

# *Being better informed*

## FS regulatory, accounting and audit bulletin

*PwC FS Regulatory  
Centre of Excellence*

**November 2012**

In this issue:

*Liikanen Report  
proposes changes to EU  
banking sector*

*Omnibus II rescheduled*

*EU recovery and  
resolution proposals for  
non-bank entities*



# 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.



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The *Liikanen Report* published in early October was rather overshadowed by discussions on the EU’s banking union proposals. But the EC is likely to adopt many, if not all, of the expert group’s recommendations and these will bring significant structural changes to the EU banking landscape. Consequently, EU banks need to consider the long-term operational and strategic impacts sooner rather than later.

The *EP’s delay of its Omnibus II vote* until March 2013 further validated many insurers’ concerns about the viability of the 1 January 2014 Solvency II implementation date. The EC has yet to confirm another Solvency II deferral, but the market and regulators are already considering 1 January 2015, or even 2016, as new implementation dates.

October saw the launch of an EU *consultation* on extending RRP requirements to non-bank entities. The consultation suggests that FMIs, G-SIIs and asset managers should

begin to reconceptualise their business models so they are not too big – or too interconnected – to fail.

The EBA published the results of its capital exercise and a stakeholder group *position paper on CRD IV liquidity rules*, which will inform the CRD IV/CRR trialogue negotiations. In this context, the latest *Basel III progress report for the next G20 summit* raised some questions on the proposed EU regime.

The SSR came into force on 1 November, and ESMA published notices identifying *exempted shares, thresholds for sovereign issuers*, links to national supervisors’ websites and an updated *Q & A*.

The Council moved ahead to adopt the financial transaction tax and the EC issued a *draft Decision* to this effect.

In the UK, the BoE published *The PRA’s Approach to Insurance Supervision* and *The PRA’s Approach to Bank Supervision*, along with the FSA’s *Journey to the FCA* – all of

which are summarised in this month’s Feature. The Feature may be insightful to those outside the UK who are monitoring changes to their own national supervisors’ approaches.

As we approach the year end, many EU legislative initiatives are not going to meet their deadlines, but are progressing. Regulatory uncertainty remains a challenge for firms that want to get on with operationalising changes, so they can return to tending their customers’ needs and investors’ demands for a return to profitability.

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## How to read this bulletin?

Review the Table of Contents the relevant Sector sections to identify the news of interest. We recommend you go directly to the topic/article of interest by clicking in the *active links* within the table of contents.

## Contents

<b><i>Executive summary</i></b>	<b><i>1</i></b>
<b><i>Feature</i></b>	<b><i>3</i></b>
<b><i>Cross Sector Announcements</i></b>	<b><i>6</i></b>
<b><i>Banking and Capital Markets</i></b>	<b><i>20</i></b>
<b><i>Asset Management</i></b>	<b><i>23</i></b>
<b><i>Insurance</i></b>	<b><i>24</i></b>
<b><i>Calendar</i></b>	<b><i>29</i></b>
<b><i>PwC insights</i></b>	<b><i>34</i></b>
<b><i>Glossary</i></b>	<b><i>35</i></b>
<b><i>Contacts</i></b>	<b><i>38</i></b>

# Feature

## ***UK's new regulatory approach emerges***

The long anticipated FSA split into the PRA and FCA is likely to take place in April 2013. To prepare the market, the BoE published twin papers outlining *The PRA's approach to banking supervision* and *The PRA's approach to insurance supervision* in October. These papers, along with the FSA's publication *Journey to the FCA*, shed more light on the new UK framework for prudential and conduct regulation.

Firms should consider these papers carefully - they offer important indicators of how the new regulators will focus their resources. Understanding their approaches now will prove time well spent when the regulators take up their new powers next April.

### ***Common themes***

The new regulatory authorities share complimentary objectives and say that they will adopt a similar approach to regulation. Each regulator's objectives recognise the importance of financial stability in both retail and wholesale markets. They will both be very interested in firms' cultures and how their senior management teams are performing, but will come at these issues from different perspectives.

Both regulators intend to be more intrusive and forward-looking than the FSA. They will focus not just on the rules, but also on firms' cultures, the attitude of senior management and the viability of the business. The PRA and the FCA both plan to have frequent contact with firms that are deemed to present a high level of risk – either to the regulators' in meeting their objectives, the stability of the financial system or to the interests of consumers.

The new approach relies the exercise of more judgement by regulators, which means they will need staff who have the experience to form judgements and the confidence to stand by their decisions.

The new approach will be more resource intensive for the regulators and for firms that pose significant risks. To manage their resources, both regulators intend to concentrate their efforts on supervising high risk firms, leaving lower risk firms with a less intrusive regime.

### ***PRA supervisory approach***

The PRA's approach to prudential supervision of banks and investment firms will be based on just one objective: promoting the safety and soundness of the firms it supervises. The PRA will not keep firms from

failing but it will seek to ensure that if a firm fails, its customers will be appropriately protected ( e.g. via the FSCS), and that there will be minimal disruption to the supply of critical financial services. The PRA will also expect firms be resilient to the failure of other market participants.

The PRA has an additional objective in respect of insurers: to contribute to securing an appropriate degree of protection for those who are or may become policy holders. This objective will factor into the risk assessment of insurance firms and groups. Otherwise, they will apply the same supervisory approach to insurers.

### ***Supervision***

The PRA will divide its regulated firms into five prudential supervision categories (P1 to P5) based on risk profiles. The BoE estimates that around 20 firms will fall into the highest risk category - firms whose failure could cause "very significant disruption" to the financial system. One third of PRA supervisors will be devoted to this group. The BoE estimates that 70 to 80 firms will be captured by the next category – firms whose failure could prove individually disruptive. Those firms will be supervised by another third of

PRA staff. The 1,500 or more firms which are not deemed individually significant, but for which together with other firms could cause widespread failure across a sector with serious consequences, will form a further three tiers. These lower risk firms will be supervised by remaining staff on a group basis.

#### *Proactive intervention*

If the PRA deems that a firm is at risk of failure, it has new powers to intervene. A five stage process will give the PRA increasing powers of intervention, including powers to remove authorisation for new businesses, limit trading activity and require a change in the firm's management, as the risk of failure escalates. The intervention process includes contingency resolution planning, in the event that PRA intervention is unable to prevent a firm from failing.

#### ***FCA supervisory approach***

The FCA's broad objective is to ensure that financial services markets function well, and this is supported by three underlying operational objectives:

- secure an appropriate degree of consumer protection
- protect and enhance the integrity of the UK financial system
- promote effective competition in the interest of consumers.

The BoE says that FCA will focus on supervising the corporate governance and market conduct of its

regulated firms. It will intervene where it deems necessary to ban products that it believes are unfair or harmful to consumers, to ban misleading financial promotions and to pursue enforcement action more rigorously than in the past.

Under a new Business Model Threshold Condition, firms will be required to demonstrate that their business model is appropriate, viable and sustainable given the nature and scale of their business, and include some contingency planning. Firms must be able to demonstrate how their business model will enable them to effectively meet the needs of customers without placing them at undue risk or undermining financial stability. The FCA will be forming its opinion of the attitudes and suitability of senior management from the business model review.

#### *Risk based supervision*

As with the PRA, the FCA will divide firms into four conduct supervision categories (C1 to C4) based on the risk that the firm presents to the FCA's core objectives. The FCA will classify firms depending on the size of their retail business and/or the market impact of their wholesale business, with retail business activities subject to closer supervision than wholesale business activities of a similar scale.

Firms that are designated C1 or C2 will have a nominated supervisor and be continuously supervised. The FSA will supervise firms in the C3 and C4 categories collectively by teams of sector specialists.

A new division called Policy, Risk and Research, to be staffed by 250 people, will monitor the market for developments that pose risks to consumers, markets and firms, to try to anticipate problems before they become significant. It will assess those risks to develop a common view, to inform the FCA's policy-making, supervision and enforcement activities.

#### *Wholesale conduct*

Although the FCA is bringing in a strong retail focus, wholesale firms will be subject to more scrutiny than before. The FCA believes that poor conduct originating in wholesale markets is regularly transmitted into the retail sector. Going forward, wholesale firms will need to be alive to which of their activities could affect consumers in the retail space.

The FCA also disagrees with the traditional view that all wholesale market participants are equal, and capable of looking after themselves and managing their relationships with other market participants effectively, with little regulator intervention. Wholesale firms should be taking a close look at their counterparties - they can no longer assume that smaller market participants necessarily have the skill or experience to understand all products.

#### *Competition*

The FCA will have a new objective to support competition, framed in ensuring retail customers have access to appropriate products at affordable prices. It is not clear yet how the FSA will achieve this. The FCA



would particularly like firms' views on how it can encourage competition to benefit consumers, how it can monitor improvements in the competitive landscape, and what barriers firms face to entering the market or expanding their businesses.

### *Prudential regulation*

The FCA will be directly responsible for prudential regulation of approximately 23,000 firms – consisting of all firms other than the deposit-takers, insurance companies and a few systemically significant investment firms which will be regulated by the PRA. The FCA will divide firms into three prudential categories (CP1 to CP3). CP1 will include those firms deemed prudentially critical. CP2 will include prudentially significant firms, and the remainder of prudentially insignificant will fall in CP3. Only CP1 firms and MiFID regulated CP2 firms will be subject to ICAAP and ILAA reviews. Other firms will have to ensure that they have adequate capital to enable an orderly wind-down in the event of failure.

