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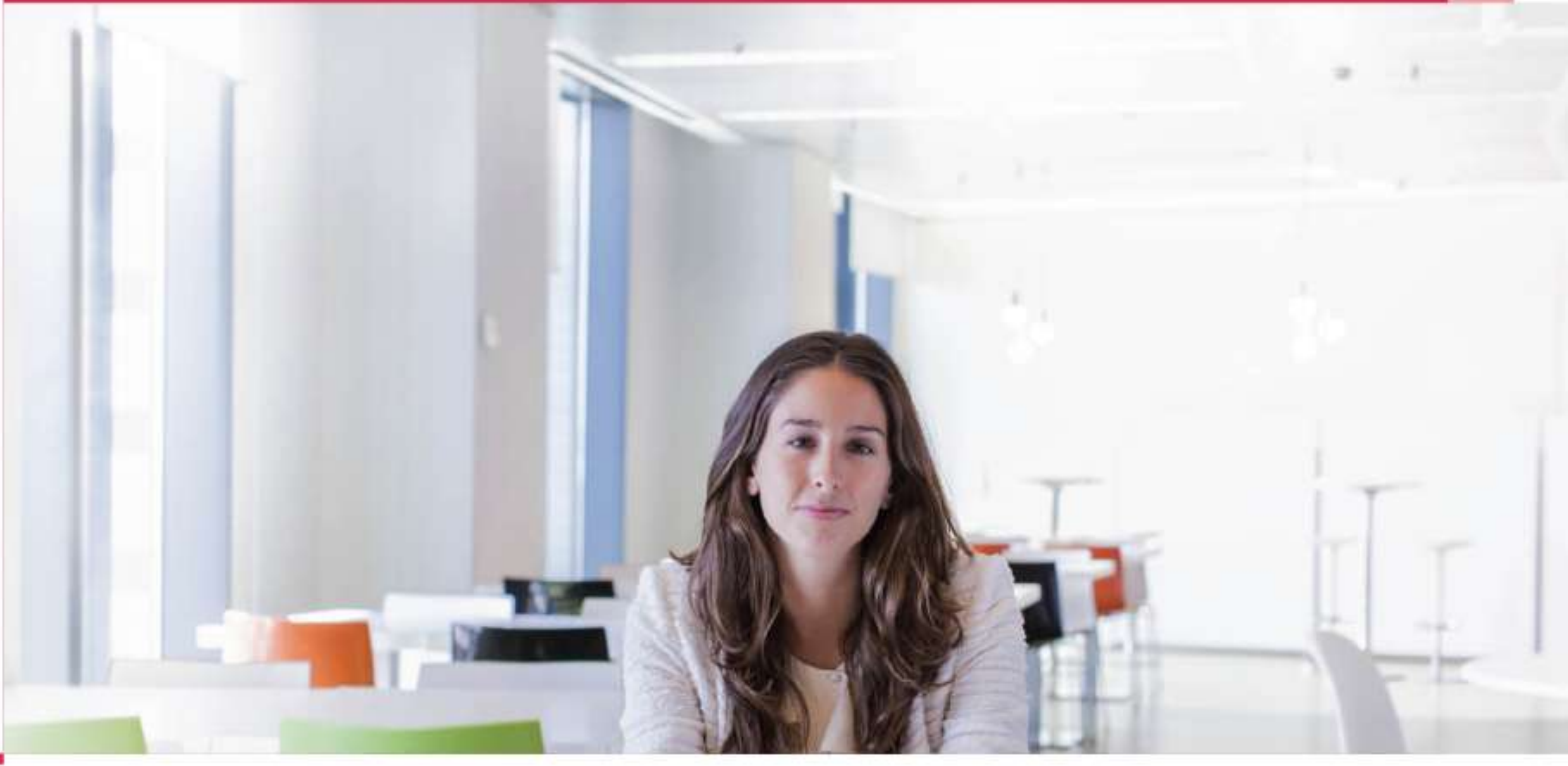
Being better informed

FS regulatory, accounting and audit bulletin



PwC FS Regulatory Centre of Excellence

July 2012

In this issue:

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Executive summary

Welcome to this edition of "Being better informed", our monthly FS regulatory, accounting and audit bulletin, which aims to keep you up to speed with significant developments and their implications across all the financial services sectors.

Laura Cox
Lead Partner
FS Regulatory Centre of Excellence

Over the past month we have seen significant progress on the G20's international regulatory agenda, with G20 leaders meeting in Los Cabos to discuss ways to bolster the global recovery. But the eurozone crisis escalated during the summit and somewhat overshadowed leaders' commitments to increase economic development and many positive findings presented at the summit. The G20's financial services reforms are making great strides and national regulators are making meaningful efforts to adopt international standards. Our feature article this month reports on the summit.

Swiftly after the summit, eurozone leaders made good on promises to pursue deeper integration. Herman Van Rompuy, President of the Council, previewed key elements of the *plan for greater EU integration through an EU banking union*, including:

- common resolution scheme
- pan-European deposit guarantee scheme
- single bank supervisor for the EU.

This dynamic plan addresses a number of concerns about the current EU aid regime, but will lead to significant changes in European banking and is likely to pose unique challenges for UK institutions and regulators.

In addition to these new proposals, we saw advances on several legislative measures with critical 2013 implementation deadlines:

- EBA released several *CRD IV consultations* and ECON released several *CRD IV reports*
- Council released *near-final EMIR text* and the ESAs released two related RTS consultation papers (final text on EMIR is expected in August)
- Council also released *MiFID II* and *MAR* compromise texts, with some *guidance notes*.

On the UK front, the government issued a *white paper* outlining its proposals to implement the ICB's recommendations for ring-fencing retail banks. The proposals are largely consistent with the discussion paper issued in January. They provide more clarity, but still leaving a number of important questions about how it will all work in practice unanswered.

Finally, last week the FSA announced a *fine relating to LIBOR fixing*, likely to be first of many, and a number of investigations have been launched. These events have brought into sharp focus the issue of trust - like one's reputation, trust is easily lost and difficult to regain.

We hope that Martin Wheatley's upcoming review on reforming how LIBOR is set and the governance around that process will help the industry to focus on the future and move forward.

Despite recent events, we should not lose sight of the fact that most people working in the financial services industry aim to do the right thing for their customers. We need to work together to make a start on regaining the public's trust. More regulation is not the answer – but better regulation, more insightful supervision and a stronger focus on serving and protecting customers would be a good start.

Laura

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How to read this bulletin?

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Contents

G20 Los Cabos summit: financial reforms moving ahead despite eurozone worries

At the G20 summit held 18-19 June 2012 in Los Cabos, Mexico, world leaders discussed efforts to build sustainable and balanced growth and job creation to support the global economic recovery. Regarding the financial services reform agenda, ahead of the meeting the FSB and other supranational organisations issued a stack of progress reports showing that, on balance, most of the post financial crisis regulatory reforms are starting to take hold. However the deteriorating eurozone economic situation overshadowed the event and concerns about the euro and its effects on world markets monopolised a lot of the discussions.

Economic stabilisation and recovery take precedence

In the *G20 Leaders Declaration* the eurozone leaders vowed to continue their efforts to safeguard the integrity and stability of the eurozone area and in particular, to work to reduce the dangerous feedback loop between eurozone banks and their sovereigns. As a group, the G20 leaders pledged to continue to pursue growth oriented policies, work to stabilise oil prices and to control trade balances to smooth out economic instability.

The G20 leaders are committed to job creation that generates 'quality employment' – jobs that come with labour rights, social security coverage and a reasonable level of income. Quality employment supports stable growth and enhances social inclusion, as well as having the obvious benefit of reducing poverty.

But quality employment requires widespread labour market measures and targeted job creation, particularly to address the special needs of young people and other vulnerable groups. Lower income countries are likely to find some measures challenging, such as introducing social protection 'floors' and minimum employment standards.

Shifting the balance of power

During the summit EU leaders watched nervously as the Greek political uncertainty and Spain's bank recapitalisation request played out. The other G20 leaders seemed able to do little more than lecture Europeans. But Angela Merkel, who as German Chancellor presides over the eurozone's largest economy, gave them enough assurances to forestall interference from President Obama and the other G20 leaders.

What was remarkable about this summit was the distinction between the declining political powers and economic fortunes of developed countries in the EU and the continued consolidation of the power and growing fortunes of emerging markets.

This shift in political power was evident in several comments made during the summit. Julia Gillard, Australian Prime Minister, boasted on the last day 'about the situation of being AAA rated by all the major credit rating agencies' and being 'an island of strength in a world of economic upheaval'. While Francois Hollande, the new French President, stated somewhat defensively that Europe should be left to solve its own problems and that solutions should not be imposed from outside.

IMF funding arrangements agreed at the summit reinforced this role reversal. Emerging market countries pledged an additional $26bn to the IMF's $430bn emergency fund, which will likely be used to subsidise ailing developed countries. The fund is intended to be a second line of defence after EU national or regional resources are drained.

Emerging market leaders are disappointed by the slow transfer of official power in recognition of their growing contributions, and are pushing the G20 to implement IMF voting reforms in full by October 2012 to give them a greater say.

Key outcomes

Despite these distractions, the *G20 leaders Declaration* affirmed their agreement in some key areas:

- the growth agenda (set out under the *Los Cabos Growth and Jobs Action Plan*) - aiming to strengthen global growth and restoring confidence but monitoring the fragile economic conditions
- Eurozone banking union - Germany, France and Italy promised to 'take all necessary policy measures to safeguard the integrity and stability' of the eurozone and work toward closer integration
- price stability - balancing price stability with economic recovery
- monitoring unintended consequences of regulation - monitoring whether or not international reforms are having unintended consequences or bias
- global rebalancing - to continue efforts to rebalance international country account surpluses and deficits
- avoiding protectionism - many jurisdictions are retrenching back into narrow self interest, at the expense of fair market practices.

We are likely to see a continued focus on many of these issues at the St Petersburg G20 summit in 2013.

Supranational bodies report on FS reforms

Ahead of the Mexico summit, the FSB and other supranational bodies published a number of reports commissioned in prior summits. On balance the reports showed that G20 financial services reform commitments are building steam:

Third Implementation Progress Report on Over-the-counter (OTC) Derivatives Market Reforms *(FSB, 15 June 2012).* Progress has been made in international policy development and in operational efficiency in the largest OTC derivative markets, but most jurisdictions are 'markedly behind' in moving standardised contracts on exchanges or electronic trading platforms. All jurisdictions and markets need to aggressively step up their efforts to achieve full implementation of the Pittsburgh OTC derivatives reforms by end 2012.

Implementing the Principles for Sound Compensation Practices and their Implementation Standards (FSB, 13 June 2012). Most G20 countries have implemented the Basel III Principles and Standards and progress has been made in implementing the Pillar 3 disclosure requirements on remuneration, but more needs to be done to embed them into supervisory guidance. Most financial institutions have made progress in adjusting compensation practices to align them with the Basel III Principles and Standards. However, challenging areas remain in aligning compensation to ex-ante risk taking and ex-post performance, and in the identification of material risk takers.

Legal Entity Identifier for Financial Markets: FSB Report to G20 (FSB, 8 June 2011). The FSB made 35 recommendations for the development and implementation of a global LEI system and a set of High Level Principles, drawing extensively from the LEI Industry Advisory Panel and public participants in workshops and on the LEI standards published by IOSCO. Leaders endorsed the report's recommendations at the summit. Next the FSB will create an FSB LEI Implementation Group to take the work forward, with a view to launching a global LEI system in March 2013.

Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences (*FSB, with the IMF and the World Bank,* 19 June 2012). While many emerging markets and developing economies (EMDEs) do not expect significant adverse effects, policy measures for Basel III, measures aimed at G-SIFIs and OTC derivative reforms may result in some disadvantages for EMDEs and their financial institutions, while favouring developed market economies and firms. The report found it was difficult at this stage to distinguish between intended and unintended consequences and to assess materiality.

Report to G20 leaders on Basel III implementation (Basel Committee, 11 June 2012). The report reviewed progress in the G20 countries, Hong Kong, Singapore and six other non-G20 European countries in three areas:

- Level 1: ensuring timely adoption of Basel III - as of 31 May all members had issued draft regulations except Argentina, Hong Kong, Indonesia, Korea, Russia, Turkey and the United States. The majority are confident that they can finalise regulations in time for the agreed start dated 1 January 2013, but for others it is likely to be a challenge.
- Level 2: ensuring regulatory consistency with minimum Basel III standards – whilst all member countries will be assessed over time, the initial focus will be on the home jurisdictions of G-SIBS. Preliminary findings from the Level 2 review identified areas of divergence between domestic regulations and Basel III minimum standards but these are subject to further investigation. The EC had several challenges to the findings in its response (published in the report).
- Level 3: ensuring that the outcomes of the Basel III rules are consistent in practice - initially focused on risk-weighted assets. The review will seek to identify areas of material inconsistency in the calculation of risk weighted assets in both the banking book and the trading book. Preliminary conclusions from the detailed analysis are expected in Q4 2012.

Report on the Credit Default Swap (CDS) Market (IOSCO, 16 June 2012). The report discusses recent changes and current trends in the CDS market and provides information about trading, pricing and clearing of CDS but does not make any policy recommendations. The report states that existing empirical evidence on many aspects of the CDS market tend to be mixed, for example the impact CDS have on the orderly functioning of the primary and secondary markets of the underlying bonds and on creditor incentives.

Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability, *and accompanying summary* Scoreboard Status Report (FSB, 19 June 2012) The FSB believes good progress has been made in implementing Basel II.5 capital reforms, but noted that there is a long way to go in designing and implementing standards on OTC derivative reforms, measures to reduce the risks of globally systematic firms and institutions, compensation reform and the development of a functioning international LEI system.

Globally coordinated reforms begin to take effect

It has been nearly four years since the most spectacular collapses of the financial crisis (Lehman Brothers, Bear Stearns and AIG), but this is a relatively short period of time in which to agree and implement a coordinated global policy response. Inevitably, legislation addressing such complex issues will take longer than expected to develop, particularly when the process involves the substantial challenges of achieving international consistency and conforming to an evolving body of international standards.

But these long planned reforms are finally gaining momentum, clarity on the local detail is beginning to emerge and implementation dates are coming into view. By the next G20 summit we should have a much clearer picture of whether the G20's global financial reform agenda is resulting in a more harmonised and effective approach to regulating our markets and institutions.

Cross Sector Announcements

In this section:

Regulation

Capital and liquidity

Basel Committee reports to G20 on Basel III implementation

The Basel Committee published an interim report, *Report to G20 leaders on Basel III implementation*, on 11 June 2012. The review covers the G20 jurisdictions (which includes the EU) plus Hong Kong, Singapore and six other non-G20 European countries. The implementation review process has three levels:

- Level 1: ensuring timely adoption of Basel III. As of 31 May all members have issued draft regulations except Argentina, Hong Kong, Indonesia, Korea, Russia, Turkey and the United States. The majority are confident that they can finalise regulations in time for the agreed start dated 1 January 2013, but for others it is likely to be a challenge. Progress reports will continue to be published six monthly.
- Level 2: ensuring regulatory consistency with Basel III– that regulation of member countries complies with the minimum standards. Whilst all member countries will be assessed over time, the initial focus will be on the home jurisdictions of G-SIBS. Assessments of the EU, Japan and the United States have commenced and are expected to be completed in September. Singapore will commence later in 2012 with China and Switzerland starting in early 2013. Australia and Brazil will follow later in 2013.
- Level 3: ensuring that the outcomes of the Basel III rules are consistent in practice across banks and jurisdictions, initially focused on risk-weighted assets. The review will seek to identify areas of material inconsistency in the calculation of risk weighted assets in both the banking book and the trading book. Preliminary conclusions from the detailed analysis are expected in Q4 2012.

Preliminary findings from the Level 2 review identified areas of divergence between domestic regulations and Basel III minimum standards but these are subject to further investigation.

