

# *Being better informed*

## FS regulatory, accounting and audit bulletin

*PwC FS Regulation*

**Q3 2015**

*In this quarter's edition:*

- *Qatari regulator to grant licences to GCC banks*
- *CBB updates its Handbook*
- *GCC boards becoming more professional*
- *Updates on latest global developments*



# Executive summary

*Welcome to this edition of “Being better informed”, our quarterly 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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Those keeping pace with developments at the global agenda level would have seen that FSB recently announced that it had done much of the work it set out to do back in 2009 following the global financial crises while recognising that a lot needs to be done at the national levels in the different G20 countries where G20 has a predominant say.

Within the Middle East Region, the banking and capital market regulators, particularly, those within GCC continue to make good progress in aligning their regulatory and supervisory frameworks to match the increasing risks and depth of the respective financial services sectors.

The Press carried a number of announcements that suggested that some of the GCC central banks were now going to be issuing additional licenses to some of the major banks from other GCC counterparts. In particular, Qatar and Saudi Arabia attracted attention in the press.

With the regional economies slowing down, the impact of Basel III and, more particularly, the liquidity rules as was pointed out in our last edition, would be an important matter of concern for some regulators and for banks which have been aggressively allocating their assets to match shareholder return expectations or stock market performance measures. In this issue we bring to you insights into some of the current changes to regulatory frameworks. We have also covered global or European regulatory issues that are particularly important if you are a regional player with interactions or ambition to do business on a cross border basis.

This bulletin is not meant to be comprehensive, however, we will endeavour to provide our high level points of view in relation to the significant

announcements in the financial services regulatory space.

Your feedback is important to us so we can continue to make this bulletin more meaningful.

## How to read this bulletin?

Review the Table of Contents and 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.

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## Middle East announcements

### Conduct

#### *New qualification approved*

Central Bank of Bahrain has duly recognised the “Securities Market Regulation Certification” provided by the Bahrain Institute of Banking and Finance as one of the minimum qualifications required for professionals undertaking capital market advisory and investment banking activities in the Kingdom of Bahrain.

### Corporate governance

#### *BDI: Boards of GCC businesses becoming more professional*

Businesses across the GCC are increasingly adopting more rigorous corporate governance standards and are becoming more transparent in their communications to win deeper public trust, and the shift is being driven by chairmen and more professional boards, as recently discussed at the 3rd Chairman Summit hosted by the GCC Board Directors Institute (BDI) in Riyadh in partnership with Investcorp.

GCC BDI is the pre-eminent not for profit institute in the Gulf focused on helping boards become more effective

so that organizations may perform better and grow. This year the Chairman Summit featured three panel discussions with each focusing on a specific aspect of the role of the chairman: the value of reputation, the chairman's role in enhancing board effectiveness, and the board's role in leading companies through change. Panellists included notable members of the business community.

### Supervision

#### *Qatar's regulator to grant licenses to GCC banks in Qatar*

Qatar's central bank is to grant licenses to Gulf Cooperation Council banks to open branches in the state. Licenses for new banks will be given according to the criteria set out by the central bank. Qatar currently licenses 11 domestic banks and 7 foreign banks. Among the foreign banks, Mashreq is the only GCC-based institution to have a Qatari banking license. Bahrain's Ithmaar Bank has a representative office in Qatar but not a full license.

#### *CBB updates its handbook*

The CBB has made changes to Bahrain's regulatory handbook through the third quarter of 2015. The changes are as follows:

- Volume 1 (Conventional) and Volume 2 (Islamic)

Amendments made to the Transitional Arrangements section under the Capital Adequacy (CA) module i.e. during the transition period (when regulatory adjustments to AT1 and T2 capital begin at 20%, 40%, 60%, 80% and 100% of required adjustments on 1 January 2015, 1 January 2016, 1 January 2017, 1 January 2018 and 1 January 2019 respectively), the remainder of the exposures held prior to 1<sup>st</sup> January 2015 not deducted from capital is subject to risk weights.

Amendments made to the Regulatory adjustments section under the Capital Adequacy (CA) module to reflect the treatment of the risk weighting for exposures below the threshold limit. That is the amount of any significant investments in commercial entities exceeding the materiality threshold is risk weighted at 800%, while those exposures that are not subject to the 800% risk weight, must be allocated risk weighting on a pro rata basis.

