

FS regulatory, accounting and audit bulletin



PwC FS Risk and Regulation Centre of Excellence

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In this month's edition:

- FSB sets out TLAC proposals for G-SIBs
- ESMA consults on changes to EMIR reporting requirements
- ESAs consult on KIDs for PRIIPs
- ESMA looks at AIFMD passport for third countries
- In-depth analysis of remuneration rules and how they differ across the globe

Executive summary



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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.

The financial sector took centre stage again at the November 2104 G20 summit in Brisbane, albeit with greater emphasis on expanding its role in contributing to economic growth and investment. G20 leaders committed to raising GDP by at least 2 percent by 2018, adding more than €1.6 trillion and “millions of jobs” to the global economy. They set out more than 800 measures in an action plan to achieve this goal. Stimulating long-term infrastructural funding was the lead, with plans to establish a global infrastructure hub in Australia funded with both public and private money.

In a similar vein, EC President Jean-Claude Juncker announced plans to create a new European Fund for Strategic Investments in November, to “mobilise at least €315 billion of additional investment over the next three years”. The fragile state of the banking system, highly indebted public sector and weak EU economy may explain why investment levels are €370 billion below pre-crisis norms in Europe. But Juncker sees huge potential to break the vicious cycle of under-confidence and under-investment. Vast amounts of liquidity slushing about the bank accounts of corporations, individuals and financial institutions is “ready to be used”. Investors are desperately searching for good long-term investment projects in

an environment of persistent low interest rates.

Stimulating investment runs at the heart of Juncker’s future plans. In his first speech as EC President in late October, Juncker proposed a Capital Markets Union (CMU) to expand and develop non-bank equity and debt finance in the EU. Reducing reliance on bank credit, particularly amongst SMEs which get 85% of their funding needs from banks, will be a significant challenge. Legislators have already started to lay the foundations for a CMU – AIFMD, long term investment funds, crowd-funding, simplified prospectuses, SME growth, EuVECA and EuSEFs will all help. But significant work will be required to create a truly integrated market for non-bank funding, from harmonising investor protection, taxation policies and insolvency laws throughout the 28 Member State Union. Juncker’s vision of a CMU remains, “a concept under construction”, according to ESMA’s Steven Maijoor. Commissioner Hill intends to publish a green paper in early 2015 which should outline his action plan for implementing the new ideas.

The true benefits of facilitating alternative funding mechanisms will only be fully realised if they supplement rather than replace financing provided

by a robust and sustainable banking system. In Brisbane, the G20 Leaders welcomed the FSB’s proposal requiring G-SIBs to hold additional loss absorbing capacity (TLAC) that will protect taxpayers if these banks fail. The FSB’s proposal requires G-SIBs to hold a minimum amount of regulatory capital (Tier 1 and Tier 2) plus long term unsecured debt that together is at least 16-20% of their risk weighted assets, i.e. at least twice the minimum Basel III total regulatory capital ratio of 8%. The proposal will be subject to a rigorous quantitative impact assessment and further refinement before the G20 Leaders agree any final measure at their 2015 summit. The impact analysis will include consideration of the consequences of this requirement on banks in emerging markets and state-owned banks.

TLAC is meant to ensure that G-SIBs’ critical functions can continue immediately following resolution without taxpayer funded bail-out. Banks’ IT systems are proving to be increasingly important ‘critical functions’. In November, UK regulators hit RBS a £56 million fine for its extended IT system failure two years ago, the largest fine ever for a UK retail bank. The FCA fined the state-backed lender a record £42 million, with the PRA levying a further £14 million fine on its NatWest and Ulster Bank

subsidiaries. UK regulators have made it clear that they won't tolerate IT systems failures that negatively impact customers. . We have produced a *hot topic* outlining our views on the common reasons for IT system failure and, importantly, the lessons we have learnt which can help banks become technology resilient organisations.

We've seen a real ramp up in Solvency II missives from EIOPA and the PRA regulators in the past few months, as implementation looms. At the Solvency II Conference in late October the PRA provided information on what insurers must do to prepare for Solvency II in the months ahead on internal model approval. We have prepared a *hot topic* to help firms get on the front foot in responding to the regulator. We cover the PRA's guidance on supervisory approvals, in particular the matching adjustments and undertaking specific parameters and the key messages for standard formula firms.

In our feature this month, we offer our perspective on remuneration and the impact that divergent global regulation is having on the competitive landscape and the challenge of attracting key talent.

From myself and the rest of the FS Risk and Regulation Centre of Excellence team, we would like to thank you for your readership and support over the past year. We wish you a very Merry Christmas and a Happy New Year, and

hope you enjoy all the festivities of the holiday season.



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Contents

<i>Executive summary</i>	1
<i>Reward regulations in financial services</i>	4
<i>Cross sector announcements</i>	8
<i>Banking and capital markets</i>	14
<i>Asset management</i>	18
<i>Insurance</i>	20
<i>Monthly calendar</i>	23
<i>Glossary</i>	28
<i>Contacts</i>	33

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.

Reward regulations in financial services



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Reward regulations in financial services – an unlevel playing field?

Over the past two years, EU policy makers have introduced new remuneration requirements with far reaching consequences to the financial services industry. The differences in the way in which authorities have applied the set of globally agreed rules to different firms within the sector, across geographies, and by type of firm, have grown wider. Concerns about an ‘unlevel playing field’ for firms subject to EU regulations have intensified.

The unlevel playing field

Much remuneration regulation does not impact the competitiveness of firms. Regulation generally follows what is already regarded as good practice and allow firms flexibility in the way that they comply. Examples include rules on the governance of remuneration policies and practices, and those that encourage a prominent role for risk and compliance functions in the design and implementation of policies. Regulation that aims to improve performance management, e.g. by specifying that non-financial as well as financial metrics should be set for employees, is also generally flexible enough to avoid hindering competition.

But other regulation can give firms less flexibility in the way they comply, and

restrict the ability of a firm to use remuneration to recruit, retain or motivate staff. Differences in implementation can impact the competitiveness of firms. Firms which operate in multiple jurisdictions, or that recruit employees in one jurisdiction to work in another are particularly vulnerable to these competition concerns.

Rules concerning remuneration structures – deferral of variable remuneration, payment in shares or other instruments, retention periods and bonus caps - have the greatest impact on the competitiveness of firms. The application of malus (the reduction of unvested deferred remuneration) and the clawback of variable remuneration that has vested raise equally important competitiveness issues.