Basel Committee publishes Basel III capital disclosure rules

The Basel Committee published *Composition of capital disclosure rules* on 26 June 2012.

Basel III introduced a set of detailed requirements to raise the quality and consistency of capital in the banking sector. In addition, Basel III established certain high level disclosure requirements to improve transparency of regulatory capital and enhance market discipline. These rules provide the Pillar 3 disclosure requirements.

The Basel Committee sets out the new capital disclosure requirements in five sections:

- a template which banks will use to report the breakdown of their regulatory capital. The use of this template will be compulsory post 1 January 2018.
- a three step approach to reconcile the regulatory capital to financial statements. The new requirements will oblige banks to describe the main features of their regulatory capital instruments.
- a main features template, a common template which banks are required to use to describe the main features of the regulatory capital instruments they use.
- other disclosure requirements, what banks must do to meet the Basel III requirements to provide full terms and conditions of regulatory capital instruments on their websites, and reporting on the calculation of any ratios involving componenets of regulatory capital.
- a modified template that the banks will use in the transitional period (before 1 January 2018).

The national authorities need to implement the disclosure requirements by 30 June 2013 and banks will be required to comply with the disclosure requirements from the date of publication of their first set of financial statements relating to a balance sheet date on or after 30 June 2013 (with the exception of the post 1 January 2018 template).

Banks must publish required disclosures with the same frequency as, and concurrent with, the publication of their financial statements, irrespective of whether or not the statements are audited. Banks are required to update the main features template information and full terms and conditions of capital instruments whenever a new capital instruments is issued and included in capital, and whenever a redemption/conversion/writedown or other material change to the nature of an existing capital instrument occurs. The rules set out further conditions and exceptions to these requirements.

Basel Committee publishes report on Basel III implementation

The Basel Committee published its *Report to G20 leaders on Basel III implementation* on 11 June 2012, for review at the G20 Los Cabos summit. The report covers the G20 countries, Hong Kong, Singapore and six other non-G20 European countries. The implementation review process was undertaken as a three level process.

Level 1 reviewed the timely adoption of Basel III. As of 31 May all members had issued draft regulations except Argentina, Hong Kong, Indonesia, Korea, Russia, Turkey and the United States. The majority are confident that they can finalise regulations in time for the agreed start dated 1 January 2013, but for others it is likely to be a challenge. Progress reports will continue to be published semi-annually.

Level 2 reviewed the regulatory consistency with minimum Basel III standards. Whilst all member countries will be assessed over time, the initial focus will be on the home jurisdictions of G-SIBS. Assessments of the EU, Japan and the US have commenced and are expected to be completed in September. Singapore will begin later in 2012 with China and Switzerland starting in early 2013. Australia and Brazil will follow later in 2013.

Preliminary findings from the Level 2 review identified areas of divergence between domestic regulations and Basel III minimum standards but these are subject to further investigation. The European Commission (EC) responded to the preliminary findings published in the report. First, the EC defended its decision to apply a 'maximum harmonisation' approach. Then it discussed how its decision to apply Basel rules to all banks (as well as investment firms), as well as the features of certain EU markets, justified a number of polices which the report noted posed potential differences from Basel III rules.

Level 3 reviewed the outcomes of the Basel III rules are consistent in practice and initially focused on risk-weighted assets. The review will seek to identify areas of material inconsistency in the calculation of risk weighted assets in both the banking book and the trading book.

Preliminary conclusions from the report's detailed analysis are expected in Q4 2012.

EBA consults on draft ITS on disclosure for own funds

The EBA published a consultation on *draft Implementing Technical Standards (ITS) on disclosure of own funds by institutions* EBA/CP/2012/04 on 7 June 2012. The draft ITS sets out the uniform templates to be used to make Pillar 3 disclosures relating to regulatory capital and forms part of the EU's implementation of the enhanced disclosures requirements arising from Basel III.

The draft ITS requires standardised and uniform disclosure of prescribed details of regulatory capital to facilitate detailed assessment and comparison. The EBA proposes three sets of templates:

- a general own funds template reflecting capital positions
- a transitional disclosure template covering the phasing in (1 January 2013 – 31 December 2017) of regulatory adjustments - deductions and regulatory filters together with transitional provisions implemented by firms
- a template describing the main features of the capital instruments issued.

The EBA drafted the templates to be consistent with the Basel Committee templates, and with the EBA Common Reporting (COREP) framework. The templates include a reconciliation between the components of regulatory capital and the balance sheet of the audited financial statements of firms.

The consultation closes on **31 July 2012**. The EBA is due to submit this draft ITS to the EC for approval by 31 December 2013.

EBA consults on ITS for liquidity reporting and leverage ratio reporting

The EBA published a consultation on *draft Implementing Technical Standards (ITS) on supervisory reporting for liquidity coverage and stable funding* EBA/CP/2012/05 on 7 June 2012. This follows the draft ITS on supervisory reporting covering capital adequacy, large exposures and financial information it issued in December 2011 and February 2012. Also related are Consultation Papers 50 and 51, which are due to be finalised in Q3 2012.

Initially, the EBA will use the reporting data to inform its economic impact assessment of the liquidity requirements and its reporting to the EC, prior to the introduction of minimum standards. The EBA developed the ITS from EBA templates used for the Basel III monitoring exercise, on COREP/FINREP guidelines and on voluntary reporting exercises conducted mainly with large firms. The EBA is also developing additional liquidity monitoring metrics, and will consult on these in due course.

Liquidity coverage reporting is set to be required monthly and stable funding reporting will be required quarterly. The first reporting period is currently expected to be January 2013. The consultation closes on **27 August 2012**.

The EBA also published a consultation on *draft Implementing Technical Standards (ITS) on supervisory reporting requirements for leverage ratio* EBA/CP/2012/06 on 7 June 2012.

Initially the EBA will use the data to assess the impact and effectiveness of the leverage ratio. The EBA are due to report on this to EC in 2016. Thereafter, the EC are due to report to the Council and EP before the end of 2016 prior to the introduction of minimum standards. The ITS has been developed based on the templates used by BCBS for their Quantitative Impact Study and on COREP/FINREP guidelines.

Leverage ratio reporting is set to be required quarterly. The first reporting period is currently expected to be for the first quarter January 2013. The consultation closes on **27 August 2012**.

The EBA plans to issue separate consultations on the relevant technical specifications necessary for developing an IT reporting format for reporting on liquidity and leverage ratios later in 2012.

ECON publishes reports on CRD IV

ECON issued reports that it adopted in May, including draft legislative resolutions to CRD IV and CRR, on 21 June 2012. The resolutions will be considered by the EP at one of its plenary sessions in July.

The EP also published a *summary of amendments to the CRD IV Directive* and *summary of amendments to CRR*.

Corporate governance

FSB publishes report on compensation practices

On 15 June 2012, the FSB published its first *Implementation monitoring report on compensation practices*, for consideration at the G20 Los Cabos summit. This report assesses the progress made by national authorities and individual firms to apply the Principles for Sound Compensation Practices developed by the FSB in 2009 (the Principles).

The Principles are designed to eliminate the types of reward structures at large financial institutions that contributed to the financial crisis in 2007. Some structures rewarded staff for earning short-term profits without adequate regard to longer-term risks. The Principles cover firms' governance structures, how to align compensation with (appropriate) risk-taking and oversight principles for supervisors and shareholders.

National authorities will need to implement the Principles consistently to achieve a level playing field between firms. The FSB's implementation standards issued in 2009 included significant restrictions on pay structures (e.g. restrictions on cash bonuses and deferral of bonus payments), and required certain minimum disclosures to allow shareholder and other stakeholder scrutiny.

The FSB found that:

- Indonesia and Russia have not yet introduced legislation, and five other jurisdictions have elected not to implement the standards in full

- significant progress has been made in implementing the Basel Committee's Pillar III disclosure requirements
- important differences remain in application between countries, particularly in relation to the scope of firms and employees covered by the principles and standards
- supervisory review has increased markedly, with cross-border cooperation improving; although further progress can be made.

The FSB has established a compensation monitoring group which will conduct further reviews, and a complaint handling process to address specific complaints based on level playing field concerns.

FRC publishes report on a single figure for remuneration.

FRC published *Lab project report: a single figure for remuneration* on 21 June 2012. The Department of Business Innovation and Skills (BISIS) requested that FRC undertake this project, involving the investment community, to help it develop its thinking on the issue. BISIS are now expected to publish their proposals later this summer.

The report describes the components of remuneration that should be contained within the total single figure for remuneration: salary, benefits, pension, bonus and long term incentives (including options and matching shares). The report also addresses how these components should be measured, favouring simplicity and consistency of application (thereby aiding comparison) ahead of complexity and accuracy. Supplemental disclosure is also suggested.

ESMA publishes responses to proxy adviser consultation

ESMA posted the responses to its Discussion Paper on Proxy Advisors on 29 June 2012. Over 56 responses were published on the *ESMA site*, including from FRC and ABI

- *FRC* - believes that concern is warranted. With the equities markets expanding internationally and coming under increased pressures, investors are putting ever more reliance on the judgements of agencies. If there is a problem with agencies, part of the solution is in convincing their clients to be more critical of agents' advice. However, the FRC conclude that with little evidence of systematic abuse or market failure, there is insufficient reason to pursue further EU wide regulation.
- *ABI* - believes that before any standards or regulations are brought in, more precision is needed in the description of the role of proxy agents and their impact on the voting behaviours of investors. The ABI believes that further research is required into the way proxy advisers are being used, specifically in the area of "influencers" and "facilitators", where it believes some confusion exists. The ABI concluded that standards based on a common set of values would be the most effective approach.

ESMA expects to publish a feedback statement in Q4 2012.

Dodd-Frank Act

SEC publishes Road Map on US derivatives reform

The SEC published on a *policy statement* for consultation on 11 June 2012, describing the order in which it expects new rules regulating security-based swaps and security-based swap market participants to take effect. The paper does not set out a proposed sequence of rule-making rather than prescriptive dates for the phase in of the remaining Dodd-Frank Act rules that the SEC is required to implement. The SEC has proposed nearly all rules required under the act, but is in the early stages of implementation. The consultation closes on **13 August 2012**.

SEC adopts new provisions for reviewing clearing submissions under the Dodd- Frank Act

The SEC adopted *rules* on 28 June 2012 that establish procedures for its review of certain clearing agency actions required under the Dodd-Frank Act. The rules detail how clearing agencies will provide information to the SEC about security-based swaps that are accepted for clearing. The information is intended to aid the SEC in determining whether or not such security-based swaps are required to be cleared. The effective and compliance date for this rule is **10 December 2012**.

CFTC passes rules on swap data record keeping and reporting requirements

The CFTC passed *final rules* on 12 June 2012 establishing a new framework for swap data record keeping and reporting requirements. The new rules are effective **13 August 2012**.

CFTC passes rules on requirements for designated contact markets

The CFTC passed *final rules* 19 June 2012 on core principles and other requirements for designated contract markets. The new rules are effective **20 August 2012** with a compliance date of **17 October 2012**.

CFTC consults on amendments to block trade rules

The CFTC's *proposed rules* amending its rules on block trades in swap contracts were published on 27 June 2012. The proposals prohibit the aggregation of orders from certain accounts, subject to exemptions in the proposal, to satisfy minimum block sizes or cap size requirements and establish the eligibility requirements for parties to block trades. The consultation closes **27 July 2012**.

CFTC publishes draft consultation on cross-border application of certain swap provisions

The CFTC published a draft of the *interpretive guidance and policy statement* on the cross-border application of certain swap provisions of the Commodity Exchange Act. The draft guidance will shortly be published for formal consultation, and the comment period will be 45 days from publication.

Enforcement

LIBOR scandal sparks more investigations and reviews

On 27 June 2012, the FSA published the *final notice* it has issued to Barclays Bank plc a fine of £59.5 million for misconduct relating to its submission of rates that formed part of the LIBOR and EUROBOR rate setting processes. In addition, the CFTC imposed a penalty of $200 million on Barclays and the company agreed to pay a penalty of $160 million as part of an agreement with the US Department of Justice (DoJ).

A number of investigations and reviews are pending or underway into this matter. On 2 July 2012, the SFO Director, David Green QC, decided to formally to accept the LIBOR/EURIBOR matter for investigation. In a *press release*, the SFO said it was reviewing evidence received from the FSA and was considering whether it is both appropriate and possible to bring criminal prosecutions. The TSC is also undertaking its own investigation into the case.

On 2 July 2012, HM Treasury published a *statement* by George Osborne, Chancellor of the Exchequer, on the FSA's review what reforms are needed to the current framework for setting and governing LIBOR. The review will be lead by Martin Wheatley, the Chief Executive designate of the FCA, and will include looking at:

- whether participation in the setting of LIBOR should become a regulated activity
- the feasibility of using of actual trade data to set the benchmark
- the transparency of the processes surrounding the setting and governance of LIBOR.

The review will also look at the adequacy of the UK's current civil and criminal sanctioning powers with respect to financial misconduct, and market abuse offences and sanctions with regards to LIBOR.

FSA settles with firms on interest-rate SWAPs sales

FSA published details of its *settlement* with four high-street banks over their sales of Interest-Rate SWAPs to small and medium sized enterprises on 29 June 2012. This issue has drawn significant political interest over the past month, with comments from a range of key stakeholders including Andrew Tyrie, TSC Chairman and Ed Balls, Shadow Chancellor.

Whilst interest rate hedging products can meet customers' needs, the FSA were concerned that the complexity of these products made them susceptible to mis-selling. The FSA therefore reviewed the sales of such products and indentified thematic failings in many sales to small and medium sized businesses (SMEs).

The FSA's concerns included:

- the inappropriate sales of more complex varieties of interest rate hedging products (such as structured collars)
- a number of poor sales practices identified in selling other interest rate hedging products.

The FSA focused on sales to non-sophisticated clients, and agreed with the banks concerned that they will:

- provide fair and reasonable redress to non-sophisticated customers who were sold structured collars
- review sales of other interest rate hedging products (except caps or structured collars) for non-sophisticated customers
- review the sale of caps if a complaint is made by a non-sophisticated customer during the review.

The settlement specifically states that the CEOs of each bank "have personally confirmed that they will have responsibility for oversight of this exercise within their bank and will ensure that complainants are treated fairly". The FSA's emphasis on executive personal responsibility will no doubt focus the minds of the wider industry.

Eurozone integration

EC publishes memo on banking union

The EC published its *Memo on banking union* on 6 June 2012, discussing deeper economic integration within the EU. In the memo the EC lists what the EU has already been done to bring about a convergence in banking standards and rules toward a functioning banking union:

- established new European supervisory authorities to achieve a better integrated financial services supervision
- improved better bank capitalisation by working on Basel III's capital implementation
- facilitated the banking sector restructuring, including enforcing policy measures for banks receiving international financial assistance
- improved depositor protection by introducing a new European deposit protection guarantee of up to €100,000 per account
- put in place a crisis management regime including guidance on how member states can support distressed banks.

The Commission's proposal on bank resolution is the last measure due to be adopted to strengthen the financial system. The memo referred to other measures that could be implemented to strengthen union:

- integrated system for the supervision of cross-border banks
- single deposit guarantee scheme
- EU resolution fund.

The EC believes that the concept of banking union will require extensive discussion. Once political agreement is reached, the EC will propose its implementation measures.

Eurozone leaders seek greater financial integration

Eurozone leaders issued a statement on 29 June 2012 confirming that they have agreed to use European Stability Mechanism to recapitalise troubled banks in regions such as Spain and Ireland. This move could off-load billions of euros of debt from the balance sheets of sovereigns, giving sovereign banks the chance to recover and rebuild their economies.

However, this agreement is conditional on structural and institutional reform. In a report published on 26 June 2012, *Towards a Genuine Economic and Monetary Union*, Herman Van Rompuy, President of the Council, gave a tentative blueprint for reform based on greater monetary, fiscal and economic integration in the eurozone.