The FCA may not be able to reduce the capital burden for smaller firms, as it is unable to exempt smaller firms from MiFID and the CRD requirements. In practice most firms are unlikely to see a significant change in capital requirements, but some may experience less prudential scrutiny.

### *Dual regulation*

The PRA regulated firms will be subject to FCA conduct regulation. A draft *memorandum of*

*understanding* between the two regulators, published in January 2012, establishes the scope of each of the PRA and FCA's duties.

The regulators will undertake supervisory activity together where possible, and will share information from their individual activities where necessary. The PRA lead on authorisation, variation of permission and approval of Approved Persons for dual-regulated firms, but the FCA has power of approval. The FCA will approve individuals for customer facing functions.

The regulators will maintain separate rulebooks and each will have the authority to grant waivers, but must notify the other before a waiver is granted. The PRA has the power to veto the actions of the FCA if it feels that the FCA's actions may threaten the stability of the financial system or induce the failure of a systemically important, dual-regulated firm.

### *Transition*

All existing authorisations, Part IV permissions, controlled functions, rule waivers and modifications, passports, limitations and requirements will be grandfathered. Firms do not need to take any action to transfer their existing regulatory approvals to the new regulators.

### *Next steps*

The BoE and the FSA plan to publish more consultations over the next few months and to notify firms of new requirements as they transition the FSA's

operations and interactions with regulated firms to the new regime. At this critical stage firms still have a unique opportunity to inform and shape the regulators' approaches. This may be the last such opportunity for some time, as the new regulators may get stuck in quickly to develop their own regimes and to distance themselves from the FSA's perceived failures.

Both firms and regulators will have a steep learning curve as they get to grips with the new regime. Regulators will need to efficiently apply the new regulatory framework and make dual regulation work. Firms will need to consider the impact of the new regulatory approaches and changes to regulatory processes on their businesses, in particular how their strategy, business model, culture, products and services may be viewed by the FCA and PRA. Firms will want to understand the new framework, the division of responsibilities, how they will be supervised, and how the regulator's expectations are changing to maintain a good rapport with their supervisors and achieve good outcomes for their customers.

# Cross Sector Announcements

In this section:

## **Regulation** 7

### **Capital and liquidity** 7

Basel Committee examines Basel III implementation	7
ECB's Praet discusses bank deleveraging poses concerns	7
EBA Banking Stakeholder Group advise on dangers of regulating liquidity	7
EBA assesses SME proposals for CRD IV	8
Fed begins bank stress tests	8

### **Consumer protection** 8

ESMA's Maijor speaks on restoring investors' trust	8
--	---

### **Corporate governance** 9

EDTF issues first report on banks' risk disclosures	9
PwC publishes 'Corporate governance - towards best-practice reporting'	9

### **CRAs** 9

EU publishes rules granting CRAs enforcement rights	9
---	---

### **Dodd-Frank Act** 9

SEC upgrades CCP standards	9
CFTC Dodd-Frank Title VII regime comes into force	10
CFTC conforms its regulations to Title VII rules	11

### **Financial crime** 12

ENISA reports on EU-wide cyberattack exercise	12
EU High Representative speaks on cyber security	12
FATF corruption experts meet	12

### **Market infrastructure** 12

FSB reports progress on OTC clearing	12
--------------------------------------	----

IOSCO commodity derivatives market principles gain traction	13
ECB clarifies SEPA migration requirements	13

### **Operating rules and standards** 13

EU brings short selling regime into force	13
---	----

### **Other regulatory** 14

ESMA publishes 2013 work programme	14
EU publish US, Australian and Canadian CRA equivalence	14

### **Pensions** 15

EIOPA launches QIS for occupational pensions	15
--	----

### **Prospectus Directive** 15

ESMA consults on mineral company requirements in prospectus rules	15
---	----

### **Regulatory reform** 15

IOSCO Board gets started	15
FSB reviews progress on G20 agenda	15
IMF's Lagarde bemoans patchy progress on reforms	16

### **RRPs** 17

EC publish non-bank RRP proposals	17
-----------------------------------	----

### **Shadow banking** 17

IOSCO finalises recommendations for MMFs	17
--	----

### **Single supervisory mechanism** 18

Council considers Banking Union proposals	18
---	----

## **Accounting** 18

<b>IASB</b>	18
IFRS - Revenue recognition project	18

IASB amends IFRS 10 to exempt 'investment entities' from consolidation	18
PwC publications	19

## Regulation

### Capital and liquidity

#### *Basel Committee examines Basel III implementation*

The Basel Committee published its *Report to G20 Finance Ministers and Central Bank Governors on Basel III implementation* on 31 October 2012. The report finds that, generally, there has been significant progress since the publication of the previous report in June 2012.

The Basel Committee found:

- eight of the 27 Basel Committee members had now issued final regulations on Basel III standards
- 17 members have published draft regulations
- two are in the process of drafting regulations.

The Basel Committee has undertaken assessments on draft regulations in the EU and US, and these jurisdictions now have the opportunity to address gaps as they finalise their rules. But both jurisdictions must apply significant efforts to ensure that they are ready for

1 January 2013 Basel III implementation date.

#### *ECB's Praet discusses bank deleveraging poses concerns*

Peter Praet, member of the Executive Board of the ECB, gave a speech on *'Deleveraging and the role of central banks'* at Bocconi University in Milan on 26 October 2012.

Since 2008, banks have been forced to restructure their balance sheets to reduce their debts and, clearly, when the deleveraging process becomes abrupt and disorderly, it can pose a serious threat to the financial system. Praet highlights the challenges that central banks face in managing this deleveraging process, focusing on the special circumstances of the euro area and the benefits of an integrated financial market union.

The ways in which banks choose to deleverage - from disposal of assets to recapitalisation - do not necessarily foster economic welfare. When a bank increases its capital this dilutes existing shareholder capital. Under normal market conditions, central banks can provide liquidity to the banking sector while controlling the ultimate interest

rate impact on the real economy. During financial and banking crises, central banks' intervention can help to stabilise the situation but their monetary policy cannot resolve structural problems.

Praet reviewed the ECB's measures during the crisis, including the ECB's recent enhanced credit support programme which took the form of a three-year refinancing operation. He explained how those measures have helped to prevent abrupt deleveraging and mitigate the disparity between stable and less stable central banks within the euro area.

On banking union, Praet wants the institutional architecture to be based on principles that prevent excessive risk-taking and cross-border fragmentation of the banking sector. The latest policy measures to achieve this include the EC's proposal on a single supervisory mechanism under the ECB, and its recent proposals for a bank recovery and resolution directive and deposit guarantee schemes.

#### *EBA Banking Stakeholder Group advise on dangers of regulating liquidity*

The EBA's Banking Stakeholder Group (the Stakeholder Group) published a position paper on *New Bank Liquidity Rules: Dangers Ahead* on 3 October 2012. The paper focuses on the potential impact of the Liquidity Coverage Ratio (LCR) under CRD IV.

The Stakeholder Group estimated that EU banks will need an additional €1.15 trillion worth of liquid assets to comply with the LCR rules, expected to come into force in 2015. Since the crisis, this shortfall has widened as banks have focused on replenishing their capital base rather than building-up their liquidity buffers. The Stakeholder Group believes banks may direct funding towards LCR-eligible assets, rather than providing loans to the SME sector. They worry that the LCR will 'crowd out' productive investments and 'sterilise' €1.15 trillion of liquidity from the real EU economy.

This trend is already evident. More than US\$850 million worth of large EU banks' deposits are sitting in central bank coffers and thus playing 'no role



in financing the real economy'. The Stakeholder Group calls on the EBA to consider ways to expand the range of assets eligible for liquidity buffers. For example, allowing banks to use corporate bonds and asset-backed securities as liquid assets, would enable capital markets to support lending activities that banks are not providing under the new regime.

The Stakeholder Group believes that the impact of LCR and other new banking regulations are not yet fully understood, but further research will help to inform the debate and help the EBA design technical standards. New standards should not just bolster the stability of financial markets but also help to support the important credit intermediation role that banks play.

#### *EBA assesses SME proposals for CRD IV*

The EBA published a detailed *Assessment of SME proposals for CRD IV/CRR* on 22 October 2012. Back in July 2011, the EC asked the EBA to analyse the current risk weights (RWs) and thresholds under CRR for small and medium sized enterprises (SMEs).

The EBA's report recommends that the proposed RWs and thresholds for SMEs should not be relaxed to stimulate a growth in credit for the 20 million SMEs in the EU. The EBA argue that chipping away at CRD IV/CRR is not optimal as it will "endanger" future financial stability. The current regulatory framework already incorporates a discount factor for RWs vis-à-vis SMEs (75% RW for exposures below €1 million). Loans in the Corporate exposure class have an RW according to the rating of the borrower (from 20% to 150% depending on the rating--but usually 100% for most unsecured corporate loans).

SME loans do not appear to be less risky than other corporate loans so there is no justification for allowing banks to treat those loans more favourably than currently proposed. However, the EBA does recognise that lending conditions are deteriorating for SMEs and some temporary measures may be needed in the medium term. The EBA can see some sense in neutralising the affects of the conservation buffer, which comes into effect in 2016, for SMEs. It believes that structural reform to make SMEs less

reliant on bank loans would work better. Promoting venture capital, private equity and the use of consistent ratings across SMEs, would open up new, more stable funding lines to help get the engine of the EU economy working again.