Global Standards

Differences across jurisdictions have arisen because of the way that the EU and national supervisors have implemented the Principles and Standards for ‘Sound Compensation Practices’ published by the Financial Stability Board (FSB) in 2009. The FSB addressed these principles to significant financial institutions, and the key standards focus on the following:

- **Governance and Process.** The need for Boards or Remuneration Committees to have effective and independent oversight of remuneration policies across the firm and specifically for the

remuneration of senior management and material risk takers.

- **Risk Adjustment and Performance Management.** Performance measurement should include both financial and non-financial metrics. Bonus pool calculation should consider the cost of capital and liquidity requirements as well as current and future risks facing the organisation.
- **Remuneration of control functions.** Firms should base performance metrics for risk and compliance staff on their own responsibilities rather than the financial performance of the business areas that they oversee.
- **Remuneration structures.** Firms should remunerate senior management and material risk takers (MRTs) in specific ways. Regulations require 40% and sometimes 60% of variable remuneration to be deferred: at least 50% of variable remuneration should be in shares or share linked instruments and firms should apply malus in the event of poor performance.
- **Guarantees.** Guarantees should only exist in exceptional circumstances. Firms should only guarantee bonuses for new hires, limited to the first year of employment.

- **Disclosure.** Firms should disclose their governance arrangements and the design features of their remuneration arrangements. Disclosure should also include quantitative disclosure of remuneration for senior management and material risk takers.

The FSB has not issued further direct guidance since 2009, although at the FSB's request the Basel Committee issued detailed guidance for firms on risk adjustment and disclosure.

Competitive challenge for EU firms

An unlevel playing field can arise for three reasons. The first and most significant is a difference in the implementation of remuneration regulations by national regulators, or by a supranational body such as the EU. The second results from differences by type of firm (e.g. banks as opposed to insurers) and the third results from differences by size of firm.

Variations between jurisdictions

- **Principles and guidance versus Rules**

All major financial centres have adopted the FSB principles and standards but the ways in which FSB members have implemented those standards differ. The EU has incorporated the principles and standards into national law and regulation through a series of Directives and Regulations. The third iteration of the Capital Requirements Directive

(CRD III) incorporated the first set of EU rules in January 2011. CRD III followed the FSB Standards, albeit with some strict interpretations on the question of scope. But the subsequent CRD IV introduced additional rules, most notably a bonus cap.

Other jurisdictions including the US and most countries in Asia have promulgated the FSB Principles and Standards as high level principles or guidance.

- **Scope and proportionality**

The FSB directed its Principles and Standards at significant financial institutions, and most jurisdictions focus their regulatory attention on these larger firms. But in the EU, CRD IV included all banks, building societies and a large number of investment firms within scope. Nearly 1,000 UK firms alone fall within the scope of CRD IV.

The EU rules do include an element of proportionality to allow member states to apply the rules in a way which reflects the size, complexity and nature of business of firms within scope. Yet this flexibility creates some level playing field issues of its own (see below). 85% of UK firms within the scope of CRD IV are allowed to disapply the more prescriptive rules on remuneration structures.

The EC has since introduced remuneration rules to other parts of the financial sector. The AIFMD includes similar remuneration rules for managers (AIFMs) of hedge funds, private equity and other non-UCITS funds as for banks and investment firms under CRD III. As a result there is no requirement for a bonus cap, and firms still have flexibility in how they identify MRTs. Proportionality applies for smaller fund AIFMs, but larger AIFMs need to comply with the rules on remuneration structures.

Further Directives will extend remuneration rules to more firms - UCITS V to UCITS fund managers, and Solvency II to insurers. We expect both Directives to come into force by the end of 2016.

- **Identifying Material Risk Takers**

The FSB Principles and Standards introduced the concept of MRTs, employees whose professional responsibilities or activities may have a significant impact on the risk profile of the firm. Most remuneration rules focus on MRTs.

US regulators expect firms to identify a large number of covered employees, including groups of employees whose individual responsibilities are unlikely to have a material impact on the firm's risk profile but who could have a material impact when acting collectively. But

because US covered employees are not bound by prescriptive rules, the implications of being a covered employee in the US are less significant than for MRT's in EU headquartered firms. The US regulators believe that the main purpose of identifying more junior covered employees is to encourage regulated firms to apply other aspects of the FSB standards appropriately.

In the EU regulators expect all firms within the scope of the CRD IV to follow a set of complex rules to identify MRTs. The criteria include all employees with total remuneration above €500k. The number of MRTs in EU firms has increased substantially since CRD IV came into effect.

All MRTs in the larger banks and investment firms must comply with the full set of CRD IV rules, including the bonus cap and other rules on remuneration structures. Proportionality allows MRTs in smaller firms to disapply these rules.

In the UK, the new Senior Managers Regime (SMR) will operate in addition to the MRT process. Individuals that the PRA identifies as Senior Managers within the terms of the SMR (likely to be around 8-12 individuals for a major UK bank) will face additional deferral requirements as set out below.

- **Remuneration structures**

There is a strong expectation from US regulators that senior management and senior MRTs in the large firms should be subject to deferral, proportion in shares, etc. to align incentives with the longer term interests of the firm. In many cases big US banks can show that their senior staff exceed the requirements of CRD IV. But flexibility is possible. US banks may flex the rules to recruit or retain a key hire.

The EU provides no flexibility on the rules for large banks and investment firms. Proportionality allows smaller firms to disapply rules in most jurisdictions. The EBA may use revised guidelines in 2015 to further restrict national authorities' flexibility on proportionality.

The UK is currently consulting on tougher rules than CRD IV, raising the minimum period of deferral for MRTs to 5 years. For PRA designated Senior Managers the minimum deferral will be seven years, and supervisors can extend this period to ten years if either the firm or the regulator is investigating events which could lead to them applying malus.

- **The Bonus cap**

The US has no bonus cap, but the EU does. The EU bonus cap is the most significant additional rule introduced by

CRD IV. It limits the ratio between fixed and variable remuneration. CRD IV sets the cap at 100% of fixed pay (200% with the approval of shareholders). Most EU firms that operate in international markets have sought or will be seeking shareholder approval to increase the cap to 200%.

There is very little flexibility on the bonus cap rule for large banks and investment firms. Many firms took legal advice that the definition of fixed remuneration in CRD IV permitted the use of allowances, adjustable in certain defined circumstances, as an element of fixed pay. But the EBA published an Opinion on the use of allowances in October 2014. We expect the EBA to finalise revised guidelines during 2015 to curtail the use of allowances.