Mr. Van Rompuy called for an integrated financial framework which would ensure financial stability in the eurozone to minimise the cost of bank failures for citizens. Creating a single supervisor, involving the ECB, is a fundament part of this framework and would appease sceptics by allowing a central regulator to monitor EU supported banks. The new single supervisor would be given supervisory authority and pre-emptive intervention powers applicable to all banks.

Other pillars would involve EU joint deposit guarantees or resolution funds, both of which seek to reduce the need for intervention. Moreover, building on the single regulatory rulebook, a common deposit insurance scheme and crisis management procedures would be administered by a common resolution authority. The credibility of any deposit guarantee scheme requires access to a solid financial backstop. The European Stability Mechanism could act as the fiscal backstop to the resolution scheme and deposit guarantee authority.

While Mr. Van Rompuy's proposals are notional at present, with much preparation required before reforms can even be considered, they represent a significant shift in thinking from top officials in their approach to the eurozone crisis. Deep structural reforms and tighter integration appear to be the long-term medicine to deal with the eurozone's ills.

EC investigates banking union

A European banking union would facilitate tighter economic integration and complement the existing monetary union, according to the EC in its *Update - The banking union* on 22 June 2012. But the EC believes that a banking union would work only if there is a strong fiscal union between participating countries.

Once the vision of a banking union is agreed at political level, the EC will propose implementing legislation, which could be as early as autumn 2012. The EC also wants the Council and EP to accelerate the decision-making process on key legislation already in the pipeline to strengthen the financial sector.

Financial crime

EU Danish presidency progress report on MAR

The outgoing Danish Presidency published progress reports on several key dossiers, including on *MAR on 21 June 2012*.

The document reports a good degree of harmonization and general consensus, although it does identify six key outstanding issues, including insider trading a lack of common understanding. Member States have also agreed to wait for the outcome of a European Court of Justice ruling on the MAD before finalising the proposed MAR.

Member States reached broad agreement on accepted market practices (AMPs) (i.e. where an action would fall under market abuse except it is currently authorised in a Member State). However, some Member States are keen to limit these concessions to existing Member States, rather than allowing cross-European expansion of each AMP.

Competent authorities has expressed concern that their powers could be limited – which is not the intention but depending on the reading of the text is a possible outcome. This situation is similar to the area of sanctions where the Danish Presidency's compromise aims to provide sufficient flexibility for Member States to adopt local measures. This flexibility also extends to the compromise text in relation to publication of sanction, which can be anonymous, and/or published for information purposes only (rather than as a sanction itself).

FATF publishes report to G20 leaders

The FATF submitted a *Report to the G20* dated 28 June 2012 to update leaders on its work to counter financial crime, and to request G20's commitment to implementing the new FATF Recommendations produced by FAFT in February 2012.

The report includes a summary of:

- the significance of the new FATF Recommendations
- FATF's ongoing work to identify high-risk jurisdictions with strategic AML/CFT deficiencies
- FATF's work plan to reinforce the G20 anti-corruption agenda
- FATF's focus on transparency and better cooperation against tax crimes
- initiatives on 'financial inclusion' to ensure that businesses and consumers have access to the products and services they need.

The G20 expressed full support for renewing FATF's mandate and its Recommendations. FATF is currently revising its assessment methodology for the next round of country evaluations based on the new standards, which are expected to start in the second half of 2013.

HMRC issues AML guidance for Money Service Businesses

HMRC announced the release of *new guidance for Money Service Businesses* under the Money Laundering Regulations 2007 on 22 June 2012.

Money service businesses are businesses that exchange currency, transmit money or cash cheques for their customers. Those businesses are required to register with HMRC for the purpose of money laundering supervision, unless they are already supervised by the FSA.

The guidance provides clarification on cases where registration may not be necessary, including occasional money services activities that meet specific criteria, transmitting money without making a profit, and acting as a cash courier. Pawnbrokers must register with HMRC if they offer money business activities, or with the OFT if they only offer pawnbroking services.

The guidance also sets out procedures on how to register with HMRC and how to apply for the fit and proper test required for money service businesses.

FSA and HMRC establish MoU for joint supervision

The FSA and HMRC have put in place a *Memorandum of Understanding* (MoU) for the exchange of information and conducting joint visits under the Money Laundering Regulations 2007 (MLR) and Payment Services Regulations 2009 (PSR). The MoU, published on 1 June 2012, is relevant to firms that are supervised by the FSA and make filings with HMRC.

The document sets out the respective roles of the FSA and HMRC and explains how they will work together to avoid duplication of efforts, minimise the regulatory burden for firms and disclose information on those that are not complying with the Regulations.

The MoU replaces the 'Practical Arrangements for Disclosing Information Relating to Payment Services Providers' agreed on 11 June 2009 (updated on 15 August 2011). It does not affect previous arrangements agreed between FSA and HMRC under FSMA, nor does it create any enforceable rights.

The FSA and HMRC will review the MoU at least annually to reflect any legislative changes and other relevant developments.

FSA issues Guidance Consultation on investment fraud

The FSA proposes to update the Financial Crime guide for firms in a new guidance consultation, *GC12/7: Examples of good and poor practices in 'Banks' defences against investment fraud*, published on 28 June 2012. The guidance is most relevant to deposit-taking institutions.

GC 12/7 follows FSA's thematic review *Banks' defences against investment fraud,* which highlighted the lack of adequate governance in the identification, investigation and monitoring of investment fraud amongst the retail banks visited. Through the thematic review, the FSA found several issues around fraud identification and communication with customers, but also identified good examples of banks maintaining intelligence on investment fraudsters and a range of transaction monitoring technologies.

GC12/7 sets out the cost benefit analysis of the proposals and the proposed revisions to the Financial Crime guide. These include amendments to the Fraud chapter in Part 1 and adding a new chapter in Part 2 with examples of good and poor practices highlighted in the thematic review.

The consultation closes on **23 August 2012**.

Financial stability

FSB publishes G20 stability progress report

FSB publishes report on G20 financial stability recommendations and scoreboard status report.

The FSB published is *Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability*, and accompanying summary *Scoreboard Status Report* on 19 June 2012, for review at the G20 summit.

The FSB believes good progress has been made in implementing Basel II.5 capital reforms, but noted that there is a long way to go in designing and implementing standards on OTC derivative reforms, measures to reduce the risks of globally systematic firms and institutions, compensation reform and the development of a functioning international LEI system.

The FSB's report goes on to commend extension of the G-SIFI regime to global insurers and domestic banks, measures to address the regulation and oversight of shadow banking, and the development of a governance framework for a global Legal Entity Identifier (LEI) system.

The FSB's report noted that many jurisdictions still need to address weaknesses in their supervisors' mandates, to ensure sufficient independence to act, appropriate resources, and a full suite of powers to proactively identify and address risks. The Basel Core Principles are being strengthened in this area- BCBS issued a consultation paper on this issue last December.

In October 2011 the FSB established a Coordination Framework for Implementation Monitoring (CFIM), in collaboration with international standard-setting bodies, to intensify its monitoring and public reporting on implementation, focusing on priority reform areas. The FSB now provides a progress report to leaders at each G20 summit.

BoE publishes the results of systemic risk survey

The BoE published the results of the biannual *Systemic Risk Survey* on 15 June (2012 H1 survey), which gathers views on risk to the UK financial system. 73 banks, building societies, hedge funds and other financial institutions completed the survey between 16 April and 15 May 2012.

The BoE found that:

- Overall respondents believed the highest risk was of a single large high-impact event and its impact on the public's confidence in the UK financial system. Thirty-six per cent of respondents considered this risk to be very high or high in the medium term and forty-eight per cent believed it to be high in the short term. The responders' confidence in the stability of the UK financial system over the next three years was low.
- 80% of respondents were cited sovereign risk and the economic downturn risk as risks that could have the greatest impact.
- Respondents believed the most challenging risks for firms were the risk of an economic downturn (56%); risks around regulation/taxes (37%) and funding risk (34%).

BoE is due to publish its next Systemic Risk Survey on 19 November 2012.

ESRB publishes views on EU systemic risk

The ESRB published a *press release* on 21 June 2012 summarising the ESRB Board meeting that day. The Board discussed the EU current situation from a macro-prudential perspective, noting that systemic risk remains high despite the provision of central bank liquidity and recapitalisation programmes.

The Board observed that the EU faces further economic slowdown and persistent sovereign debt crisis, that many national governments face negative growth projections and that their borrowing costs are still growing. In the midst of these conditions, EU banks need to continue to lower their leverage ratios and continue to find wholesale funding.

The Board noted the persistent EU challenge of developing an effective macro-economic strategy for growth and fiscal consolidation, and that the risk of contagion continued between Member States. The ESRB appealed to national authorities to further support the EU banking sector's recapitalisation and restructuring needs by:

- making improvements to the valuation and transparency of banks' asset quality
- implementing strong conditionality with regards to the use of any publicly funded recapitalisation
- resolving non-viable institutions
- building resilience among banks.

Finally, the ESRB stated that national and EU authorities should act 'in unison, with speed and ambition' to maintain financial stability, and that the authorities should exchange information and coordinate actions at the ESRB level when necessary.

Market infrastructure

IOSCO publishes report on the credit default swap market

IOSCO published its report for the G20, *The credit default swap (CDS) market*, on 16 June 2012. The report discusses recent changes and current trends in the CDS market and provides information about trading, pricing and clearing of CDS. The report is intended to inform ongoing regulatory debate and highlight key policy issues but makes no policy recommendations.

One of the main sources of risk in the CDS market is counterparty risk generated by the default of large protection sellers. This arises from the highly concentrated and interconnected nature of the market and the evidence of possible under collateralisation of CDS positions. The use of CCPs is seen as a way of mitigating this risk.

Although the amount of public information on CDS has increased over recent years, the CDS market is still comparatively opaque and regulators would benefit from better access to information on trade and position data.

Research shows that CDS have an important role in the price discovery process on credit risk. However, the inception of CDS trading, whilst reducing the cost of funding for more highly rated entities, increases the cost for entities of lower credit quality. To date, there is no conclusive evidence on whether taking short positions on credit risk through naked CDS is harmful for distressed firms or high yielding sovereign bonds.

In summary, the report states that existing empirical evidence on many aspects of the CDS market tend to be mixed. There is mixed evidence on the impact of CDS on the orderly functioning of the primary and secondary markets of the underlying bonds and on creditor incentives. However, the CDS market does have an important role in the price discovery process.

IOSCO issues standards for derivatives market intermediary regulation

The Technical Committee of IOSCO issued a final report *International Standards for Derivatives Market Intermediary Regulation* on 6 June 2012. The financial crisis exposed the scale of OTC derivatives trading, its links and dependencies to traditional forms of securities markets and the generally low level of regulation that the OTC derivatives markets operate under. This report recommends an international standard for the regulation of derivatives market intermediaries, defined as dealers, market makers or those involve in intermediating transactions'(DMI).

The report discusses the unique features of OTC derivatives markets and distinctions between different jurisdictional approaches and describes general regulatory requirements for markets. The report then makes 15 recommendations in the following substantive areas:

- Registration/licensing
- Capital standards or other financial resource requirements for non-prudentially regulated DMIs
- Business conduct standards
- Business supervision standards
- Record keeping standards.

The recommendations are intended to help mitigate systematic risks created by OTC derivatives trading, to better manage counterparty risk in these markets and to protect participants from unfair, improper or fraudulent practices. The report is also designed to give guidance in the areas where international coordination among market authorities is key to managing differences that can create risks, including the risk of regulatory arbitrage.

FSB publishes recommendations on global LEI system

In response to G20's request at the 2011 Cannes Summit, the FSB published *'A Global Legal Entity Identifier (LEI) for Financial Markets'*, on 8 June 2012 in advance of the G20 Los Cabos summit on 18-19 June 2012.

The document sets out recommendations for the development and implementation of a global system that uniquely identifies counterparties to a financial transaction by assigning a unique ID to each participant in the financial markets. In a crisis situation, the standardisation of client identifiers will help regulators to identify the consolidated risks and exposure of complex transactions in an effective and timely manner.

The FSB puts forward 35 recommendations and 15 high level principles which underpin the system. It also sets out the proposed governance structure including a Regulatory Oversight Committee, a Central Operating Unit and local operating units. Industry firms would be able to use the system by paying a registration fee.

The G20 endorsed the FSB's proposal at Los Cabos Summit and now the FSB intends to invite industry firms to join a global LEI consultative group to participate in the preparatory work for implementation. The G20 asked the FSB to report on implementation progress at the November 2012 G20 Finance Ministers and Central Bank Governors' meeting. The target implementation date is currently March 2013.

FSB publishes progress report on OTC derivatives reforms (G20 update)

The FSB published its *Third Implementation Progress Report on Over-the-counter (OTC) Derivatives Market Reforms* on 15 June 2012 ahead of the G20 Los Cabos summit. The G20 jurisdictions have agreed to introduce central clearing requirements, exchange and electronic platform trading, reporting to trade repositories, capital requirements and standardisation of contracts for OTC derivatives by the end of 2012.

The FSB noted that dependencies have evolved during the implementation process, as countries with less developed markets wait for larger countries to develop rules, and larger countries wait on international standards to be set. Now that international standards are largely complete, the FSB insisted that all jurisdictions need to promptly develop and implement appropriate frameworks.

The FSB recommended that market participants take practical steps to ensure that the necessary OTC derivatives market infrastructure is available soon. The OTC Derivatives Supervisory Group (ODSG) has made some strides toward increased central clearing and trade reporting. Work establishing trade repositories and in standardising contracts among major market participants is also moving forward.

The FSB estimated that one eighth of credit default swaps and one third of interest rate derivatives were centrally cleared by the end of 2011, levels below its expectations. The FSB wants to see further progress on increasing central clearing initiatives and improving the reporting of cleared trades.

Most jurisdictions are 'markedly behind' in implementing the rules requiring standardised contracts to be traded on exchanges or electronic trading platforms. Only the largest countries, such as the US, EU and Japan have started to introduce exchange trading requirements and associated transparency rules.

Progress has been made in international policy development and in operational efficiency in the largest OTC derivative markets. However, all jurisdictions and markets need to aggressively step up their efforts to achieve full implementation of the OTC derivatives reforms by end 2012.

EMIR advances apace

To meet its G20 commitment to implement OTC derivatives reforms by end 2012, the EU is working to complete both the EMIR draft legislation and the RTS, ITS and delegated acts required to fulfil the operational requirements. On 5 July the Council adopted the EMIR legislation and the final EMIR text is expected to be published in the Official Journal in August. The Council published a *near-final version of EMIR* text on 17 June 2012. A press release published by the EBA on 18 June 2012 states that the final EMIR text will be signed and made available before August 2012.

The ESAs are required under EMIR to deliver their final recommendations for RTS and the draft delegated acts required to implement these recommendations to the EC by 30 September 2012. However, the draft delegated acts must undergo the EU legislative process, which will likely take some months, before they are passed.

Both ESMA and the EBA have been active on this issue. On 25 June 2012

ESMA published its consultation *Draft Technical Standards for the Regulation of OTC Derivatives, CCP and Trade Repositories*, one of three EMIR consultations on RTS expected this summer. On 15 June 2012 the EBA published an EMIR consultation *Draft Regulatory Technical Standards on Capital Requirements for CCPs*. Later this summer the ESAs will deliver a joint consultation on risk mitigation techniques for OTC derivatives that are not cleared by a CCP.

The ESMA consultation addresses OTC derivatives, clearing obligations and procedures, public registers, non-financial counterparty rules, intra-group exemptions and 3rd party trades in scope. ESMA has responded to industry concerns by confirming exemptions for certain commercial hedging arrangements, which some companies cited as a potential increased cost.

ESMA is seeking to introduce separate thresholds for five classes of derivatives: credit, equity, interest rate, foreign exchange, and commodity derivatives, below which the requirements for central clearing will not apply. For credit and equity derivatives, the proposed threshold is 1bn euro; for interest rate, FX and commodity it is 3 billion euro. Crossing the threshold for any of these classes would bring the trading of all classes of derivatives into the scope of the EMIR clearing obligations.

