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Banking Union: ECB publishes SSM supervisory priorities for 2019

The European Central Bank (ECB) Banking Supervision has published its supervisory priorities for the Single Supervisory Mechanism (SSM) in 2019.

The priorities relate to three high-level areas, specifically:

- credit risk, including work to:
  - ensure continued progress to reduce legacy risks arising from non-performing loans (NPLs) and to achieve consistent coverage of the stock and flow of NPLs over the medium term; and
  - assess the quality of banks' underwriting criteria with a focus on new lending, including specific asset class exposures such as real estate and leverage finance;
- risk management, including:
  - a continuation of the targeted review of internal models (TRIM) and updating the existing ECB guide to internal models;
  - finalisation of guides on internal capital and liquidity adequacy assessment processes (ICAAP and ILAAP) for use from 2019;
  - IT and cyber risk; and
  - the 2019 stress test, which will focus on banks' resilience against liquidity shocks; and

activities comprising multiple risk dimensions, including ongoing preparations for Brexit and work relating to trading risk and asset valuations.

EU Council agrees negotiating stance on NPLs

The Permanent Representatives Committee (COREPER) has approved the EU Council's negotiating position on the EU Commission's proposal for a prudential framework for banks to deal with non-performing loans (NPLs).

Under the proposal, capital requirements would apply to banks to set aside sufficient own resources when new loans become non-performing, i.e. when more than 90 days pass without the borrower paying the agreed instalments or interest. This is intended to create appropriate incentives for banks to address NPLs at an early stage and, by dealing with new NPLs, to reduce the risk of their accumulation in the future. The proposal also includes a prudential backstop for the amount of money that banks need to set aside to cover losses caused by future loans that turn non-performing. The Council's position is that different coverage requirements should apply depending on the classification of NPLs as unsecured or secured and whether the collateral is moveable or immovable.

The approval of the Council's negotiation position means that trilogue negotiations with the EU Parliament can proceed as soon as the Parliament has agreed its stance.

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EBA publishes final guidelines on management of non-performing and forborne exposures

The European Banking Authority (EBA) has published its final report on guidelines on management of non-performing and forborne exposures (NPEs and FBEs). The guidelines are aimed primarily at reducing NPEs on banks' balance sheets by providing supervisory guidance and are intended to help achieve a sustainable reduction of NPEs on credit institutions' balance sheets by means of the institutions' own NPE strategies.

Among other things, the guidelines specify sound risk management practices for credit institutions in their management of NPEs and FBEs, including requirements on NPE reduction strategies, governance and operations of NPE workout framework, internal control framework and monitoring. The guidelines set out requirements relating to processes for recognising NPEs and FBEs, as well as a forbearance-granting process, which the guidelines specify should be granted only when it aims to restore sustainable repayment by the borrower. Credit institutions are expected to monitor the efficiency and effectiveness of forbearance measures and have in place policies and processes to assess borrowers' financial difficulties and identify NPEs. The guidelines also set out requirements for competent authorities' assessments of credit institutions' NPE management activities.

The guidelines will be translated into all of the official languages of the EU and will apply from 30 June 2019.

CRR: Delegated Regulation amending LCR Delegated Regulation published in Official Journal

Commission Delegated Regulation (EU) 2018/1620 amending Delegated Regulation (EU) 2015/61 on the Liquidity Coverage Ratio (LCR), which supplements the Capital Requirements Regulation (CRR), has been published in the Official Journal. The Regulation makes minor amendments to the LCR Delegated Regulation in order to align it with international standards and improve its practical application.

Amongst other things, it amends:

- the calculation of expected liquidity outflows and inflows on repos, reverse repos and collateral swaps transactions;
- the treatment of certain reserves held with third-country central banks that are not rated at least ECAI 1;
- the waiver of the minimum issue size for certain non-EU liquid assets; and
- the application of the unwind mechanism for the calculation of the liquidity buffer.

It also introduces simple, transparent and standardised (STS) criteria for securitisation into the LCR Delegated Regulation.

The Regulation will enter into force on 19 November 2018 and will apply from 30 April 2020.

BRRD: EU Commission adopts ITS on provision of information for resolution planning to repeal Commission Implementing Regulation (EU) 2016/1066

The EU Commission has adopted a Commission Implementing Regulation laying down implementing technical standards (ITS) with regard to procedures, standard forms and templates for the provision of information for the purposes of resolution plans for credit institutions and investment firms under the Bank Recovery and Resolution Directive (BRRD).