- Volume 2 (Islamic)

Amendments to the Business Conduct (BC) module to reflect IFSB-9 'Guiding principles on conduct of business for institutions offering Islamic financial

services'. Banks are required to provide a gap analysis to the CBB by 30<sup>th</sup> September at the latest reflecting areas of non-compliance with the updated module. All Islamic bank licensees are required to fully comply with the updated module by 31<sup>st</sup> December 2015 at the latest.

- Volume 3 (Insurance)

Amendments made to the rules on insurance broker commissions to the Client Money (CM) module i.e. where international insurance business is involved wherein the insurance broker is dealing with an international insurance/reinsurance broker, the insurance broker may choose to deduct its commission from the premium/contribution account.

## International announcements

### Capital and liquidity

#### *FAQs on measuring counterparty credit risk*

On 19 August 2015, the Basel Committee published Basel III: the standardised approach for measuring counterparty credit risk exposures: frequently asked questions. The FAQs relate to the standardised approach for

measuring counterparty credit risk (SA-CCR), which is replacing the current exposure method and the standardised method, and cover:

- the general formula
- the PFE add-on
- specific derivatives
- miscellaneous edits.

Also, the Basel Committee has made a technical amendment to the SA-CCR framework, which applies where the perimeters of the margin agreement and the netting set differ, particularly where one margin agreement covers multiple netting sets.

#### *Updated Basel III monitoring*

The Basel Committee published *Instructions for Basel III monitoring* on 31 July 2015 alongside an updated *worksheet* and *FAQ* which it specifically asks participating banks to observe.

The instructions cover the:

- scope of the exercise
- structure of the questionnaire
- different worksheets for collecting data on the interest rate risk in the banking book, large exposures,

operational risk and sovereign exposures

- Basel III leverage ratio and liquidity.

In addition, the Basel Committee introduced new worksheets to further its policy initiatives in these areas.

#### *Financial crime*

##### *Updated risk assessment FAQs*

The Wolfsberg Group published *Frequently Asked Questions on Risk Assessments for Money Laundering, Sanctions and Bribery & Corruption* on 7 September 2015, providing guidance on current best practices. In contrast to the heavily quantitative assessment of credit and market risks, financial crime risk management requires a qualitative, risk-based approach calibrated to the size, complexity, global reach, and risk appetite of the financial institution. Moreover, guidance from national regulators on the management of financial crime risk vary.

To provide uniformity, the Wolfsberg Group's guidance addresses:

- the purpose, frequency, and organisation of a risk assessment

- whether the scope of a money laundering risk assessment should encompass other financial crimes such as bribery and corruption
- the conventional/standard money laundering risk assessment methodology, comprised of the assessment of inherent risks mitigated by internal controls to derive a residual risk rating
- the use of issues highlighted during the risk assessment, i.e., the assignment of action owners to track and remediate issues prior to the next risk assessment
- the impact of the risk assessment on the financial institution's risk appetite
- the use of software/systems to conduct a risk assessment.

Throughout, the Wolfsberg Group emphasises the involvement of senior management and business units in the success of a financial crime risk assessment.

Global financial institutions with broad geographic reach will be interested in aligning themselves to the Wolfsberg Group's uniform risk assessment framework, particularly in countries where regulatory approaches vary.

#### *Financial stability*

##### *G-SIFI assessments delayed*

The FSB *delayed* its final assessment of methodologies for NBNI G-SIFIs on 30 July 2015. The FSB wants to wait until its work on financial stability risks from asset management activities is finalised before it issues further communications.

The FSB expects to report to the G20 on these asset management activities before the end of 2015, with further work in 2016. It will then commence work on finalising any methodology to designate asset managers and investment funds as G-SIFIs.

#### *Insurance update*

##### *Evaluating insurers' pay*

The FSB published *FSB-IAIS 2015 Workshop on compensation practices in the insurance sector* on 3 August 2015, which it held in May 2015 with IAIS and a number of senior insurance staff responsible for their firm's remuneration policy.