#### *Fed begins bank stress tests*

The Federal Reserve's *final rules with stress testing requirements for both banks and non-bank financial companies* under Dodd-Frank were published in the Federal Register on 9 October 2012.

The Federal Reserve will start stress tests for 19 US bank holding companies; with bank run stress tests to follow later this autumn. The test results will be published in March 2013. The Federal Reserve will release scenarios and historical data which will be used in this year's stress tests in November 2012.

Other companies that fall within the scope of the final rules are required to comply with the stress testing rules from October 2013.

### **Consumer protection**

#### *ESMA's Maijor speaks on restoring investors' trust*

Steven Maijor, ESMA Chairman, spoke on *Restoring investors' trust in Europe's markets* at a BBA conference on 17 October 2012. He outlined the causes of investors' distrust and considered regulatory initiatives to address the problem.

Maijor believes the root cause of investor distrust is a combination of general economic circumstances: the financial crisis, the sovereign debt crisis, longer-term consumer concerns over poor service, low returns, hidden costs and high-profile retail scandals resulting in large compensation payments.

He said that stricter investor protection rules, such as bans on inducements and limits on remuneration for advice or sales, won't restore confidence. Maijor acknowledged concerns that a ban on inducements could lead to competitive distortions and impact some firms' business models, stressing that firms must have time to adjust.

ESMA is engaging in more dialogue with firms, and Maijor believes that the UK financial sector's participation is crucial to ESMA's work, especially for the single rulebook. He encouraged firms to look beyond the Eurozone and non-Eurozone Member State divide over the Banking Union to ESMA's pan-European work.

Maijor's focus on the benefits of the single rulebook and his concerns about the growing sense of UK disenfranchisement suggest that some policy makers are aware of the increasing tension between politics and economics in Europe's financial markets.

### Corporate governance

#### *EDTF issues first report on banks' risk disclosures*

The Enhanced Disclosure Task Force (EDTF), formed by the FSB in May 2012, published *'Enhancing the Risk Disclosures of Banks'* on 29 October 2012.

The EDTF identified the risk disclosure principles applicable to all banks: clarity, completeness, relevance, consistency, comparability and

timeliness. It makes 32 specific recommendations covering, inter alia:

- risk governance and risk management strategies/business model
- capital adequacy and risk weighted assets
- liquidity and funding
- market risk, credit risk and other risks.

The report includes best practice examples on risk disclosures and bank reporting.

The EDTF wants banks to start implementing its recommendations proactively to help restore investors' confidence in their risk disclosure in 2012-2013, although some recommendations that require regulators to make new policy will take longer to implement.

#### *PwC publishes 'Corporate governance - towards best-practice reporting'*

Our *guide*, which we developed with the London Stock Exchange, will help listed companies understand how they can use governance reporting to build the confidence of investors and other

stakeholders – and therefore company value.

### CRA's

#### *EU publishes rules granting CRA's enforcement rights*

A *delegated regulation containing rules of procedure on fines imposed by ESMA on CRA's (No 946/2012)* was published in the Official Journal on 16 October 2012 and came into force on 19 October 2012. The regulation supplements CRA1 and grants CRA's new rights during enforcement and sets out a clear process for ESMA to following for CRA investigation and enforcement:

- rights for CRA's to comment during enforcement investigations and enforcement stages
- rights for CRA's access their ESMA files
- limitation periods for imposing and enforcing penalties.

CRA's now have clear rights to review an Investigating Officer's findings prior to submission to the ESMA Board of Supervisors, and to comment during

the investigation and any resulting enforcement.

The regulation also establishes fixed procedures and time periods for the imposition of penalties and enforcement actions. ESMA may impose fines within three years for any infringement for which the minimum amount of the fine is 50,000 Euros or less, and five years for imposing penalties on all the other infringements. ESMA has a five year state of limitations period during which it may bring an enforcement action.

Supervision of CRA's is ESMA's first direct supervisory duty and expands its role from policy maker to supervisor. The CRA supervisory procedures will likely create a precedent for its future supervisory duties, in particular its supervision of TRs starting in 2013.

### Dodd-Frank Act

#### *SEC upgrades CCP standards*

The SEC adopted *Rule 17Ad-22* under the Securities Exchange Act of 1934, establishing standards on risk management and operations for registered clearing agencies that provide CCP services. The rule,

adopted on 22 October 2012, sets out new requirements for CCPs:

- risk management standards for credit exposures, margin requirements and financial resources
- membership standards, e.g. providing fair and reasonable terms for participants
- record keeping
- financial disclosure and
- other standards for clearance and settlement processes.

The new rule comes into effect 60 days after its publication in the Federal Register.

### *SEC proposes capital, margin, and segregation requirements*

The SEC adopted proposed rules on capital and margin requirements for security based swap dealers and major security based swap participants (SBSPs) and segregation requirements for SBSPs on 17 October 2012. The SEC is also proposing to increase the minimum net capital requirements for broker-dealers using the alternative

internal model-based method for computing net capital.

The proposed rules require security based swap dealers and SBSPs to hold a minimum of \$20 million in net capital, in addition to eight percent of the total collected margin. The SEC is seeking to revise net capital rules for large brokerages that rely on internal modeling to comply with net capital rules by increasing the fixed minimum requirement from \$500 million to \$1 billion.

But the proposals exempt firms designated as “end-users,” such as some asset managers, from margin requirements when use swaps to hedge risk.

The proposals also set out a client money/assets regime for security based swap dealers. Dealers would be responsible for maintaining customers’ fully paid and excess margin securities, in addition to maintaining an account with reserve cash that equals the net cash owed to the customers.

The consultation period will close 60 days after its publication in the Federal Register.

### *CFTC Dodd-Frank Title VII regime comes into force*

On 12 October, 2012, the regulation of swaps under the Dodd-Frank Act by the CFTC commenced. This first compliance date set the compliance dates for other Dodd-Frank Act Title VII rules which will be phased in during the coming months. To address market requests for guidance, on 11 and 12 October CFTC issued 16 no-action letter and staff interpretation letters addressing:

- Swap entity definitions
- Extraterritoriality
- Foreign exchange
- Agricultural and exempt commodities
- Commodity pool regulations
- Introducing brokers, commodity pool operators, commodity trading advisors, floor brokers and floor traders
- Energy-related transactions
- Swap data reporting
- Eligible contract participants.

To further assist firms, the CFTC published five frequently asked question (FAQ) documents. Of particular interest to prospective swap dealers are the two no-action letters concerning the handling of potentially exempt FX swaps and forward and the definition of ‘U.S. person’ for the purpose of the *de minimus* test.

See our *FS Regulatory Brief* for more details.

Q & A documents:

- *On Start of Swap Data Reporting*, 9 October 2012
- *FAQ on the Reporting of Cleared Swaps*, 10 October 2012
- *FAQ - Division of Swap Dealer and Intermediary Oversight (“DSIO”) Responds to FAQs About Swap Entities*, 12 October 2012
- *Q & A – Confidentiality and Indemnification Provisions of 21 (d) of the Commodity Exchange Act*, 22 October 2012
- *Q & A – Proposed Amendments to Enhance Customer Protections*, 23 October 2012

## No-action letters and interpretations:

- Staff No-Action Relief: Preservation of the Regulatory Status Quo With Respect to Swaps Cleared by a DCO (and Related) Collateral (12/10), 10 October 2012
- Preservation of the Regulatory Status Quo with Respect to Certain CEA Provisions That May Apply to RTOs, ISOs, and/or Their Participants (12/11), 11 October 2012
- Preservation of the Regulatory Status Quo with Respect to Certain CEA Provisions That May Apply to FPA Section 201(f) Entities and Other Electric Cooperatives (12/12), 11 October 2012
- Request for Interpretation of the Definition of "Commodity Pool" under Section 1a(10) of the Commodity Exchange Act (12/13), 11 October 2012
- Request for Exclusion from Commodity Pool Regulation for Securitization Vehicles (12/14), 11 October 2012

- Staff No-Action Positions: Registration Relief for Certain Persons (12/15), 11 October 2012
- Time-Limited No-Action Relief: Cleared Swaps in Agricultural and Exempt Commodities and Swaps Exchanged for Futures Not to be Considered in Calculating Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception (12/16), 12 October 2012
- Swap Guarantee Arrangements: Jointly and Severally Liable Counterparties; Amounts Invested on a Discretionary Basis; and "Anticipatory ECPs" (12/17), 12 October 2012
- Temporary Relief from the De Minimis Threshold for Certain Swaps with Special Entities (12/18), 12 October 2012
- Interpretation of Bona Fide Hedging in Commission Regulation 4.5: Restatement of Terms Incorporated by Reference (12/19), 12 October 2012
- Time-Limited No-Action Relief: Swaps in Agricultural and Exempt

Commodities Not to be Considered in Calculating Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant (12/20), 12 October 2012

- Time Limited No-action Relief: Foreign Exchange Swaps and Foreign Exchange Forwards Not to be Considered in Calculating Aggregate Gross Notional Amount for Purposes of Swap Dealer De Minimis Exception or in Calculating Substantial Position in Swaps or Substantial Counterparty Exposure for Purposes of the Major Swap Participant Definition AND Time-Limited No-action Relief for persons that meet the definitions of Commodity Pool Operators and Commodity Trading Advisors Solely as a Result of their Foreign Exchange Swap and Foreign Exchange Forward Activities (12/21), 12 October 2012
- Time-Limited No-Action Relief: Swaps Only With Certain Persons to be Included in Calculation of Aggregate Gross Notional Amount

for Purposes of Swap Dealer De Minimis Exception and Calculation of Whether a Person is a Major Swap Participant (12/22), 12 October 2012

- Interpretation of Regulation 22.2(d) (12/28), 17 October 2012
- Request for No-Action Relief for Swap Dealers and Major Swap Participants from Compliance with Certain Internal Business Conduct Requirements Found in Subpart F to Part 23 of the CFTC's Regulations, (12/29) 26 October 2012
- Temporary Delay of Compliance Date for Part 22 Rules Due to Effects of Hurricane Sandy (12/30), 31 October 2012

**CFTC conforms its regulations to Title VII rules**

Final Rule Amending existing CFTC Regulations to Incorporate Swaps was approved by the CFTC on 16 October, 2012. The CFTC has amended certain of its regulatory definitions and record keeping rules for swap transactions to make them equivalent to its rules for futures transactions. The final rule was



published in the Federal Register 2 November 2012 and will become effective on 2 January 2013.

