A Brussels Briefing
The EU Regulatory Agenda: an update

EU Banking Regulatory Reform - what is the final direction and major industry players response?

11 December 2017
A distinctly digitally-focused Estonian EU Presidency... but banking still central to funding the EU economy

Brexit – ongoing, uncompromising negotiation positions with European Council and EU Parliament (EP)

Re-energising the Capital Markets Union (CMU)
- Securitisation regulation – risk-retention (5%), no 3rd country originators, ban on re-securitisations and self-certified mortgages, restricted to institutional investors
- Non-bank funding – promoting private equity and debt, removing tax biases on debt, lower SII capital charges on infrastructure investments, crowdfunding, block-chain IT

Revised resolution regime – a new statutory category of unsecured debt

Revised Capital requirements Regime – NSFR, Leverage Ratio, Trading book, large exposures, IFRS 9 ...

Completing the post-crisis regulatory agenda – Regulatory technical standards, Level III guidance on MiFID II, IDD and PRIIPS – all before 1Q 2018!

Action Plan on sustainable finance (High Level Expert Group on Sustainable Finance outcome) – banks, asset managers, insurers

Non-performing Loans – sharper measures to reduce NPL levels and promoting secondary markets of NPLs

Meanwhile…

EU27 doing more together – “EU Protection” Agenda, “European Monetary Fund”, “Social & Fiscal Convergence” – led by Macron and Merkel

Juncker State of the Union speech (September 2017) – remainers should join the Banking Union, do more trade deals, enact more harmonisation on tax and foreign policy

ECB tapering of QE programme (starting January 2018), but running out of eligible assets, inflation still weak (1.2%), strong Euro moderates inflation

Ultra-low interest rates – “It can’t be forever that deposit-taking is loss making…for banks” (Deutsche Bank, CEO): low interest income and fees paid to park money at ECB

Reform of US Dodd-Frank regime:
- Banks: removing restrictions on traders, limiting TLAC
- Non-banks: restricting regulators’ ability to designate insurance and asset managers as TBTF - diverging with Europe

Meanwhile…
Revisions to CRD IV/CRR
… shift to global standards with local (European) calibration

EC revisions to CRD IV/CRR (November 2016)
► NSFR
► New trading book rules
► The leverage ratio
► Transition to TLAC and revisions to MREL
► Possible exemptions for ‘small banks and credit unions’ (proportionality)

Not included:
► IRB approaches (probability of default, loss-given-default, exposure to default)
► Standardised approach to credit and operational risks
► Output floor

► Inexorable evolution towards a slow, incremental CRD regime
► Pronounced divergences between Basel Committee, USA, and EU on the final cut for the EU banks
► EU Parliament, EC and most EU Member States aligned on limiting further capital increases

“Underlines that a hefty rise in capital requirements, in combination with regulation which is not proportionately balanced, affects the real economy and every individual who requests a bank loan; is concerned that banks would be hampered in financing the economy as well as providing liquidity to the markets”

MEP ECON Resolution (November 2016)
Estonian Presidency Progress report on the Banking Legislative Package
...29 November 2017

- O-SII buffer cap for “non-systemic” and subsidiaries
- Financial risk in the Trading Book phase-in
- Net Stable Funding ratio for repos and reverse repos
- Net Stable Funding Ratio for derivatives
- Capital and Liquidity Waivers in CRR
- Exemptions in CRR/CRD
- MREL Calibration

Estonian Progress Report on the Banking

- Fast-tracked
- IFRS 9
- Large Exposures
- Unsecured debt Instruments (SRMR/BRRD)
Implications of Brexit on European Banks ... ECB lays down the law ...affecting non-Eurozone banks too!

ECB vision on pre-Brexit measures:

- Ensuring consistent bank supervision – no matter where they operate
- New bank authorisations – regardless of size – to operate in the Eurozone – will not accept letterbox firms in Frankfurt, Paris or Dublin run by remote control from London.
- Assessment of ‘size, risk and complexity of business being booked back-to-back’

ECB vision on post-Brexit measures:

- Review banks assessment of risks and consequences of Brexit in their recovery plans – avoid complex group structures that complicates recovery and resolution of the entity
- Systemic important Investment firms with similar risk profiles as banks in the Eurozone to be (possibly) directly supervised by the ECB

More vigilant approval of non-EU branches – beyond ‘significant’ class:

- Greater than €30bn total assets
- Ratio of its total assets to GDP exceeding 20%
- At its own initiative, ECB considers the branch of ‘significant relevance’ in the domestic economy
- Possible inclusion of foreign branches in EU Intermediate Parent Undertaking classification

