **MiFID II implementation**. The **clearing obligation** timeline was triggered by the publication of technical standards for the European Market Infrastructure Regulation (EMIR) in the Official Journal. The **Single Resolution Board (SRB)** published its work plan for 2016, while the European Central Bank (ECB) reflected on the first year of the **Single Supervisory Mechanism (SSM)**. And the European Banking Authority (EBA) published its long-awaited report on the **prudential regime for investment firms**.

This note is produced for information only on a best efforts basis, and does not constitute advice of any kind.

Capital (including stress testing)

The Bank of England *published* the results of the **2015 stress test**, which covered seven major UK banks and building societies. For five the stress test “did not reveal capital inadequacies.” Royal Bank of Scotland did not meet its individual capital guidance after its proposed strategic management actions in the stress scenario, and Standard Chartered did not meet the 6% minimum Tier 1 capital ratio. However, both had already laid out plans to raise additional capital, and the PRA did not require them to submit revised capital plans.

The Financial Policy Committee (FPC) *published* a report on the evolution of the **framework for bank capital requirements** and its final calibration post-2019. Based on a new Bank of England *research paper*, the optimal Tier 1 equity requirement for the UK banking system was said to be 11% of risk-weighted assets (RWAs).

The report also set out the FPC’s approach to using the countercyclical capital buffer, which it expected to set at 1% in a ‘standard’ risk environment, and varied according to the credit cycle.

The EBA *consulted* on new guidelines for supervisory **stress testing**. These included guidance on the use of reverse stress testing in recovery plans and the treatment of conduct risk. The revisions were aimed at harmonising stress testing practices across the EU and clarifying their (SREP).

The Prudential Regulation Authority (PRA) *consulted* on the interaction of the **Minimum Requirement for Own Funds and Eligible Liabilities (MREL)** with regulatory capital buffers, making clear that firms should not double count Common Equity Tier 1 (CET1) capital towards MREL and capital or leverage buffers. CET1 used to meet minimum capital requirements would count towards MREL, but firms would need to meet buffers before any additional CET1 would count towards MREL. See the Crisis Management section for more on the Bank of England’s approach to setting MREL.

The Basel Committee on Banking Supervision (BCBS) *consulted* for a second time on revisions to the **Standardised Approach for credit risk**. The BCBS proposed to re-introduce the use of external credit ratings for corporate and bank exposures in a “non-mechanistic” fashion, subject to “due diligence requirements, which could result in a higher risk weight than determined by ratings”. The revised consultation did not cover sovereign exposures (for which a separate consultation is expected).

The PRA *published* a Policy Statement setting out final rules on the **UK leverage ratio framework**. It extended the transition period for disclosure of daily averaging of the ratio by 12 months, ending on 31 December 2017. It also published two new Supervisory Statements, one on its expectations in relation to *leverage ratio buffers and the averaged leverage ratio calculation* and one containing instructions on *reporting*; and *updated* an earlier Supervisory Statement on capital requirements. In addition, the PRA *published* the additional leverage ratio buffer requirements for global systemically important institutions (G-SIIs), specifying that G-SIIs must submit a capital plan if their capital falls below the buffer requirement.

The European Commission *published* a speech by Commissioner Jonathan Hill, summarising responses to the consultation on the **impact of the CRR and CRD IV on bank financing of the economy**. He said respondents were divided on whether CRR's lower capital requirements for SME lending were translating into more lending to businesses and also called for specific measures to promote bank lending to infrastructure projects. He said he "shared [the] concern" voiced by respondents that implementation of remaining Basel III requirements should be proportionate, and that the Commission had requested input from the EBA to this end.

The EBA *reported* on the suitability of the **prudential regime for investment firms**. It identified several issues in the regime's current application, including "inadequate" risk sensitivity, and complexity stemming from the current categorisation of investment firms. The EBA suggested a distinction between "systemic" and "bank-like" investment firms to which full prudential requirements would apply, and other investment firms which would be considered "not systemic" or "not interconnected". The EBA also recommended an extension to the exception from prudential requirements for commodity trading firms until 31 December 2020.

Following a previous consultation paper, the FCA *published* a policy statement on **capital resource requirements for personal investment firms (PIFs)**, proposing to introduce a new requirement at the higher of £20,000 or 5% of a firm's investment business annual income. The new rules will apply from 30 June 2016 with a phased implementation period for smaller firms.