### **Financial crime**

#### *ENISA reports on EU-wide cyberattack exercise*

The EU's European Network and Information Security Agency (ENISA), the EC and Member States conducted the biggest ever EU-wide cyberattack exercise ('Cyber Europe 2012'), on 4 October 2012. The EC and ENISA issued press releases to report on the event on the same day ([\*IP/12/1062\*](#) and [\*Cyber Europe 2012: first results\*](#)).

The exercise tested how participating countries and the private sector would cooperate in the event of a large-scale attack. Participants included hundreds of experts from major financial institutions, telecom and internet service providers and national governments across the EU. The exercise used a self-contained system to simulate the characteristics and performance of a real-life critical information infrastructure but did not involve any real infrastructures.

ENISA announced that Cyber Europe 2012 was, overall, a success and that it would publish a report on the exercise before end of the year. The EC and the European External Action Service also plan to present a strategy on cyber security before the end of 2012 which will include a legislative proposal to improve network and information security standards across Europe.

#### *EU High Representative speaks on cyber security*

Catherine Ashton, High Representative of the Union for Foreign Affairs and Security Policy and Vice-President of the EC, *spoke* at the Conference on Cyberspace in Budapest on 4 October 2012. Ashton discussed the significant global impact of the internet in recent years. Global growth presents opportunities for the economy (as well as opportunities for enhancing social and democratic reforms) and challenges.

Ashton believes that the EU should stand united in its protection of fundamental rights: freedom of speech, freedom of expression, freedom of association and the right of access to information. The EU must promote

trust and confidence by agreeing pan-European norms of behaviour in cyberspace and enhancing international communication on cyber crisis issues. In doing so, the EU should apply the principles of existing international laws, e.g. the International Covenant on Civil and Political Rights, the Geneva Conventions to resolve conflicts, and the Budapest Convention on cybercrime.

Finally, Ashton mentioned the EU's development of its Cyber Security Strategy, which will help to harmonise the way that Member States deal with cyber issues. She also emphasised that preserving the benefits of cyberspace and working for a safe, secure and free internet are responsibilities shared by the private sector, civil society, governments, international organisations and individuals.

#### *FATF corruption experts meet*

The FATF held an *Experts Meeting on corruption*, in collaboration with the G20 Anti-Corruption Working Group, on 13 October 2012, focusing on:

- asset tracing and financial investigations

- provisional measures on the freezing and seizing of assets
- confiscation
- international cooperation in asset recovery.

Experts shared their experiences on how to exploit the synergies between anti-money laundering (AML), counter terrorist financing (CTF) and anti-corruption (AC) measures.

FATF concluded that AML/CTF and AC efforts have not always been brought together effectively and that regulators and firms can further leverage their efforts to improve that through policy, legislative, operational and enforcement measure.

### **Market infrastructure**

#### *FSB reports progress on OTC clearing*

The FSB published its fourth progress report on *OTC Derivatives Market Reforms* on 31 October 2012. The report departs from earlier policy focussed reports to analyse the readiness of market infrastructures. It also includes an update on the progress of international standards and national implementation efforts.



The FSB's key messages were that:

- The market infrastructure is in place and can be scaled to meet the increasing numbers of products and participants subject to clearing, reporting and execution requirements.
- International policy work setting the global clearing standards is substantially completed and national implementation is proceeding. All jurisdictions should, without delay, implement their regulatory approach to central clearing.
- Regulatory uncertainty remains the most significant impediment to further progress and the comprehensive use of market infrastructure.

The FSB noted that central clearing levels seems to have reached a plateau since 2010, with clearing rates of approximately 40% for interest rate derivatives and 12% for credit derivatives. CCPs believe this is due to regulatory uncertainty and that volumes will increase when regulators have finalised rules on the scope of

products and participants subject to mandatory clearing.

Transaction reporting figures were more encouraging - over 90% of interest rate and credit derivative contracts are reported to TRs. But reporting formats have not been standardised between jurisdictions which hampers regulators' ability to aggregate counterparty exposure information. Legal impediments, such as confidentiality, will also hinder aggregation.

Organised trading platforms are available in each of the primary derivatives asset classes (interest rate, credit, equity, FX, commodities) but market providers are unable to further develop platforms until regulators finalise the scope of clearing, trading and reporting requirements. Platform providers are also concerned about the extra-territoriality of many national OTC reform rules.

The FSB plans to publish its fifth progress report in spring 2013 which will focus on the readiness of market participants.

### *IOSCO commodity derivatives market principles gain traction*

At the G20 summit in Cannes in November 2011, the G20 representatives endorsed the *IOSCO Principles for the regulation and supervision of commodity markets*. On 29 October 2012, IOSCO published its *Review of Implementation of Commodity Market Principles* which the G20 requested at the Los Cabos summit last June.

The 21 Principles address contract design, trading surveillance, disorderly markets, enforcement, information sharing, and price discovery. A majority of members are already broadly compliant with the principles. Some members did fail to comply with the principles but generally where local commodity markets were limited or non-existent. Some EU respondents noted that current gaps in the application of the principles would be addressed by MiFID II and the revised MAD so EU Member States would be compliant when they come into force.

### *ECB clarifies SEPA migration requirements*

On 25 October 2012, the ECB released '*SEPA (Single Euro Payments Area) migration key facts*', with key information on Regulation No 260/2012, known as the 'SEPA migration end-date regulation' or 'SEPA regulation' which came into force on 31 March 2012. The regulation harmonises the initiation and processing of euro payments across the 30 EEA countries, as well as Switzerland and Monaco. The factsheet summarises SEPA regulation's key requirements and implementation dates. Member States in the euro area have until 1 February 2014 to implement the SEPA regulation, and non-euro countries have until 31 October 2016

### *Operating rules and standards*

#### *EU brings short selling regime into force*

The SSR came into force on 1 November 2012. Firms now have to notify their competent authority of net short positions in securities where they exceed a specified threshold. The

relevant competent authorities have to identify shares which have their principal trading venues located in a third country.

ESMA published the *threshold levels for net short positions in sovereign debt* on 11 October 2012, and *the list of shares exempt* from the notification and disclosure requirements and the restriction on uncovered short sale on 4 October 2012. ESMA also updated its *Q&A on the Implementation of the Regulation* on 10 October 2012.

The sovereign debt threshold notice provides thresholds for approximately 60 sovereign issuers, the total amount of outstanding debt they have issued, the required threshold amounts for each issuer and their respective competent authorities.

ESMA will update the threshold document quarterly. ESMA uses a duration adjusted valuation approach, explained in the updated Q&A document. The Q&A also includes additional guidance on reporting issues for group and fund management activities.

The *list of exempted shares* includes over 10,000 shares with ISIN code, name, effective exemption date and country code. ESMA will update the list bi-annually at the end of March. However, national competent authorities can update the list on an ad-hoc basis. Any revision will be effective the day after its publication.

### **Other regulatory** *ESMA publishes 2013 work programme*

ESMA published its *2013 work programme* on 1 October 2012.

On securities markets, ESMA's programme for the coming year focuses primarily on MiFID II/MiFIR and MAD II/MAR reforms. Its other key deliverables include preparations for the new credit rating agency regulation (CRA3), revising the Transparency Directive (2004/109/EC), and the technical standards relating to central securities depositories.

For asset management, it first intends to finalise the regime for AIFMD (following the release of the Level 2 measures by the EC), and to develop technical standards relating to the

venture capital and social entrepreneurship fund regimes which also come into effect on 22 July 2013. Later in the year, ESMA will advise the EC on UCITS V and develop related technical standards, assuming that the EP, Council and EC complete the Level 1 legislative negotiations in the first half of 2013.

In addition, ESMA will work on creating a European single rule book for European securities and markets regulators through providing guidelines on existing legislation. It will also conduct peer reviews in 2013 to ascertain how Member States have implemented EU legislation - to identify areas where further convergence is required and publish summarise of best practices.

ESMA will also continue to improve its direct supervision capabilities for CRAs, and will assume direct supervision responsibilities for TRs registered under EMIR, probably from Q2 2013. It will also assume a coordinating role for all CCP supervisory colleges to be established under EMIR.

### *EU publish US, Australian and Canadian CRA equivalence*

The EU published CRA2 equivalence decisions on the *US* and *Australia* in the Official Journal on 9 October 2012, and decision on *Canada's* equivalence on 12 October 2012. The decisions come into force 20 days following publication.