Fast-tracking revised EU equivalency regime for 3rd countries – not just about the UK! – complex equivalency deal-making with the CFTC (US) on derivatives clearing…
A busy summer…
EU moves to centralize authorisation, supervision and intervention in the banking & non-banking space

…Implications for asset managers, AIFMs, central-counterparties, insurers, contracts, and funds

**EC Proposed revised CCP Regime (June 2017)**
- Strengthening ESMA powers to authorise, monitor, supervise all CCP’s – domestic and 3rd country
- Creation of a CCP Executive Session within ESMA + relevant central bank, with decision-making powers
- A two-tier assessment systems to determine if 3rd county CCPs are systematically important
- ESMA powers to designate CCPs as falling short of risk-mitigation rules, resulting in need to relocate CCP to EU27 state..
- Extra-territoriality via “substituted compliance” model

**EC Proposal to strengthen ESA’s (20 September 2017)**
- ESA’s (EBA/ESMA/EIOPA) to acquire day-to-day powers over NCA’s
- NCA’s produce annual work programme aligned with ESMA supervisory (convergence) plans
- ESA’s granted oversight of all significant firms’ plans to outsource/delegate risks to non-EU jurisdictions
- EIOPA to authorise and ensure convergence of insurers internal models used to calculate capital requirements

**Extend DIRECT SUPERVISING powers over specific areas of capital markets - highly integrated, cross-border in nature, regulated by directly-applicable EU law:**
- Critical benchmarks
- Data Reporting services
- Market Abuse
- Prospectuses
- EU capital (EuVECA), social entrepreneurship (EuSEF) and long-term investment (ELTIF) funds
- Product intervention powers
### EC review of financial (and non-financial) conglomerates
Growing complexity, with many remaining outside the scope of the SSM

<table>
<thead>
<tr>
<th>Threshold 1</th>
<th>The ratio of the balance sheet total of the regulated and unregulated financial sector entities in the group to the balance sheet total of the group as a whole should exceed <strong>40%</strong> (significantly financial)</th>
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<td>Threshold 2</td>
<td>For each financial sector the average of the ratio of the balance sheet total of that financial sector to the balance sheet total of the financial sector entities in the group and the ratio of the solvency requirements of the same financial sector to the total solvency requirements of the financial sector entities in the group should exceed <strong>10 percent</strong> (significant in both sectors)</td>
</tr>
<tr>
<td>Threshold 3</td>
<td>The balance sheet total of the smallest financial sector in the group exceeds <strong>€6b</strong> (significant cross-sectorial activities)</td>
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| NCA discretion | Supervisory authorities may waive the requirements of FICOD if a financial group meets only 1 of either Threshold 2 or 3 and they consider the application of the FICOD requirements to be unnecessary or inappropriate. **EC envisage NO change in the thresholds, but…**
  - **Threshold 3 not risk-sensitive enough**
  - **Does not capture cross-sectorial activities, i.e., asset management, non-financial entities** |
The Retail Financial Services Action Plan (March 2017)
Moving beyond national frontiers

In an era of digitalisation and continuing cross-border restrictions (for firms and citizens)

- Amend regulation on cross-border payments to reduce charges for cross-EU border transactions
- Review current practices in dynamic currency conversion - consider means (enforcement of existing legislation, voluntary approaches, reinforced legislation) allowing consumers to choose the best rate
- Further steps to enable switching to more advantageous retail financial services, - the Payment Accounts Directive
- Enhance the quality and reliability of financial services comparison websites, by promoting the uptake of existing principles and through voluntary certification schemes
- Review of the Motor Insurance Directive to improve the cross-border recognition of claims history, i.e., no-claims bonuses, transparent car-rental pricing of insurance-related elements
- Identify risks/opportunities in distance selling rules
- Access to loans across borders whilst ensuring a high level of consumer protection - addressing consumer over-indebtedness linked to credit activities.
- Examine national consumer protection and conduct rules to assess whether they create unjustified barriers to cross-border business
- Introduce common creditworthiness assessment standards based on a minimum set of data to be exchanged between credit registers
- Electronic identification and know-your-customer portability based on EIDAS to enable banks to identify customers digitally
### Priorities for 2017