Since the adoption of Commission Implementing Regulation (EU) 2016/1066, resolution authorities have gained experience in resolution planning and the Commission now deems it necessary to update the minimum set of templates for the collection of information for resolution planning purposes under that Regulation. Given the extent of the necessary amendments to Implementing Regulation (EU) 2016/1066, the Commission views it as preferable, for reasons of legal certainty and clarity, to adopt a new Implementing Regulation. The ITS adopted by the Commission will therefore repeal Implementing Regulation (EU) 2016/1066.

AIFMD and UCITS Directive: Delegated Regulations on depositary safekeeping duties published in Official Journal

Commission Delegated Regulation (EU) 2018/1618 amending Delegated Regulation (EU) 231/2013 under the Alternative Investment Fund Managers Directive (AIFMD) and Commission Delegated Regulation (EU) 2018/1619 amending Delegated Regulation (EU) 2016/438 under the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive have been published in the Official Journal. The Regulations aim to clarify rules relating to the safekeeping of client assets by depositaries.

Both Regulations will enter into force on 19 November 2018 and will apply from 1 April 2020.

EMIR: ESMA issues clarifications on clearing and trading obligations deadline

The European Securities and Markets Authority (ESMA) has issued a statement on challenges certain groups and non-financial counterparties above the clearing threshold (NFC+) would face ahead of the 21 December 2018 deadline to start clearing some of their OTC derivative contracts and trading them on trading venues.

Under EMIR, the current derogation from the clearing obligation for certain intragroup transactions concluded with a third country group entity, and the phase-in for counterparties in Category 4 (broadly speaking NFCs+) for the interest rate derivative classes denominated in the G4 currencies subject to the clearing obligation will expire on 21 December 2018.

With respect to the current derogation from the clearing obligation, ESMA undertook a review of the Commission Delegated Regulations on the clearing obligation and developed draft amendments to extend the derogation expiration to 21 December 2020.

With respect to the phase-in for Category 4 counterparties, the Commission's May 2017 proposal to amend EMIR (Refit), currently being negotiated by the

EU institutions, envisages that NFCs+ would only be subject to the clearing obligation in the asset class or classes where their level of activity is above the clearing threshold.

In the event that these amendments have not entered into force by the current expiration date these counterparties would need to have clearing arrangements in place and start clearing these transactions before they are no longer required to do so after the amendments enter into force. Additionally, given the link between the MiFIR trading obligation and the EMIR clearing obligation, this potential timing gap would also have implications with regards to the trading obligation.

In this respect, ESMA expects competent authorities not to prioritise their supervisory actions towards group entities that benefit from the derogation for intragroup transactions meeting certain conditions on and after 21 December 2018, and towards NFCs+ that are not above the clearing threshold as prescribed under the current EMIR legislation in the interest rate derivative asset class on or after 21 December 2018, and to generally apply their risk-based supervisory powers in a proportionate manner.

ESMA renews product intervention measure on CfDs

ESMA's renewal decision for its product intervention measure relating to contracts for differences (CfDs) has been published in the Official Journal. ESMA announced its intention to renew the measure on 28 September and adopted the renewal decision on 23 October 2018.

Marketing, distribution or sale of CFDs to retail clients will continue to be restricted, including:

- leverage limits on the opening of a position by a retail client;
- a margin close out rule on a per account basis;
- negative balance protection on a per account basis;
- a restriction on the incentives offered to trade CFDs;
- a standardised risk warning, including the percentage of losses on a CFD provider's retail investor accounts; and
- a new reduced character risk warning.

The measure will apply for three months from 1 November 2018.

Basel Committee publishes fifteenth progress report on Basel III adoption

The Basel Committee on Banking Supervision (BCBS) has published its fifteenth progress report on the adoption of Basel III standards for each member jurisdiction as of end-September 2018, including the finalised Basel III post-crisis reforms published by the Committee in December 2017.

Since the Committee's last report in April 2018 member jurisdictions have made further progress in implementing standards whose deadline has already passed, including the leverage ratio based on the 2014 exposure definition, which is now partly or fully implemented in 26 member jurisdictions. However, there are still rules for standards yet to be finalised in many jurisdictions, most notably for the net stable funding ratio, where only ten member jurisdictions had final rules in force at end-September.

The Committee urges member jurisdiction to work towards the full, timely and consistent implementation of Basel III standards and will continue to monitor the implementation of these standards.