The UK expressed strong opposition to the bonus cap, arguing that effective use of malus and clawback on variable remuneration is a better way of aligning remuneration with prudent risk taking. But an adverse opinion from the ECJ Advocate General led the UK government to withdraw a challenge to the legality of the bonus cap lodged with the ECJ.

- **Malus**

Malus is the reduction or cancellation of deferred but unvested variable remuneration.

US regulators expect large firms to subject senior management and senior MRTs to malus. In the EU, CRD IV requires EU firms to be able to apply malus in cases where an individual was responsible for conduct which resulted in significant losses to the firm or failed to meet appropriate standards of fitness and propriety.

The UK extends the application of malus to situations where there is reasonable evidence of employee misbehaviour or error, where the firm or the business unit suffers a material downturn in its financial performance and where there has been a material failure of risk management. In the latter two cases, firms can apply malus to senior management if they were ultimately responsible for the failure. The PRA has reinforced the EU rule with detailed guidance expecting firms to prepare policies on the application of malus. The FCA is currently consulting on similar guidance.

- **Clawback**

Clawback is the recovery of variable remuneration which has been vested to the employee. The US Sarbanes-Oxley Act contains provisions requiring CEOs and CFOs to return previously awarded compensation, but it is unclear whether or how often this has been applied.

In the EU, CRD IV makes reference to clawback but the text is unclear and

stakeholders doubt how effectively individual regulators will apply clawback to firms.

The UK Remuneration Code clarifies the national implementation of CRD IV. The Code requires a firm to 'make all reasonable efforts' to apply clawback during a period of at least seven years from the date that the firm awarded variable remuneration. Firms should utilise clawback in cases of employee misbehaviour or material error, or where the firm or business unit suffered a material failure or risk management.

Different business, same sector

Large UK banks and investment firms are subject to the full range of EU rules plus super-equivalent requirements from the UK regulator relating to deferral, malus and clawback. But many firms with which they compete for skilled staff – asset managers, hedge funds, insurers, etc. – are not.

Large banks are also at a competitive disadvantage relative to the 'challenger banks' which aim to compete in retail and commercial banking in the UK, since the latter do not have to apply prescriptive rules on structure or the bonus cap. The asset management subsidiaries of large banks must follow the prescriptive rules and apply the bonus cap, unlike their standalone competitors, unless those subsidiaries can prove that they are sufficiently independent.

Challenges for EU firms

Large EU-based banks and investment firms need to recruit and retain MRTs in leadership roles and with specialist skills in competition with firms which are not subject to prescriptive rules. These competitors may be located in jurisdictions which apply the FSB Principles and Standards as principles or guidance. Competitors may be EU firms that operate in another part of the financial sector (e.g. asset management or insurance). These firms may even be active in the same market but benefit from proportionality because they are smaller or less complex.

Competition is not just a question of the ability to compete based on products or services. Large EU banks and investment firms may be in competition with firms located in other jurisdictions to find the right talent, because they search for individuals with certain specialist skills on a global basis. Firms may even find themselves competing with non-financial firms when recruiting at the most senior levels of management, where qualities of leadership and strategic thinking are common across sectors. Offering attractive remuneration structures while complying with complex and divergent global regulation will continue to be a key challenge for firms in 2015.

Cross sector announcements

In this section:

Regulation	8
Approved persons	8
Data	8
Financial literacy	8
Financial stability	9
Investor protection	9
Market infrastructure	9
Other regulatory	9
Remuneration	10
Securities and Derivatives	10
Shadow banking	12
Accounting	13

Regulation

Approved persons

International branches captured by SMR

On 17 November the UK's HMT consulted on *Regulating individual conduct in banking: UK branches of foreign banks*. HMT proposes applying the SMR to UK branches of foreign credit institutions and PRA designated investment firms. Senior managers in a branch would not be liable for the new criminal sanction of causing a financial institution to fail, unlike UK firms.

The FCA expects to designate more senior management functions in branches than the PRA and to nominate more significant harm functions (roles where an individual could cause significant harm to the firm). As branches do not have their own balance sheet or capital, they are not subject to the same level of prudential regulation as a UK firm or subsidiary.

The PRA does not expect to designate any senior management functions in UK branches of EEA firms because EU law limits the ability of regulators to prudentially supervise firms incorporated in other EEA states. The PRA's regime for non-EEA firms will be subject to consultation but it has indicated that it expects to specify significantly fewer senior management

functions in branches of non-EEA credit institutions than in UK domiciled firms. Many of these branches may need only one individual approved by the PRA as the Overseas Senior Branch Manager.

The consultation closes on **31 January 2014**.

Data

Hiding in the shadows

On 13 November 2015, the FSB published *Standards and Processes for Global Securities Financing Data Collection and Aggregation*. The FSB recommends that authorities need more data to identify shadow banking activities and their prevalence. It suggests regulators should collect more data on securities financing markets to detect financial stability risks and develop policy responses. This data can then be given to the FSB to identify global trends or threats to financial stability.

The FSB proposes standards and processes to define the data elements that should be reported locally (then up to the FSB) for repos, securities lending and margin lending. But it is concerned that data architecture issues and problems around how to report will limit the effectiveness of the collected data. So the FSB proposes six recommendations to ensure that the same data is collected globally and aggregated in the same way to avoid different figures on

the quality of global aggregates. It also outlines the potential uses of the aggregated data are discussed and the next steps for the completion of the initiative.

The consultation closes on **15 February 2014**. The FSB then plans to finalise its reporting standards and processes by the end of 2015.

Financial literacy

IOSCO wants coordinated education

IOSCO published its *Final report - strategic framework for investor education and financial literacy* on 4 November, which sets out its strategic role and approach to promoting investor education and financial literacy. IOSCO's Committee on Retail Investors was set up in June 2013 to improve retail investor education and financial literacy.

IOSCO identified good practice including:

- improving retail investor knowledge on products
- developing programmes that meet investor need and the needs of specific audiences and support regulatory initiatives
- considering insights gathered from research and using these in investor education/financial literacy programmes

- designing programmes with clear measurable outcomes and evaluating these on a timely basis
- collaborating with partner organisations, considering national strategies and promoting international co-operation.

The Committee on Retail Investors will review IOSCO members' current practices to identify effective techniques for increasing education and literacy. It will also provide a forum for sharing information and experiences, and spot emerging issues or themes before they crystallise.

Financial stability

Low economic stresses

The ECB published its biannual *Financial Stability Review* on 27 November 2014. Indicators of stress among banks and sovereigns remain low, despite occasional bouts of market turbulence.