#### Supervisory activities for 2017 and beyond

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<tr>
<th>Priorities for 2017</th>
<th>Supervisory activities for 2017 and beyond</th>
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<tr>
<td>Business models and profitability drivers</td>
<td>Assess banks' business models and profitability drivers</td>
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<td>Brexit preparations – dialogue with banks</td>
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<td>Non-bank competition/FinTech</td>
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<td>Credit risk focus on NPLs and concentrations</td>
<td>Consistent approach to NPLs/ forborne exp. (e.g. deep dives/OSIs)</td>
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<td>Evaluate banks’ preparedness for IFRS 9</td>
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<td>Track exposure concentrations (e.g. shipping/real estate)</td>
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<td>Risk management</td>
<td>Assess compliance with BCBS 239 - Basel principles on risk data aggregation and risk reporting</td>
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<tr>
<td>TRIM</td>
<td>Credit Risk models</td>
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<td>Market Risk models</td>
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<td>Counterparty Credit Risk models</td>
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<td>Improvement of banks’ ICAAP and ILAAP</td>
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<td>Outsourcing</td>
<td>Thematic review</td>
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SSM Priorities for 2017 and beyond…
…thematic reviews

<table>
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<th>Thematic reviews</th>
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<tr>
<td><strong>Assess banks’ business models and profitability drivers</strong></td>
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<tr>
<td>▶ The thematic review addresses banks’ profitability drivers both at firm level and across business models.</td>
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<tr>
<td>▶ Spanning two years, the review will assess banks’ ability to mitigate weaknesses in their business models, monitor how weak profitability impacts on banks’ behaviour thus enrich horizontal analysis. Pooling the insights gained by the JSTs and harmonised follow-up action across banks</td>
</tr>
<tr>
<td>▶ ECB Banking Supervision detailed guidance to support JSTs’ profitability analysis at firm level in 2017: i.e., banks’ core capacity to generate revenues, their ability to steer profits etc</td>
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<td>▶ The results of the in-depth assessment conducted by all JSTs will inform the SREP, primarily in 2018, as well as the supervisory engagement and planning for individual institutions</td>
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<tr>
<td><strong>Evaluate banks’ preparedness for IFRS 9</strong></td>
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<tr>
<td>▶ ECB Banking Supervision carry-out a two-year thematic review (over 2016 – 2017), to scrutinise how banks implement the new accounting standard IFRS 9, esp. the new impairment model</td>
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<tr>
<td>▶ The review also assesses whether banks are taking into account the Basel Committee guidance on credit risk and accounting for expected credit losses</td>
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<td>▶ The specific objectives aims: (i) evaluate how institutions are prepared for the introduction of IFRS 9, (ii) assess the potential impact on institutions’ provisioning practices, and (iii) help to foster high-quality implementation of IFRS 9</td>
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<tr>
<td><strong>Risk data aggregation and risk reporting</strong></td>
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<tr>
<td>▶ Several banks will need time to fully comply with BCBS 239 risk aggregation rule: the process of defining, gathering and processing risk data</td>
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<tr>
<td>▶ The results of the thematic review to contribute to developing further supervisory actions and will feed into the next SREP cycle</td>
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<tr>
<td>▶ However, G-SIBs’ full compliance with BCBS 239 will not be achieved in the near future as several banks’ implementation schedules will run until the end of 2018 or beyond</td>
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<td><strong>Risk governance and appetite</strong></td>
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<tr>
<td>▶ Continued JSTs assessment: capacity of boards to independently challenge senior management and to the inclusion of the risk perspective in the decision-making process</td>
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<td>▶ Further JST work to monitor (i) the comprehensiveness of risk appetite frameworks (particularly regarding the inclusion of non-financial risks), (ii) the effectiveness of limits, (iii) the interplay between risk appetite and strategy, as well as (iv) the deployment of the risk appetite framework</td>
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<tr>
<td><strong>Leveraged finance</strong></td>
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<tr>
<td>▶ In 2017 the ECB will follow up on the public consultation and issue the final guidance on leveraged transactions. It will complement this approach with a dedicated monitoring of key developments in the most relevant banks’ appetite for leveraged transactions</td>
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MiFID II/MiFIR
Meeting regulatory expectations

Requirements in need of further clarification

Bond Syndicates

- MiFID II disclosure by banks on how bonds (i.e. government) are sold in the primary market: “provide a justification for the final allocation made to each investment client” and fee levels
- Problematic for each investor on intraday bond pricing

Is a non-financial firm’s commodity derivatives trading activity ancillary to its main business?
Size of the trading activity vs. overall market trading activity (ESMA)

<table>
<thead>
<tr>
<th>Derivative asset class</th>
<th>Size of trading</th>
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<tbody>
<tr>
<td>Metals</td>
<td>4%</td>
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<tr>
<td>Oil and oil products</td>
<td>3%</td>
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<tr>
<td>Coal</td>
<td>10%</td>
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<tr>
<td>Gas</td>
<td>3%</td>
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<tr>
<td>Power</td>
<td>6%</td>
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<tr>
<td>Agriculture products</td>
<td>4%</td>
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<tr>
<td>Other, including freight</td>
<td>15%</td>
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<tr>
<td>Emission allowances</td>
<td>20%</td>
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</tbody>
</table>
Trading under MiFID II
…Far from plain sailing