The FSB here sets out some key messages and areas it sought wider feedback on (by 31 August 2015), including:

- the applicability of its Principles and Standards for Sound

Compensation Practices for the insurance sector and the consistency of application across the sector on a worldwide basis

- the participants' view that compensation practices and the specific nature of business activities at insurers differ significantly from those of banks
- the importance of sound risk management and a focus on internal controls and designing compensation structures that align with the firm's long term strategy and risk management horizon
- compensation in the context of the risk management framework
- the use of compensation as a proactive tool to promote or insure good behaviour
- the use of clawback clauses.

The FSB plans to include the workshop findings in its next report on compensation practices, to be published in advance of the November 2015 G20 Summit.

### *Managing conduct risk*

The IAIS published an Issues Paper on Conduct of Business Risk and its Management on 1 July 2015. It

discusses issues supervisors may wish to consider when looking at conduct of business risks and looks at the sources and impact of conduct risk and its place within risk management frameworks. The IAIS also considers how to mitigate conduct risk, in terms of both how firms manage conduct risk and the role that regulators play.

The consultation closed on 14 August 2015.

### *Regulating captive insurers*

The IAIS published an Application paper on regulation & supervision of captive insurers for consultation on 1 July 2015. It defines a captive insurer as "an insurance or reinsurance entity created and owned, directly or indirectly, by one or more industrial, commercial or financial entities, the purpose of which is to provide insurance or reinsurance cover for risks of the entity or entities to which it belongs, or for entities connected to those entities and only a small part of any of its risk exposure is related to providing insurance or reinsurance to other parties."

The IAIS considers how its Insurance Core Principles and Standards apply to captives and provides additional information to help insurance

supervisors develop an appropriate supervisory approach to captives. It also considers issues relating to cell company structures and insurance managers.

The consultation closed on 3 August 2015.

### *Investment funds*

#### *IOSCO looks at MMFs*

IOSCO published a peer review of money market regulation (both proposed and final) by IOSCO members on 2 September 2015. It considered:

- developing specific regulatory definitions for MMFs
- limiting asset types and risk, with all of the largest jurisdictions reporting implementation
- introducing valuation requirements, with some jurisdictions failing to define the parameters around acceptable use of the amortised cost method
- putting measures in place to ensure the resilience of stable MMFs, with the US and EU utilising liquidity fees and redemption gates
- limiting the reliance on external credit ratings, with a number of jurisdictions still requiring that

MMFs invest in instruments with such ratings

- requiring investor disclosures such as on the fund's valuation method, potential for market stress and clarifying the limitations of stable NAV MMFs (such as no capital guarantee)
- establishing requirements around MMF participation in the repo markets.

IOSCO's review is timely in light of the final US rules published last year and the near-finalisation of the EU's Regulation on MMFs.

#### *Extending AIFMD outside EU*

On 30 July 2015 ESMA published its advice to the EP, Council and the EC on the application of the AIFMD passport to non-EU AIFMs and AIFs. Currently non-EU AIFMs and AIFs can only be marketed in the EU under national private placement regimes (NPPRs). While this allows AIFMs and AIFs access to EU investors, they must adhere to differing local requirements to access the market - in addition to the AIFMD requirements relating to investor disclosure, annual reporting and regulatory reporting.

ESMA's advice opens up the passport (on an optional basis) to non-EU AIFMs and AIFs located in Guernsey, Jersey and Switzerland. ESMA did not recommend access for fund managers and funds in Hong Kong, Singapore and the US. ESMA said it needs more time to analyse information on each country's local regulatory regime. The exclusion also reflects ESMA's view that these countries do not currently provide reciprocal access for EU AIFMs and AIFs into their home market and investors.

Countries not approved by ESMA should not face immediate marketing difficulties as NPPRs will continue until at least 2018. But given the difficulties some firms have experienced in marketing under NPPRs and understanding the different local requirements imposed by different EU member states it would be beneficial to have the option of using an AIFMD passport. We are beginning to see more EU investors questioning AIFMD compliance and opting for funds that are within scope of AIFMD. Non-EU AIFMs and AIFs may find they need to start complying with AIFMD to satisfy investors as much as making use of the AIFMD passport.