The BCBS *consulted* on the **identification and measurement of "step-in risk"**, defined as the risk that a bank would provide financial support to an unconsolidated entity in the absence of a contractual obligation, in order to protect itself from any reputational damage should the unconsolidated entity experience financial stress. The proposed framework included approaches that could be used to reflect step-in risk in banks' prudential measures, although the BCBS did not set out whether these would fall within Pillar 1 and/or Pillar 2.

The EBA *consulted* on draft Regulatory Technical Standards (RTS) on the supervisory assessment and approval of **internal models for market risk**. The EBA proposed two methodologies for supervisors to assess the significance of positions, covering general and specific risks, based on the Standardised Approach. The draft RTS also set out the methodology for assessing compliance with the Capital Requirements Regulation (CRR) criteria for a firm to use the internal models approach for market risk.

The EBA *consulted* on three draft RTS specifying a **harmonised prudential framework for central securities depositories (CSDs)**. A draft RTS on capital requirements sought to clarify the definition of capital for all CSDs, following the definition in EMIR. The other two draft RTS, which would apply only to CSDs offering ancillary banking services, would determine how an additional risk-based capital surcharge could be applied, and also covered monitoring, measuring and reporting.

The EBA *issued* an Opinion on the calculation and transparency of the **Maximum Distributable Amount (MDA)** – the amount of capital a bank can distribute to shareholders in the event that it has failed to meet capital requirements. The EBA clarified that capital under both Pillar 1 and 2 had to be taken into account when calculating the MDA, and asked the Commission to review the relevant provision in the Capital Requirements Directive (CRD) to make this clear. The EBA also said banks should consider whether Pillar 2 capital requirements met the criteria of inside information under the Market Abuse Regulation (MAR), and whether therefore such data needed to be publicly disclosed.

The ECB made a *Recommendation on dividend distribution policies* to clarify the terms on which banks should pay dividends under CRD IV/CRR. Banks which met current capital requirements but which did not meet future requirements on a "fully loaded" basis were recommended to pay dividends only if they would still meet capital requirements in a stress scenario, and progress towards meeting fully loaded capital requirements.

The PRA *issued* a letter by Chris Moulder, Director of General Insurance of the PRA, on "continued **soft market conditions**" in the UK general insurance sector due to low interest rates and a year without significant natural catastrophes (the letter was dated prior to significant flooding in the UK). The letter reminded firms that they should ensure the appropriateness of their business strategy, and that boards should provide adequate oversight and challenge, and set out its expectations in terms of underwriting, reserving, reinsurance and the assessment of capital requirements. Mr Moulder also *delivered* a speech on policy priorities for prudential regulation and supervision in the insurance sector.

The PRA *approved* 19 insurers' full or partial **internal models** ahead of the Solvency II go-live date of 1 January 2016.

Liquidity

The EBA *reported* on the impact and calibration of the **Net Stable Funding Ratio (NSFR)**, and recommended its introduction for EU banks. The EBA did not recommend an exception for smaller banks but suggested taking into account “EU specificities” for trade finance, pass-through financing models, Central Counterparties (CCPs), and other areas. A majority of banks were already NSFR compliant as of December 2014. The shortfall faced by non-compliant banks was seen as significant, but concentrated in a small number of firms, for which the EBA foresaw some “significant and difficult adjustments”.

The International Organisation of Securities Commissions (IOSCO) *reported* on **liquidity management tools in Collective Investment Schemes (CIS)**, following a survey conducted among its members. The most common tools included redemption gifts, redemptions in kind, and suspensions of redemptions, while open-ended funds were subject to additional regulatory requirements on fund leverage, asset concentration, and restrictions on investments in illiquid assets and short-term borrowings.

Governance and risk management (including remuneration)

The EBA *published* its final Guidelines on **sound remuneration policies for firms subject to CRD IV**. The bonus cap should apply to all firms regardless of size, although small and non-complex firms will be excluded from the requirements to apply deferral and payment in instruments for variable remuneration. Long-term incentive plan awards will no longer need to be valued at the end of the vesting period, and will be valued for the purposes of the cap in the year in which the award is granted. The EBA also *published* an Opinion on the **application of the proportionality principle** to remuneration which supported these changes, and stated that the remuneration principles should be limited in their scope when applied to staff receiving “low levels” of remuneration. The FCA *published* a statement saying that it will review the proposed changes, and will consult on any necessary changes to UK rules.