But vulnerability persists. The ECB identifies systemic risk that could derail the financial system including:

- abrupt reversal of the global search for yield (medium risk; constant)
- persistent weak bank profitability in a fragile and uneven macroeconomic recovery (medium risk; constant)
- re-emergence of the sovereign debt crises (potential risk; rising).

The ECB notes that the economic growth outlook is underlying all key risks. The weak economy has the potential to “aggravate and trigger the existing vulnerabilities” if the current situation continues for longer than expected or conditions deteriorate further.

Investor protection

Making sense of risk and reward disclosures

The Joint Committee of ESAs published *Discussion paper: key information documents (KIDs) for PRIIPs* on 17 November 2014, which sets out the initial views on the challenges presented in developing a KID for a broad range of products.

PRIIPs mandates the structure of the KID. The Joint Committee is considering what type of information should be included within the KID. The most complex areas of the KID relate to the disclosures on risks, rewards and costs and it sets out a number of options.

The Joint Committee believes that any reward disclosures need to be carefully considered to ensure that retail investors do not focus wholly on these, ignoring the costs and risks. Part of the difficulty is also developing a practical solution that fits for all types of PRIIPs.

For costs, the Joint Committee wants to disclose both initial and ongoing costs as a percentage and absolute figure, although the time period for total cost is unclear,

although it proposes this could be linked to the manufacturer's suggested holding time for any particular PRIIP.

The ESAs also consider:

- the KID template – whether to develop a single template for all PRIIPs or a variations for different PRIIPs
- providing the KID – following the MiFID II approach of providing information in good time before an investor invests
- plain language – the ESAs, local regulators or industry bodies should further consider providing guidance for writing the KID in plain language.

The discussion paper closes for comments on **17 February 2015**. The Joint Committee plans to publish a follow-up consultation based on responses and then provide draft RTS to the EC on that basis.

Market infrastructure

Market operators get final rules

On 19 November 2014, the SEC published its *final rules* requiring market infrastructure operators to have automated systems with adequate capacity, integrity and resilience. Registered and exempt clearing agencies, alternative trading systems and plan processors are all within scope of the final rule. These firms must have:

- written policies and procedures around systems monitoring

- mandatory participation by designated members or participants in scheduled testing of business continuity and disaster recovery plans

- coordination of industry-wide testing.

The SEC amended the draft rule to reflect industry feedback, including allowing quarterly rather than monthly reporting and amending some key definitions to narrow the scope of firms caught by the rule.

Other regulatory

G20 focuses on global economy

The G20 published a *communiqué* following the Brisbane summit on 15 and 16 November 2014. Financial regulatory reform took centre stage again, but with a greater emphasis on the financial sector's role in contributing to a stronger and more sustainable global economy.

The main talking points from the summit included:

- Shadow banking – G20 countries have made progress in delivering the shadow banking framework this year. The G20 endorsed an updated roadmap for further work. It also wants more market-based financing, which reflects EC President Juncker's agenda for the CMU.
- Creating a more resilient financial system - the G20 believes progress made to improve banks' capital and liquidity positions and to make derivatives

markets safer will reduce risks in the financial system.

- Too big to fail - the G20 welcomed the FSB's proposal requiring G-SIBs to hold additional loss absorbing capacity (TLAC) that will protect taxpayers if these banks fail.
- Derivatives reforms - the G20 called on regulatory authorities to accelerate their efforts to implement the central clearing of all standardised derivative contracts. Countries are encouraged to defer to each other when it is justified, in line with the September 2013 St Petersburg Declaration.

The G20 warns that critical work remains to build a stronger, more resilient financial system. Its next task is to finalise elements of policy framework and fully implement agreed financial regulatory reforms, while remaining alert to new risks.

US bribery guidance

Andrew Ceresny, SEC Director of Enforcement, *spoke* about the SEC's actions regarding the new Foreign Corrupt Practices Act (FCPA) on 19 November 2014. The FCPA prohibits US firms from paying bribes to foreign officials to win business.

Ceresny stated that:

- the SEC will continue to focus its enforcement actions on both individuals and companies

- firms (and individuals within firms) should fully cooperate with the SEC if they identify the payment of bribes
- "anything of value" is considered a bribe under FCPA which could include charity contributions designed to induce business or payments to family members rather than individuals directly linked to a business.

The SEC may take a different approach to firms if firms can demonstrate they have implemented comprehensive policies across their global businesses to prevent bribes being paid to induce business.

Remuneration UK drops bonus cap challenge

HMT published a *letter* on 20 November 2014 from George Osborne, Chancellor, to Mark Carney, Chairman of the FSB requesting more supranational work on remuneration issues. Advocate General Jääskinen issued an *opinion* rejecting the UK's challenge on the legality of the CRD IV bonus cap on the same day.

Osborne indicated that the UK maintains that the EU approach to bankers' remuneration is not correct, although the UK will now drop its legal challenge in the ECJ.

He notes that the bonus cap will increase fixed pay, which is not subject to claw-back and is effectively guaranteed even if the bank is facing financial distress. Osborne suggests that as part of the FSB's ongoing

work there is a need for careful consideration of how, in jurisdictions where the balance of banking remuneration has shifted towards fixed remuneration, compensation schemes can still achieve the objective of supporting sound risk taking.

The Chancellor also intends to ask the UK's *Fair and Effective Markets Review* to consider this issue as part of its work on responsibilities, governance and incentives.

Securities and Derivatives Derivative reform falls further behind

The FSB urged the G20 to complete outstanding reforms and implement them quickly in its *OTC Derivatives Market Reforms, Eighth Progress Report on Implementation* published 7 November 2014. The G20 agreed to implement OTC derivative reforms by the end of 2012 but the FSB found that most jurisdictions won't have fully (or in some cases even partially), implemented the reforms by the end of 2014.

The G20 countries have largely completed the first stage of the reform process by adopting legislation to implement change. But they will not bring some critical rules for managing counterparty risk, central clearing and non-centrally cleared margin rules in effect until the end of the 2015.

The FSB also provided an update on specific reforms in each country:

- trade reporting – 16 of the 19 G20 countries will have reporting rules in

effect this year. But data quality remains poor and barriers to reporting hinder reporting regimes' effectiveness.

- central clearing – five jurisdictions have rules in effect requiring the central clearing of interest rates, credit and currency derivatives, and five additional countries are expected to implement rules by the end of 2015.
- capital and margin requirements – most countries are expected to implement rules governing capital for cleared and non-centrally cleared derivatives and non-centrally cleared margin in 2015, in accordance with international standards.
- exchanges and electronic platforms – seven jurisdictions are developing execution requirements.