EMIR specifies CCP capital requirements for clearing activities. In its consultation, ESMA sets out considerations for its CCP requirements, including prudential, organisational and conduct of business. The ESMA consultation also covers the authorisation and regulation of TRs.

ESMA is holding a public hearing on **12 July 2012**. The consultation closes on **5 August 2012**.

The EBA's RTS consultation also seeks comments on for capital requirements in relation to the credit, counterparty and market risks arising from other activities of the CCP, as well as its overall operational risks. Comments on EBA's consultation are due on **31 July 2012**.

ECB Task Force consults on Cross-CSD Settlement in T2S

An ECB Task Force (TFAX) charged with increasing the efficiency of cross-CSD settlement published a Second Mini-Consultation on Adaptation to Cross-border settlements (CDS) on 28 June 2012. The T2S project is designed to make cross-border settlements in the EU as efficient as domestic settlements.

Market participants are asked to comment on the solution papers, identifying any difficulties they see for their own market adopting to these proposals. The consultation closes on **14 September 2012.**

MiFID

Council publishes MiFID II compromise texts

The Council published MIFID II compromise proposal and *progress report* on amendments to MiFID and a compromise proposal *and progress report on the MiFIR proposal*, both dated 20 June 2012. The compromise text addresses some scope issues on MiFID II. Structured deposits have been included in the scope of MiFID II, but insurance linked investment products have not. The text also seeks to clarify and grant exemptions in relation to investment services and products aimed exclusively at hedging commercial risk with further clarification to come through an RTS on the exemption criteria.

The requirements relating to organised trading facilities (OTFs) remain, but each text indicates that further debate is required to resolve this issue. The compromise text maintains the ban on proprietary trading on OTFs, but permits matched principle trading, which will be defined under RTS.

The rules regarding general pre-trade transparency waivers for non-equity instruments and request for quote, voice trading systems and professional participant traders remain unconfirmed. Policy makers may investigate a compromise with minimum size limits based on reference prices.

Investor protection faced renewed scrutiny, and the rules on inducements may permit Member States limited discretion to retain stricter rules. The issue of allowing complex UCITs to be sold on an execution-only basis will be addressed in a review of the UCITs directive rather than adding more complexity to the MiFID rules.

Individuals exempt from MiFID would still have to contribute to investor compensation schemes (ISDC) (as defined by the Investor Compensation Scheme Directive (97/09/EC)). However, the compromise suggests that insurance may be provided as an acceptable alternative. Firms providing structured deposit arrangements that are currently in MiFID scope, and which are subject to the deposit guarantee scheme directive will not have to register under the ICSD.

Finally, the compromise texts makes extensive changes to the rules for competent authorities and sanctions, bringing MiFID II provisions in line with proposals under MAR , the Transparency Directive (2004/109/EC) and whistle blowing provisions of CRD IV.

ECON is scheduled to vote on MiFID II and MiFIR after the EP's summer recess ends, on or around 3 September 2012.

ESMA updates MiFID Q&A on Investor Protection and Intermediaries

ESMA updated its *Q&A on MiFID I* on 18 June 2012, solely in relation to trade signals. The new question considers whether or not a website allows clients to choose one or more third parties (listed on the website) that provide trade signals and then authorises the service provider to issue orders on the client's behalf without further intervention, falls within any of the investment services listed in Annex I of MiFID.

ESMA stated that portfolio management is characterised by the fact that investment decisions are implemented without any intervention by the client, other than the conclusion of an agreement ('mandate') between the service provider and the client. Therefore, the trade signals website provider requires authorisation. The website provider is subject to portfolio management duties, such as carrying out a suitability assessment on the client, other conduct of business obligations and the provision of periodic reports to clients and regulators.

To see the Q&A, please visit the *EMSA website*.

Other regulatory

IOSCO recommends practices for emerging markets to draw institutional investors

IOSCO published a report on *Institutional Investors in Emerging Markets* on 14 June 2012, which focuses on issues and challenges faced by emerging markets seeking to develop their institutional investor base. IOSCO's Emerging Markets Committee commissioned the project, which was lead by the Chinese Securities Regulatory Commission.

The report highlights that institutional investors play an increasingly important role in the development of emerging markets, which are at very different levels of development as regards institutional investor participation.

IOSCO surveyed 25 jurisdictions in Eastern Europe (9), Latin America (5), Africa (5) and Asia (5). The report includes a detailed analysis of institutional investors' activity in emerging markets, identifies key issues and challenges, and makes recommendations to help regulators to develop and regulate the activities and products in their markets that are relevant for institutional investors.

Key issues included:

- challenging macroeconomic and business environment
- limited capital market size, liquidity and transparency issues
- lack of underlying products and innovation
- overly dominant distribution channels and investor culture
- lack of qualified professionals and incentives for investors
- excessive tax on institutional investors
- legal and regulatory restrictions on cross-border activities.

IOSCO provided recommendations in the following areas to make emerging markets more viable for institutional investment:

- capital market environment

- product offering and innovation
- multi-pillar pension system
- distribution channels and practices
- market openness
- human capital and professional integrity
- regulatory framework and financial stability.

IOSCO believes that both regulators and the market have to make concerted efforts in order to increase institutional investor business without destabilizing the financial system. Adopting a sequenced approach, with adequate safeguards at market and regulatory levels, will help to achieve this aim.

IOSCO updates cross-border cooperation MoU

IOSCO revised its *Multilateral Memorandum of Understanding concerning consultation and cooperation and the exchange of information (MMoU)* and published the latest version (dated May 2012) on 20 June 2012.

The MMoU is a common understanding between IOSCO members which sets an international benchmark for cross-border cooperation in order to combat violations of securities and derivatives laws. IOSCO developed the MMoU following the events of 11 September 2001, and last updated the MMoU in 2005.

The MMoU defines the market activities within its scope and the type of assistance securities regulators can provide under this agreement. It also sets out specific requirements on the nature of the information that can be exchanged and the related procedures, as well as requirements on confidentiality and information sharing.

BIL annual report reviews state of global recovery

Global policy makers gave a sobering assessment of the state of the financial sector in their 2011/2012 annual reports. The Bank of International Settlement's annual report (24 June 2012) says that the global economy has yet to overcome the legacies of the financial crisis to achieve balanced, self-sustaining growth. In different ways, vicious cycles are hindering the transition for both the advanced and emerging market economies.

After reviewing the past year's economic developments, the 82nd Annual Report addresses fundamental aspects of these cycles: unfinished structural adjustments, risks in the current stances of monetary and fiscal policy, and the ongoing challenges of financial reform. A special section examines these issues in the context of problems in Europe's currency union.

ESMA annual report focuses on implementing reforms

ESMA issued its 2011 annual report annual report on 25 June 2012, noting that it intends to reduce the energy it expends on internal operational and procedural matters. It will prioritise the completion and implementation of new directives and regulations on short-selling, EMIR and AIFMD. ESMA will continue to develop technical standards and advice to build a single rulebook, while providing advice and support on proposed legislation being debated by the Council and EP. Also, this year ESMA will fully exercise its CRA supervisory duties covering registration to effective supervision.

ECON votes on new CRA rules

ECON *announced* its 19 June 2012 vote on amendments to the draft legislation to regulate CRAs:

- sovereign debt ratings - establishing standards for the quality, timing and frequency of such ratings, including requiring CRAs to publish an annual timetable of their sovereign rating releases and a restriction from publishing ratings during trading venue market hours.
- presentation - ratings would have to be provided in numbers.
- conflicts of interest - CRAs would be prevented from issuing ratings on any company that owned more than 2% of the CRAs capital or voting rights, and prohibit any person from holding 5% of the capital or voting rights in more than one CRA (i.e. limiting cross-holdings).
- liability - making CRAs directly liable to investors under civil law for methodological and other procedural mistakes which result in investor loss.

Financial institutions would have to reduce their reliance on CRAs and develop their own internal rating capacity. They would also be prohibited from selling assets off automatically in the event of a credit rating downgrade.

The proposals set out a framework for creating an internal EU public rating capacity, to be undertaken by existing EU institutions. Further, ECON proposes to ban from EU laws or regulations any references to CRA credit ratings. EU regulators would also play a wider role in checking CRAs' methodologies.

EC publishes delegated acts on CRA III sanctioning regime

The EC presented a roadmap on 26 June 2012 for the adoption of further rules on the new sanctioning regime for CRAs in the Delegated Act on Fines Pursuant to Article 23(e)(7) under Regulation 1060/2009. The delegated act will clarify procedures relating to the imposition of fines and penalties by ESMA under CRA Regulation III (Regulation 1060/2009), including issues such as rights of defence for CRAs (e.g. right to be heard, right to access the file).

The delegated act will also establish prescription periods for infringements of the CRA Regulation. However the delegated act is not intended to provide ESMA new powers, in addition to those it has under CRA Regulation II (Regulation 513/2011). The EC is consulting with European Securities Committee technical experts and ESMA in preparing its draft legislation.

ESMA updates statistics on CRA performance

ESMA released new data on the performance of CRAs, including transition matrices and default rates, in its *Central Rating Repository* (CEREP). The new data provides information on credit ratings issued by 16 CRA which have either been registered or certified in the European Union in the last six months.

This data was first published on 2 February 2012, and is updated semi-annually. The CEREP database allows investors to assess and benchmark the performance of credit ratings on different types of ratings, asset classes and geographical regions for a given time period. It is part of wider transparency efforts to improve the CRAs' performance and reliability of their ratings.

FSA publishes final Annual Report

The FSA published its *Annual Report 2011/12* on 19 June 2012. The FSA's Annual Reports are presented to HMT and set out how the FSA:

- discharges its functions under FSMA
- has met its regulatory objectives under FSMA (in the FSA's opinion)
- the FSA's consideration of the principles of good regulation, set out in section 2(3) of FSMA.

The FSA noted that it achieved 75% of the 24 objectives set out in its Business Plan for 2011/12. Six of these objectives were not achieved because they were 'reprioritised'.

In particular the Annual Report focuses on the FSA's role and work in the structural reform of financial regulation, delivering its statutory objectives under FSMA 2000 and delivering its operational platform.

The Annual Report also sets out the FSA's financial statements for 2011/12 and discusses where it spent its budget. The Annual Report also details the remuneration received by the FSA's Executive Board.

FSA publishes quarterly consultation paper

The FSA published its *quarterly consultation paper (CP12/11)* on 6 June 2012, containinga number of policy consultations.

The FSA has proposed changes to BIPRU and SYSC to incorporate guidance issued by the EBA on the advanced measurement approach (the AMA Guidelines). The FSA wants firms to demonstrate they have taken the AMA Guidelines into account when managing AMA extensions and changes. The FSA is also amending BIPRU to address the need to consider contractual netting arrangements when assessing capital requirements.

In addition, FSA want to amend General Prudential sourcebook (GENPRU), the Prudential sourcebook for Insurers (INSPRU), the Interim Prudential sourcebook for Friendly Societies (IPRU (FSOC)) and the Interim Prudential sourcebook for Insurers (IPRU (INS)) to alter the base capital resources requirements for insurers and reinsurers (other than general reinsurers) to reflect changes to the European index of consumer prices.

The FSA has concerns over the behaviours in the EU emission allowances market, so it has proposed changes to the Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC) to reflect the FSA's powers to reprimand recognised auction platforms (RAPs) if they do not take responsibility for vetting bidders for EU emission allowances.

Under proposed changes to the listing rules (LR) The FSA is introducing an annual notification form that sponsors must submit and sponsors will be required to provide each January (instead of on the anniversary of the sponsor's appointment). It would also s extend the listed securities cancellation exemptions, to reflect the rules applicable to European as well as UK investors.. Finally, the FSA is proposing changes to COBSl to delay implementation of rules relating to the interaction between nominee unitholders and beneficial owners of holdings in authorised investment funds until 31 December 2013, to allow for further consultation.

The consultation closes for comment on **6 July 2012** in relation to the changes to BIPRU for insurers and the COBS changes to authorised investment fund rules, and on **6 August 2012** for the other proposals.

FSA publishes Handbook Notice 121

The FSA published Handbook Notice *121* on 29 June 2012, setting out instruments recently made by the FSA Board. The Handbook Notice includes five instruments (effective dates in brackets):

Prospectus Directive Amending Directive Instrument 2012 (FSA 2012/29). Amends the Listing Rules, Prospectus Rules and Disclosure and Transparency Rules. It sets out the FSA's final rules for implementing the Amending Directive, following the Prospectus Regulations 2012 being laid before Parliament on 15 June 2012 (effective 1 July 2012).

Handbook Administration (No 26) Instrument 2012 (FSA 2012/31). Makes minor amendments to various sourcebooks within the FSA Handbook. These amendments do not represent any alteration in FSA policy. For this reason FSA was not required to issue a consultation (effective on various dates between 1 July 2012 and 31 December 2012).

Training and Competence Sourcebook (Qualifications Amendments No 6) Instrument 2012 (FSA 2012/32). Adds further qualifications to the existing list in the Training and Competence sourcebook (effective on 29 June 2012).

Liquidity Standards (Miscellaneous Amendments No 6) Instrument 2012 (FSA 2012/22). Clarifies existing guidance referring to reporting frequency in a firm-specific liquidity stress or market liquidity stress, corrects an omission in the supporting notes accompanying reporting requirements in material currency reporting and gives additional clarity to data items FSA050 and FSA 052 when a firm is recording its liquid assets buffer (effective 1 July 2012).

Prospectus Regulation (Amendment) Instrument 2012 (FSA 2012/34). Agreed following publication of Commission Delegated Regulation (EU) No 486/2012. The changes made to the Prospectus Rules reflect the new material added to the Prospectus Regulation by the Delegated Regulation. Changes are intended to assist readers so they can easily access relevant information about the content and form of prospectuses and related documents (effective 1 July 2012).

The FSA included a summary of industry feedback on policy proposals in the Handbook Notice.

FSA publishes Policy Development Update

The FSA published its latest Policy Development Update Number 148 on 29 June 2012. The policy development update is published monthly and provides:

- lists of publications issued since the last edition
- information on recent Handbook developments
- other publications (consumer publications, Guidance Consultations and Finalised Guidance)
- updated timetable for forthcoming publications.

Firms should review FSA's publication plans to anticipate developments relevant to their business. We provide a consolidated list of regulatory developments in the Calendar section of this bulletin.

Consumer Panel publishes 2011/12 annual report and comments on insurance and retirement

The Consumer Panel issued its annual *report for 2011/12* on 15 June 2012.

The report states that consumer behaviour in the general insurance market had changed due to increased competition and the availability of comparison websites. The Consumer Panel wants to understand how the market can deliver better outcomes to consumers, and the issues that impact consumers' income level in retirement, to influence the debate on better regulation.

The annual report summarises Consumer Panel's work in 2011/12 in the following areas:

- the shape of future UK regulation: influencing the government, the FSA and EU regulators in ensuring consumer protection under the new regulatory structure
- EU regulatory and legislative issues - working closely with the European Consumers' Organisation ('BEUC')
- future regulation of consumer credit - supporting incorporating the Consumer Credit Act being incorporated into FSMA and moving CCA responsibility for consumer credit regulation from the OFT to FSA
- the MMR - working with the FSA on the development of new mortgage regulation
- the advice gap on RDR - publishing research on new models for delivering advice and 'simple outcome products'
- effective regulation of business conduct - developing the FCA's approach to regulation.

FSCS publishes statement on interim levy: CIS tariff issues

The FSCS published a *statement* on issues raised regarding reporting annual eligible income (AEI) for CIS on 29 June 2012.

Following its January 2011 interim levy, many firms sought to resubmit tariff data for the SD-01 Investment Fund Management sub-class, indicating that AIE reporting for CIS has not been consistently interpreted by firms.