The EBA *consulted* on guidelines on **remuneration policies and practices in retail banking** which said that these need to take account of consumer rights, prevent conflict of interests and use quantitative and qualitative criteria for determining the level of variable remuneration. The EBA asked firms to document their compliance, retaining records for at least five years, ensuring these were made available to supervisors on request and were “easily accessible” to “relevant persons” in the firm.

The PRA *published* a final Policy Statement on the **application of the Senior Managers Regime (SMR) to UK branches of non-EEA banks**, and also *updated* its Supervisory Statement. There were no substantial changes from the previous draft. The FCA also *published* its own final SMR rules for UK branches of EEA and non-EEA banks, which again included only minor changes and clarifications. However, individuals performing “significant harm functions” in non-EEA banks will be subject to the Conduct Rules and the Certification Regime only if they are “based in the UK”, with the test of “dealing with a UK client” removed from the final rules.

The FCA *published* a policy statement setting out amendments to the **Decision Procedure and Penalties Manual (DEPP)** and the **Enforcement Guide (EG)** under the SMR. The FCA explained that the Conduct Rules under the SMR will be applied in a proportionate manner, but refrained from giving guidance on the types of conduct that may result in the FCA bringing forward a criminal proceeding against a Senior Manager.

The FCA *published* a policy statement setting out final rules on changes to the **Approved Persons Regime for non-Solvency II insurers**. It confirmed that it will adopt the PRA’s approach to classifying such firms as small or large by considering only assets held in relation to regulated activities.

The BCBS *reported* for the third time on progress in adopting its **principles for effective risk data aggregation and risk reporting (BCBS 239)**. Banks had made improvements in their understanding and implementation of the principles, but the 1 January 2016 deadline for compliance would be missed. The BCBS recommended that non-compliant banks prepare remediation plans, and that compliance with the principles should be subject to an independent evaluation in early 2016, either by internal or external auditors.

The Financial Stability Institute of the Bank for International Settlements *published* a paper on the **“four lines of defence” model for financial institutions**. This focuses on the regulation of banks and insurers, giving supervisors and external auditors a specific role in internal controls.

IOSCO *reported* on the **use of external credit ratings in creditworthiness assessments** at “large intermediaries”. It recommended 12 practices regulators should look for as part of their oversight of market intermediaries, including the establishment of an independent credit assessment function, clearly separated from other business units, and avoidance of exposure to particular credit risks when a firm does not have the internal capacity to assess the exposure independently and adequately.

The EBA *consulted* on guidelines on the collection of information related to the Individual Capital Adequacy Assessment Process (ICAAP) and equivalent liquidity process (ILAAP) for the purposes of the SREP. The guidelines specify general considerations on the collection of information in relation to business models and strategy and risk governance frameworks, as well as ICAAP-specific and ILAAP-specific information.

Conduct of Business (including MiFID)

The FCA *published* its first consultation paper on **MiFID II implementation**, which covered wholesale markets issues including new trading venues, trading transparency and controls over algorithmic and high frequency trading. It decided not to apply the transaction reporting obligations to managers of collective investment undertakings and pension funds and suggested that existing approved reporting mechanisms should submit new applications to be authorised as data reporting services providers. The second consultation is expected in the first half of 2016.

The European Securities and Markets Authority (ESMA) *published* Implementing Technical Standards (ITS) regarding **MiFID II**. These specified standard forms, templates and procedures to be used in suspension and removal of financial instruments from trading on a Regulated Market, a Multilateral Trading Facility or an Organised Trading Facility, authorisation of data reporting services providers, position reporting and weekly position reports, and cooperation between competent authorities in supervisory activities.

ESMA *consulted* on guidelines under **MiFID II and MiFIR** in relation to transaction reporting, instrument reference data, record keeping in relation to client orders, and clock synchronisation. The Guidelines sought to elaborate different scenarios under which the reporting and record keeping requirements needed to be met, and to clarify the application of the clock synchronisation requirement which seeks to ensure that trading venues and their members report events using “an accurate time source.”

The European Commission *consulted* on **product choice and opportunities for firms and consumers** across insurance, loans, payments and savings accounts and other retail investments. The consultation was aimed at making it easier for companies to sell into other Member States, for consumers to buy such products, and for consumers to take products with them if they moved to another Member State.

The Joint Committee of the European Supervisory Authorities (ESAs) *published* a discussion paper on **automation in financial advice**. The ESAs observed that this phenomenon was not equally present across all Member States, but had the potential to grow. Following feedback on the report, the ESAs will assess whether a regulatory response is necessary.

