May saw the sustainable finance agenda moving up the list of priorities of the European Union (EU), with the European Commission (EC) publishing its first set of legislative proposals on sustainable finance, including the development of an EU taxonomy for climate change, environmentally and socially sustainable activities. In the UK, consumer vulnerability continued to be at the forefront of the FCA’s work, with the conduct regulator publishing two consultations as part of its high-cost credit review, containing proposals aimed at protecting financially vulnerable consumers.

**Brexit**

Mark Carney, Governor of the Bank of England (BoE), delivered a speech at the Society of Professional Economists. He noted that Brexit is potentially the most important supply shock to affect the UK economy in recent years, and the evolution of the latter will depend on how households and businesses change their expectations throughout the Brexit negotiation process. He also emphasised that the BoE will be ready to respond to any Brexit outcome.

European Insurance and Occupational Pensions Authority (EIOPA) published an opinion on the solvency position of insurance and reinsurance undertakings in light of the withdrawal of the UK from the EU. The opinion highlighted the changes that may apply to the determination of technical provisions, own funds, and capital requirements, such as the recognition of the risk-mitigating effects of derivatives, or firms no longer being able to provide reinsurance services in some EU countries. EIOPA said that it wanted to ensure that national supervisory authorities are properly managing risks to the solvency position of firms arising from the UK becoming a third country.

The European Central Bank (ECB) published an article on the impact of a potential Brexit transition period, in which it stated that banks should come up with credible Brexit plans as soon as possible and submit their authorisation applications by the end of Q2 2018 at the latest. The document also repeated the ECB’s intent to provide incoming banks, on a case by case basis, with more flexibility to meet certain supervisory expectations (e.g. regarding management capabilities and governance structures) after the UK leaves the EU.

**Capital (including macro prudential and stress testing)**

The European Banking Authority (EBA) published the results of its 2016 Credit Valuation Adjustment (CVA) risk monitoring exercise, which assessed the impact on own funds requirements of the reintegration of transactions currently exempted from the scope of the CVA risk charge under the CRR. The exercise found that the median bank would see its current CVA risk charge multiplied by 3.06 when reintegrating exempted transactions.

The EBA announced that, by summer 2019, it will provide technical advice and policy recommendations on the implementation of Basel 3 in order to support the Commission in drafting a “CRD6/CRR3” legislative proposal. The EBA further plans to launch an EU-wide bank data collection exercise in July to inform this work.

EIOPA published the key findings of its first comparative study on Market and Credit Risk Modelling for internal models, based on 14 insurers from 7 member states with an approved internal model at group level. The report, which flows from EIOPA’s objective to foster common supervisory practices, found significant variations in asset model outputs, which could be partly attributable to model specificities already known by the relevant National Competent Authorities (NCAs), but might also indicate a need for further supervisory scrutiny, including at European level.

EIOPA published its fourth EU-wide insurance stress test, which will test 42 insurance groups, and will be comprised of three scenarios: a yield curve up shock combined with lapse and provisions deficiency test; a low yield shock combined with longevity stress; and a natural catastrophe scenario. In addition to these, EIOPA will also assess exposure to, and best practices in dealing with, cyber risk by collating information through a questionnaire.

European Securities and Markets Authority (ESMA) issued final guidelines on anti-procyclicality of margin measures for central counterparties (CCPs) under EMIR. The guidelines seek to ensure a consistent application of EMIR in order to limit procyclicality, guide CCPs in adapting their models and processes, and enable national competent authorities to supervise their CCPs better.
The European Commission (EC) consulted on a proposal for a regulation on sovereign bond-backed securities (SBBSs). SBBSs are proposed new financial instruments backed by pools of Eurozone government bonds, which the EC hopes will help to diversify sovereign portfolios and reduce risks in the EU banking sector. The proposal seeks to remove regulatory obstacles in the development of SBBSs.

The EC welcomed the general approach reached by the Council on the risk reduction package (CRD V/CRR II). The package will implement international standards into EU law while taking European specificities into account. EC Vice-President Dombrovskis, speaking at an ECOFIN press conference, noted several key components of the package, including the 3% binding leverage ratio and the Net Stable Funding Ratio (NSFR), and called upon the European Parliament to define its negotiating position as soon as possible.

The Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO) published the criteria for identifying short-term “simple, transparent and comparable” (STC) securitisations, and in conjunction, also issued a standard setting out their capital treatment. The BCBS and IOSCO publication extended the scope of the STC criteria to short-term securitisations, particularly exposures related to asset-backed commercial paper conduits, and also set out amendments to the previous short-term STC criteria. The standard included new guidance on the short-term STC criteria around initial and ongoing data, full support for investors, redemption cash flow, and documentation disclosure and legal review.