Broadly, firms were able to report AEI from the 2010/11 levy year as either total net income or just income attributable to business with or for the benefit of eligible claimants (EOI). For the purposes of calculating EOI, firms could remove ineligible claimants from their submissions. The key change appears to be that the FSCS determined that it was not necessary to 'look through' the entity with which the firm was conducting business to assess whether investors in the business counterparty might themselves be eligible claimants.

The FSCS cannot consider claims to resubmit tariff data which are made more than 2 years after the beginning of the period to which the overpayment relates. For the FSCS levy year 2010/11, the two year period ended on 31 March 2012. Therefore, claims to revise tariff data made after 31 March 2012 are effectively time-barred. However, if a firm made a mistake of law attributable to an error *on the part of the FSA or the FSCS* -e.g. an incorrect reliance on advice from the FSA or the FSCS - then the FSCS may consider a claim to resubmit that firm's tariff data, notwithstanding that it is made after 31 March 2012.

If a firm believes it falls within the situation described above, it must notify the FSCS by **31 August 2012.**

Pensions

EIOPA consults on IORP Quantitative Impact Study (QIS) technical specifications

EIOPA launched a consultation *CP 003/2012 – Draft Technical Specifications for the QIS of EIOPA's Advice on the Review of the IORP Directive* to consider the technical specifications of the first QIS in the review of IORP on 15 June 2012.

This marks the next step in process of EIOPA's review the existing IORP Directive. EIOPA responded to the EC's April 2011 call for evidence in February 2012, but agreed to provide an impact study to accompany their recommendations. Industry has debated the impact of the IORP review – notably the 'holistic balance sheet' approach, and the likely impact on capital. Firms will need to analyse this QIS to gain an accurate insight into the future financial costs, prior to the EC's publication of draft amendments to the Directive in 2013.

The consultation is detail and complex, and with responses due by **31 July 2012**, time is short. Because UK pension funds will be significantly affected (perhaps more than the rest of the EU other than the Netherlands), it is crucial that the UK industry engage in this work to indentify the true potential cost of the proposals, both as part of their own preparation, but also to ensure the likely industry costs are clear to EIOPA.

EIOPA found a serious evolution in the funding positions of occupational retirement schemes , especially those engaged in the larger defined benefit (DB) systems, and that supervisors were taking actions to address these low funding levels. The report also noted that occupational retirement schemes had increased their sovereign debt exposures from their 2010 holdings. Given current turbulent market conditions, a number of regulators have emphasised the increasing importance of proper governance processes, increased reporting requirements, regular scenario analyses and stress tests.

Product rules

IMA consults on amending absolute return sector

The IMA consulted on *Amending the absolute return sector* on 1 June 2012. The absolute return sector groups together all UK authorised CIS that seek a positive return over rolling 12 month periods and is the only IMA sector classified by potential investment outcome rather than fund investments. This classification allows funds in the absolute return sector to hold funds with a wide range of investment strategies.

The IMA proposes three options for amending the sector:

- dividing funds by their cash benchmark (usually absolute return funds will aim to achieve LIBOR + a certain percentage over a particular period)
- dividing funds into hedge fund type categories (such as long/short, market neutral and global macro)
- retaining the existing sector but rename and redefine it (possibly using 'total return sector' or 'target return sector' rather than absolute return).

The IMA's consultation suggests that the fund industry does not have a consistent view on the best option.

The IMA's review is timely; the FSA announced in its Retail Conduct Risk Outlook 2012 published in March that it would be monitoring absolute return funds this year, in particular the potential for consumers to misunderstand the aims of such funds. The consultation period closes on **3 July 2012.**

Prospectus Directive

ESMA consults on Amending Directive

ESMA published its latest *Consultation Paper* setting out proposed technical advice for the Amending Directive (2010/73/EU) on 20 June 2012. The Amending Directive amends the Prospectus Directive and the Transparency Directive, with ESMA's technical advice feeding into the EC's delegated acts.

The EC's fact-finding exercise in 2010 suggested that some disparity exists between the prospectus Member States disclosure requirements, particularly with disclosures required prior to admitting securities to trading. ESMA's technical advice aims to provide more consistency on these standards and to make disclosure standards for convertible or exchangeable debt security issues consistent with Prospectus Regulation. ESMA is seeking to provide further legal clarity and to increase regulatory convergence across the EU.

ESMA believes the proportionate disclosure regime envisaged by the Amending Directive does not apply to non-convertible debt securities. However, ESMA suggests that non-convertible debt securities should still be included within the disclosure regime because they have the same capital raising objective as convertible securities. Securities related to small capitalisation or securities issued by small and medium-sized enterprises that are debt securities (whether convertible or not) fall within the new proportionate disclosure regime.

The consultation closes by **20 August 2012.** ESMA confirmed that it will deliver its advice to the EC by the end of 2012.

FSA publishes final rules for implementing Amending Directive

The FSA published the *Prospectus Directive Amending Directive Instrument 2012* (FSA 2012/29) on 22 June 2012. This instrument follows PS12/9, which set out FSA and HMT's final policy and response to comments raised on CP11/28.

The FSA's final rules contain two changes. The Glossary definition for a 'person discharging managerial responsibilities' has been changed to reflect that Article 10 of the Prospectus Directive was deleted by Amending Directive 2010/73/EU. Secondly the FSA is amending guidance in the Prospectus Rules sourcebook (PR) to reflect the amendment to FSMA made by the Prospectus Regulations 2012.

All changes are effective from **1 July 2012**.

RDR

FSA publish latest RDR newsletter

FSA published the June issue of their *RDR newsletter*, summarising recent RDR developments, including the finalised guidance on independent and restricted advice, qualification gap fill and information requirements relating to Statements of Professional Standing (SPS).

The newsletter also provides clarity on 'Consultancy Charging'. FSA reminded firms to take into account the wider DWP and HMRC pension scheme rules when considering Consultancy Charging. Some of these rules may restrict the level of charges that a firm can impose, even if FSA rules would permit a higher charge to be deducted. On auto-enrolment, FSA highlighted that where a firm uses a group personal pension (GPP) for automatic enrolment, the minimum contribution levels are *net* of any consultancy charge, i.e. a consultancy charge is not permitted to reduce contributions to an automatic enrolment scheme below the minimum amounts.

The FSA also signalled that they are concerned some firms are trying to 'get round' adviser charging/commission-banning rules, e.g. by soliciting or providing payments that do not look like traditional commission, but are generally intended to achieve the same outcome – to secure distribution. The FSA stated that it is "considering ways to reinforce our expectation that firms can only be remunerated by adviser charges in relation to their new advisory business", giving a clear warning that firms should tread very carefully in designing RDR-compliant solutions.

FSA RDR: independent and restricted guidance

The FSA published *finalised guidance on Retail Distribution Review: independent and restricted advice* (FG12/15), containing the 'independent and restricted' criteria and definitions, on 6 June 2012. The guidance seeks to provide additional clarity for firms on the new definitions.

The guidance doesn't materially add to previous policy statements, but confirms points such as the prohibition on firms holding themselves out to be independent if their offering is not entirely independent, and reaffirms previous stances on the use of panels, and relevant markets. The FSA also provides additional guidance on the communication of services which firms are obliged to make, and highlights the role of certain recognised specialist activities, such as pension transfers and long-term care insurance contracts.

The FSA also addresses discretionary investment management services, indicating that the standards relating to independence apply only to personal recommendations of retail investment products. Therefore recommendations that an investor buy a discretionary investment management service (as opposed to a product) is not within scope. However, the FSA observe that if the recommendation for such services include explicit or implicit recommendations of specific funds, then the recommendation would amount to a 'personal recommendation' and trigger independence requirements.

The FG12/15 rules come into force on **31 December 2012**.

FSA consults on platforms

The FSA published its long-awaited consultation *Payments to platform* *service providers and cash rebates from providers to consumers* (CP12/12) on 27 June 2012. The consultation, following last year's policy statement, sets out the proposed final requirements for platform services operators and the deadlines for transition.

The application of RDR to platforms is complex. The main RDR requirements, such as adviser charging (and thus no trail in fund pricing), will come into effect at the end of 2012, as does the new definition of a 'platform service' and associated rules on unbiased fund presentation and in-specie re-registration. The information provision requirements for the wider set of 'Intermediate Unit Holders' currently comes into force at the end of 2012, but a delay to the end of 2013 is currently under consultation (as yet to be agreed).

This latest consultation paper proposes an implementation date of 31 December 2013 for additional platform requirements. The consultation contains two proposals:

- a ban on cash rebates from product providers to consumers, but permitting rebates in units
- a ban on payments from product providers to platforms, requiring platforms to levy a fee for their services or alternatively avoid being classified as a platform service by being remunerated solely through adviser charging.

The platform requirements apply to both advised and execution-only sales.

The paper is silent on a variety of other important issues, such as transitional provisions. If cash rebates are entirely banned from the end of 2013, consumers who currently hold share-classes that pay cash rebates will be challenged to make decisions, and the changes may have tax implications for consumers who be forced to realise gains when changing arrangements.

The consultation closes on **27 September 2012**.

Regulatory reform

IOSCO consults on global developments in securities regulation

IOSCO published a consultation paper on *Global Development in Securitization Regulation* on 7 June 2012. The paper seeks public comments on IOSCO's assessment of global regulatory and industry initiatives on:

- risk retention
- transparency
- disclosure standardisation.

The FSB, as part of its work to strengthen the regulation of shadow banking, requested IOSCO to undertake this project with a focus on the US and the EU, which are the largest markets globally. The FSB also requested IOSCO to assess differences in regulatory approaches, their impact and policy recommendations.

The consultation paper is based on a survey of IOSCO members about global regulatory developments and industry initiatives which was undertaken in March 2012. The survey also includes work undertaken by the EC and the SEC. The paper provides an overview of the background to the project, the work undertaken, a description of the global securitization market, findings and observations.

The consultation closes on **6 August 2012**.

FSB and others publish study on effects of reforms on emerging markets

The FSB, the IMF and World Bank published a study *Identifying the Effects of Regulatory Reforms on Emerging Market and Developing Economies: A Review of Potential Unintended Consequences* on 19 June 2012, for consideration at the G20 Los Cabos summit. The G20 commissioned this report to identify any unreasonable or unsustainable impacts that regulatory reforms are having on emerging market and developing economies (EMDEs), reflecting their increasing prominence, and an awareness that they have differing needs because of the way that their financial markets operate.

While many EMDEs do not expect significant adverse effects, policy measures for Basel III, measures aimed at G-SIFIs and OTC derivative reforms may result in some disadvantages for

EMDEs and their financial institutions, while favouring developed market economies and firms. For example, the extraterritorial effects of EU capital requirements and the Volcker Rule under the Dodd-Frank Act in the US may lead to unintended effects and a perceived protectionist bias against emerging markets. Similarly, credit rating agency regulation could result in overstating the risks of operating in EMDEs, leading to higher finance charges and less liquidity.

The report found it was difficult at this stage to distinguish between intended and unintended consequences and to assess materiality, concluding that EMDEs need to engage in ongoing dialogue and cooperation with standard setting bodies and international financial institutions.

HMT sets out proposal to implement ICB recommendations

HMT published its white paper *Banking reform: delivering stability and supporting a sustainable economy* on 14 June 2012. The paper sets out the government's proposals to force UK banks to split their retail banking businesses (including services to small and medium sized enterprises) from investment banking and other non deposit taking activities. The proposals also aim to make banks more resilient to shocks in the financial system, to make banks easier to resolve and to foster more competition in the banking sector.

The government remains committed to implementing the key principles of the ICB recommendations, building a zero-failure regime that allow banks to fail safely without relying on an implicit government guarantee or putting critical services to the real economy at risk.

UK banks with mandated deposits of over £25billion will have to ring fence (legally separate) investment banking and related activities from traditional personal and business lending. The government believes this is vital to reduce structural complexity and make banks easier to resolve. Separation would be comprehensive and the white paper makes clear that risk management, and other corporate governance functions would need to be maintained independently as operational safeguards. The proposals carry forward critical limitations on the activities and operating standards carried on by ring fenced entities. The ring-fencing requirement would apply from 2019, rather than the 2017 deadline initially suggested by the ICB.

Ring-fenced banks will have to have a total primary loss absorbing capital level equal to 17% of their risk weighted assets, with supervisors have the ability to require additional capital on top of that. This strict financial obligation would be supplemented by:

- exemptions for overseas affiliates, but only if such entities have no recourse to UK funding in insolvency
- a bail-in tool (introduced through European resolution framework) under which insured depositors would be preferred
- binding leverage ratio at Basel III levels, currently 3%.

Finally, to foster competition in this sector, the government has undertaken to place a break on any prudential and conduct requirements deemed to interfere with competition and or which create unreasonable barriers to entry.

The government has also proposed measures such a new industry funded switching service (to be introduced by September 2013), enhanced product transparency rules, and facilitating more payment system access.

Read our *What now? White Paper on Banking Reform* which discusses proposal details and identifies key impacts for firms.

The consultation closes on **6 September 2012**.

TSC recommends further Financial Services Bill amendments

The TSC published a *report* on 8 June 2012 recommending further amendments to the Financial Services Bill. The TSC has issued this report to inform the House of Lords of its views of the bill's defects and advise on revisions before the bill is passed. The TSC believes that the House of Commons was rushed in its deliberations and was not given adequate time to consider and make the amendments it deemed necessary to the bill.

The report's recommendations remain consistent with the TSC's earlier recommendations that the:

- Court of the BoE should have duty to undertake retrospective reviews of the BoE's performance
- Chancellor of the Exchequer should have the general power to direct the BoE when public funds are at risk, rather than the circumscribed powers under the draft bill
- TSC should have a role in the appointment and dismissal of the Governor of the BoE
- bill should set out ways to require the FCA under statute to publish board minutes without setting precedent on board functions
- TSC should have the statutory power to request retrospective reviews of FCA work.

Andrew Tyrie MP, Chairman of the TSC, commented:

No explanation has been given for the rush to produce the bill and place it on the statue Book by the end of the year. Better to take a little more time, and get it right, than rush it.

The bill completed its passage through the House of Commons in May and commenced its proceedings through the House of Lords in June. The bill is expected to pass in the House of Lords in early autumn, receive Royal Assent in December and the new regulatory bodies commence operations in April 2013.

FSA instructs on Handbook split for PRA/FCA

The FSA published a *One-minute guide-Handbooks for the PRA and FCA* webpage in June to inform regulated firms about its approach to amending the FSA Handbook. The FSA states that when the new regulators commence operations, each regulator will maintain its own Handbook. However, the FSA noted that most provisions of the FSA Handbook will be incorporated into the new handbooks.

Along with draft copies of the new handbooks, the FSA will publish a consolidated handbook which will show provisions of both Handbooks and contain instructions indicating the regulatory responsible for each entry.

The FSA anticipates that the new regulatory regime introduced under the Financial Services Bill will result in substantive changes to the permissions, passporting, controlled functions, threshold conditions and enforcement powers provisions.

The FSA expects to introduce draft Handbooks in early 2013 and will publish interpretation guidance with the drafts.

Draft MoU between PRA and FSCS published

The FSA and FSCS published a draft *Memorandum of Understanding between the Prudential Regulation Authority and the Financial Services Compensation Scheme Ltd.* on 26 June 2012. The FSA has published the draft MoU to fulfil the requirements of section 217A(2) of FSMA, as amended by the draft Financial Services Bill. This section requires the PRA and the FSCS to co-operate and maintain a memorandum of understanding describing compliance with that duty. The draft MoU states that 'the arrangements for co-ordination and co-operation between the FSCS and the PRA need to be well defined, effective and efficient'.

The draft MoU remains subject to change until Financial Services Bill is complete and receives the Royal assent.

Remuneration

DFBIS consults on executive pay reforms

DFBIS published a consultation *Directors Pay, Consultation on revised remuneration reporting regulations* on 27 June 2012, setting out reform proposals on executive pay. This follows the government's discussion paper last autumn and a package of measures that Vince Cable, the Secretary of State for Business, Innovation and Skills, outlined to Parliament on 20 June 2012.