Brexit: SIs under the EU (Withdrawal) Act for 29 October – 2 November 2018

HM Government published new draft statutory instruments (SIs) under the EU (Withdrawal) Act 2018 last week.

HM Treasury (HMT) published guidance drafts of the:

- draft Financial Markets and Insolvency (Amendment and Transitional Provision) (EU Exit) Regulations 2018;
- draft Payment Accounts (Amendment) (EU Exit) Regulations 2018;
- draft Venture Capital Funds (Amendment) (EU Exit) Regulations 2018; and
- draft Social Entrepreneurship Funds (Amendment) (EU Exit) Regulations 2018.

The draft instruments are still in development and are intended to provide Parliament and stakeholders with further details on HM Treasury's approach to onshoring financial services legislation. The drafting approach, and other technical aspects of the proposals, may change before the final instruments are laid before Parliament.

The draft Service of Documents and Taking of Evidence in Civil and Commercial Matters (Revocation and Saving Provisions) (EU Exit) Regulations 2018 and draft Companies, Limited Liability Partnerships and Partnerships (Amendment etc.) (EU Exit) Regulations 2018 have been laid for sifting. SIs going through the sifting process are considered by a committee in the House of Commons and the House of Lords, which determine the suitability of the 'negative procedure'. The sifting end dates for these instruments are, respectively, 19 and 21 November 2018.

The draft Central Securities Depositories (Amendment) (EU Exit) Regulations 2018 have been laid before Parliament. The instrument proposes amendments to the retained EU law Central Securities Depositories Regulation (Regulation (EU) No 909/2014 - CSDR) and the revocation of delegated legislation under CSDR.

The Civil Jurisdiction and Judgments (Hague Convention on Choice of Court Agreements 2005) (EU Exit) Regulations 2018 (SI 2018/1124) have been made. The instrument makes provision in relation to directly effective rights derived from the 2005 Hague Convention on Choice of Court Agreements in domestic law, both in relation to choice of court agreements that will lose the benefit of the convention on exit day and in relation to choice of court agreements to which the convention will apply when the United Kingdom accedes to the convention in its own right.

For information on all draft SIs under the EU (Withdrawal) Act published last week, visit www.gov.uk and www.legislation.gov.uk.

PRA publishes approach to banking and insurance supervision

The Prudential Regulation Authority (PRA) has published updated approach documents on banking supervision and on insurance supervision.

The approach documents are intended to serve three purposes:

- to describe what the PRA seeks to achieve;
- to communicate to regulated firms the PRA's expectations of them, and what they can expect from the PRA in the course of supervision; and
- to issue guidance on how the PRA intends to advance its objectives.

In the context of Brexit, the documents also highlight that the PRA's approach to advancing its objectives will remain the same as the UK withdraws from the EU.

The approach document for insurance includes references to the Senior Managers and Certification Regime (SM&CR) ahead of the extension of the regime to insurers from 10 December 2018.

BaFin publishes circular on groups of connected clients

The German Federal Financial Supervisory Authority (BaFin) has published a circular (14/2018) to implement the European Banking Authority (EBA) guidelines on connected clients under Article 4(1)(39) of the CRR.

The circular specifies the term 'group of connected clients' within the meaning of Article 4(1)(39) of the CRR. It provides clarification on the cases in which customers pose a uniform risk due to linkages and must therefore be grouped according to the relevant provisions in the CRR, technical standards and EBA guidelines.

Bank of Italy adopts second-level regulations implementing PSD2 and IFR

The Bank of Italy has adopted three acts intended to implement Legislative Decree No. 218 of 15 December 2017, which transposed the new regime based on the revised Payment Services Directive (PSD2) into Italian law and adjusted the internal framework to the Regulation on interchange fees for card-based payment transactions (IFR).

In particular, the measures concern:

- the abrogation of the provisions of 5 July 2011, implementing Title II (rights and obligations of the parties) of Legislative Decree No. 11 of 27 January 2010 (the Italian act implementing PSD1, recently amended to implement PSD2);
- the implementation of Legislative Decree No. 11 of 27 January 2010 (art. 2 p. 4-bis) as regards the modalities and terms for submitting the information payment service providers are required to notify to the competent authorities; and
- the implementation of Title IV-bis, Chapter I, of Legislative Decree No. 11 of 27 January 2010, implementing the IFR.

Bank of Italy updates its regulations on remuneration policies

The Bank of Italy has replaced its existing regulations on remuneration policies applicable to banks, banking groups, investment firms and groups of investment firms, included in its Circular No. 285 of 17 December 2013, with a new set of regulations.