**Liquidity**

ESMA launched its first liquidity assessment for bonds subject to the pre- and post-trade requirements of MiFID I/MiFIR. Based on 71,000 bonds assessed for the first quarter of 2018, ESMA found that 220 were sufficiently liquid to become subject to MiFID II’s real-time transparency requirements. The requirements for bonds deemed liquid today will apply from 16 May 2018 to 15 August 2018, the date from which the next quarterly assessment, to be published on 1 August 2018, will become applicable.

**Governance and risk management (including remuneration)**

The Prudential Regulation Authority published a Supervisory Statement on “Financial management and planning by insurers”, setting out expectations for Solvency II firms regarding the development and use of a risk appetite statement. Some of the requirements include the expectation that any significant change to an insurer’s risk appetite will be made by the board only following an overall discussion on the risk and capital requirements of the business. A further expectation is that the PRA will be informed in advance where a firm is close to risk appetite boundaries, or where a proposed dividend would take a firm close to risk appetite boundaries.

The European Supervisory Authorities (ESAs) launched two joint consultations to amend technical standards on the clearing obligation and risk mitigation techniques for Over-the-Counter (OTC) derivatives not cleared by a CCP. The consultation on the draft RTS on risk mitigation techniques seeks to extend the treatment currently associated with covered bonds to simple, transparent and standardised (STS) securitisations; while the proposed amendments to the EMIR clearing obligation under the Securitisation Regulation seek to clarify which arrangements in relation to covered bonds and securitisations adequately mitigate counterparty risk and, as a result, may benefit from an exemption from the clearing obligation.

The Committee on Payments and Market Infrastructures (CPMI) and IOSCO issued a report on their implementation monitoring of the Principles for financial market infrastructures (PFMI). The report found that while participating CCPs have made progress in implementing arrangements consistent with the PFMI, some CCPs are still failing to implement a number of measures in the areas of risk management and recovery planning.

**Conduct of Business (including MiFID)**

The Financial Conduct Authority (FCA) published the findings from its review of seven firms offering automated online discretionary investment management (ODIM) and three firms offering retail investment advice exclusively through automated channels (auto advice). The FCA concluded that most of the reviewed firms had failed to show adequate ongoing client relationship, and filtering and governance processes to tackle auto advice-specific risks. The FCA also found weaknesses in the capacity of firms’ auto-advice services to identify and support vulnerable customers.
The FCA published the interim report of its mortgages market study, which identified how the mortgage market could be made to work better. Specifically, the FCA would like it to be easier for consumers to find the right mortgage; there to be a wider range of tools providing consumers with a choice about the support (including advice) that they receive; consumers choosing an intermediary to be able to do so on a more informed basis; and consumers to be able to switch more freely to new deals without undue barriers. The FCA will publish its final report by the end of the year.

The FCA published guidance to its approach to the review of Part VII insurance business transfers, detailing the documents it expects from firms, what its overall approach will be when reviewing a proposed transfer (such as how the changes affect competition, e.g. through affecting a policyholder’s ability to switch providers), and detailed information about key documentation.

The FCA published two Consultation Papers as part of its high-cost credit review. The main proposals included a price cap on rent-to-own products; new disclosure requirements for home-collected credit; and changes to catalogue credit and store cards to help customers avoid persistent debt, with the FCA proposing similar rules to those which now exist for credit cards.

The BoE, HM Treasury and the FCA published a progress report on the Fair and Effective Markets Review (FEMR). Areas assessed included individual accountability, market standards, benchmarks, and approach to Fixed Income, Currencies and Commodities markets. Overall, the report found that firms and authorities have made significant progress in implementing FEMR, but also highlighted that industry must take a leading role in monitoring developments and ensuring that market infrastructures and practices keep pace with innovation, and that authorities will be ready to catalyse reforms held back by private sector co-ordination failures.

ESMA published final guidelines on MiFID II suitability requirements. Building on the existing guidelines, they cover the increased automation of advice, NCAs’ implementation of the suitability requirement, and recent studies on behavioural finance. The guidelines also contain good practice for firms on including sustainability preferences in financial advice.

The EC consulted on changes to the safe-keeping duties of depositaries and custodians under UCITS and AIFMD. The amendments seek to harmonise existing rules to protect safe-kept assets more effectively, and clarify the requirements regarding asset identification, segregation, and protection in case of insolvency of the depositary or the custodian.

The EC proposed amendments to the Market Abuse Regulation (MAR) and the Prospectus Regulation, as well as technical amendments to delegated acts under MiFID II, to promote the use of SME Growth Markets, which are a recently-created category of trading venues under MiFID II. The proposed changes seek to reduce the administrative burden faced by smaller companies in listing on public markets. The Commission also announced that it will shortly launch an external study to assess the potential impact of MiFID II rules on SME research coverage.