The FCA *consulted* on measures designed to increase **transparency, competition and engagement at renewal** in the general insurance market. It proposed to introduce rules requiring renewal notices to disclose the previous year’s premium, and for additional disclosure when customers renewed the same product four times or more. The FCA also *published* results of field trials testing the potential for different renewal notices to encourage consumers to switch or negotiate their policies at renewal.

The FCA *published* a policy statement setting out final rules in response to its **market study in the cash savings sector**. This introduced rules requiring firms to disclose a ‘summary box’ for direct offer financial promotions in relation to a savings account, including prescribed information across seven fields, such as the interest rate. The FCA also *published* data listing firms according to their lowest interest rates on open and closed easy-access cash savings accounts, and easy access cash ISAs.

The FCA *presented* findings from its review of the **suitability of retail investment portfolios** provided by wealth management and private banking firms. While some had taken steps to address the issue, many needed to make substantial improvements in gathering and regularly updating customer information.

The FCA *presented* findings from its thematic review into how investment banking firms manage **confidential and inside information**. It found that some of the practices resulted in risks for market participants and firms, including conduct and conflict of interest failings, and FCA regulatory and legal breaches. Further work was necessary for the appropriate management of these risks.

The European Insurance and Occupational Pensions Authority (EIOPA) *published* its fourth **Consumer Trends Report**. It identified emerging issues such as the relationship between customer analytics and Big Data, which led to the development of more customised products and pricing techniques, but potentially also consumer protection issues. Supervisory authorities focused on the management of conflicts of interest, given the complexity introduced by financial innovation.

The FCA *reported* on findings from its follow-up **review of the mobile phone insurance market**. It identified improvements made in relation to the recording and analysis of complaints, and clearer terms in relation to theft and loss. However, some firms’ complaints-handling was not sufficiently independent of the rest of the business, and three firms took over 15 days on average to process and settle successful claims. EIOPA separately *reported* on consumer protection issues in relation to mobile phone insurance.

The FCA *fined* Threadneedle Asset Management Limited £6,038,504 for failing to put in place **adequate controls** in the fixed income area of its front office, for providing inaccurate information to the regulator, and for failing to correct the inaccurate representation for four months.

ESMA *published* results of its follow-up review of **supervisory regimes with regards to the Market Abuse Directive (MAD)**. The review focused on national supervisory practices to monitor whether investment firms, regulated markets and multilateral trading facilities had the necessary market abuse investigation capabilities, and whether firms complied with the provisions on insider lists.

ESMA *published* final guidelines on **cross-selling practices under MiFID II**, which covered cross-sold packages that include the provision of an investment service. The guidelines clarified that where costs cannot be calculated with precision on an ex-ante basis, firms should estimate the costs based on reasonable assumptions, and that firms are not obliged to disclose information in relation to competitor firms' products.

ESMA *consulted* on measures to improve **access to trade repository (TR) data** and to facilitate the aggregation and comparison of data across trade repositories. The improvements focused on standardising the output format of the TR data and securing data exchange between TRs and the authorities.

ESMA *agreed* to an extension of the emergency **short selling prohibition** by the Hellenic Capital Market Commission on the shares of certain credit institutions under the Short Selling Regulation.

ESMA *published* its final report on guidelines for the **assessment of knowledge and competence** of investment firms' staff when they are providing investment advice or information about financial instruments under MiFID II. The guidelines aimed to enable firms to fulfill their obligations around requirements on conduct of business, information to clients, and suitability and appropriateness.

ESMA *informed* the European Commission of a delay in submitting the RTS on **indirect clearing of exchange-traded derivatives** under MiFIR, needed in order to maintain consistency with the RTS on indirect clearing of OTC derivatives under EMIR. ESMA said it planned to submit both RTS together, following a consultation on suggested amendments to the EMIR RTS.

The BCBS *consulted* on guidance on how its core principles for banking supervision can be applied to **financial inclusion**. The document examined the risks of catering to "financially unserved or underserved" customers, including money laundering and terrorism financing, and provided guidance for proportionate regulation and supervision of banks and non-banks.

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

The ECB and SRB *published* their **Memorandum of Understanding** in relation to cooperation and information exchange. The authorities aim to "cooperate closely" in all phases of recovery and resolution, such as recovery and resolution planning activities, early intervention and resolution itself. The SRB assumed its full responsibilities and powers on 1 January 2016.