Sailing too close to the implementation date, with guidance still patchy and incomplete …

<table>
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<tr>
<th>MiFID II Share Trading Obligation and dual-listings challenges</th>
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<tbody>
<tr>
<td>▶ Ban on sending orders via non-MiFID II venues – unless equivalency deal reached by EU and USA (deeper pools of liquidity)?</td>
</tr>
<tr>
<td>▶ Raises questions of modus operandi according to the matched principle structure on a back-to-back basis</td>
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<tr>
<td>▶ AIFMD and UCITs-accredited firms not subject to the MiFID II Trading Obligation - clients obtain better execution that MiFID II clients?</td>
</tr>
<tr>
<td>▶ Non-EEA branches of EEA firms do not apply MiFID standards – fall under local rules, but triggers MiFID II requirements, notably, post-trading reporting at consolidated level…</td>
</tr>
<tr>
<td>▶ EC dashing to reach EU-US Equivalency agreement soon…</td>
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<tr>
<th>Systematic Internalisers - used for other purposes? …Not any more - EC clarifies in Delegated Regulation (September 2017)</th>
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<tbody>
<tr>
<td>▶ Used for transacting shares for own use and not clients, but in private venues (for favoured clients, i.e., HFT) or via broker-dealer networks</td>
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<tr>
<td>▶ ESMA: Contributes to dark pools – use of cross-3rd party buying and selling entities via matched principle trading/back-to-back – transactions – could spread beyond equities</td>
</tr>
<tr>
<td>▶ “A systematic internaliser is not allowed to engage, on a regular basis, in the internal or external matching of trades via matched principal trading or other types of de facto riskless back-to-back transactions in a given financial instrument outside a trading venue ”.</td>
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<tr>
<td>▶ SI mandate delayed to September 2018</td>
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PRIIPS
Key Information Document (KID)

A focus on pre-contractual product disclosure

KID detailed questions (EC Supplementary Regulation, March 2017)

What is this product?
► Factors upon which the return depends
► Underlying investment assets/reference values
► How the return is determined
► Target retail investor identified by PRIIP manufacturer
► Maturity date
► Can the PRIIP manufacturer terminate the PRIIP unilaterally?
► Cases when the PRIIP can be automatically terminated

What are the risks and what could I get in return?
► The level of risk on a scale of 1 to 7
► Explicit reference to illiquid PRIIP
► Is the PRIIP denominated in another currency
► Description of PRIIP’s risk and reward profile, i.e., if the PRIIP is not held to maturity?
► Include four performance scenarios – stress scenario, unfavourable scenario, moderate scenario and favourable scenario

KID content

What happens if the PRIIP manufacturer is unable to pay out?
► Loss faced by investors due to default of PRIIP Manufacturer

What are the costs?
► Description of methodology for calculating the costs
► Costs over time and composition of costs tables
► Any one-off costs, as entry and exit costs (%)
► Any incidental costs, i.e., performance fees, carried interest
► How long should I hold it and can I take my money out earlier?
► Description of reasons for the selection of the recommended, or minimum holding period
► Description of features of the disinvestment procedure and when disinvestment is possible
► Information on penalties and fees incurred in disinvestment
### Timeline of expected implementation

**Slow progress on implementation Level 2 rules**

<table>
<thead>
<tr>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
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<tr>
<td>Q1</td>
<td>Q2</td>
<td>Q3</td>
<td>Q4</td>
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**2014**

- **IDD**
  - EU Parliament review and ratification

**2015**

- **PRIIPS**
  - Implementation measures: two delegated acts

**2016**

- **MiFID II**
  - Implementation measures: delegated regulation on KID

**2017**

- **CRD IV**
  - Implementation at national level between Q2 2013 to 2019

- **EMIR**
  - Clearing obligation applies for interest rate derivatives

**2018**

- **BRRD & SRM implementation**

**Notable Events**

- **Solvency II implemented January 2016**
- **IDD EU Parliament review and ratification**
- **EC CRD V/CRR 2 proposals; start of EP and European Council review of package; ratification**
- **Variation margining rules for non-centrally cleared trades apply to ‘other’ institutions**
Thank you
Useful acronyms