The Government will introduce rules under the Enterprise and Regulatory Reform Bill which increase the power of shareholders and to promote better engagement between shareholders and companies, to encourage the link between pay and long-term performance. This consultation seeks views on the Government's proposals to increase transparency in pay reporting and on draft regulations which will set out the content of directors' remuneration reports. The regulations will replace and revoke Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulation 2008 (SI 2008/410).

The draft regulations provide for a remuneration report containing two parts: the first part will be a forward-looking policy report discussing the company's remuneration policy and key factors taken into account in setting that policy. This requirement is critical because shareholders will be afforded a binding vote on policy. Once approved the company will be able to make payments only within the policy parameters.

The second part will report contains requirements for implementing the policy and disclosure of actual payments in the preceding year to directors, which must link pay to performance, including a single total remuneration figure, and detail on base salary, bonuses, pension entitlements etc. Certain elements of this part of the report will have to be audited.

The consultation closes on **26 September 2012**.

RRPs

EU publishes RRP proposals

The EC published its *Proposal for a directive on the recovery and resolution of deposit-taking banks and some investment firms* COM(2012) 280/3 On 6 June 2012.

The proposals build on broad principles established by the FSB and G20 countries, aiming to bring a degree of harmonisation to the measures already being developed by various individual EU countries. Outside of the EU, the measures are similar to those being adopted here, although there are differences.

Underlying the proposals is the EC's desire to minimise (but not eliminate) the cost of bank failure and fundamentally change on whom that cost falls. The cost of bank failure, in terms of disruption and damage to financial systems, can be many times greater than the short term cost of supporting that bank – particularly if its operations extend beyond one country. Traditionally, a central bank's role was to act as 'lender of last resort' but that approach led to the impression that banks could (and did) take excessive risks on the basis that rewards would flow to shareholders, but any catastrophic losses would be covered by the State (an implicit state guarantee). To eliminate this perception of a state guarantee, the resolution proposals put the burden on shareholders and lenders to pay for resolution. Even short term emergency funding will be provided by banks through a levy.

The proposals require each Member State to establish legal frameworks and enforcement bodies, together with mechanisms to resolve cross-border issues (at least within the EU itself) with the EBA positioned to act as mediator of any disputes. The proposals cover:

- preparation and prevention measures which required by banks (recovery plans)
- intervention by the national authority to prevent further deterioration
- resolution if failure becomes inevitable.

The EC anticipates reaching political agreement on the legislative proposal in 2013 and proposes transposition by Member States into local law by 31 December 2014.

IIF proposes key steps to strengthen cross-border resolution

The Institute of International Finance (IIF) published *Making resolution robust – completing the legal and institutional frameworks for effective cross-border resolution of financial institutions* on 7 June 2012, its third report on this issue. The report builds on the IIF's prior work and on work undertaken at international level, notably the FSB's Key Attributes of Effective Regimes for Financial Institutions published in October 2011.

The IIF has developed specific suggestions on how to make cross-border resolution of G-SIFIs work in practice. The IIF's suggestions are based on three principles:

- resolving a firm while respecting its group structure,
- leaving creditors no worse off than in liquidation and
- ensuring consistent treatment of transactional claims (derivatives and other financial contracts),

including appropriate recognition of netting contracts and collateral rights, subject to safeguards to avoid destruction of value.

In conclusion, the IIF calls on the FSB to mandate (not just urge) effective cooperation among jurisdictions on cross-border resolution.

To give full clarity as to how resolution of a failed SIFI would be carried out, the IIF suggests that this could take the form of a Convention, initially a non-binding standard, but ultimately a fully binding international Convention.

The IIF considers that policy responses that envisage radical measures that regulators are considering, such as size limitations, the mandatory break-up of banks and national ring fencing are unnecessary and disproportionate. Such measures are likely to give rise to unintended consequences and should therefore be avoided, not least in view of the constraints such measures would inevitably place on the freedom of banks to determine their own business models.

Shadow banking

EIOPA publishes reply to the EC's Green Paper on Shadow Banking

EIOPA has published their *response* to the EC's Green Paper on Shadow Banking. Overall EIOPA believes the Green Paper is a good starting point in the EU's preparation for applying the FSB's recommendations. EIOPA's reply focuses on questions linked to the insurance area, including the definition of shadow banking and insurance regulatory reform measures already taken. In particular, EIOPA believes that it is important for the EC to analyse the merit of including certain activities undertaken by insurance companies in a definition of shadow banking.

Accounting[1]

IFRS

IASB/FASB redeliberate leases – June 2012

At their June meeting, the IASB and FASB Boards made significant decisions on how a lessee should recognise lease expenses and revisited some previous decisions concerning lessor accounting. In particular, lessees will recognise all leases of more than 12 months on-balance-sheet and there will be two approaches to recognising lease expenses in the income statement. See our *Straight Away* publication for details.

The Boards plan to discuss remaining issues in July with the aim of issuing an exposure draft towards the end of 2012 and a final standard during 2013. The Boards have not made any recent comment on the new standard's effective date, but they have previously stated that they will allow plenty of time for the new requirements to be implemented.

[1] *This section includes accounting developments with a direct or potential impact on the financial services industry only. For a complete update on accounting developments in the UK visit* http://www.pwc.co.uk/eng/services/ifrs_services.html

Other accounting news

Parliament approves FRC reforms

The FRC announced that the UK Parliament approved *proposed reforms of the FRC* on 26 June 2012, following a formal consultation in October 2011 and the Government and FRC responses in March 2012. The FRC Board has assumed responsibility for the strategic direction of key decisions on standards and on how the organisation discharges its responsibilities from 2 July 2012.

The reforms will enable the FRC to operate as a unified regulatory body, with enhanced independence from the firms it regulates, and undertake a more proportionate range of sanctions.

The FRC Board will be supported by three committees: Codes and Standards Committee, Conduct Committee and Executive Committee. The Committees will be advised by the three Councils on

Accounting, Actuarial and Audit & Assurance matters.

FRC consults on disciplinary schemes

The FRC published a consultation paper *Disciplinary Schemes - proposed changes* on 28 June 2012.

Following a recent restructuring at the FRC, responsibility for operating the disciplinary schemes for actuaries and accountants was transferred from the Accountancy and Actuarial Discipline Board to the FRC. FRC advises that changes to the schemes are necessary to enhance its independence and to promote the effective and efficient operation of the schemes.

Most of the changes apply to both the Accountancy and Actuarial Schemes. The proposals include:

- the introduction of a procedure to enable cases to be concluded by agreement, without the need for a full tribunal hearing although with published conclusions
- the ability to conduct enquiries before the commencement of an investigation
- a power to impose interim orders
- amendments to reduce the potential for delay
- changes to improve the procedure for making futures changes to the schemes.

The consultation closes on **19 September 2012**.

FRC publishes update listed company directors

The FRC published an *Update for Directors of Listed Companies* on 15 June 2012. It highlights the more significant economic issues facing certain countries and that directors should consider country risks when preparing interim reports.

The FRC released the first Update in January 2012 which provided guidance on annual reports. The second Update includes requirements for interim reports and focuses on country and currency risks. Directors should consider:

- the company's exposure to country risk (direct and indirect)
- the impact of austerity measures being adopted by certain countries (impairment testing and going concern considerations)
- the possible consequences of currency events
- possible enhanced disclosure of any relevant post balance sheet events.

The FRC says directors should 'focus on disclosures on the strategic, operational and financial risks facing their companies and clearly identify the nature and scope of (direct and indirect) exposure to currency and other current risks'.

Sharman Panel gives conclusions on going concern reporting

In its final *report on going concern and liquidity risk* the Sharman Panel is seeking to shift the debate in two important ways. The report published on 13 June 2012 puts less emphasis on identifying going concern firms and more on demonstrating 'going confidence' in firms: i.e. that a firm has a valid expectation of continuing in business and a strategy to achieve survival. As a consequence the focus shifts away from purely external reporting of 'concerns' to investors towards internal assessment and management of a continuing business. As Lord Sharman states in his covering letter:

The aim of the directors' assessment and reporting of going concern risks is not primarily to inform outsiders of distress. Rather, it is to ensure that the company is managed to avoid such distress, while still taking well-judged risks.

Underlying this objective is a desire to reinforce responsible long-term corporate behaviour. The report makes five specific recommendations:

- reviewing and learning from company failures and difficulties
- clarifying and harmonising going concern definitions
- integrating going concern assessment with the firm's business planning and risk management processes
- continuous reporting and explanation of the entity as a going concern rather than highlighting when there are significant doubts about its survival

- requiring a statement from auditors in respect of the assessment process.

The report asserts that assessments should cover both capital (solvency) and liquidity; and acknowledges special considerations for banks, where public acknowledgement of a going concern risk could accelerate or trigger the bank's failure. A bank's likely dependence on central bank liquidity is not in itself a significant going concern risk, provided that support is expected to be available. Nevertheless, firms should still have to make disclosure where accounting, auditing or listing rules require it, even if the regulator desires secrecy in the interests of financial stability.

PwC publications

Summary of responses to re-exposed proposals on revenue from contracts with customers.

The FASB and IASB received approximately 360 comment letters in response to the updated exposure draft of their revenue proposals, issued in November 2011. PwC's *practical guide* summarises the feedback generally and also addresses industry-specific concerns.

Summary of proposed IFRIC means levies to be recognised at certain point in time.

The IFRS Interpretations Committee has published proposed guidance on the accounting for levies charged by public authorities on entities that operate in a specific market. PwC's *Straight Away* publication summarises the proposals.

Summary of Proposed IFRIC to change measurement of NCI puts.

The IFRS Interpretations Committee has published a proposed interpretation on the accounting for a put option written by a parent entity on the shares of its subsidiary held by a non-controlling-interest shareholder. PwC's *Straight Away* publication summarises the proposals.

Investor view - insight from the investor community.

PwC's *Investor view* series aims to provide preparers of corporate reports with insights and observations gleaned from our ongoing dialogue with the investment community. These points of view focus on the areas that are of most interest to analysts and investors.

- *Investor view 22: Clear language* - Investors often indicate that they don't necessarily want more information in financial statements but more useful information. They cite among their frustrations boilerplate accounting policies and a lack of useful commentary in the notes. This issue looks at the investors' concerns and simple ways entities can address them.
- *Investor view 23: Disclosures about the impact of the eurozone crisis* - Analysts and investors tell us about a number of areas where they are frustrated with current corporate reporting around the uncertainty in the eurozone and suggest some improvements that could be made to annual report disclosures

IFRS news

IFRS news is our monthly newsletter highlighting developments at the IASB. Articles the *June 2012* edition address:

- The latest discussions about the financial instruments project.
- Progress with the various improvement projects.
- Draft IFRIC on levies and on put options.
- New appointments at the IASB and IFRS IC.
- IFRS quiz: impairment of assets.

UK GAAP

The future of UK GAAP

All firms presently reporting under UK GAAP will be impacted by the ASB's exposure drafts which propose replacing current UK GAAP with a single new financial reporting statement which will be applicable in the UK and the Republic of Ireland. The ASB has released a separate discussion paper considering the options for insurance accounting. The comment period closed on 30 April 2012 and responses are available on ASB's website. The ASB commenced its consideration the responses to the Exposure Drafts and Discussion Paper at its 24 May meeting, at which it decided to continue to work towards its proposed 1 January 2015 effective date.

PwC quarterly reporting updates – June 2012

- We have published the June 2012 issues of IFRS Quarterly Update and

UK GAAP Quarterly Update. These publications outline reporting requirements as at 30 June 2012, highlighting topical issues to consider, standards that apply and standards that are published but not yet effective and require disclosure.

Banking and Capital Markets

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Regulation

Banking and liquidity

Basel Committee issues framework for dealing with domestic systemically important banks

G-SIBIs will have additional loss absorbency requirements over and above the Basel III requirements from 2016 onwards. On 29 June 2012 the Basel Committee released a Framework for Dealing with Domestic Systemically Important Banks (D-SIBIs) to apply similar principles on assessment methodology and a higher loss absorbency requirement to some, but not all, D-SIBIs.

The proposed D-SIBI framework takes a complementary perspective to the G-SIBI framework by focusing on the impact that the distress or failure of banks will have on the domestic economy. However, the proposed D-SIBI framework will take a principles-based approach, in contrast to the prescriptive approach of the G-SIBI framework. This will allow national banking regulators to have some discretion in the assessment and application of policy tools to accommodate the structural characteristics of individual jurisdictions.

The report proposes that banks identified as D-SIBIs by their national authorities must comply with the principles from January 2016, consistent with the timing of G-SIBI framework.

The Basel Committee will introduce a peer review process for the implementation of the principles. This review will help ensure that appropriate and effective frameworks for D-SIBIs are in place across different jurisdictions. The consultation closes on **1 August 2012**.

Capital and liquidity

Basel Committee publishes bank internal audit guidelines

The Basel Committee published *The internal audit function in banks* on 28 June 2012, which replaces its 2001 *internal audit in banks and other supervisor's relationships with advisors*. The guidance draws upon the lessons from the banking crisis and brings the guidelines into line with reforms introduced under other supervisory practices.

These guidelines are part of a concerted effort by regulators to improve banks' governance and controls. The guidelines set out areas that internal auditors can improve to give Boards and senior management more confidence in systems and controls, as well as encouraging the development of national standards.

The guidance contains 20 principles which are organised under three sections:

- supervisory expectations relevant to the internal audit function
- relationship of the supervisory authority with the internal audit function
- supervisory assessment of the internal audit function.

The guidance also discusses internal audit communication channels and the main responsibilities of bank audit committees.

The Basel Committee urges the banking industry to consider the effectiveness of their current internal audit functions and understand where improvements can be made.

Other regulatory

HMRC updates the Banking Code of Practice

HMRC issued a *document* updating the Code of Practice on Taxation for Banks on 11 June 2012. The document summarises the code implementation progress and reviews implementation in the following segments:

- the top 15 banks
- the rest of the banks in the Large Business Service
- banks in Local Compliance.

HMRC also provided some guidance on the terms 'promote' and 'facilitate' included in the code.

The code was introduced in November 2009 and its aim was to ensure that:

- banks have strong governance around tax, which is integrated into their business decision making
- banks follow the spirit of the law in addition to the letter (e.g. when undertaking tax planning to support business operations)

- HMRC and the banks work together to encourage mutually open and transparent relationships.

In addition, HMRC set out the governance process around communication and escalation procedures to be followed when HMRC has concerns about a bank's compliance with the code.

EBA annual report sets out CRD IV priorities

The EBA issued its 2011 annual report on 28 June 2012, which provides an account of the activities and achievements of the EBA in its inaugural year. The main priorities for 2011 included:

- building up the single rule book
- enhancing crisis management tools
- creating a risk analysis infrastructure across the European banking system
- developing the college of supervisors
- consumer protection
- financial innovation.

The process of drafting the binding technical standards under the new CRD IV/CRR framework will present the most difficult challenge for the EBA in 2012: 40 technical standards are required by the 1 January 2013 and over 100 in total in the next few years.

Tax

HMRC issues guidance on Code of Practice on Taxation for Banks

HMRC published the *Governance Protocol on Compliance with the Code of Practice on Taxation for Banks* (Governance Protocol) on 11 June 2012, providing insight on how HMRC escalates compliance issues raised under the *Code of Practice on Taxation for Banks* (the Code).

The Governance Protocol (dated March 2012) sets out HMRC's considerations when it escalates its compliance concerns under each of the three key Code categories: Governance, Tax Planning, and Relationship between the Bank and HMRC. HMRC seeks to escalate its concerns about a bank at the earliest opportunity, moving to Board level discussions if HMRC's questions are not answered. If HMRC's concerns are not resolved, it expects the bank to publically disclose the HMRC findings of non-compliance with the Code.

HMRC also published the following materials related to the Code on the same day:

- *statistics on Code implementation* - 225 banks have adopted the code, including the 15 largest UK banks
- *guidance on the terms 'promote' and 'facilitate'* - delineating the boundary between transactions in which banks 'promote' tax planning (covered by the Code), and those where banks merely 'facilitate' tax planning through transactions that are part of normal banking services or are done on standard market terms (which falls outside the Code).