The SRB *published* its **work programme for 2016**, putting "full resolution planning capacity" as its main objective. The SRB said it will focus on ensuring resolution readiness, operationalising the Single Resolution Fund (SRF), fostering cooperation between authorities, and consolidating its organisational capabilities. Setting MREL for individual banks will also constitute a crucial part of its work.

The Bank of England *consulted* on its approach to **MREL**, largely in line with the EBA's proposed standards. For firms which will be subject to bail-in as their resolution strategy, MREL will be approximately double the minimum Pillar 1 + Pillar 2A regulatory capital. Other capital buffers will sit on top of the MREL requirement (see Capital section above). The Bank of England also *published* a final Policy Statement on its power to direct firms to address **impediments to resolvability**, which was not materially different from the earlier consultation.

The PRA *clarified* the scope of its proposals on ensuring **operational continuity in resolution**. These would apply to CRR firms for which the value of total assets, safe custody assets or sight deposits over the previous three years exceeded £10bn, and aimed to capture firms that provided or received services supporting critical economic functions (such as retail deposit taking). It estimated that at least 65 firms may be within scope.

The EBA *published* a comparative report on **recovery plan scenarios**. 19 recovery plans were analysed. A number were already in line with the requirements of the Bank Recovery and Resolution Directive (BRRD) while others required further improvements with regard to the relevance and severity of scenarios and their impact on the relevant recovery indicators.

The EBA *published* final draft RTS on the methodology for **valuing derivative liabilities** for the purpose of bail-in. The proposed standards are intended to enable resolution authorities to value derivative liabilities objectively and in line with the 'no creditor worse off' (NCWO) principle, and also take into account the costs or gains that would be incurred by the counterparty in replacing the contract. Derivatives counterparties will be able to submit their own data for the valuation within a certain time period, otherwise resolution authorities will use 'observable market data.'

The EBA *published* final RTS on business reorganisation plans as required under the BRRD. Reorganisation plans are required to identify the causes of an institution's failure, and to set out how the institution will be restored to long-term viability. The RTS set criteria against which resolution authorities should assess the plans.

The EBA *published* final draft RTS setting out requirements in relation to the **detailed records of financial contracts** which must be kept on an ongoing basis, to enable resolution authorities to obtain information on financial contracts quickly to support the application of resolution powers or tools.

The European Commission *requested* 10 Member States to implement the revised **Deposit Guarantee Scheme Directive** (DGSD): Belgium, Cyprus, Estonia, Greece, Italy, Luxembourg, Poland, Romania, Slovenia and Sweden. The implementation of the DGSD is a pre-condition for the future European Deposit Insurance Scheme (EDIS) proposed by the Commission.

The Bank of England's Andrew Gracie *spoke* about **resolution for CCPs**. He said that supervisory measures must account for idiosyncratic requirements for CCP recovery and resolution, particularly with regard to loss-absorbing capacity, the right point of entry for resolution, and creditor safeguards.

HM Treasury *consulted* on elements of the **implementation of the BRRD** into UK law. It proposed new early intervention powers for the PRA and FCA to be able to remove members of a firm's senior management and to appoint temporary managers, and powers for the Bank of England to resolve branches of third country firms.

The PRA *published* the 2015 list of **UK-headquartered G-SIIs**, providing details of the applicable scores, sub-categories and buffer rates, following the Financial Stability Board's (FSB) update to the list in November.

The Bank of England *published* the results of its latest **Systemic Risk Survey** which indicated that confidence in the UK financial system had risen, although economic downturn was cited as the greatest risk. The perceived possibility of financial market disruptions remained high and the risk of cyber-attack had reached a new survey high. The Bank also *published* its latest **Financial Stability Report** which said that cyber risks represented a "serious and growing" threat to the resilience of the UK financial system. The FPC would provide an update on its work in relation to cyber resilience by summer 2016.

The **FPC** *published* the record of its meetings from 25 and 30 November. It made no new Recommendations, but said that its Recommendation that the Bank of England and PRA should develop proposals to stress test the UK banking system on a regular basis could now be considered implemented. For the time being, the countercyclical capital buffer for UK exposures was set at 0%.

The European Systemic Risk Board (ESRB) *reported* on **systemic risks in the EU insurance sector**. It identified four ways in which the insurance sector can have a systemic impact, which include involvement in non-traditional and non-insurance activities, and vulnerability to a "double-hit" scenario where sustained low-risk free rates are combined with a sudden drop in asset prices. The ESRB questioned whether the tools provided to regulatory authorities under Solvency II would be able to address these concerns.