- ABCP - Asset-backed commercial papers
- ABS - Asset-backed securities
- AIFs - Alternative Investment Funds
- AIFMD - Alternative Investment Fund Managers Directive
- AMs - Asset Managers
- AQR - Asset Quality Review
- ASF - Available stable funding
- BCBS - Basel committee on banking standards
- BEPS - Base erosion and profit shifting
- BIS - Bank of International Settlements
- BRRD - Bank Recovery and Resolution Directive
- BSR - Banking structural reform
- CCCTB - Common Consolidated Corporate Tax Base
- CCP - Central counterparty
- CFTC - Commodity Futures Trading Commission
- CMU - Capital Markets Union
- CNAV - Constant Net Asset Value
- COP21 - The 21st session of the Conference of the Parties
- CRR/CRD - Capital Requirements Regulation/Directive
- CVA - Credit Valuation Adjustments
- DG - Directorate General
- DGS - Deposit Guarantee Scheme
- DTA - Deferred tax assets
- DPO - Data protection officer
- EBA - European Banking Authority
- EC - European Commission
- ECB - European Central Bank
- ECJ - European Court of Justice
- ECON - Economic and monetary affairs committee
- ECPs - Eligible counterparties
- EDIS - European Deposit Insurance Scheme
- EEA - European Economic Area
- EFSF - European Financial Stability Facility
- EIOPA - European Insurance and Occupational Pensions Authority
- ESG - Environmental, social and corporate governance
- ETF - Exchange Traded Funds
- FATF - Financial Action Task Force
- FSB - Financial Stability Board
- FTAs - Free Trade Accounts
- ELTIF - European Long Term Investment Funds
- EMIR - European Market Infrastructure Regulation
- ESAs - European Supervisory Authorities
- ESFI - European Fund for Strategic Investment
- ESMA - European Securities and Markets Authority
- ESM - European Stability Mechanism
- ESRB - European Systemic Risk Board
- EU - European Union
- FX - Foreign Exchange
- GATS - General Agreement on Trade in Services
- GDP - Gross Domestic Product
- G-SIBs - Global systemically important banks
- G-SIFIs - Systemically important financial institution
- G-SIIs - Global Systemically Important Insurers
- HFT - High-frequency trading
- IBIP - Insurance Based Investment Products
- IDD - Insurance Distribution Directive
- IFA - Independent financial advisor
- IFRS - International Financial Reporting Standards
- IORP - Institutions for Occupational Retirement Provision
- IOSCO - International Organisation of Securities Commissions
Useful acronyms

- IRB - Internal ratings base
- IRS - Interest rate swap
- ITS - Implementing Technical Standards
- JST - Joint Supervisory Teams
- KID - Key information document
- LCR - Liquidity Coverage Ratio
- LNAV - Low Volatility Net Asset Value
- LR - Leverage ratio
- MEP - Member of European Parliament
- MiFID II - Markets in Financial Instruments Directive
- MiFIR - Markets in Financial Instruments Regulation
- MMF - Money market funds
- MPE - Multiple point of entry
- MREL - Minimum Required Eligible Liabilities
- MTFs - Multilateral trading facilities
- MDA - maximum distributable amount
- NAV - Net Asset Value
- NCA - National competent authorities
- NFEs - Non-financial entities
- NPLs - Non-performing loans
- NSA - National Supervisory Authorities
- NSFR - Net Stable Funding Ratio
- OECD - Organisation for Economic Cooperation and Development
- OFT - Organised trading facilities
- O-SIIS - Other Systemically Important Institutions
- OTC - Over-the-counter
- PID - Process identification number
- POG - Product Oversight and Governance
- P/L - Profit/loss
- PRIIPs - Packaged Retail and insurance-based investment products
- QCCP - Qualifying Central counterparty clearing
- QE - Quantitative Easing
- RSF - Required stable funding
- RTSs - Regulatory Technical Standards
- RWA - Risk-weighted assets
- SCR - Solvency Capital Requirements
- SFT - Securities Financing Transactions
- SLAs - Securities lending activities
- SME - Small and medium-sized enterprise
- SPE - Single point of entry
- SRB - Single Resolution Board
- SREP - Supervisory Review and Evaluation Process
- SRF - Single Resolution Fund
- SRM - Single Resolution Mechanism
- SRRF - Single Resolution Regime Fund
- SSI - Systemically Important Institutions
- SSM - Single supervisory mechanism
- STS - Standardised and transparent securitisation
- S&P - Standard & Poor's
- UCITS - Undertakings for Collective Investments in Transferable Securities
- UFR - Ultimate forward rate
- TCFD - Task force on Climate-related Financial Disclosures
- TLAC - Total Loss-Absorbing Capacity
- VNAVs - Variable net asset values
- WAL - Weighted average life
- WAM - Weighted average maturity
- WTO - World Trade Organization