The FSB plans to publish its next progress report on OTC derivative reform implementation in April 2015, with an increasing focus on monitoring the effectiveness of the reforms.

Challenges of regulating cross-border

On 25 November 2014, IOSCO published the *IOSCO Task Force on Cross-Border Regulation - Consultation Report*. The consultation focuses on the use of cross-border regulatory tools, specifically national treatment, recognition and passporting, and looks at the role that IOSCO could play in enhancing the regulation and supervision of the global securities markets going forward.

IOSCO members see various potential roles for IOSCO:

- enhancing international dialogue
- acting as a central hub of information
- being a forum
- offering technical assistance
- developing informative guidance on cross-border regulatory tools
- Producing guidelines for assessing foreign regimes
- increasing the level of granularity of standards
- developing a ‘Conflict of regulations’ framework.

But members don’t seem to support IOSCO attempting to coordinate the timing of implementation amongst its members or to facilitate the settlement of disputes.

IOSCO is seeking input from all interested parties. The consultation closes on **23 February 2015**.

EMIR reporting rules 2.0

ESMA published a *Review of the technical standards on reporting under Art 9 of EMIR, ESMA/2014/1352* on 10 November 2014, proposing substantial changes to EMIR transaction reporting data formats and requirements. ESMA is elevating certain EMIR Q&A guidance to the status of binding legislation and revising many of the

statutory reporting data fields and formats. ESMA propose:

- Clarifying data fields and their descriptions – to require consistent use of key reporting terms, narrow the reporting scope for complex products and clarify how valuation should be calculated and reported.
- Adapting existing fields to the reporting logic prescribed in the Q&A – to harmonise data formats, expand the list of counterparties, create a new “Reporting Tracking Number” to replace the “Transaction Reference Number” and amend the instructions on reporting life cycle events.
- Introduce new fields and values – to replace the EEA/non-EEA field with “country of domicile”, create a new industry sector for corporate counterparties, include an additional notional field to reflect original and daily notional calculations and create a new field to identify which reporting entity is responsible for creating and transmitting UTIs.

The consultation closes on **13 February 2014**. ESMA is expected to deliver its final recommendations and draft rules to the European Commission for endorsement next year and final rules are expected to come into effect in the second half of 2015.

CFTC clarifies Volcker requirements

On 13 November 2014, the CFTC *clarified* the treatment of mortgage-backed securities (MBS) issuers sponsored by government-sponsored entities (GSEs) under the Volcker Rule’s covered funds provisions. The final Volcker Rule limits banks’ investment and sponsorship of ‘covered funds’, which are defined as any funds relying on the Investment Company Act’s (ICA) private fund exemptions to avoid ICA regulation.

GSEs sponsoring MBS qualify as federally sponsored structured financings and do not meet the Volcker Rule’s definition of a covered fund. The CFTC confirmed that banking entities can invest in such entities without breaching Volcker requirements.

Swap relief extended

On 14 November 2014, the CFTC *extended* the time limited no-action relief for non-US swap dealers from Dodd-Frank “Transaction Level Requirements”. This action allows non-US swap dealers that carry out swap transactions with non-US persons, provided the non-US swap dealer has no US presence other than staff fulfilling front office activities.

This extension means that these swap dealers do not need to comply with the Dodd-Frank rules until 30 September 2015.

Fine tuning US trading rules

On 14 November CFTC Commissioner Wetjen *suggested* the CFTC should fine tune its trading regulations to avoid

international market fragmentation and align them with overseas regulatory trends. Specifically, Wetjen embraced substituted compliance and argued for reducing US intrusiveness over foreign trading venues by adopting a transaction-by-transaction approach.

Likewise, he believes that the CFTC should exempt foreign trading venues if they can demonstrate that they are subject to comparable home country regulation, which would substantially improve their foreign participants’ access to the US market.

Focus on CCP risk

On 18 November 2014, CFTC Chairman Timothy Massad *spoke* about the significant global progress that derivatives regulators have made but warned of challenges still to come. He noted that although central clearing is an essential tool in mitigating bilateral risk it also concentrates risk in CCPs, potentially creating systemic risk.

Massad suggests the best option would be for regulators to impose dual (or increased) approval requirements on CCPs, and cooperate more on oversight. He does not want the US to solely rely on overseas regulatory requirements as a tool to allow non-US CCPs to access the US market. He suggests that this could only happen by establishing swap data repositories that can distribute transaction data globally.

Treasury affiliate scope extended

On 26 November 2014 the CFTC issued a no-action letter that reduces the obligations that treasury affiliates must meet to be exempt from Dodd-Frank clearing requirements. Counterparties engaging in swap transactions that must be cleared should do this through registered derivatives clearing organisations. But counterparty firms that do not meet the criteria of ‘financial entity’ can take advantage of the end-user exception to these requirements if using swaps for the purposes of hedging or mitigating commercial risk.

While the exception was extended in June 2013 to treasury affiliates that would themselves be considered financial entities, market participants complained that a number of the required conditions were inappropriate. The CFTC has updated its no action letter to reflect this feedback and identifies those conditions which are either no longer applicable, and those that remain in force.

Data reporting relief extended

On 24 November 2014 the CFTC extended no-action relief from the swap data reporting rules for swap dealers and major swap participants from a small group of jurisdictions - Australia, Canada, the EU, Japan and Switzerland. Firms can only use this relief if they are not part of an affiliated group with an ultimate parent entity from the US.

The no action relief will end on 1 December 2015 or earlier if the SEC issues a comparison of the reporting rules of those jurisdictions against US rules beforehand.

Shadow banking

G20 moves out of the shadows

The G20 published a communiqué following the Brisbane summit on 15 and 16 November 2014. Financial regulatory reform took centre stage, albeit with a greater emphasis on the financial sector’s role in contributing to growth and a stronger and more sustainable global economy.

The main points from the summit included:

- Shadow banking - progress has been made in delivering the shadow banking framework this year and the G20 endorsed an updated roadmap for further work. It also wants more market-based financing (reminiscent of Juncker’s EU agenda for a Capital Markets Union).
- Creating a more resilient financial system - the G20 believes progress made to improve banks’ capital and liquidity positions, and to make derivatives markets safer, will reduce risks in the financial system.
- Too big to fail - the G20 welcomed the FSB’s proposal requiring G-SIBs to hold additional loss absorbing capacity (TLAC) that will protect taxpayers if these banks fail.