Regulatory perimeter

The RTS on the **clearing obligation under EMIR** was *published* in the Official Journal of the EU, triggering the clearing obligation timetable. The first mandatory clearing obligation for interest rate derivatives will be phased in as of 21 June 2016. The Regulation imposed a clearing obligation for fixed-to-float interest rate swaps, basis swaps, forward rate agreements and overnight index swaps for EU financial counterparties, and for non-financial counterparties over the clearing threshold.

ESMA *consulted* on the **margin period of risk** (MPOR) used to calculate initial margin collected by a CCP for centrally cleared instruments other than OTC derivatives. ESMA suggested a reduction in the MPOR from two days to one day for gross omnibus and individual segregated accounts for exchange traded derivatives and securities, provided that certain conditions were met. This approach is similar to that under the Dodd-Frank Act and, if adopted, would bring the EU closer to recognising the US regime as equivalent.

ESMA *published* its annual **market share calculation for EU registered credit rating agencies** (CRAs) required by the CRA Regulation. The three largest CRAs, Fitch, Standard & Poor's, and Moody's, had around 90% of the market based on revenues in 2014. ESMA also *published* its latest set of semi-annual statistical data on the performance of credit ratings which is available in the *Central Rating Repository*.

The Committee on Payments and Market Infrastructure and IOSCO (CPMI-IOSCO) *consulted* on harmonising the **Unique Product Identifier** (UPI). The report proposed principles for the harmonised global UPI, for OTC derivatives products that authorities require to be reported to trade repositories.

IOSCO *reported* on **business continuity plans for trading venues** in relation to electronic trading risks, as part of its work on the impact of technology on trading. It observed that many market disruptions were related to technological malfunctions and emphasised the importance of effective testing and controls given that technological advances increased complexity in systems.

IOSCO *published* its third **Hedge Fund Survey**, covering developments in the two years till September 2014. Assets under management had grown 34% since the previous survey, and the industry's performance was "overall positive", with an average net investment return of 10.89% in the year to September 2014.

IOSCO *published* a report on the **regulation of crowdfunding**, accompanied by a *summary* of responses to a survey on the topic. Despite varying approaches, IOSCO found that there was a common objective across jurisdictions to balance the risks of crowdfunding with its role in contributing to economic growth. There were no immediate recommendations, but IOSCO will continue to assess the need for further work.

HM Treasury *consulted* on amendments to UK legislation required by forthcoming **Level 2 measures under the CSDR**. The proposed amendments include the creation of a new category for CSDs – a ‘recognised central securities depository’ (RCSD) – in order to reflect the differences between CSDs and CCPs. HMT also consulted on the powers of the Bank of England in respect of the regulation of CSDs.

The EBA *consulted* on the separation of payment card schemes and processing entities under the **Interchange Fee Regulation (IFR)**. The draft RTS included requirements for the accounting processes of card schemes and processing entities to produce annual audited information for separated balance sheets, separate profit & loss accounts, separate workspaces, and independence of management.

The Payment Systems Regulator (PSR) *consulted* on the **application of the IFR in the UK** in the first of a two-phase consultation. The PSR specified the interchange fee caps, the scope of their application and exemptions. It also set out how the PSR will monitor compliance with IFR provisions, the PSR’s powers and procedures as competent authority, and penalties under the IFR regime. In addition to gathering initial compliance reports and data the PSR will also investigate complaints about non-compliance with the IFR.

The EBA *published* a discussion paper on strong **customer authentication and secure communication** under the second Payment Services Directive (PSD II). The paper sought input for the development of six RTS which set out the requirements, as well as exemptions from their application. It also included provisions for protecting users’ security credentials, common and secure open standards of communication, and measures to ensure security between various payment providers.

The EBA *published* final guidelines on institutions’ **exposures to ‘shadow banking entities’** that carry out bank-like activities. Institutions will be required to set internal limits for their exposures, and limit aggregate exposures if they do not have sufficient information about their shadow banking counterparties. The guidelines were *informed* by a data collection exercise which, although containing a broader definition of shadow banking than in the guidelines, showed exposures for larger banks of almost 45% of eligible capital in aggregate.

The FCA *published* a call for input into regulatory barriers to **social investments**, setting out the different structures a social enterprise can have, and how FCA rules may apply, and seeking views on specific policies which may be hindering investment for social purposes.