The ECB updated its Guide to fit and proper assessments, bringing it in line with the suitability guidelines jointly published by the EBA and ESMA. The Guide provides explanations on the policies and processes conducted by the ECB and outlines its main expectations regarding suitability assessments. The Guide is meant to be a practical tool that will be updated regularly.

The Bank of International Settlements (BIS) issued a statement of commitment to the FX Global Code. It confirmed that it acts as a market participant as defined by the code, and has taken steps to align its FX market activities with the Code’s principles.

The Financial Stability Board (FSB) consulted on recommendations for consistent national reporting of compensation data to address misconduct risk. The FSB recommends firms use two data sets – a “core set” for the supervision of compensation practices, and additional information to provide further insight on compensation and misconduct risk.

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

The EBA and ESMA issued a joint statement on the treatment of retail holdings of liabilities eligible for bail-in. The statement found that there may be significant consumer protection issues relating to the sale of liabilities eligible for bail-in to retail investors. It further found that retail holdings of liabilities eligible for bail-in may be an impediment to resolvability.
The BIS published a report on the progress made by CCPs on risk management and recovery planning. The report found that some CCPs have failed to implement a number of measures related to risk management and recovery planning, which, in some cases, was cause for serious concern and warranted immediate action.

**Regulatory perimeter**

Andrew Bailey, Chief Executive of the FCA, presented the 7 cross-sector priorities included in the FCA’s Business Plan for 2018/2019. These priorities will include: high-cost credit; financial crime; data security, resilience and outsourcing; innovation, Big Data, technology and competition; treatment of existing customers; long-term savings, pensions and intergenerational differences. He also highlighted the FCA’s plans to conduct more work on general insurance, namely on the treatment of existing customers and firms’ use of customer data and data governance.

Members of IOSCO met to discuss and address key issues facing securities market regulators and supervisors. The topics covered included the growth of Initial Coin Offerings; the protection of retail investors from the offer of binary options and other OTC leveraged products; idiosyncratic risks arising from Exchange-Traded Funds (ETF) structures; the interaction between the new General Data Protection Regulation (GDPR) and cross-border information sharing; the role of securities markets and regulation in sustainability issues; and the role of regulation in financial technology and automation. The IOSCO Board also agreed to launch a Fintech Network to facilitate sharing of information, knowledge, and experiences.

**Rethinking the domestic and international architecture for regulation**

The New Payment System Operator (NPSO) took over responsibility for the operation of two of the UK’s retail payment system, Bacs and Faster Payments, and expects to take over Cheque and Credit Clearing Company over the next few months. The NPSO will also be responsible for delivering the New Payments Architecture, which seeks to increase competition and innovation across the payments and banking industry.

Sarah Breeden, Executive Director of International Banks Supervision at the BoE, spoke on the risks presented by climate change to the safety of financial institutions and financial stability. She noted that the Bank of England will be publishing its findings on its prudential work engaging with banks’ and insurers’ climate-related risks later in the year, and also expressed support for the recommendations from the FSB’s Task-force for Climate Related Finance Disclosures, particularly the introduction of scenario analysis.

Mark Carney spoke at the Markets Forum 2018 and argued that public authorities should move from relying on punitive ex-post fines to more compelling ex-ante incentives for individuals, and focus on encouraging the improvement of firms’ culture and governance. Mr. Carney also highlighted future challenges to consider for capital markets, in particular the transition to alternative benchmarks, including the Sterling Overnight Index Average (SONIA).

Jonathan Davidson, Director of Supervision - Retail and Authorisations at the FCA, spoke on the opportunities for the building society sector given wider developments in the market. He highlighted how changes in the mortgage market and innovation have increased competition in retail banking and some of the options building societies have to respond to these developments. These include: taking a long term view on affordability and lending risk; properly understanding customers’ individual needs; and maintaining a dialogue with regulators.

Ignazio Angeloni, Member of the Supervisory Board of the ECB, spoke on the strategic direction of the Single Supervisory Mechanism (SSM). He explained that, in the future, the ECB will seek to enhance the quality of supervision further; strengthen its focus on market risks and macroprudential linkages; and further develop crisis management and prevention frameworks.

Yves Mersch, Member of the Executive Board of the ECB, delivered a speech noting that ring-fencing measures may be needed to safeguard financial markets, firms, investors and consumers from the risks posed by virtual currencies (VC). He highlighted four areas that will require particular attention from the regulators, including VCs themselves; VC exchanges and wallet providers; financial market infrastructures; and the banking sector.
Tao Zhang, the International Monetary Fund Deputy Managing Director, gave a speech on the challenges and opportunities of the digitisation of money and finance. He highlighted the opportunities and risks that FinTech, and in particular crypto-assets, can present for financial stability. He also presented options for regulators to tackle these risks in the future, including overseeing activities in addition to entities; strengthening governance; supporting open networks; and modernising legal principles.