The new regulations are mainly intended to amend certain specific aspects of the remuneration regime in light of a number of updates and adjustments to the EBA's guidelines implementing the Capital Requirements Directive (CRD 4) in relation to remuneration policies.

SFC sets out new regulatory approach to virtual assets

The Securities and Futures Commission (SFC) has issued a statement setting out its new approach intended to bring virtual asset portfolio managers and distributors of virtual asset funds under its regulatory scope.

The SFC will adopt new measures within its regulatory remit to protect those who invest in virtual asset portfolios or funds and impose licensing conditions on firms which manage or intend to manage portfolios investing in virtual assets, irrespective of whether the virtual assets meet the definition of 'securities' or 'futures contracts'.

In an accompanying circular on distribution of virtual asset funds, the SFC has also provided detailed guidance and reminded firms which distribute funds investing in virtual assets that they should be registered with or regulated by the SFC and comply with its regulatory requirements, including the suitability obligations, when distributing these funds.

The statement also sets out a conceptual framework for the potential regulation of virtual asset trading platforms. Under the framework, the SFC will explore whether virtual asset trading platforms are suitable for regulation in the SFC Regulatory Sandbox. The SFC will observe the operations of interested trading platform operators and their compliance with proposed regulatory requirements in the Sandbox environment.

If it is decided at the end of the exploratory stage that it is appropriate to regulate platform operators, the SFC would then consider granting a licence and putting them under its close supervision. Alternatively, it may take the view that the risks involved cannot be sufficiently addressed and no licence should be granted as protection for investors cannot be ensured.

The SFC intends to monitor the development of virtual assets closely and may issue further guidance where appropriate.

HKMA issues guidance on sale and distribution of debt instruments with loss-absorption features and related products

The Hong Kong Monetary Authority (HKMA) has issued a circular to all registered institutions to provide guidance on the sale and distribution of debt instruments with loss-absorption features and related products to enhance investor protection measures. The circular follows the HKMA's earlier circular on distribution of fixed income and structured products issued on 8 February 2018 and consultation conclusions on rules on loss-absorbing capacity requirements for authorised institutions published on 25 July 2018.

The HKMA notes that debt instruments with loss-absorption features are subject to the risk of being written down or converted to ordinary shares (such as recapitalising the issuer as it goes through resolution), potentially resulting in a substantial loss to the investors concerned. The circumstances in which these debt instruments may be required to bear loss are difficult to predict and ex ante assessments of the quantum of loss will also be highly uncertain.

Hence, debt instruments with loss-absorption features are inherently complex and are of high risk, and are generally not suitable for retail investors.

The HKMA has advised registered institutions to implement the requirements set out in the circular as soon as possible, but no later than 6 April 2019. In case an individual registered institution has strong justifications that more time is needed for implementation, it may approach the HKMA for discussion. For for loss-absorption products that were issued before the date of the circular, the enhanced investor protection measures, including selling restrictions, in the circular will be applicable to future sale and distribution in the secondary market by registered institutions. Further, senior management of registered institutions should review and put in place adequate policies, procedures and controls to ensure compliance with the circular and other relevant requirements and standards, and provide sufficient training and guidance to relevant staff. The HKMA has indicated that it will monitor registered institutions' compliance as part of its on-going supervision.

HKMA issues guidance on requirements applicable to offline distribution of non-SFO-regulated structured investment products

The HKMA has issued a circular to authorised institutions to provide guidance on the requirements applicable to offline distribution of structured investment products not regulated by the Securities and Futures Ordinance (SFO) (non-SFO-regulated structured investment products).

Following the issuance of the guidelines on online distribution and advisory platforms by the SFC on 28 March 2018, the HKMA consulted the banking industry in May 2018 on applying the same principles to online and offline distribution and advisory platforms for non-SFO-regulated structured investment products on a risk-based basis. Taking into consideration the feedback received, the HKMA provided guidance by issuing a circular entitled 'Online Distribution and Advisory Platforms for Non-SFO-Regulated Structured Investment Products' (Circular on Online Platforms) on 24 August 2018.

To avoid potential regulatory arbitrage, in respect of distributing or providing advice on non-SFO-regulated structured investment products in an offline environment, the HKMA expects authorised institutions to follow the same applicable requirements as those applicable to online platforms. In other words, section II (application of the suitability requirement) and section IV (exemptions for institutional professional investors and corporate professional investors) of the Annex to the Circular on Online Platforms are equally applicable to distribution and advice in an offline environment. Section III (minimum information and warning statements) of the Annex to the Circular on Online Platforms will be slightly adapted to cater for the offline environment.