The EBA *reported* on its analysis and market practice assessment of the **synthetic securitisation market** for small and medium-sized enterprises. It supported the Commission’s legislative proposal to extend the simple, standardised and transparent securitisation (STS) capital requirements to banks that originate and retain certain SME balance sheet synthetic securitisation positions.

Rethinking the domestic and international architecture for regulation

The ECB *published* the results of its **annual ‘significance’ assessment**, determining those banks subject to direct ECB supervision. Eight banks were added and two removed, so that the total increased from 123 to 129.

Sabine Lautenschläger *spoke* on the **achievements in the first year of the SSM**, in the area of organisational structure, supervisory activity and harmonisation of rules. The ECB will continue to challenge bank business models, to implement a consistent approach to non-performing loans (NPLs), to follow-up on capital quality, and analyse risk governance. As thematic reviews for 2016, she highlighted the assessment of banks’ profitability drivers, and compliance with the BCBS principles on risk data aggregation and risk reporting (BCBS 239), as well as an evaluation of the impact of IFRS 9 on provisioning.

The FCA *published* revised guidance for firms and consumers on **what to expect from the FCA** and how it intended to deliver its statutory responsibilities. The FCA also *published* a feedback statement. Responses to the earlier draft were in overall terms supportive of the FCA but requested more information on the exercise of its powers and how it used evidence to inform decisions.

The UK Government *consulted* on **powers of direction for the FPC in the buy-to-let market**. The FPC is already able to direct the PRA and FCA to place loan-to-value and debt-to-income limits on owner-occupied mortgage lending. The consultation proposed extending these powers to buy-to-let mortgage lending, and added interest coverage ratios to the FPC’s toolbox.

The International Association of Insurance Supervisors (IAIS) *adopted* revisions to its **Insurance Core Principles (ICPs)**. The revisions related to ICP 4 (Licensing), ICP 5 (Suitability of Persons), ICP 7 (Corporate Governance), ICP 8 (Risk Management and Internal Controls), ICP 23 (Group-wide Supervision) and ICP 25 (Supervisory Cooperation and Coordination).

The EBA *published* a report and an opinion on the application of legal provisions on **cooperation and information sharing between EU and third country authorities** under CRD IV. Although it found no major concerns, more clarity was needed in equivalence assessment processes of third country supervisory and regulatory regimes, confidentiality provisions and consolidated supervision.

The EBA *published* a report reviewing the **publication by competent authorities of administrative penalties** imposed for breach of the national provisions transposing the CRD and CRR. Certain competent authorities have set up websites where those subject to administrative penalties were named. The EBA recommended the setting up of such websites, in a commonly used EU official language, with the grounds for the publication of administrative penalties on an anonymous basis where appropriate.

Disclosure, valuation and accounting

The BCBS *published* supervisory guidance on **how expected credit loss (ECL) accounting frameworks should interact with banks' overall credit risk practices**. The guidance aimed at ensuring consistent interpretations and practices where there are commonalities across accounting frameworks, but did not aim to drive convergence where there were differences between those frameworks.

The FSB published two reports of the **Enhanced Disclosure Task Force (EDTF)** – a fourth *progress report* on the EDTF's Principles and Recommendations, and a *report* on the impact of expected credit loss approaches on bank risk disclosures. While implementation of the 2012 EDTF principles had increased, it varied across jurisdictions. Improvement was needed in credit risk disclosure, information about counterparty credit risk, and collateral. The EDTF said that implementation of IFRS 9 may necessitate significant changes to banks' systems and processes, as some banks may need to enhance their governance over expected credit losses, such as developing capabilities to make judgements about the use of forward-looking information.

The FSB *announced* the establishment of an industry-led task force on **disclosures on climate-related financial risks**. The task force will consider the physical, liability and transition risks associated with climate change. It will seek to develop a set of recommendations for consistent, comparable and reliable climate-related disclosures for use by companies in providing information to lenders, insurers, investors and other stakeholders.

The EBA *consulted* on changes to the ITS on **supervisory reporting with regard to financial reporting (FINREP)** following changes in IFRS 9. The amendments included changes for the measurement of financial instruments depending on the characteristics of cash flows and the business model, the new impairment model based on expected losses determined in accordance with the credit quality of a financial instrument, and changes which bring hedge accounting closer to risk management practices.

Information security and data privacy

The European Commission, European Parliament and Council of the European Union *announced* agreement on new EU **data protection rules**, with the aim of establishing a modern and harmonised data protection framework across the EU. The new framework is set to be formally adopted at the beginning of 2016. It introduces potential fines of up to 4% of global turnover for significant breaches; mandatory Data Protection Officers and privacy impact assessments; and a greater focus on explicit consent for the use of personal data.