## Market infrastructure

### LEI ROC reporting

On 7 September 2015, the Legal Entity Identifier Regulatory Oversight Committee (LEI ROC), an FSB and G20 endorsed committee of 60 national public authorities, consulted on collecting data on direct and ultimate parents of legal entities in the Global LEI System. The LEI ROC seeks stakeholder feedback on the proposed approach for collecting data on direct and ultimate parents of entities covered by the LEI framework.

The LEI ROC proposes that entities that have or acquire an LEI would report their ultimate accounting consolidating parent, as well as their direct accounting consolidating parent. It acknowledged the accounting consolidation approach will not capture many types of control relationships, but it believes the increased simplicity it brings will establish a strong foundation for expanding reporting parameters in the future. LEI ROC suggested that entities report to the Local Operating Units of the Global LEI system, which then verifies the relationship based on available public documents. Entities would be required to provide information on parent

companies for an LEI to be issued or renewed, but they will have the option to decline in certain circumstances. LEI ROC notes that certain data on certain types of relationships will not be captured, such as joint ventures and branches, but it indicates that these will be addressed in separate proposals.

The consultation period closes on **19 October 2015**.

### Strengthening CCPs into 2016

The chairs of the FSB, IOSCO, the Committee on Payment Markets and Infrastructures (CPMI) and the Basel Committee released a progress report on the CCP Workplan on 22 September 2015. It sets out the current status and future of plans for CCP resilience, recovery planning and resolvability, as well as an analysis of interdependencies.

The organisations set out the following timeline for future developments:

- a CPMI-IOSCO consultation on CCP resilience and recovery issues, which will cover stress testing, risk management and recovery mechanisms - mid 2016
- a CPMI-IOSCO report on Level 3 implementation of the Principles for Financial Market

Intermediaries (i.e. the consistency of outcomes) - mid 2016

- an FSB Resolution Steering Group (ReSG) report on the need for and proposals for further guidance to support CCP resolvability and resolution planning - end of 2016
- a joint Basel Committee, CPMI, FSB and IOSCO report on key interconnections between CCPs and clearing members and the potential for contagion effects - October 2016.

A final report on all these issues is then due by the end of 2016.

### Derivatives data reporting

On 2 September 2015 IOSCO and BIS' Committee on Payments and Market Infrastructures (CPMI) consulted on proposed key data elements for derivatives transaction reporting, covering the following data elements:

- effective date
- end date
- whether cleared or not
- settlement method, such as physical, cash or other
- primary obligor ID

- notional amount
- notional currency
- valuation currency.

The consultation period closed on 9 October 2015. IOSCO and CPMI plan to consider unique transaction identifiers (UTIs) and unique product identifiers (UPIs) in separate consultation work streams at a later date.

#### *IOSCO supports more transparency*

IOSCO published *Post-Trade Transparency in the Credit Default Swaps Market: Final Report* on 7 August 2015. IOSCO surveyed market participants and observers on the use of publicly available post-trade data and the perceived impact on the market. In this report, it analyses the survey results in combination with its own quantitative analysis of the US, where mandatory post-trade transparency in certain CDS markets is now in effect.

It found that the introduction of the transparency regime has not had a substantial effect on market risk exposure or market activity for credit default swaps. The report also cites a study performed by the Federal Reserve Bank of New York when disclosure was voluntary. That study found that dealers do not typically hedge large

transactions by trading in the opposite direction on the same product type on the same day or the day after a trade is executed.

After considering the potential costs and benefits, IOSCO suggests that it would be valuable to make the price and volume of individual CDS transactions publicly available. IOSCO also recommended increasing post-trade transparency in the global corporate bond and structured finance product markets given the positive impact on transaction costs.

In the EU, the transparency regime forms part of MiFID II, which will come into effect on 3 January 2017.

#### *Applying FMI principles for central banks*

On 19 August, 2015, IOSCO published *guidance* on how its principles for financial market intermediaries (FMIs) owned and operated by central banks. It observed that generally the principles apply in the same way for central bank FMIs as they do for private-sector FMIs, with a handful of exceptions:

- a central bank's governing body should not be constrained by the principles on governance when a FMI is operated as an internal function of the central bank

- the requirement to hold ring-fenced liquid net assets to cover business risk and to support a recovery or wind-down plan does not apply to central bank FMIs (given a central bank's inherent financial soundness)
- central bank policy around offering of central bank accounts, provision of credit or acceptance of collateral is not meant to be constrained by the principles.