Further, to provide consistent customer experience in both online and offline channels, the HKMA expects authorised institutions to implement the requirements applicable to the offline environment by the same implementation date as that applicable to online platforms, i.e. on 23 August 2019. Individual authorised institutions that have strong justifications for an extended transition period should approach the HKMA for discussion.

HKMA and Monetary Authority of Macao sign MOU to promote enhanced competency framework for banking practitioners

The HKMA and the Monetary Authority of Macao (AMCM) have signed a memorandum of understanding (MOU) jointly to promote mutually recognised professional training and certifications under the enhanced competency framework for banking practitioners (ECF). The framework is intended to support talent development and facilitate mobility of talent for the banking industry in Hong Kong and Macao.

Developed by the HKMA in collaboration with the banking industry, the Hong Kong Institute of Bankers (HKIB) and other relevant professional bodies, the ECF provides a set of common competency standards for the industry. As per the MOU, the HKMA and the AMCM have designated the HKIB and the Macau Institute of Financial Services (MIFS) to work together in providing related professional training and implementing the mutual recognition of professional certifications under the ECF. The HKIB and the MIFS will also offer a bridging course on relevant laws and regulations of Hong Kong and Macao for banking practitioners in the respective jurisdictions.

MAS issues information paper on thematic review of credit review standards and practices of corporate lending business

The Monetary Authority of Singapore (MAS) has issued an information paper setting out the results of its thematic review of credit review standards and practices of corporate lending business.

The information paper sets out the MAS' findings from its thematic review of selected banks' credit review standards and processes for their corporate loan portfolios, which was conducted between October 2016 and June 2017. The review assessed the banks':

- credit grading standards and practices against the credit grading requirements under MAS Notice 612 on Credit Files, Grading and Provisioning;
- credit monitoring framework and controls; and
- loan portfolio management framework and processes.

The review found that whilst the banks had established policies and processes to monitor and manage the exposures of their corporate borrowers, the robustness of their credit grading, monitoring and portfolio management processes could be improved, particularly in relation to the qualitative criteria set out in the notice. In addition, the MAS has highlighted:

- instances of restructured loans not being classified appropriately in line with the requirements of the notice;
- that the watch-list process could be enhanced for more effective identification and management of accounts with signs of credit weaknesses;
- that on portfolio management, some banks did not conduct adequate credit stress tests on a regular and timely basis to assess the impact of economic shocks or worrying trends in the local operating environment; and

- that stress test scenarios should be enhanced to incorporate macroeconomic and industry trends.

The MAS has set out its findings in detail in relation to credit grading, credit monitoring, loan portfolio management and also in relation to post-mortems on non-performing loans and has highlighted that banks should continue to strengthen their credit review standards and practices to enable them to:

- identify problem loans appropriately and promptly;
- develop and implement appropriate actions to minimise credit losses;
- ensure the adequacy of provisions; and
- assign appropriate credit grades to borrowers in line with the notice.

RECENT CLIFFORD CHANCE BRIEFINGS

OIS and RFR Futures Conventions – Lessons for LIBOR replacement term rates

The development of term benchmarks based on risk-free rates (RFRs) is an important aspect of the work to facilitate a successful transition from LIBOR, particularly for corporate lending and other cash products.

This briefing considers how conventions used in Overnight Index Swaps (OIS) and RFR futures markets are relevant to the development of RFR-based term rates.

https://www.cliffordchance.com/briefings/2018/10/ois_and_rfr_futuresconventionslessonsfro.html

Good news for banks in the Budget –providing certainty on the tax treatment of regulatory capital

In his October 2018 Budget speech, the UK Chancellor announced the replacement of UK regulations governing regulatory capital instruments with new tax rules for all hybrid capital instruments.

This briefing examines the background, State aid and MREL/TLAC aspects of bank regulatory capital and provides commentary on the solution announced in the Budget.

https://www.cliffordchance.com/briefings/2018/10/good_news_for_banksinthebudgetprovidin.html

Big Data Regulations May Be Introduced in Russia

A draft law regulating big data was recently submitted to the State Duma.

This briefing discusses the draft law, including its proposed definition of 'big user data' and the obligations that could be imposed on big data operators.

https://www.cliffordchance.com/briefings/2018/10/bid_data_regulationsmaybeintroducedinrussi0.html