The European Parliament *confirmed* that the provisional text for a new set of EU **Cyber Security** laws had been agreed, representing the first law of its kind in the EU. The new Network and Information Security Directive (NISD) will apply to companies including banks, energy companies, health care providers and digital service providers, and will require appropriate cyber security controls to be implemented to protect IT networks and data against cyber security incidents. The NISD will also include requirements for cyber security incidents and data breaches to be reported to the relevant regulatory authorities.

The European Payments Council (EPC) *published* version 7.1 of its **SEPA Cards Standardisation Volume** aimed at improving the security of card payments in the EU. For the first time functional and security requirements for card-not-present ("remote") payments were included. A new framework also defined the business principles and requirements for market access and participation in card payment processing services.

Financial crime

The FCA *published* a speech by Rob Gruppeta, Head of the Financial Crime Department, on the future of **anti-money laundering (AML)** regulations, expressing a worry that AML checks are perceived to be a barrier to business, innovation and competition. The FCA was "not wedded to any one technology or approach", was "more than happy to see innovative methods being deployed", and wanted to know if it was doing anything to create barriers "so that [it] can stop." The FCA had also commissioned research into "derisking," as much of its existing information was anecdotal or represented isolated case studies, but the FCA was "clear" that effective AML risk management "need not result in wholesale derisking."

Other

The PSR *consulted* on its **regulatory fees** for 2016/17. Of its £15m Annual Funding Requirement for 2016/17, 90% would be dedicated to its Banking Reform Act responsibilities and the remainder to the IFR. To fund its activities under the Banking Reform Act it will allocate fees equally across regulated pan-UK payment systems, adjusted for relative transaction volumes. For its IFR responsibilities fees will be calculated according to a three tier approach based on the scale of UK transactions.

The **Financial Ombudsman Service (FOS)** *consulted* on its plans and budget for 2016/2017. Complaints about packaged bank accounts had increased faster than expected, while the industry is “still likely some years off finally resolving” issues around payment protection insurance (PPI), which also saw “higher than expected” volumes of new complaints.

The EBA *published* its eighth semi-annual report on **risks and vulnerabilities in the EU banking sector**. Banks continued to improve their capital positions and asset quality, although exposures to NPLs remained high and profitability weak. Key risks included exposures to emerging market economies and shadow banking, and the fragile state of financial markets indicated by volatility in banks’ funding spreads.

EIOPA *published* its **Risk Dashboard** for December 2015. Risks for insurers included weak growth and low interest rates which could contribute to increased ‘search for yield’ behaviour. Solvency ratios had dropped, and liquidity and funding risks had increased. EIOPA also *published* its half-yearly Financial Stability Report, which pointed to the weak macroeconomic environment resulting in low yields and increased reinvestment risks.

ESMA *issued* its **Risk Dashboard** for the European securities markets covering the third quarter of 2015. Risk levels remained high, with key drivers being the low-interest-rate environment, potential spill-overs from emerging markets and fiscal and political developments within the EU.

The EBA *re-appointed* Pedro Duarte Neves of Banco de Portugal as **Alternate Chairperson of its Board of Supervisors**.

Separately, the European Parliament *confirmed* that Andrea Enria’s mandate as **Chairperson of the EBA** was extended until February 2021, *as was* Gabriel Bernardino as **Chairman of EIOPA**.

Paul P. Andrews was *appointed* as the new **Secretary General of IOSCO**, to succeed David Wright from March 2016. He joins from the US Financial Industry Regulatory Authority (FINRA).

IOSCO *published* the results of its 2015 **Securities Market Risk Trends Survey**. Cyber-security threats, banking vulnerabilities, housing markets and capital inflows were viewed as major risks. Other risks included conduct issues often reflecting weak corporate governance, financial risk disclosure and shadow banking activities.

Contacts

Clifford Smout

Partner, EMEA Centre for Regulatory Strategy
+44 (0)20 7303 6390

John Andrews

Manager, EMEA Centre for Regulatory Strategy
+44 (0)20 7007 5183

Georgia Mantalara

Senior Associate, EMEA Centre for Regulatory Strategy
+44 (0)20 7303 8979

Alexandra Boehme

Associate, EMEA Centre for Regulatory Strategy
+44 (0)20 7303 7960

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