To pass the EU's CRA2 equivalence test, a third country's CRA regime must:

- subject CRAs to appropriate supervision
- require all CRAs to be registered or authorised
- prevent interference from supervisors or other authorities in respect of the content of the credit rating or methodologies used
- agree a co-operation agreement with ESMA or EU national supervisors.

Brazil, Hong Kong and Singapore are likely to be declared equivalent soon pending the EC's final assessment on these regimes. Meanwhile, EU banks and other financial institutions can use

credit ratings issued by CRAs established in these countries.

ESMA is finalising assessments for other countries, such as Argentina and Mexico, and working on the necessary co-operation agreements with national regulators. EU firms may not use credit ratings issued by CRAs in these countries for regulatory purposes until their national regimes are deemed equivalent.

### **Pensions**

#### *ESMA launches QIS for occupational pensions*

ESMA launched its first *IORP QIS* on 16 October. The study assesses occupational pensions in nine EU countries and closes on 17 December 2012. The study will test the holistic balance sheet (HBS) approach under proposed changes to the IORP methodology. The QIS will target entities that run defined benefit pension schemes but excludes entities which operate only defined contribution schemes.

Marc Hommel, PwC partner for global pensions, encourages firms to participate in the process:

ESMA plans to publish results in spring 2013.

### **Prospectus Directive**

#### *ESMA consults on mineral company requirements in prospectus rules*

ESMA published a consultation *Further amendments to ESMA's Recommendations for the consistent implementation of the Prospectus Regulation regarding mineral companies* on 1 October 2012. The consultation seeks views on the information that mineral companies should disclose in their prospectuses. ESMA proposes to amend its recommendations of:

- definition of a mineral company
- materiality concept within the meaning of "material mineral projects"
- endorsement procedures of the NAEN Code
- thresholds and risk factors
- competent Person's Report regime.

The consultation closes on **21 December 2012**. ESMA intends to

publish the final guidelines during Q2 2013.

### **Regulatory reform**

#### *IOSCO Board gets started*

The IOSCO Board, a new governing and standard-setting body for IOSCO with representatives from 32 securities regulators, held its first *meeting* on 3-4 October 2012. Its remit is to give the IOSCO a more "efficient and inclusive structure".

The Board:

- approved recommendations on the regulation of MMFs and oil price reporting agencies
- reported on summarising the status of securitisation regulation reforms
- agreed next steps regarding IOSCO's report on the CDS market
- noted that the recently constituted Board Level Task Force on Financial Market Benchmarks of the IOSCO had held its first meeting. The task force plans to develop recommendations on safeguards against abusive practices in benchmark setting by the first quarter of 2013.

The Board considered a new initiative on reviewing the impact of national regulatory requirements on securities market cross-border activity. The Board also discussed possible work to improve retail investor protection rules and standards.

#### *FSB reviews progress on G20 agenda*

Following its Tokyo meeting on 10-11 October 2012, the FSB published a *summary of its meeting discussions* on current global market conditions and the progress and status of reports to be delivered for the November G20 meeting in Australia.

The FSB noted that recent policy announcements have led to increased investor confidence and access to financing markets. Peripheral Eurozone markets are strengthening, but recovery is fragile and policy makers must continue to act prudently and swiftly to aid recovery. The FSB found recent fragmentation trends, particularly international firms withdrawing from the Eurozone, reflected a reasonable retrenchment after overextension during the past decade. Authorities and the FSB are committed to strengthening the financial system

without discouraging global integration.

The FSB touched on a number of areas that it will report on at the G20 meeting:

- SIFIs regulation: the FSB endorsed the Basel Committee's framework for dealing with D-SIBs and the IAIS consultation on policy proposals for G-SIIs. The FSB also intends to publish a consultation paper with guidance on RRP in October 2012. It expects the ongoing FSB peer review of members' existing regimes and planned changes to bring them into line with the FSB's key attributes of effective resolution regimes to be finalised in early 2013.
- Shadow banking: the FSB will consult on an initial integrated set of policy recommendations to strengthen regulation of shadow banking activities after the November G20 meeting.
- OTC derivatives reform: the FSB issued its *fourth progress report on implementation of the G20 commitments to OTC derivatives reforms* on 31 October. The FSB will

report to the G20 meeting on members' decisions on national approaches to central clearing.

- Disclosure and accounting: the private-sector Enhanced Disclosure Task Force (EDTF) updated the FSB on its work to complete recommendations for bank risk disclosure standards. The FSB discussed progress on achieving convergence on IASB and FASB standards to agree the classification and measurement of financial instruments. However, the FSB noted that standards on the impairment of loans had yet to be developed.
- LIBOR and other financial benchmarks: the FSB agreed to coordinate the information and lessons from the benchmark reviews undertaken by the FSA, IOSCO, the EC and BIS and to set best practices and principles for standards which emerge.
- LEI: the FSB supports the draft Charter for the LEI Regulatory Oversight Committee which will be submitted to the G20 for endorsement. The FSB continues to

collaborate with the Private Sector Preparatory Group to establish the global LEI foundation, which will operate the proposed Central Operating Unit and operational elements in the global LEI system.

- CRA regulation: the FSB discussed progress on implementing its principles for reducing reliance on CRA ratings.
- Basel II implementation: the FSB reviewed the Basel Committee implementation report findings and calls on member jurisdictions to implement Basel II in a timely way and consistent with internationally agreed standards.

The FSB also reviewed the steps it had taken following its June 2012 recommendations to strengthen its capacity, resources and governance and will report its findings to the G20.

#### *IMF's Lagarde bemoans patchy progress on reforms*

Christine Lagarde, IMF Managing Director, spoke about *Global Financial Sector Reform: An Unfinished Agenda* on 26 October 2012. Lagarde believes that we have seen regulatory reform

progress since the crisis, noting that success with Basel III capital and liquidity standards for banks and large investment firms, OTC derivative reforms and recovery and resolution frameworks are evidence that we are moving in the "right direction".

But many countries have not yet delivered on these reforms and sources of systemic weaknesses exposed during the crisis are still present. Financial systems are still overly complex and interconnected. Banking assets are still highly concentrated with strong domestic bank interlinkages, some banks continue to rely excessively on wholesale funding, and many banks are still too-important-to-fail.

Lagarde posits two reasons for the slow progress of reforms. She believes that the financial systems are still under distress and "crisis-fighting efforts are inadvertently impeding reforms". In many EU countries, it might take banks decades to re-build their damaged balance sheets. However, reforms such as Basel III provide "generous implementation timetables" to allow the economy to recover so there is no



excuse for delaying the implementation of this critical regulation.

Lagarde said that there are vested interests are working against regulatory reform, slowing down progress, and that this “pushback is intensifying”. Lagarde is troubled by banks that say the new regulations will be “too burdensome” and are mounting significant lobbying efforts against them.

Policy makers should not be surprised that banks are seeking to dilute some regulatory requirements. Banking reform proposals seek to fundamentally change the banking industry and will affect its structure, culture and profitability.

### **RRPs**

#### *EC publish non-bank RRP proposals*

The EC published a *Consultation on recovery and resolution framework for non-bank financial institutions* on 5 October 2012. This consultation discusses how the failure of non-bank financial institutions such as CCPs, central securities depositaries and systemic insurance companies can threaten financial stability.

The EC discusses what arrangements can be put in place, at minimal taxpayer cost, to prevent the firms failing. It focuses on recovery and resolution issues, rather than changes to prudential or market conduct rules.

The EC identifies which non-bank failures are likely to be relevant to financial stability. A non-bank entity's systemic relevance depends on their businesses:

- are extensive
- are inter-connected with other institutions and markets
- could be replaced by products and services that other institutions provide.

The EC considers which aspects of insurance business are interconnected with the financial system and/or with the real economy, and whether that business could be replaced readily. Non-banks can fail in various ways, such as a serious insolvency problem, a major technical failure or a combination of the two.

Finally, the EC asks if other types of institutions fail could that result in

mass disruption to the financial system and the economy, and what recovery and resolution tools could be introduced to address such risks. It identifies other types of non-bank institutions including investment funds and certain trading venues, which have not been previously included in RRP regulatory proposals but could introduce systemic risk.

The consultation closes on **28 December 2012**. This consultation represents an important opportunity for all non-banks to help shape appropriate RRP requirements that are appropriate for their industries and reflect how their businesses differ from banks.

### **Shadow banking**

#### *IOSCO finalises recommendations for MMFs*

IOSCO published its *Policy Recommendations for Money Market Funds* on 9 October 2012, setting out final rules following its consultation in April 2012. The recommendations set international standards for MMF regulation and management practices, setting out 15 key principles for valuation, liquidity management, use of

ratings, disclosure to investors and use of repos.

Compared to previous MMF international policy measures which focused mainly on fund assets, these recommendations address vulnerabilities arising from fund liabilities, as well as valuation and requirements to maintain a constant net asset value (CNAV). In particular, the recommendations seek to address the risk of runs on MMFs and to remove the ‘first mover advantage’ for shareholders who redeem their shares from stable NAV funds at first suggestion of difficulties, leaving losses to be borne by residual shareholders.

As the size, features and systemic relevance of MMFs differs significantly between countries, IOSCO acknowledges that the implementation may vary between countries. It plans to review implementation within two years, to consider possible amendments to the recommendations.



## Single supervisory mechanism

### *Council considers Banking Union proposals*

Proposals to create a banking union and its requirements for a SSM in the Eurozone continue to gain support as to help address the fragility of the single currency.