Disclosure, valuation and accounting
The FCA has published a video and transcript setting out the findings of its multi-firm review of how asset managers value so-called “hard to value” assets. This focuses on illiquid assets including unquoted equities, fixed income instruments and private equities. The FCA said it will be expecting firms to demonstrate: expertise among portfolio managers but also in the second line of defense and in the valuation committee; independent challenge of portfolio managers; and evidence of meaningful adherence to the valuation policy.

The EC published its first set of legislative proposals targeting sustainable finance, which included a proposal on a unified EU classification system for determining whether an economic activity is environmentally-sustainable, a proposal amending the EU Benchmark Regulation to create low-carbon benchmarks and positive-carbon impact benchmarks; a proposal for a regulation on disclosures relating sustainable investments and sustainability risks; and amendments to MiFID II and amendments to IDD to assess how best to include environmental, social and governance considerations into financial advice. The proposals set out that firms offering financial products as environmentally sustainable and financial advice for environmentally sustainable products will have to disclose information on how, and to what extent, the criteria set out by the EU are used to determine their environmental sustainability.

Information security and data privacy
GDPR came into effect on 25 May. The Regulation updates sets a ‘gold standard’ for data privacy, and seeks to tackle the risks to organisations and individuals of data breaches, their ongoing effects, and ever-growing cyber threats. In the UK, the Data Protection Act 2018 (DPA 2018) received Royal Assent, with its provision also applying from 25 May. DPA 2018 transposes GDPR into domestic law, but it is not limited to GDPR provisions. In particular the DPA adds additional scope for UK organisations in relation to processing of personal data, and brings national security agencies into scope.

The ECB published a Framework for Threat Intelligence-based Ethical Red Teaming (TIBER-EU), aimed at reducing the risk of incompatible cyber risk red teaming frameworks developing across the EU. It included a testing framework to be implemented at the national level, and the establishment of a TIBER-EU Knowledge Centre in the ECB. This framework is not yet mandatory for most market participants as it still entails a gradual process of adoption by national and EU authorities.

Financial Crime
Christopher Woolard, Executive Director of Strategy and Competition at the FCA, delivered a speech at the Anti-Money Laundering TechSprint, in which he argued that new technologies, such as artificial intelligence and distributed ledger technology, can help monitor, analyse and prevent financial crime. He highlighted that enhanced cooperation between regulators and the industry will also be necessary to address illegal financial activities further, and that the global sandbox project is a key step in this direction.

Danièle Nouy, Chair of the ECB Supervisory Board, wrote to Mr Giegold, MEP, on money laundering risks and the need for closer cooperation amongst relevant authorities. In this context, she welcomed the fifth Anti-Money Laundering Directive (AML) which will enhance the exchange of confidential AML-related information among national authorities.

The CPMI urged industry to pursue a common strategy to improve wholesale payments security, and encouraged industry’s efforts to reduce the risk of fraud in the sector. The report is targeted at operators and participants of payment systems and messaging networks, as well as supervisors, regulators and overseers. It sets the seven elements of the strategy, covering areas relevant to preventing, detecting, responding to and communicating about fraud.
The FCA issued a notice relating to the combined PRA and FCA investigations into a whistleblowing incident at Barclays Bank.

Anneli Tuominen, Director-General of the Finnish Finanssivalvonta, was reappointed Vice Chair of ESMA for another two and a half years, after being initially appointed to the role in January 2016.

Sabine Lautenschläger, Member of the Executive Board of the ECB and Vice-Chair of the Supervisory Board of the ECB, indicated her belief that macroprudential policy, rather than monetary policy, is a better tool to address financial stability concerns, and that monetary policy should be focused on ensuring price stability.

The ECB published a disclosure report on TARGET2, the real-time gross settlement mechanism operated by the Eurosystem, regarding its self-assessment against the PFMI. The report noted that since the last assessment, TARGET2 has been regularly enhanced through technical and functional releases, and in particular the introduction of the “ASI-6 real-time” settlement model, which supports ancillary real-time payment systems.

Dietrich Domanski, Secretary General of the FSB, spoke to the Asia Securities Industry & Financial Markets Association board on the key FSB priorities for 2018. He explained that the FSB’s emphasis has now shifted from policy development towards completion of the outstanding G20 reforms and the evaluation of their effects. The main reforms to complete this year are those around central clearing and structural vulnerabilities in asset management.
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