Asset Management

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Regulation

AIFMD

ESMA consults on AIFMD remuneration guidelines

ESMA published its consultation *Guidelines on sound remuneration policies under the AIFMD* on 28 June 2012. The consultation paper provides clarity on the application of the remuneration principles under AIFMD.

The AIFMD remuneration provisions are similar to those of CRD III and CRD IV, and ESMA stated that it relied on the guidelines produced by the Committee of European Banking Supervisors (predecessor to the EBA) during the CRD process. The consultation therefore provides little new information to those firms already subject to CRD III and the FSA's Remuneration Code.

However, the consultation provides some new information and confirms certain important information. ESMA confirmed that, subject to the principle of proportionality, the remuneration provisions will apply to all EU alternative investment fund managers (AIFMs) and all non-EU AIFMs that manage EU-domiciled alternative investment funds (AIFs). AIFMs that carry out individual portfolio management and non-core services outside their primary role will also be subject to remuneration principles for these roles under MiFID. ESMA will consult on these guidelines at the end of Q3 2012. The provisions will apply to all forms of fixed and variable remuneration received by staff at the AIFM or AIF.

The guidelines address carried interest arrangements, for which ESMA confirmed that carried interest arrangements that consist of a pro-rata return on any 'investment' made by staff to the AIF are outside of the definition of remuneration and not subject to the remuneration structure requirements. Carried interest arrangements are considered exempt only if the investment consists of an actual disbursement from the staff member. This clarification will come as a relief to many, who were unsure as to whether carried interest arrangements would be considered variable remuneration.

The consultation confirms that remuneration requirements apply to a select group of individuals considered to impact the risk profile of the organisation ("Identified Staff"). These are staff working as senior management and those that have a material impact on the risk profile of the organisation.

The consultation closes on **27 September 2012.**

Corporate governance

ESMA feeds back on empty voting

ESMA published its feedback statement on the *call for evidence on empty voting* on 29 June 2012, following its call for information on the practice of empty voting.

ESMA received 29 responses from investment services, banks and asset managers. The responses were split into four key areas:

- *Ways of exercising empty voting* - responses were varied and highlighted the complexity of the issue in both identifying and providing evidence for the practice of empty voting.
- *Consequences of empty voting* - respondents were concerned about the disconnect between voting rights and the economic benefits, which could lead to voting in favour of short term gains.
- *Internal policies relating to voting practices* - only 11 respondents provided any detail in this area, which ESMA believed indicated that few organisations have developed policies.
- *Need for regulatory action* - respondents affirmed the need for greater definition around empty voting. Some firms also felt that enhancing the current transparency reporting regime would make it easier to identify where empty voting is occurring.

ESMA concluded that firms were unable to fully identify examples of empty voting. All respondents believe that it is taking place, but were unable to provide supporting evidence. In light of the indecisive nature of feedback, ESMA feels unable to justify any further research on the topic.

RDR

FSA Retail Distribution Review: independent and restricted guidance

The FSA published *finalised guidance on Retail Distribution Review: independent and restricted advice* (FG12/15), containing the 'independent and restricted' criteria and definitions, on 6 June 2012. The guidance seeks to provide additional clarity for firms on the new definitions.

The guidance doesn't materially add to previous policy statements, but confirms points such as the prohibition on firms holding themselves out to be independent if their offering is not entirely independent, and reaffirms previous stances on the use of panels, and relevant markets. The FSA also provides additional guidance on the communication of services which firms are obliged to make, and highlights the role of certain recognised specialist activities, such as pension transfers and long-term care insurance contracts.

The FSA also addresses discretionary investment management services, indicating that the standards relating to independence apply only to personal recommendations of retail investment products. Therefore recommendations that an investor buy a discretionary investment management service (as opposed to a product) is not within scope. However, the FSA observe that if the recommendation for such services include explicit or implicit recommendations of specific funds, then the recommendation would amount to a 'personal recommendation' and trigger independence requirements.

The FG12/15 rules come into force on **31 December 2012**.

Insurance

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Regulation

Other regulatory

EIOPA publishes complaints handling guidelines

Following a *consultation* EIOPA published its first set of *Guidelines* on 14 June 2012, setting out high level principles covering complaints handling by insurers across Europe. EIOPA expects supervisory authorities to make every effort to comply with them and intend to monitor insurers' compliance.

EIOPA also published a more detailed *Best Practices Report*. This report seeks to promote common supervisory approaches and practices regarding internal systems and controls and internal follow up of complaints. EIOPA appreciates the importance of proportionality in applying these Guidelines to different sized insurance undertakings and plans to consider proportionality as part of a follow up initiative.

EIOPA publishes semi-annual Financial Stability Report 2012

EIOPA's Financial Stability Committee (FSC) has updated its semi-annual *report on financial stability* in relation to the EEA insurance, reinsurance and occupational pension fund sectors. The report covers developments in financial markets, the macroeconomic environment, and the insurance, reinsurance and occupational pension fund sectors.

The report states that the majority of insurance companies are well capitalised under the current prudential regulation, Solvency I. However, insurers' capitalisation and profitability have decreased slightly.

The report highlights that the insurance sector remains vulnerable to a possible long-lasting low interest rate environment, although the sector would be able to cope with this challenge for some time. But this situation might look different renewed turmoil occurs, e.g. if governments fail to stabilise their fiscal situations or a disruptive unwinding of currency risk happens. While the effects of such events may initially be limited and likely to impact only local insurers at first, the secondary effects might impact bigger European insurers.

Despite a number of severe catastrophic events, the report states that the European reinsurance market remained relatively stable and solidly capitalised at the end of 2011. In the beginning of 2012 EIOPA observed a modest increase in rates, which can be explained in part by the absence of major loss events in Europe and North America.

EIOPA surveys regulators' consumer protection competence

EIOPA has updated an *internal survey* defining and delineating the competence of national competent authorities with regard to the area of consumer protection. Their findings include:

- Structure. The number of national authorities which are competent to supervise the market conduct of insurance undertakings and intermediaries remains largely unchanged.
- Market conduct. Over the past few years, regulators have gradually increased their elaboration of additional market conduct principles and issuance of national codes of conduct with respect to both insurance undertakings and intermediaries.
- Information requirements. There national authorities' competences for disclosure requirements towards potential/existing policyholders, insured persons, pension members and beneficiaries has not changed significantly in recent years.
- Advertising. National authorities' competences in the area of advertising remain about the same as in prior years. However, a number of Member States have introduced new regulatory frameworks or are preparing to do so, and the number of cases of supervisory intervention has increased materially in several Member States.
- General. The number of authorities exhibiting competence or enhanced involvement with regard to general good rules has increased and in some jurisdictions, Member States have sought to enhance the public

awareness and prominence of general good rules.

EC Commissioner Barnier speaks on insurance reforms

Michael Barnier, EU Commissioner for Internal Markets, delivered a speech '*Insurance reforms: putting the European economy back on the path towards sustainable growth*' at the Insurance Europe Conference on 1 June 2012. He considered the EC's proposals on Solvency II, insurance intermediaries and occupational pension schemes and how hopefully these measures will help put the European economy back on the path towards sustainable growth.

ABI update Guide of Good Practice for Unit Linked Funds

The ABI has published an updated version of their *Guide of Good Practice for Unit Linked Funds* containing standards that the ABI would like companies managing unit linked funds to follow. The ABI expects firms to review their operations against the standards set out in this Guide and begin making progress towards the changes needed to meet these standards by **31 December 2012.** The FSA indicated that it will take account of these standards in their supervision of unit linked life offices.

Indexation of BCRR and premiums and claims indices from 31 December 2012

In Chapter 4 of the *FSA Quarterly Consultation 12/11 (CP12/11)* the FSA proposes making inflationary increases to the base capital resources requirement (BCCR) for insurers (other than non-directive insurers). The FSA also plans to increase the premium and claims indices used to calculate the general insurance capital requirement (GICR), shown on Forms 11 and 12 in the regulatory return.

These increases are in line with changes in the European index of consumer prices and are required to comply with European directives. The proposed amendments will come into effect from **31 December 2012**.

FSA confirms changes to permitted links rules

In November 2011 the FSA published its consultation *Solvency II and linked long-term insurance business (CP11/23)* outlining proposed changes to align the permitted links rules to the requirements of Solvency II (see our *Hot Topic*). The FSA published *Feedback Statement (FS 12/02)* on 29 June 2012 confirming these changes - in particular the list of specific permitted links which will be disapplied for institutional policyholders.

The FSA also took the opportunity to clarify its position on reinsurance credit risk in linked funds:

- Firms must make the commercial decision over who takes the credit risk of the reinsurance firm.
- If the firm intends for the policyholder to bear this risk, the firm should set this out explicitly in the policy wording and customer facing material.
- If the policy is silent on reinsurance credit risk exposure, the FSA's approach continues to be that the risk falls on the firm.
- Firms should not seek to amend the terms and conditions of existing policies to shift, retrospectively, the risk from the firm to a policyholder without the policyholder's express agreement.

The FSA expects to publish final rules soon in a policy statement on Solvency II.

International supervisors join information exchange

The insurance supervisors of Chile, Hong Kong, Qatar and the UK issued a *press release* on 29 June 2012 announcing that they had become signatories to a supervisory cooperation and information exchange agreement. 26 jurisdictions are now signatories to the International Association of Insurance Supervisors (IAIS) Multilateral Memorandum of Understanding. These jurisdictions underwrite just over 40% of worldwide premium volume.

Solvency II

Solvency II is a fundamental review of the prudential regulatory requirements for the European insurance industry. It will apply to all insurance firms with gross premium income exceeding €5m or gross technical provisions in excess of €25m. The proposed implementation date of Solvency II is 1 January 2014.

Omnibus II updates

The Omnibus II Directive will amend Solvency II to set the implementation date and to specify areas of, and timing for further Solvency II legislation. It will also incorporate new powers given to EIOPA and make a number of other technical amendments.

Trilogue discussions continue between the EC, ECON and the Council as policymakers seek to iron out the differences between their respective proposals for Omnibus II. After policymakers reach agreement, the EP will hold a plenary vote to pass Omnibus II, and EIOPA can commence consultations to develop the Solvency II Level 2 legislation and Level 3 guidelines. The *date* for this plenary vote was delayed again and is now scheduled for 22 October 2012, putting more pressure on the Solvency II implementation timetable.

In May 2012 the EC published a formal *proposal* for a directive to delay the deadline for transposition of Solvency II into Member States' law to 30 June 2013 and to delay the effective date for companies to 1 January 2014. These proposals have been brought in separately from Omnibus II to ensure the changes are made prior to Solvency II's originally proposed implementation date of 1 November 2012. Some Member States are voicing concern over the Solvency II timeline: representatives from *Sweden* expressed concern that, given the late completion of Omnibus II legislation, it will not be practicable for Member States to transpose Solvency II into national law by the specified deadline. Representatives from the *Czech Republic* indicated that they will propose moving the Solvency II effective date back by a further year to 1 January 2015.

EIOPA publishes third country equivalence transitional measures

EIOPA published a note providing some additional information on *Solvency II – Equivalence Transitional measures* (proposed under the Omnibus II Directive) and work that the EC commissioned EIOPA to undertake.

Only three non-EEA states (Switzerland, Bermuda and, in respect of reinsurance only, Japan) are seeking to be granted equivalence prior to the implementation of Solvency II. The EC has developed a transitional regime for Solvency II third country equivalence for countries which have either a risk based regime similar to Solvency II or are willing and committed to move towards such a risk based regime over a 5 year period.

Australia, Chile, China, Hong Kong, Israel, Mexico, Singapore and South Africa have expressed an interest in qualifying under the transitional provisions. EIOPA has been asked to undertake a gap analysis on these countries' insurance regimes in 2012. The gap analysis will cover the main areas where current equivalence criteria would not be met, and professional secrecy requirements.

The transitional measures would allow undertakings in or connected to these third countries to obtain the benefits of equivalence status on a temporary basis during the transitional period. Inclusion in the transitional regime would be subject to an EC decision. The EC will most likely make their decisions in mid2013, under the working assumption that the Solvency II regime will be applied by EU undertakings from 1 January 2014.

EIOPA publishes interviews with chairman Gabriel Bernardino

In his recent speeches to *Insurance Horizon magazine (Czech Republic) and Versicherungsmagazin (Germany)* Gabriel Bernardino, EIOPA Chairman, considered why Solvency II is needed and transitional issues.

FSA issues Solvency II letter: monitoring ongoing appropriateness of internal models

The FSA sent a *letter to firms* on 18 June 2012 discussing the Solvency II internal model approval process (IMAP) and setting out the way in which the FSA will monitor the ongoing appropriateness of internal models after approval. In particular, the FSA is developing an indicator, expressed as a percentage of the pre-corridor Minimum Capital Requirement (pMCR), against which it will assess the reasonableness of the modelled Solvency Capital Requirement (SCR). The FSA's preliminary analysis indicates that this indicator will be between 175 - 200% of pMCR. However, this will be refined following a calibration exercise to be conducted in September.

The FSA indicates that their intention is to calibrate the indicator so that, in the vast majority of cases, a model approved for use by the FSA will initially produce a modelled SCR that is at least equal to the indicator. The FSA notes that the intention of the indicator is to prevent downward drift of SCR post approval. When an SCR falls below the indicator the FSA will take immediate supervisory action (e.g. requiring model recalibration or imposing a capital add-on), in all but exceptional cases.

The FSA intends to provide further information on this in September 2012. In the meantime, The FSA is requiring firms to continue to develop their internal models with their usual supervisory contact.

PwC Countdown to Solvency II publication

The PwC Countdown to Solvency II publication *Choosing the right technology* considers how to cut through the growing choice of technology developed for Solvency II. The publication will help insurers select the appropriate IT architecture and systems solutions for their particular needs.

PwC's Solvency II UK web pages are available at *www.pwc.co.uk/solvencyII*.

Accounting[2]

IFRS

IASB Insurance Contracts Project

The IASB is working alongside the FASB to develop a harmonised IFRS for insurance contracts. For background information see our project *webpage.* The IAS and FS have committed to release a review draft or revised exposure draft (ED) in the second half of 2012. In their joint note on accounting convergence, the IASB and FSB Boards indicated that on the basis of their current plan the final insurance contract standard may be issued in 2013. The IASB stated that the final standard will not be effective before 1 January 2015, but it could well be later than this date.

The IASB have updated their high level summary of the *current status* on the project, their *summary* of how IASB's tentative decisions are reflected in the ED and their *presentation* on IASB and FASB's tentative decisions, showing where those decisions would affect the proposals in the ED. PwC's **Error! Hyperlink reference not valid.** publication summarises the FASB Chairman's status update on the insurance contracts project which highlighted that the FASB and IASB are unlikely to achieve convergence on this project.

The IASB has released two podcasts in June. The *first podcast* reports on project developments during the IASB and FASB May meeting. This podcast includes discussions on risk adjustment and residual margin, use of other comprehensive income to present some changes in the insurance contracts liability, accounting for acquisition costs and the unbundling of distinct investment components and a review of unbundling and disaggregation decisions. The *second podcast* reports on developments at the June 2012 joint Board meeting. It focuses on the Boards' discussion of a possible method for determining a revenue-like measure, 'earned premiums'.

At their meetings of 12-14 June 2012, the IASB and FASB continued their discussions on insurance contracts by exploring a method of measuring earned premiums for presentation in the statement of comprehensive income. The discussions also considered how to attribute cash flows to the unbundled components of bundled insurance contracts, to measure those unbundled components. See *PwC meeting notes*. The Boards will continue their discussion at their meeting in the week commencing 16 July 2012, see *agenda*.