The Council published the conclusions of its meeting on 18 and 19 October 2012 where it considered banking union amongst other things. The Council sees the the EC's legislative proposal to create the SSM as a priority and wants to agree on it by 1 January 2013. In parallel, it advocates the quick adoption of provisions harmonising national recovery and resolution and deposit guarantee schemes, and to push ahead with the single rulebook.

The ministers discussed the treatment of Member States that will remain outside SSM. The Council calls for the equitable treatment and representation of euro and non-euro area member states participating in the single supervisory mechanism, to ensure a level playing field.

But non-eurozone Member States are still concerned about their status vis-à-vis the SSM.

## Accounting

### *IASB*

#### *IFRS - Revenue recognition project*

This IASB and the FASB joint project IFRS - Revenue Recognition aims to clarify the principles for recognising revenue from contracts with customers. The rules apply to all contracts with customers except leases, financial instruments and insurance contracts. The boards' timeline indicates that they will issue a final standard in the first half of 2013, with an effective date no earlier than 2015. The boards will continue to re-deliberate over the next several months and intend to publish guidance on some of the more significant changes.

The boards met in September and October 2012 to continue re-deliberating their revenue recognition and reached tentative decisions on:

- constraint for recognising variable consideration
- certain issues related to collectability
- time value of money

- distributor and reseller arrangement
- contract modifications
- measuring progress toward satisfying a performance obligation.

See our *Straight Away 94* and *Straight Away 95* publications for summaries of these meetings. The boards will analyse further the constraint on recognising revenue from variable consideration and the presentation of impairment losses on receivables. Findings will be discussed at a future meeting. Other key issues which the boards plan to re-deliberate include licences, allocation of transaction price, disclosures and transition. Our *practical guide* summarises the boards' re-deliberations, their tentative decisions and implications.

#### *IASB amends IFRS 10 to exempt 'investment entities' from consolidation*

Many funds and similar entities will be exempt from consolidating most of their subsidiaries under the IASB's *Amendments to IFRS 10, 'Consolidated financial statements'*. Instead, entities will measure subsidiaries at fair value, through profit or loss. The amendments published by the IASB on 31 October

2012 exempt entities that meet an 'investment entity' definition and which display certain characteristics. The IASB also amended IFRS 12 to introduce new disclosures for investment companies. See *Straight Away 97* for more details.

There are no 'roll-up' provisions in these amendments. This means that if a parent entity (e.g. an insurer) is not an investment entity, it will need to consolidate all of its subsidiaries, including those entities that are held via subsidiaries that are themselves investment entities.

#### *PwC publications*

- ***Practical guide to IFRSs 10 and 12: Questions and answers.*** – The IASB issued IFRS 10, Consolidated Financial Statements, and IFRS 12, Disclosure of Interests in Other Entities in May 2011. Some of the detailed guidance is new and may change the scope of consolidation for some parent companies. Our publication sets out our views on some of the most common implementation issues.
- ***Practical guide to IFRS: Classification of joint***

***arrangements.*** – The classification of joint activities under IAS 31 seldom created any controversy or even much in the way of discussion. But IFRS 11 has changed all that, and there will be instances which will require you to undertake significant analysis and exercise judgement. Our guide takes through the key aspects of classifying a joint arrangement under IFRS 11.

- ***IFRS pocket guide 2012.*** Our guide summarises the recognition and measurement requirements of IFRS documents issued up to August 2012. This quick-reference guide is intended for a variety of audiences, including finance directors, financial controllers and other members of the finance team, as well as broader management, actuaries, lawyers, merchant bankers and analysts.
- ***IFRS news.*** – IFRS news is our monthly newsletter highlighting developments at the IASB. The October 2012 edition addresses the following issues:

- IASB and FASB make progress with revenue discussions
- Leases - viewpoint on project's progress
- IFRS quiz: deferred tax.

- ***IFRS disclosure checklist.*** – Our checklist is designed to facilitate the collection and review of disclosures for each component of the IFRS financial statements. It has been updated to outline the disclosures required for December 2012 year ends. It also contains an appendix (Appendix H) which provides the disclosures required of entities that early-adopt IFRSs effective for annual periods beginning after 1 January 2012.
- ***IASB Foundation staff responds to SEC work plan.*** – Our publication considers the IFRS Foundation (the parent organisation of the IASB and the IFRS IC) response to the *SEC's IFRS 'work plan'*. The IFRS Foundation draws different conclusions in several areas from those reached in the SEC work plan. The IFRS Foundation also sets out information that it indicate might not have been fully

considered or given appropriate weight by the SEC staff.

- ***IFRS and US GAAP: similarities and differences.*** – The update to this publication includes:
  - revised introduction reflecting the current status, likely next steps, and what companies should be doing now
  - more current analysis of the differences between IFRS and US GAAP – including an assessment of the impact embodied within the differences
  - details on incorporating authoritative standards and interpretive guidance issued as at 1 September 2012.

# Banking and Capital Markets

In this section:

<b>Regulation</b>	<b>21</b>
<b>Other regulatory</b>	<b>21</b>
EBA publishes 2013 work programme	21
<b>Structural reform</b>	<b>21</b>
Liikanen finds EU banking sector needs structural reforms	21

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## Regulation

### Other regulatory

#### *EBA publishes 2013 work programme*

The EBA published its *2013 work programme* on 4 October 2012. The EBA's priority is to develop a single rule book, the key components of which are the technical standards required under the next CRD IV/CRR framework including capital, liquidity, remuneration and leverage ratio rules. The single rule book will provide a critical underpinning to the proposed new Single Supervisory Mechanism and improve the functioning of the EU single market overall.

The EBA will focus its oversight activities on identifying, analysing and addressing key risks in the EU banking sector. Its assessment will include analysing the consistency of outcomes in terms of risk weighted assets (RWAs), the sustainability of banks' business models, and banks' asset quality.

The EBA will also seek to promote supervisory co-operation and convergence and continue its work

supporting the college of supervisors. It will develop a Single Supervisory Handbook which will underpin the SSM.

On consumer protection, the EBA intends to develop guidelines on responsible mortgage lending and mortgage arrears. The EBA also intends to draft technical standards on professional indemnity insurance, which will be subject to the proposed RMD.

Helpfully, the EBA has published a list of tasks that it expects to deliver between 2013 and 2018, consisting mainly of technical standards under CRD IV and the proposed European bank recovery and resolution legislation.

### **Structural reform**

#### *Liikanen finds EU banking sector needs structural reforms*

On 2 October 2012, Bank of Finland Governor Erkki Liikanen published the findings of his high level expert group's (Expert Group) investigation into whether the current EU banking regulatory reform agenda should include structural reforms to increase stability and customer protection.

The Expert Group recommended legal separation of proprietary trading and other significant trading activities from core retail bank operations. The split would ensure that risky trading activities, beyond a certain threshold, are no longer supported by deposit-taking business in terms of funding or the implicit guarantee. The group believes that the long-standing universal banking model and the efficiencies it generates should not be threatened by these reforms; both trading and deposit-taking would still be allowed in the same group.

The Expert Group stressed the importance of recovery and resolution planning, as proposed in the EC's Crisis Management Directive. The resolution authority should have discretion to request further structural reforms to ensure the resolvability and operational continuity of critical banking functions.

Non-structural reform proposals, such as bail-in instruments, could help resolvability. The bail-in instrument is attractive because it applies losses at the beginning of a stressed period (based on a valuation) rather than when assets are sold, avoiding

unnecessary destruction of value. The report recommends that banks start building-up a sufficiently large layer of clearly identified bail-in debt. Better disclosure will help creditors identify the position of bail-in instruments within the hierarchy of debt commitments in bank's balance sheet.

But structural reforms will not work in isolation. The Expert Group calls on banks to apply more robust risk weights in calculating minimum capital standards and more consistent treatment of risk in internal models. The EBA is considering undertaking a review of asset quality in the EU to examine the consistency of firms' risk-weighted asset calculations.

The Expert Group also recommended improvements to EU corporate governance regulations:

- strengthening boards and management
- promoting the risk management function
- eliminating inappropriate incentive structures at banks

- improving risk disclosure under Pillar III
- strengthening enforcement and sanctioning powers.

The EC has not published a consultation document, but announced on 3 October 2013 that it would seek public feedback on the Expert Group's report. The consultation closes on **13 November 2012**.

The Liikanen Report recommendations are similar to the ICB recommendations, but not identical. The ICB recommended separating a wide range of retail banking activities from investment banking activities, whereas Liikanen would separate only deposit-taking from proprietary trading functions. Both Liikanen and the ICB called for higher capital requirements and better loss absorbency provisions. The ICB suggested strong measures to promote competition but Liikanen avoided this area.

Liikanen believes that the EU and UK reforms need to be compatible. Speaking to a UK Parliamentary Commission on Banking on 22 October 2012, he warned the Government

against fully separating retail and investment activities.

Following review of public comments, the EC will likely publish its legislative proposals on structural reform in early 2013. The Government accepted the majority of the ICB's recommendations in June 2012, which will come into force under the Financial Services (Banking Reform) Bill 2012-13.



# *Asset Management*

There are no asset management only announcements this month.