#### *Derivative market reforms continue*

IOSCO published a *Review of implementation progress in regulation of derivative market intermediaries* on 29 July 2015. It reviewed the extent to which its member jurisdictions have implemented regulatory reforms in line with its 2012 report on *International standards for derivatives market intermediary regulation*.

IOSCO is concerned that many jurisdictions do not have enough tailored OTC derivatives rules to satisfy its principles, notwithstanding the confidence many jurisdictions expressed about their conformity to the principles (given general licensing and registration requirements for market participants). Likewise, IOSCO noted

similar issues with the broader capital and conduct rules. However, IOSCO also acknowledges that OTC derivatives reform in many jurisdictions is well underway, indicating wider alignment with the principles in the future. IOSCO recommends a second review is not required before the end of 2016.

### *Supervision*

#### *FSB progress report*

The FSB published its *second annual report* on 17 July 2015. Being hosted and funded by BIS, the FSB's financial statements are limited to a Statement of Activities. The report therefore highlights the FSB's activities during the year.

Mark Carney, FSB Chair, sets out that in the year ahead the FSB will coordinate efforts to combat new risks and vulnerabilities to financial stability - risks from market-based finance (including the growing role of asset management) and misconduct risk.

#### *IOSCO sets out strategic direction*

On 28 July 2015, IOSCO published its *strategic direction* for 2015-2020. IOSCO prioritises increased inclusiveness of emerging market membership, both in terms of how standards are formulated as well as how it deploys resources to

those markets. For example, IOSCO will seek to ensure that its assessment programmes are relevant for both developed and developing markets. Likewise, it will be shifting to a more regional focus for its capacity building initiatives, looking to better harness member experience, expertise and infrastructure.

The report also notes that risk and research work should not be limited to systemic risk but should focus more broadly on risks faced by member jurisdictions arising from market activities, technology and product developments. IOSCO also emphasises that it will be reviewing the unintended consequences of regulatory change.

### Accounting

#### **Financial accounting**

##### *Insurance contracts debate continues*

On 20 July 2015, the IASB discussed the accounting consequences of applying IFRS 9 Financial Instruments before the application of the new insurance contracts standard, in particular, potential accounting mismatches and temporary volatility in profit or loss. It decided to amend IFRS 4 Insurance Contracts to mitigate accounting mismatches from the

adoption of IFRS 9 Financial Instruments before the new insurance contracts standard is issued. The IASB plans to consider the potential amendment to IFRS 4 and the alternative of deferring IFRS 9 further at its meeting in September.

See our *Insurance alert - IASB meeting on 20 July 2015* for details.

##### *Revenue from customer contracts*

On 13 July 2015, the Transition Resource Group (TRG) discussed several implementation issues related to the new revenue standard (IFRS 15). We expect further discussion of the accounting for the constraint on variable consideration and transition to the new standard. TRG members generally agreed with the FASB and IASB staff views on other matters, including questions about applying the series guidance and the scope of the revenue standard.

The IASB also published *ED/2015/6 - Clarifications to IFRS 15 'Revenue from Contracts with Customers'* on 30 July 2015. It proposes to add details to IFRS 15 on identifying performance obligations, principal versus agent considerations and licensing, but not to add information on collectability or measuring non-cash consideration. It

also proposes transition relief for modified contracts and completed contracts.

##### *Accounting changes for associates and joint ventures postponed*

The IASB published *ED/2015/7 - Effective Date of Amendments to IFRS 10 and IAS 28* on 10 August 2015. It proposes to postpone the date when entities must change some aspects of how they account for transactions between investors and associates or joint ventures until after the IASB has carried out a fuller review that may result in the approach being simplified. The areas affected cover how an entity should determine any gain or loss it recognises when assets are sold or contributed between the entity and an associate or joint venture in which it invests.

The comment period ended on **9 October 2015**.