- Derivatives reform - the G20 called on regulatory authorities to make further concrete progress in swiftly implementing the agreed G20 reforms on central clearing of all standardised derivative contracts. Countries are encouraged to defer to each other when it is justified, in line with the September 2013 St Petersburg Declaration.

The G20 warns that critical work remains in relation to building a stronger, more resilient financial system. The next task is to finalise elements of policy framework and fully implement agreed financial regulatory reforms, while remaining alert to new risks.

Removing the shadows from market-based finance

The FSB published Transforming Shadow Banking into Resilient Market-based Financing: An Overview of Progress and a Roadmap for 2015 on 14 November 2014. The FSB has adopted a two-pronged strategy to deal with the systemic risks in shadow banking. First, it has created a system-wide monitoring framework to track developments in the shadow banking system with a view to identifying the build-up of systemic risks and initiating corrective actions where necessary. It will continue to conduct its annual monitoring exercise and publish its results in the fourth quarter of 2015. The results will include the analysis of the global hedge fund sector by IOSCO.

Second, the FSB is coordinating and contributing to the development of policy measures in five areas:

- Mitigating risks in banks’ interactions with shadow banking entities - the Basel Committee have finalised Capital requirements for banks’ equity investments in funds (December 2013) and the Supervisory framework for measuring and controlling large exposures (March 2013).
- Reducing the susceptibility of MMFs to “runs” - IOSCO issued final policy recommendations in October 2012 that provide the basis for common standards of regulation and management of MMFs across jurisdictions.
- Improving transparency and aligning incentives in securitisation - IOSCO is currently undertaking a level one peer review on national/regional approaches to align incentives associated with securitisation, including risk retention requirements
- Dampening pro-cyclicality and other financial stability risks in securities financing transactions (SFT) - in October 2014, the FSB published a Regulatory framework for haircuts on non-centrally cleared securities financing transactions.
- Assessing and mitigating financial stability risks posed by other shadow banking entities and activities. In August

2013, the FSB *developed* a forward-looking high-level policy framework for adoption by authorities to detect and assess the sources of financial stability risks from shadow banking in the non-bank financial space.

The FSB intends to maintain this progress in 2015. It aims to introduce numerical haircut floors for non-centrally cleared SFTs, finalise standards for data collection of SFTs and harmonise regulatory approaches to re-hypothecation of client assets. The FSB plans to report on the progress of the above work to the G20 in November 2015.

Accounting

Reminders for 2014 reporting

The FRC's Financial Reporting Lab published its *Lab reminders for the 2014 reporting season* on 5 November 2014. This summarises the Lab's published reports and highlights areas where relatively simple changes could improve corporate reporting, enhancing the usefulness of reports for investors. The summary brings together key findings from the reports:

- towards clear & concise reporting
- accounting policies and integration of related financial information
- reporting of audit committees
- reporting of pay and performance

- a single figure for remuneration
- presentation of market risk disclosures
- debt terms and maturity tables
- net debt reconciliations
- operating and investing cash flows.

Proposed amendments to IFRS 2

The IASB published *ED/2014/5: Classification and Measurement of Share-based Payment Transactions - Proposed amendments to IFRS 2*. This includes proposed amendments and guidance on:

- accounting for the effects of vesting conditions on the measurement of a cash-settled share-based payment
- classification of share-based payment transactions with net settlement features
- accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

The consultation closes on **25 March 2015**.

Accounting briefing

Our publication *Accounting briefing – November 2014* provides you with a quarterly technical update, focusing on the practical implications of recent developments and topical issues in UK

GAAP. This issue includes the following articles:

- Investment properties under new UK GAAP
- FRC – Corporate reporting review annual report
- FRC issues a consultation regarding changes of the EU accounting directive for small entities
- Timeline for new UK GAAP.

IFRS News - November 2014

Our *November edition of IFRS News* considers:

- Revenue TRG - October meeting
- EFRAG - New governance structure
- ESMA enforcement priorities
- Cannon Street Press
- Leases
- Conceptual Framework
- Research agenda

Questions and answers - 'U' is for underlying

IFRS disclosure checklist 2014

The global version of our *IFRS disclosure checklist 2014* has been updated to outline the disclosures required for December 2014 year ends. It also contains a section providing the disclosures required of entities that

early-adopt IFRSs effective for annual periods beginning after 1 January 2014.

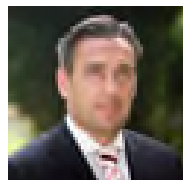
IFRS Illustrative financial statements - Investment funds 2014

Our *Illustrative IFRS financial statements 2014 for investment funds* are based on the requirements of IFRS standards and interpretations for the financial year beginning on 1 January 2014. The new standards and amendments effective for annual periods beginning on 1 January 2014 which are relevant to investment funds include; Amendments to IAS 32, 'Offsetting financial assets and financial liabilities and amendments to IFRS 10, IFRS 12 and IAS 27, 'Investment entities'. The guidance and illustrative disclosure on these amendments are contained in either the main body of the financial statements or an attached appendix and are largely consistent with our 2013 publication.

Banking and capital markets

In this section:

Regulation	14
Capital and liquidity	14
Consumer credit	15
Other regulatory	15
Recovery and resolution	15



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Regulation

Capital and liquidity

Improving consistency on capital

On 12 November 2014, the Basel Committee published findings of a *review into its members' implementation of national discretions* within the Basel III capital framework. National regulators can exercise a number of discretions in implementing the framework. The Basel Committee permitted this flexibility so countries could accommodate differences in the structure and development of their financial systems. But it recognises that the use of national discretions can make comparability of implementation across jurisdictions more difficult, so it wants national regulators to give more disclosure on their use of the flexibility allowed by Basel III.

Adding to its transparency drive, the Basel Committee also published a *report to G20 Leaders* outlining measures it plans to take to improve consistency and comparability in bank capital ratios. These measures include:

- revising the standardised approaches for calculating RWAs
- implementing capital floors for internal-model based approaches to calculating RWAs

- reducing the modelling choices in the capital framework when determining internal-model based estimates of RWAs.

The Basel Committee also discussed the role of disclosure, implementation monitoring and additional analytical and policy work in progress. It updated G20 Leaders on the steps that by Basel Committee member countries have taken to adopt the Basel III standards and banks' progress in bolstering their capital and liquidity positions.

Meeting minimum IRB requirements

The EBA published a consultation paper on *Draft RTS on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB Approach in accordance with the CRR* on 12 November 2014. This sets out standards for assessing if a bank meets minimum IRB requirements when it applies to use the IRB approach.