## *Asset Management*



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# Insurance

In this section:

## **Regulation** 25

### **International regulatory reform** 25

IAIS consults on policy for global systemically important insurers 25

### **Other regulatory** 25

EIOPA publishes 2013 work programme 25

EIOPA publishes risk dashboard 25

EIOPA reports on knowledge and ability requirements for insurance intermediaries 26

### **RRP** 26

EC consults on nonbank financial institution RRP regime 26

### **Solvency II** 26

EP reschedules Omnibus II vote 26

EIOPA publishes part 1 update to Solvency II technical specifications 27

## **Accounting** 27

### **IASB** 27

IASB Insurance Contracts Project – IFRS 4, phase II 27

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## Regulation

### International regulatory reform

#### *IAIS consults on policy for global systemically important insurers*

The IAIS published a *consultation* on 17 October 2012 on policy proposals for G-SIIs together with responses to issues raised in its May 2012 consultation on G-SIIs identification methodology.

Under IAIS proposals for enhanced supervision, G-SIIs must develop a plan to reduce their systemic importance but will nevertheless face additional capital requirements, including group level capital requirements and specific capital requirements for non traditional and non insurance business.

Supervisors, insurers and other interested parties should review the proposals. The consultation period closes on **16 December 2012**. The IAIS plans to develop detailed G-SIIs supervisory policies, with the requirements for the systemic risk reduction taking effect in 2016 and higher capital requirements effective in

2019. See our *Hot Topic* for further details.

### Other regulatory

#### *EIOPA publishes 2013 work programme*

EIOPA published its *2013 work programme* on 8 October 2012. Its key task is to finalise the 53 Solvency II technical standards and guidelines defining standards for capital requirements, group supervision, supervisory transparency and accountability, reporting and disclosure and governance. The work programme annex contains a complete list of the Solvency II technical standards and guidelines.

EIOPA intends to create a supervisory handbook to promote a common Solvency II supervisory approach. The handbook will include supervisory best practices and a question and answer (Q & A) procedure. EIOPA will use the Q & A to provide on established guidelines, recommendations and standards.

EIOPA also plans to develop a centre of expertise to help insurers understand how to get approval for and use internal models under Solvency II. EIOPA has

not yet announced how the anticipated delay to the Solvency II implementation will affect its plans.

Finally, EIOPA plans to conduct a pan-European insurance sector stress test in 2013. The outcome will inform EIOPA's development of financial stability supervisory activities and will be used as a measure of insurers' preparations for Solvency II.

Alongside the 2013 work programme, EIOPA published its *Multi-Annual Work Programme 2012-2014*. This provides an overview of EIOPA's 2012 activities in 2012 and 2013-2014 activities: regulatory tasks, supervisory tasks, consumer protection and financial innovation, common supervisory culture, financial stability, crisis prevention, management and resolution, external relations and EIOPA internal organisation. The plan also includes an outline of EIOPA's deliverables for each year.

#### *EIOPA publishes risk dashboard*

EIOPA published its most recent *Risk Dashboard* in October, assessing the systemic risks and vulnerabilities of the European insurance industry. The

dashboard monitors risks under the following categories:

- macroeconomic
- credit
- market
- liquidity/ funding
- profitability/solvency
- inter-linkages/ imbalances
- insurance.

The Dashboard shows that macroeconomic risk, market risk and insurance risks have increased since June. Macroeconomic risk increased due a decrease in demand for insurance products. The decrease was due to uncertain economic conditions, as well as to the political uncertainty around the Eurozone. Market risk increased due to the prolonged low-yield environment which dampens the profitability and solvency of the insurance sector. Insurance risk increased due to uncertainty about the sustainability of premium growth (which may result from the weak economic outlook).

However, both credit and liquidity/funding risks showed a reduction in risk. The decrease in credit risk was due to a decrease in CDS spreads. Stabilising default rates and a rising ratio of liquid over illiquid investments had a positive effect on the liquidity/funding risk.

The risk barometers for interlinkages/imbances risk and profitability/solvency risk remained largely unchanged. The interlinkages/imbances risk indicates the continuing possibility that banking sector problems may spill over to insurance companies. The profitability/solvency risk benefitted from stable solvency ratios in life underwriting and positive non-life underwriting performance in Q2-2012.

### *EIOPA reports on knowledge and ability requirements for insurance intermediaries*

EIOPA published a *report* looking at requirements which could fulfil knowledge and ability standards for EU insurance intermediaries, finding that

- Knowledge and ability requirements are generally a combination of academic and professional

experience. In many Members States the requirements for knowledge and ability are more stringent for insurance brokers than insurance agents. The requirements to maintain knowledge and ability through continuous professional development (CPD) and assessment practices vary considerably among Member States.

- Member State supervisors have little experience or common standards from which they can determine the mutual recognition of knowledge and ability qualifications from other Member States.
- Most Member States operate basic sanctions when intermediaries fail to possess adequate knowledge and ability with regulators usually refusing to register intermediaries or withdrawing their licence/authorisation.

EIOPA's findings and suggestions will inform EU legislators' work to revise IMD.

## **RRP**

### *EC consults on nonbank financial institution RRP regime*

The EC published a *Consultation on a Possible Recovery and Resolution Framework for Financial Institutions other than Banks* on 5 October 2012. The consultation defines non-bank financial institutions as systemic insurance companies, asset managers and financial market infrastructure providers, such as central counterparties and central securities depositories. The consultation considers how and when the failure of a financial institution, other than a bank, can threaten financial stability.

The consultation defines systemic risk as the risk to financial stability and the wider market from an institution's failure and considers what this means in detail. The EC identifies high risk insurers as those undertaking insurance that is highly interconnected with the rest of the financial system, highly interconnected with the real economy and is not readily substitutable.

The consultation discusses arrangements to prevent nonbank

financial institution failures from compromising financial stability. The RRP arrangements are designed to contain the wider market impact of a failure (crisis management or recovery and resolution standards), not to prevent failure (enhanced prudential or market conduct rules).

The consultation identifies the tools used by some EU countries for dealing with insurer insolvency and asks whether these tools should be developed and harmonised at EU-level. This consultation also seeks feedback on whether Member States should have a specific powers to resolve systemically relevant insurance companies and provides scenarios under which regulatory powers might be used.

This consultation closes on **28 December 2012**.

## **Solvency II**

### *EP reschedules Omnibus II vote*

Following the EC's decision to undertake detailed analysis of the proposed requirements on long-term guarantees to be contained in Solvency II, the EP formally rescheduled its plenary vote on Omnibus II to 11 March

2013 (from 20 November 2012). Omnibus II amends the Solvency II text and must be adopted before Solvency II can be finalised. The EP's rescheduling brought home to many observers the potential impact on the overall timetable. Many, even EIOPA, are suggesting a further delay is necessary, perhaps to 1 January 2016.

The continuing uncertainty over the implementation date is causing frustration for both firms and EU national regulators. In October EIOPA wrote a *letter* to the EC voicing their considerable concerns over the lack of a clear and credible Solvency II implementation timetable.

### *EIOPA publishes part 1 update to Solvency II technical specifications*

Specific scope and calibration of the long-term guarantee assessment (LTGA) are still being determined. These items will be incorporated in the annual QIS study on Solvency II requirements. To help participants prepare for the QIS, EIOPA published part 1 of its *updated technical specifications* for issues which are not dependent on the long term guarantees. These technical specifications reflect

changes resulting from Omnibus II negotiations and also the implementing measures and technical standards that have developed since EIOPA published the most recent set of technical specifications in 2010 as part of the QIS

## *Accounting<sup>1</sup>*

### *IASB*

#### *IASB Insurance Contracts Project – IFRS 4, phase II*

The IASB has been working with the FASB to develop a harmonised IFRS for insurance contracts. However, differences between the IASB and FASB's decisions mean that full convergence between the two bodies' standards is unlikely to be achieved. For more information see our *webpage* and also the IASB's high level summary of the *current status* on the project.

<sup>1</sup> 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\\_service.html](http://www.pwc.co.uk/eng/services/ifrs_service.html)

The IASB and FASB boards met in October 2012 (see *IASB podcast*) and discussed:

- **Implementation date and transition** – The IASB tentatively decided that the effective date will be approximately three years after the issue of the final standard. An exposure draft is due in the first half of 2013. If the final standard were to follow a year later (but no publication date has been announced) then the effective date could apply from 2018 for insurers with December year-ends. Insurers will be required to restate comparative financial statements and early adoption will be allowed. The boards reached different conclusions on the extent to which they would permit re-designation and/or reclassification of financial assets.
- **Presentation and recognition pattern of premiums /presentation and recognition pattern of acquisition costs.** – The boards tentatively agreed to apply the *earned premium approach*. This would include premiums and claims in the statement of comprehensive income and recognise acquisition costs in the statement of comprehensive income consistent with the proposed allocation of the residual/single margin. The FASB also decided that acquisition costs should be presented as part of the margin liability and that the portion of the insurance liability relating to the policyholder obligations should be separated from the unearned margin liability on the face of the balance sheet.
- **Determination of discount rate for accretion of interest under premium allocation approach (PAA).**– Under the premium allocation approach, the boards decided to use the discount rate at inception of the contract to measure the liability for remaining coverage. The discount rate will also determine the amount of claims and interest expense in profit or loss for the liability for incurred claims.
- **Participating contracts.**– The discussions clarified that the mirroring decisions would take



precedence over the decision to present discount rate changes in other comprehensive income (OCI). The FASB decided that for contracts where the mirroring decisions do not apply and the contractual obligation to the policyholder is directly linked to the fair value of the underlying items, changes in the insurance liability should be presented in profit or loss.