The Insurance Working Group met in London on 25-26 June 2012 to discuss previous board decisions and seek feedback on the remaining issues, including presenting 'earned premiums' in the statement of comprehensive income. A webcast of the meeting,

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[2] *This section includes accounting developments with a direct or potential on the financial services industry only. For a complete update on accounting developments in the UK visit http://www.pwc.co.uk/eng/services/ifrs_services.html*

together with agenda papers, is available on *IASB's website*.

Guidance on IFRS 10 for asset managers.

PwC have produced a *practical guide* which sets out a framework for asset managers to use when interpreting IFRS 10 to determine whether control exists – in particular, the assessment of principal versus agent. It also includes an analysis of the illustrative examples from IFRS 10, and other factors that may be useful to consider in practice.

Taxation

Tax reporting implications of life tax reform

The Finance Bill 2012 - 2013 means significant changes for life companies, particularly in the accounts. With the bill expected to have its third reading, and therefore be substantively enacted for the purposes of IFRS and UK GAAP in summer 2012. The changes will take effect on 1 January 2013. In this *short paper* we consider how each of the significant changes to the life tax rules may be reflected in the financial statements in 2012 and future periods.

Monthly calendar

Open consultations

Closing date for responses	Paper	Institution
13/07/2012	*Revisions to the UK Corporate Governance Code and guidance on audit committees*	FRC
18/07/12	*Consultation Paper on draft Guidelines for assessing the suitability of members of the management body and key function holders*	EBA
31/07/12	*Consultation paper on draft Implementing Technical Standards on disclosure for own funds*	EBA
31/07/12	*Consultation paper on draft Regulatory Technical Standards on Capital Requirements for CCPs*	EBA
31/07/12	*Arch cru funds –redress for mis-selling (CP 12/9)*	FSA
01/08/12	*Consultative document: a framework for dealing with domestic systemically important banks*	BIS
02/08/12	*Principles of Liquidity Risk Management for Collective Investment Schemes*	IOSCO
05/08/12	*ESMA consultation on derivatives, central counterparties and trade repositories*	ESMA
06/08/12	*Consultation report – global developments in securitisation regulation*	IOSCO
06/08/12	*CP12/11 Quarterly Consultation Paper number 33 (chapters 3-7)*	FSA
13/08/12	*Consultation on response to call for evidence on the review of FICOD*	ESAs

Closing date for responses	Paper	Institution
17/08/12	*Consultation on future regulation of authorised professional firms*	SRA
20/08/12	*Consultation on the taxation of unauthorised unit trusts*	HMRC
20/08/12	*Consultation paper on possible delegated acts of the Prospectus Directive*	ESMA
27/08/12	*Consultation paper on draft Implementing Technical Standards on supervisory reporting requirements for liquidity coverage and stable funding*	EBA
27/08/12	*Consultation paper on draft Implementing Technical Standards on supervisory reporting requirements for leverage ratio*	EBA
06/09/12	*Government white paper on implementation banking reform*	HMT
07/09/12	*Basel Committee on Banking Supervision fundamental review of trading book*	BCBS
14/09/12	*Consultation on new general anti-abuse rule*	HMRC/HMT
14/09/12	*Consultation paper – adaptation to cross-CSD settlements in T2S*	ECB
15/09/12	*Consultation on changes to disciplinary scheme*	FRC
26/09/12	*Consultation on revised remuneration reporting regulations*	BIS
27/09/12	*Consultation paper – guidelines on sound remuneration policies under the AIFMD*	ESMA
27/09/12	*CP12/12 – payments to platform service providers and cash rebates from providers to customers*	FSA
30/09/12	*Consultation paper – guidelines on sound remuneration policies under the AIFMD*	ESMA

Forthcoming publications in 2012

Date	Topic	Type	Institution
Accounting			
Q2 2012	Insurance Contracts Standard – re-exposure / review draft	Consultation paper	IASB
Banking Structure			
Q3 2012	Report from the high-level expert group examining the structural aspects of the EU banking sector	Discussion paper	EC
Q4 2012	Large exposures regime	Policy statement	FSA
Capital and Liquidity			
Q2 2012	EBA Capital Requirements Directive Common Reporting Application	Consultation paper	FSA
Q3-Q4 2012	Capital Requirements Directive IV	76 regulatory technical standards, 32 implementing technical standards and 20 guidelines	EBA
Q4 2012	Strengthening Capital Standards 4 – consultation on CRD IV	Consultation paper	FSA
Consumer protection			
Q3 2012	Directive on misleading and comparative advertising (2006/114/EC)	Communication	EC
Q3 2012	FSCS: changes to the Compensation sourcebook	Policy statement	FSA
Q3 2012	Mortgage Market Review: Proposed package of reforms	Policy statement	FSA
Q3 2012	Packaged bank accounts: New ICOBS rules for the sale of non-investment insurance contracts	Policy statement	FSA

Date	Topic	Type	Institution
Q4 2012	National Depositor Preference and UK depositors	Consultation paper	FSA
Q4 2012	Bank accounts	Legislative proposals	EC
Q4 2012	FSCS funding model review	Consultation paper	FSA
Financial crime, security and market abuse			
Q3 2012	European terrorist finance tracking system	Legislative proposals	EC
Q3 2012	Financial message data transfer from the EU to the USA for the purposes of the Terrorist Finance Tracking Program	Report	EC
Q4 2012	Market Abuse Review	Technical advice	ESMA
Q4 2012	An EU framework for collective redress	Legislative proposals	EC
Q4 2012	Securities Law Directive	Legislative proposals	EC
Q4 2012	Review of Financial Conglomerates Directive	Legislative proposals	EC
TBC 2013	Revision of Financial Conglomerates Directive (FICOD II)	Legislative proposals	EC
TBC 2012	Third Anti-Money Laundering Directive	Legislative proposals	EC
Insurance			
Q3 2012	Revision of the Insurance Mediation Directive (2002/92/EC) (IMD)	Legislative proposals	EC
Q3 2012	Institutions for Occupational Retirement Provision	Legislative proposals	EC
Q4 2012	Tracing employers liability insurers	Consultation paper	FSA
Q2 2013	Client money rules for general insurance intermediaries	Consultation paper	FSA

Date	Topic	Type	Institution
Market Infrastructure			
Q3 2012	Regulating bidding for Emissions Allowances	Policy statement	FSA
Q3 2012	Amendments to the Listing Rules	Policy statement	FSA
Q3 2012	OTC Derivatives, CCP Requirements, Trade Repositories and CCP Interoperability (EMIR)	Guidelines	ESMA
Q4 2012	Limitation period and further procedures for fining credit rating agencies	Regulation	EC
Q4 2012	Credit Rating Agencies III Regulation	Technical advice	ESMA
Q4 2012	Revision of the Transparency Directive	Discussion papers	ESMA
TBC 2012	Investor Guarantee schemes- revision	Legislative proposals	EC
TBC 2012	Close-out netting	Legislative proposals	EC
Products and investments			
Q3 2012	Packaged Retail Investment Products	Legislative proposals	EC
Q3 2012	Undertakings For The Collective Investment Of Transferable Securities V	Legislative proposals	ESMA
Q3 / Q4 2012	Product projections and transfer value analysis	Policy statement	FSA
Q4 2012 / Q1 2013	Implementation of Alternative Investment Fund Managers Directive	Consultation paper	FSA
Q4 2012	Consumer redress scheme for Arch cru funds	Policy statement	FSA
Q4 2012	Alternative Investment Fund Managers Directive – cooperation agreements	Technical standards	ESMA

Date	Topic	Type	Institution
Q4 2012	Markets in Financial Instruments Directive II	Technical advice	ESMA
Q4 2012	Markets in Financial Instruments Directive II	Guidelines	ESMA
Q4 2012	Markets in Financial Instruments Directive I-financial consumer protection	Guidelines	ESMA
Q4 2012	Markets in Financial Instruments Directive I- supervisory convergence	Guidelines	ESMA
Q4 2012	Packaged Retail Investment Products	Technical standards	ESMA
Q4 2012	Prospectus Directive	Technical advice	ESMA
Q4 2012	Social Investment Funds	Technical advice	ESMA
Q4 2012	Venture Capital	Technical advice	ESMA
Q4 2012	Undertakings For The Collective Investment Of Transferable Securities V	Technical advice	ESMA
Q1 2013	Non-mainstream investments	Consultation paper	FSA
Recovery and Resolution			
Q3 2012	EU framework for recovery and resolution plans	Technical advice	EBA
Q3 2012	Recovery and resolution plans	Policy statement	FSA
Q4 2012	Rescue and restructuring of financial institutions in Europe	Guidelines	EC
Solvency II			
Q3 2012	Draft Level 2 delegated acts	Level 2 text	EC
Q4 2012	Transposition of Solvency II- Part 1	Feedback statement	FSA

Date	Topic	Type	Institution
Q4 2012	Solvency II and linked long-term insurance business	Policy statement	FSA
Q4 2012	Solvency Level 3 measures finalised	Level 3 text	EC
Supervision, governance and reporting			
Q3 2012	Corporate reporting	Guidelines/ recommendations	ESMA
Q3 2012	Financial resources requirements for Recognised Bodies	Policy statement	FSA
Q3 2012	CASS Reporting / Oversight and Mandates	Consultation paper	FSA
Q3/4 2012	Remuneration- EBA Data Collection	Consultation paper	FSA
Q4 2012	EU corporate governance and company law	Action plan	EC
Q4 2012	Storage of regulated information at ESMA	Discussion paper	ESMA
Q4 2012	Supervisory convergence	Discussion paper	ESMA
Q4 2012	Revision of Enforcement Standards	Consultation paper	ESMA
Q4 2012	Corporate Governance (proxy advisors, empty voting)	Discussion paper(s)	ESMA
Q4 2012	Remuneration and supervisory co-operation arrangements	Guidelines/ recommendations	ESMA
Q4 2012 / Q1 2013	CASS, EMIR and porting	Consultation paper	FSA

Main sources: ESMA 2012 work programme; EIOPA 2012 work programme; EBA 2012 work programme; EC 2012 work programme; FSA policy development update (Issue 147)

Education – Conferences and event (June and July)

Date	Topic	Institution
11 July	FCA update briefing	FSA
17 July	Basel III workshop	BBA
29 – 31 July	FSA Risk Management symposium	FSA

PwC insights

Banking

What now for the UK banking industry? The impacts of the ICB's banking reform white paper

PwC investigates the impact of the recent announcement for the UK banking industry. Read What now? for a succinct overview of the white paper; an analysis of the key points of the white paper, and details on what the impact could be for different parts of a bank.

Read more here

Basel III and beyond: Using stress testing to answer the big strategic questions.

With banks facing so many challenges today, the need for an effective stress testing process is clear. Our latest flyer outlines the scope of integrated stress testing, how you can bring it into your business, the importance of getting valid results, and making stress testing worthwhile.

Read more here

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Asset Management

Top issues facing asset managers

Even though mild recovery has increased profitability in the asset management industry recently, there are still many challenges to deal with. While the industry has opportunities for profitable growth, not all firms will succeed, given the magnitude of the challenges and change. The firms that succeed will be those that grasp what's happening and then engineer the transformations that they need to adapt.

Read more here

Engineering a path to profitable growth

Four years on from the credit crisis and asset management CEOs are turning their attention towards growth once more. But margins are still under pressure and the CEOs have not forgotten the impact of market volatility on their revenue streams. How can asset managers grow in an efficient and cost-controlled manner?

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Insurance

Choosing the right IT systems for Solvency II

The technology decisions for Solvency II can't be put off any longer. What kind of IT architecture will be needed, what are the key criteria for choosing the right technology for your business, and how can you make the most of your investment?

Read more here

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http://www.pwc.com/insurance

Cross Financial Services

Reward regulations in financial services

Financial services pay models for firms with European operations have changed profoundly since the financial crisis as a result of European Union and domestic regulation. Read our summary or watch our short video of the European and UK regulations that financial services firms are facing in respect of their remuneration and reward arrangements.

Read more here

Glossary

ABI	Association of British Insurers
AIFMD	Alternative Investment Fund Managers Directive
AIMA	Alternative Investment Management Association
AMICE	Association of Mutual Insurers and Insurance Cooperatives
ASB	UK Accounting Standards Board
Basel Committee	Basel Committee of Banking Supervisors
BBA	British Bankers' Association
BIBA	British Insurance Brokers Association
BIL	Bank for International Settlements
BIS	Bank of International Settlements
BoE	Bank of England
CCPs	central counterparties
CEA	European Insurance and Reinsurance Federation
CEBS	Committee of European Banking Supervisors
CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
CFPB	Consumer Financial Protection Bureau
CFTC	Commodities Futures Trading Commission
CIS	collective investment schemes
Consumer Panel	Financial Services Consumer Panel
Council	European Council of Ministers
CPI	Consumer Price Index
CRAs	credit rating agencies
CRD	Capital Requirements Directive 2006/48/EC
CRR	Capital Requirements Regulations 2006 (S.I. 2006/3221)
DFBIS	Department for Business, Innovation and Skills
DG MARKT	Internal Market and Services Directorate General
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act
D-SIBs	Domestically systematically important banks
EBA	European Banking Authority
EC	European Commission
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council of the EU
ECON	European Parliament Committee on Economic and Monetary Affairs
EEA	European Economic Area
EFAMA	European Fund and Investment Management Association
EIOPA	European Insurance and Occupations Pension Authority
EP	European Parliament

EMIR	European Market Infrastructure Regulation COM(2010) 484 final
ESA	European Supervisory Authority
ESMA	European Securities and Markets Authority
ESRB	European Systematic Risk Board
EURIBOR	Euro Interbank Offered Rate
FASB	US Financial Accounting Standards Board
FATF	Financial Action Task Force
FCA	Financial Conduct Authority
FDIC	Federal Deposit Insurance Corporation
FICOD	Financial Conglomerates Directive 2002/87/EC
FOS	Financial Ombudsman Service
FPC	Financial Policy Committee
FRC	Financial Reporting Council
FSA	Financial Services Authority
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FMI	financial market infrastructure
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
G30	Group of 30
GAAP	Generally Accepted Accounting Principles
G-SIBs	Globally systematically important banks

G-SIFIs	globally systemically important financial institutions
G-SIIs	globally systemically important insurers
HMRC	Her Majesty's Revenue & Customs
HMT	Her Majesty's Treasury
IASB	International Accounting Standards Board
ICB	Independent Commission on Banking
IFRS	International Financial Reporting Standards
IMA	Investment Management Association
IMD	Insurance Mediation Directive (2002/92/EC)
IMF	International Monetary Fund
IORP	Institutions for Occupational Retirement Provision Directive 2003/43/EC
IOSCO	International Organisations of Securities Commissions
ISDA	International Swaps and Derivatives Association
JMLSG	Joint Money Laundering Steering Committee
MAD	Market Abuse Directive 2003/6/EC
MAR	Market Abuse Regulation COM(2011) 651 final
Member States	countries which are members of the European Union
MiFID	Markets in Financial Instruments Directive 2004/39/EC
MiFIR	Markets in Financial Instruments Regulation COM(2011) 652 final
MLD	Money Laundering Directive 2005/60/EC
MMR	Mortgage Market Review
MoJ	Ministry of Justice

Official Journal	Official Journal of the European Union
Omnibus II	EC proposed Directive 2011/0006 (COD) amending Solvency II
OTC	over-the-counter
PRA	Prudential Regulation Authority
PRIPS	Packed Retail Investment Products
RAO	Financial Services and Markets Act 2000 (Regulated Activities Order) 2001
RDR	Retail Distribution Review
RRPs	recovery and resolution plans
RTS	regulatory technical standards
SCR	solvency capital requirement
SEC	Securities and Exchange Commission
SFO	Serious Fraud Office
SOCA	Serious Organised Crime Agency
Solvency II	Taking up Pursuit of Business of Insurance and Reinsurance Directive 2009/138/EC
T2S	TARGET2-Securities
TR	trade repository
TSC	Treasury Select Committee
UCITS	Undertakings for Collective Investments in Transferable Securities
US	United States of America

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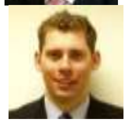

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