National supervisors will also use these draft RTS to assess whether a bank meets minimum IRB requirements on an ongoing basis following their regular review of the IRB approach. Consequently, these RTS will need to be embedded in day-to-day practices of supervisory authorities.

The consultation closes on **12 March 2015**.

Guaranteeing deposits

The EBA published a consultation paper on *Draft Guidelines on methods for calculating contributions to Deposit Guarantee Schemes* (DGSs) on 10 November 2014. The proposed Guidelines set out methods for calculating ex-ante contributions to DGSs, and particularly the methods for adjusting contributions to banks' risk profiles to incentivise sound risk behaviours. The proposed methods will ensure that DGSs are properly financed by banks and meet the target funding level foreseen by the DGS Directive (0.8% of covered deposits by 2024).

These Guidelines offer a comparable basis for assessing progress in convergence when reviewing the framework in 2017 and complement the *Guidelines on payment commitments*, which the EBA launched for consultation on 25 September 2014.

Consumer credit

Raising standards on retail product

The EBA published a consultation paper on *Draft Guidelines on product oversight and governance arrangements for retail banking products* on 10 November 2014. These require firms to establish internal arrangements for the design, marketing and life cycle maintenance of products to ensure that the interests of consumers are protected.

The Draft Guidelines apply to manufacturers and distributors of retail banking products, such as mortgages,

personal loans, credit and debit cards, savings products, payment services and current accounts. They set out requirements for manufacturers relating to internal control functions, the identification of the target market, product testing, disclosure, product monitoring, remedial actions and the selection of distribution channels. The requirements for distributors relate to internal arrangements, identification and knowledge of the target market and information requirements

The consultation closes on **10 February 2015**.

Other regulatory

New Chinese G-SIB

The FSB and the BCBS updated the *list* of G-SIBs on 6 November 2014, using end-2013 data and an *updated assessment methodology*. Agricultural Bank of China is now a G-SIB, increasing the number of G-SIBs to 30.

Crédit Agricole and UBS were demoted to requiring only a 1% capital buffer, reflecting their downsizing of investment banking or international activities.

'Credit institution' definition to be tightened

The EBA published an *Opinion* on the definition of 'credit institution' in the CRR on 27 November 2014. The opinion is based on the results of third surveys to assess how different countries interpret the definition, whether moving the definition to CRR has

impacted the coverage, and how many firms performing credit intermediation now fall out of scope of CRD IV/CRR at the national level. Although greater harmonisation has been brought by the use of a regulation, differences in interpretation persist and undermine the Single Rulebook.

The opinion offers more detailed definitions of 'deposit', 'other repayable funds' and 'received from the public' to more easily determine whether a corporate entity is a credit institution. The EBA also recommends that the EC introduces harmonised rules for corporates that carry out bank-like activities but are not subject to existing European prudential rules.

Recovery and resolution

Contractual recognition of bail-ins

The EBA published *Consultation paper - draft RTS on the contractual recognition of liabilities subject to write-down and conversion powers under the BRRD* on 5 November 2014. The EBA is seeking to align the proposals with the FSB's consultation on *cross-border resolution*, published in September 2014, where compatible with the BRRD. The EBA provides guidance on which liabilities are exempted from being written down or converted to equity under the BRRD, and clarifies that any part of a liability which is unsecured or any liability which has transitioned from secured to unsecured is included as a bail-in-able liability. Which liabilities firms should consider as being

'issued or entered into after the transposition date' are also clarified, and includes those:

- entered into after the transposition date
- created after the transposition date but under agreements entered into before that date
- under agreements entered into before the transposition date but amended after that date
- under debt instruments issued after the transposition date where the programmes existed prior to the transposition date.

The EBA also identifies the key elements of third country law or binding international agreement which should be present before a liability is determined to be bail-in-able by a resolution authority. It also specifies the mandatory components which must be present in a liabilities contract if the contract is governed by the law of a country outside the EU where no statutory mechanism or international agreement exists to ensure bail-in. This includes the express acknowledgment, agreement and consent of the counterparty to bail-in and the effect on the liability.

The EBA highlights the BRRD requirement that resolution authorities may require firms to provide authorities with a legal opinion relating to the legal enforceability and effectiveness of contractual recognition terms governed by third-country law.

The consultation closes on **5 February 2015**.

Equity in failing firms

The EBA published *Draft Guidelines on the rate of conversion of debt to equity in bail-in* on 11 November 2014. The EBA clarifies and develops the BRRD provisions on bail-ins which apply to:

- bail-in as a resolution tool
- claims or debt instruments that are transferred to a bridge institution or when using the sale of business tool or asset separation tool
- the conversion of capital instruments at the point of non-viability.

These EBA guidelines sit together with the draft guidelines on treatment of liabilities in bail-in, the draft guidelines on treatment of shareholders in bail-in and the draft RTS on valuation in resolution to establish how valuation information should inform the determination of the terms of bail-in.

Under EBA's draft guidelines, regulators will be expected to use two principles for setting the conversion rate of debt to equity on bail-in:

- No shareholder or creditor should receive worse treatment than they would have received in a normal insolvency ("No Creditor Worse Off" safeguard). This is determined by comparing the expected treatment of shareholders and creditors calculated at the point of

resolution and based on the 'ex-ante valuation'.

- Assess whether appropriate regard has been given to the right to property under the Charter of Fundamental Rights Creditor Hierarchy. In particular, shareholders should bear first loss, creditors bear loss after shareholders in order of the priority of their claims under normal insolvency and creditors of the same class should be treated in an equitable manner.

An institution's assets and liabilities should be valued in line with BRRD before the bail-in tool is applied. The consultation closes on **6 February 2015**.

Shareholders in crisis

The EBA published *Draft Guidelines on the treatment of shareholders in bail-in or the write down and conversion of capital instruments* on 11 November 2014. EBA clarifies the circumstances which should guide the choice between the cancellation of existing shares or their transfer to bailed-in creditors, or the dilution of current shareholders or equivalent through conversion of capital instruments/eligible liabilities to equity.

BRRD states that dilution can only be used when an institution has a positive NAV and must be conducted at a rate of conversion that severely dilutes existing equity. Where an institution has a negative or zero NAV, the only choice is cancellation or transfer.

A dilution could be combined with a partial cancellation or transfer.

In some circumstances, the power to write-down or convert capital instruments may be triggered without also triggering resolution. The extent of write-down or conversion must be the amount required to achieve resolution objectives. It could be zero if extraordinary public financial support is provided to a well-capitalised institution which is not deemed failing or likely to fail.