# Glossary

ABC	Anti-Bribery and Corruption	CCPs	Central Counterparties
ABS	Asset Backed Security	CDS	Credit Default Swaps
AIF	Alternative Investment Fund	CET1	Core Equity Tier 1
AIFM	Alternative Investment Fund Manager	CFTC	Commodities Futures Trading Commission (US)
AIFMD	Alternative Investment Fund Managers Directive 2011/61/EU	CFT	Counter Terrorist Financing (translation)
AML	Anti-Money Laundering	CGFS	Committee on the Global Financial System (of the BIS)
BCBS	Basel Committee of Banking Supervision (of the BIS)	CMA	Capital Markets Authority
Basel II	Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework	CRD IV	Capital Requirements Directive 2013/36/EU
Basel III	Basel III: International Regulatory Framework for Banks	CRR	Regulation on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012
BCBS	Basel Committee on Banking Supervision	CTF	Counter Terrorist Financing
BIBF	Bahrain Institute of Banking and Finance	DFSA	Dubai Financial Services Authority
BIS	Bank for International Settlements	Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act (US)
CBB	Central Bank of Bahrain	D-SIBs	Domestically Systemically Important Banks
CBK	Central Bank of Kuwait	EBA	European Banking Authority
CBO	Central Bank of Oman		

EEA	European Economic Area	FTT	Financial Transaction Tax
EIOPA	European Insurance and Occupations Pension Authority	G30	Group of 30
EMIR	Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EC) No 648/2012	GAAP	Generally Accepted Accounting Principles
EP	European Parliament	GCC	Gulf Cooperation Council
ESMA	European Securities and Markets Authority	G-SIBs	Globally Systemically Important Banks
FASB	Financial Accounting Standards Board (US)	G-SIFIs	Globally Systemically Important Financial Institutions
FATCA	Foreign Account Tax Compliance Act (US)	G-SIIs	Globally Systemically Important Insurers
FATF	Financial Action Task Force	IAIS	International Association of Insurance Supervisors
FC	Financial counterparty under EMIR	IASB	International Accounting Standards Board
FCA	Financial Conduct Authority	IIFS	Institutions offering Islamic Financial Services
FDIC	Federal Deposit Insurance Corporation (US)	IFRS	International Financial Reporting Standards
FMI	Financial Market Infrastructure	IFSB	Islamic Financial Services Board
FRC	Financial Reporting Council	IMF	International Monetary Fund
FSB	Financial Stability Board	IOSCO	International Organisations of Securities Commissions
FSI	Financial Stability Institute (of the BIS)	ISDA	International Swaps and Derivatives Association
FSOC	Financial Stability Oversight Council	ITS	Implementing Technical Standards
		LCR	Liquidity coverage ratio

LIBOR	London Interbank Offered Rate	RRPs	Recovery and Resolution Plans
MiFID	Markets in Financial Instruments Directive 2004/39/EC	RTS	Regulatory Technical Standards
MiFID II	Proposed Markets in Financial Instruments Directive (recast) (COM(2011) 656 final)	SAMA	Saudi Arabian Monetary Agency
MiFIR	Proposed Markets in Financial Instruments Regulation (EC) (COM(2011) 652 final)	SCA	Abu Dhabi's Securities and Commodities Authority
NAV	Net Asset Value	SEC	Securities and Exchange Commission (US)
NSFR	Net stable funding ratio	SIPP	Self-invested personal pension scheme
OECD	Organisation for Economic Cooperation and Development	SOCA	Serious Organised Crime Agency
OIC	Organization for Islamic Cooperation	Solvency II	Directive 2009/138/EC
PCBS	Parliamentary Commission on Banking Standards	SSAP	Statements of Standard Accounting Practice
PRA	Prudential Regulation Authority	SYSC	Senior management arrangements Systems and Controls sourcebook, UK regulation
QCB	Qatar Central Bank	T2S	TARGET2-Securities
QFMA	Qatar Financial Markets Authority	TR	Trade Repository
QFCA	Qatar Financial Centre Authority	UAECB	United Arab Emirates Central Bank
QFCRA	Qatar Financial Centre Regulatory Authority	UAEIA	United Arab Emirates Insurance Authority
QIS	Quantitative Impact Study	UCITS	Undertakings for Collective Investments in Transferable Securities
RDR	Retail Distribution Review		

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