- **Investment contracts with discretionary participation features (DPF) - IASB only.** –

The IASB agreed some consequential amendments are needed for financial instruments with DPF that are in the scope of the insurance contract standard.

*See PwC summary of the meetings and education sessions.* The boards plan to meet next in November 2012.

In September, the IASB decided that the exposure draft to be issued in the first half of 2013 would seek comment on only the five most significant areas of change from the previous exposure draft. A group of industry bodies wrote a joint *letter* to the IASB to request the

right to comment on the package of measures as a whole.

# Calendar

## Open consultations

Closing date for responses	Paper	Institution
13/11/12	<u>Consultation on the recommendations of the High-level Expert Group on Reforming the structure of the EU banking sector</u>	EC
29/11/12	<u>Consultation on a Possible Framework for the Regulation of the Production and Use of Indices serving as Benchmarks in Financial and other Contracts</u>	EC
16/12/12	<u>Policy prescriptions for Systemically Important Insurers</u>	IAIS
21/12/12	<u>Further amendments to ESMA's Recommendations for the consistent implementation of the Prospectus Regulation regarding mineral companies</u>	ESMA
28/12/12	<u>Consultation on a possible Recovery and Resolution Framework for Financial Institutions other than banks</u>	EC

## *Forthcoming publications in 2012*

Date	Topic	Type	Institution
<b><i>Capital and Liquidity</i></b>			
Q4 2012 – Q2 2013	CRR/CRD IV	76 regulatory technical standards, 32 implementing technical standards and 20 guidelines	EBA
Q4 2012	Review of Financial Conglomerates Directive	Legislative proposals	EC
TBC 2013	Revision of Financial Conglomerates Directive (FICOD II)	Legislative proposals	EC
<b><i>Consumer protection</i></b>			
Q4 2012	Directive on misleading and comparative advertising (2006/114/EC)	Communication	EC
Q4 2012	An EU framework for collective redress	Legislative proposals	EC
Q4 2012	Investor Guarantee schemes- revision	Legislative proposals	EC
Q4 2012	Bank accounts	Legislative proposals	EC
<b><i>Financial crime, security and market abuse</i></b>			
Q4 2012	Financial message data transfer from the EU to the USA for the purposes of the Terrorist Finance Tracking Program	Report	EC
Q4 2013	Market Abuse Review	Technical advice	ESMA
TBC 2012	Third Anti-Money Laundering Directive	Legislative proposals	EC
<b><i>Insurance</i></b>			
Q3 2013	Institutions for Occupational Retirement Provision	Legislative proposals	EC
Q4 2013	Technical standards for Omnibus II	Technical standards	ESMA

Date	Topic	Type	Institution
<b><i>Securities and markets</i></b>			
Q4 2012	Securities Law Directive	Legislative proposals	EC
Q4 2012	Limitation period and further procedures for fining credit rating agencies	Regulation	EC
Q4 2012	Revision of the Transparency Directive	Discussion papers	ESMA
Q4 2012	Close-out netting	Legislative proposals	EC
Q1 2013	OTC Derivatives, CCP Requirements, Trade Repositories and CCP Interoperability (EMIR)	Guidelines	ESMA
Q1 2013	Guidelines on the enforcement of EMIR provisions on OTC derivatives	Guidelines	ESMA
Q1 2013	Joint technical standards on Article 11 of EMIR (exchange of collateral)	Technical standards	ESAs
Q2 2013	Guidelines on MiFID remuneration	Guidelines	ESMA
Q4 2013	Technical standards following the revision of MiFID (MiFID II and MiFIR)	Technical standards	ESMA
TBD 2013	Credit Rating Agencies III Regulation	Technical advice	ESMA
<b><i>Products and investments</i></b>			
Q4 2012	Alternative Investment Fund Managers Directive – Level 2 measures	Regulation	EC
Q4 2012	Alternative Investment Fund Managers Directive – cooperation agreements	Technical standards	ESMA
Q1 2013	Social Investment Funds	Technical advice	ESMA

Date	Topic	Type	Institution
Q1 2013	Venture Capital	Technical advice	ESMA
Q1 2013	Implementation of the Alternative Investment Fund Managers Directive (Part 2)		
Q2 2013	Technical advice on the revised Prospectus Directive	Technical advice	ESMA
Q3 2013	Technical standards on the revised Transparency Directive: notification requirements and update and maintenance of Q&A	Technical standards	ESMA
TBD 2013	Packaged Retail Investment Products	Technical standards	ESMA
TBD 2013	Undertakings For The Collective Investment Of Transferable Securities V	Technical advice	ESMA
TBD 2013	Markets in Financial Instruments Directive II	Technical advice	ESMA
TBD 2013	Markets in Financial Instruments Directive II	Guidelines	ESMA
<b>Recovery and resolution</b>			
Q4 2012	Rescue and restructuring of financial institutions in Europe	Guidelines	EC
TBD 2013	EU framework for recovery and resolution plans	Technical advice	EBA
<b>Solvency II</b>			
Q1 2013	Draft Level 2 delegated acts	Level 2 text	EC
TBD 2013	Solvency Level 3 measures	Level 3 text	EIOPA
<b>Supervision, governance and reporting</b>			
Q3 2012	Corporate reporting	Guidelines/recommendations	ESMA
Q4 2012	EU corporate governance and company law	Action plan	EC



Date	Topic	Type	Institution
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	Remuneration and supervisory co-operation arrangements	Guidelines/recommendations	ESMA
Q2 2013	Delegated acts from the EC Green Paper on the European Corporate Governance framework	Delegated acts	ESMA
Q4 2013	Revision of Enforcement Standards – financial information	Technical standards	ESMA

Main sources: ESMA 2012 work programme; EIOPA 2012 work programme; EBA 2012 work programme; EC 2012 work programme; ESMA 2013 work programme; EIOPA 2013 work programme; EBA 2013 work programme

# PwC insights

## Cross financial services

### *Sharing deal insights - European Financial Services M&A news and views*

In this edition, we look at whether the pick-up in deal activity seen in the middle of the year is likely to continue. The other main focus of this edition is the prospects for investment in financial services in Russia and Central Europe.

Read more [here](#)

## Asset management

### *Safeguarding asset managers against mounting cyber security threats*

In this edition of Asset Management insights we look at the risks and options available to asset managers in response to the mounting cyber security threats.

Read more [here](#)

### *Regulation in South Africa may slow asset manager growth*

In South Africa's developing asset management industry, new regulations threaten to put a brake on revenue

growth, according to local asset managers. While the country's managers are growing far faster than those in developed markets, a raft of regulatory changes associated largely with local pension fund reforms and enhanced investor protection threaten to stifle the pace of expansion. We explore the challenges ahead.

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## Insurance

### *Reinsurers confront a new reality*

As emerging market trade flows become more interconnected, 'Confronting the new market realities' looks at how to make sure your company is in the right place to pick up the best business. The paper also examines the challenges of keeping underwriting up to speed with the new risk and economic landscape.

As your business assesses how to compete in a world of twin-speed growth, the paper also looks at how to harness the latest advances in analytics to sharpen underwriting and refocus resources on higher margin business.

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### *Insurance 2020: Turning change into opportunity*

**Future of Insurance** is a new research study from PwC. We're exploring the drivers of change for the insurance industry. Bringing together PwC insurance professionals from around the world to share perspectives and challenge research findings, we have created new insight that will provide an important discussion tool to shape strategic thinking and direction.

Read more [here](#)

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<http://www.pwc.com/insurance>

# Glossary

AIFMD	Alternative Investment Fund Managers Directive
AIMA	Alternative Investment Management Association
AMICE	Association of Mutual Insurers and Insurance Cooperatives
AML	anti-money laundering
Basel Committee	Basel Committee of Banking Supervisors
BIL	Bank for International Settlements
BIS	Bank of International Settlements
CCD	Consumer Credit Directive 2008/48/EC
CCPs	central counterparties
CDS	credit default swaps
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
Council	European Council of Ministers
CPI	Consumer Price Index
CPSS	Committee on Payment and Settlement Systems

CRAs	credit rating agencies
CRD	Capital Requirements Directive 2006/48/EC
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 Systemic Risk Board
EURIBOR	Euro Interbank Offered Rate
FASB	US Financial Accounting Standards Board
FATCA	Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Federal Reserve Board (US)
FICOD	Financial Conglomerates Directive 2002/87/EC
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FMI	financial market infrastructure
G30	Group of 30
GAAP	Generally Accepted Accounting Principles
G-SIBs	Globally systemically important banks
G-SIFIs	globally systemically important financial institutions
G-SIIs	globally systemically important insurers
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
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

IRS	Interest rate swap
ISDA	International Swaps and Derivatives Association
ITS	implementing technical standards
JMLSG	Joint Money Laundering Steering Committee
LEI	legal entity identifier
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
MMF	money market funds
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
QIS	quantitative impact study
RMD	Residential Mortgage Directive COM (2011)142 final
RRPs	recovery and resolution plans
RTS	regulatory technical standards

SCR	solvency capital requirement
SEC	Securities and Exchange Commission
Solvency II	Taking up Pursuit of Business of Insurance and Reinsurance Directive 2009/138/EC
SSM	single supervisory mechanism
T2S	TARGET2-Securities
TR	trade repository
UCITS	Undertakings for Collective Investments in Transferable Securities
UCITS IV	UCITS Directive 2009/65/EC
UCITS V	Proposed directive amending UCITS IV, COM(2012)350 final
US	United States of America



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