The consultation closes on **6 February 2015**.

Advancing G-SIFI resolution plans

On 12 November 2014, the FSB published *Towards full implementation of the FSB Key Attributes of Effective Resolution Regimes for Financial Institutions*. It reported to the G20 Leaders on the progress on resolution regimes and resolution planning for G-SIFIs. Only Japan and the US have regimes fully align with the FSB's key attributes. Although significant progress is being made in other countries, the FSB concluded that there is significant global work still needed, particularly on:

- resolution powers, especially the ability to write down and convert unsecured creditor's claims so the G-SIFIs can absorb losses
- implementing restrictions on early termination rights
- giving legal effect to mechanisms that enable cross-border cooperation.

The FSB promises further progress reports in 2015.

Setting MREL for European Banks

The EBA published *Draft RTS on criteria for determining the minimum requirement for own funds and eligible liabilities ('MREL') under BRRD* on 28 November 2014. The BRRD sets out banks' MREL - these are set on a case-by-case basis by resolution authorities, based on at least six common criteria.

The EBA is consulting on the minimums for these criteria, to achieve convergence across Member States.

The MREL should be set at a level which is sufficient to implement a bank's resolution plan, absorb losses and recapitalise the bank. Where resolution plans identify that it could be less feasible or credible to bail-in certain liabilities, even if legally possible, the resolution authorities need to either increase the MREL or take alternative measures (e.g. affecting the ranking of liabilities in insolvency). The EBA also considers the effect of the Deposit Guarantee Scheme (DGS) contributions to the cost of resolution.

For the most part, the EBA's proposals are compatible with the FSB proposals for the TLAC requirement for G-SIBs – but there are some differences between the two proposals, including scope (MREL applies to non G-SIBs), the instruments that are considered eligible for bail-in and implementation dates for the respective

proposed rules. These differences may need to be ironed out before both are finalised.

The consultation closes on **27 February 2015**.

TLAC for G-SIBs

The FSB issued a long-awaited consultation on *Adequacy of loss-absorbing capacity (TLAC) of G-SIBs in resolution* on 10 November 2014. TLAC is designed to create a buffer at G-SIBs to ensure that critical functions can continue to operate, during and after the resolution phase, without public bail-out or threat to financial stability.

The FSB proposes that G-SIBs should hold a minimum amount of regulatory capital (Tier 1 and Tier 2) plus long term unsecured debt that is set within the range of 16 – 20% of RWAs, which equates to at least twice the minimum Basel III total regulatory capital ratio of 8%. In addition, the amount of a bank's regulatory capital and long-term debt cannot be less than 6% of its leverage exposure.

To help ensure that there are sufficient resources available in resolution, there is an expectation that TLAC in the form of debt capital instruments and other TLAC-eligible liabilities that are not regulatory capital will constitute an amount equal to, or greater than, 33% of the Minimum Pillar 1 TLAC requirement. TLAC should consist only of liabilities that can be effectively written down or converted into equity during resolution of a G-SIB without disrupting the

provision of critical functions or giving rise to material risk of successful legal challenge or compensation claims. To this end, the FSB term sheet proposes a set of specific criteria that liabilities must meet to be eligible as TLAC.

The final calibration of the common Pillar 1 Minimum TLAC requirement will take account of the results of this consultation and the Quantitative Impact Study and market survey which will be carried out in early 2015.

The Consultation closes on **2 February 2015**.

Valuing a firm in resolution

On 7 November 2014 the EBA issued *Consultation on draft RTS on valuation under BRRD*. The RTS highlight the circumstances pre-and post-resolution where valuations need to be performed. Prior to resolution valuations might be performed to determine whether write-down or conversion conditions have been met or to help decide what resolution choice should be used. If these valuations are provisional, then final valuations must also be performed. Under such circumstance, a buffer is required to be included for possible future losses.

After resolution a valuation might be performed to determine whether an entity's shareholders and/or creditors would have received better treatment if the entity had entered into normal insolvency proceedings

i.e. safeguarding the “no creditor worse off” (NCWO) principle.

For resolution decisions, valuation needs to assess economic value to ensure losses are fully recognised, even if this requires departure from accounting and prudential rules. This is needed to ensure that resolved institutions are recapitalised to a prudent extent and because certain resolution actions, such as selling off part of a business, will require a valuation based on economic value rather than on a going concern basis. To determine compensation for creditors or shareholders who would have been better off in insolvency, a valuation conducted on a gone-concern basis is needed.

The consultation closes on **6 February 2015**.

Asset management

In this section:

Regulation	18
AIFMD	18
Alternative investments	18
Other Regulatory	19
Retail products	19



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Regulation

AIFMD

AIFMD passporting call for evidence

ESMA *called for evidence* on EU AIFM passporting from EU and non-EU asset managers on 7 October 2014. In 2015 ESMA is required to comment on the functioning of both the EU AIFM passport regime and the current private placement regime for non-EU AIF managers. ESMA must issue advice on the suitability of applying the passport to non-EU AIFMs and AIFs, especially in the areas of investor protection, market disruption, competition and monitoring systemic risk.

ESMA makes clear that the assessment of passport suitability will be on a country-by-country basis. Non-EU authorities must demonstrate cooperation with the EU around investor protection, systemic risk monitoring and other issues, and demonstrate that there are not any obstacles that could impede an EU authority from performing its duties in a non-EU country.

ESMA will also consider whether extending the AIFMD passport regime to non-EU managers and funds will increase the risk of

market disruption and distort international competition.

The consultation closes **8 January 2015**. ESMA is required to submit an opinion to the EC by 22 July 2015.

Alternative investments

ESMA EuSEF and EuVECA Q&A

ESMA *published Q&As – application of the EuSEF and EuVECA Regulations* on 11 November 2014. ESMA uses the Q&As to provide informal guidance based on questions submitted by industry.

ESMA confirms that EuSEF and EuVECA managers will be unable to take advantage of the lighter passport requirements in the EuSEF and EuVECA Regulations once they trigger AIFMD authorisation. But fund will still be able to market to both professional investors and the special categories of investors provided for in the Regulations, subject to a minimum investment of €100,000 and a written statement indicating awareness of risk.

ESMA also confirms that EuSEF and EuVECA managers that exceed the threshold (and so become AIFMs) must meet the AIFMD requirements as well as continuing to adhere to certain parts of the EuSEF/EuVECA Regulations. This includes

rules on non-qualifying assets, leverage and use of borrowing.

Other Regulatory

Maijoor talks MiFID and UCITS

ESMA Chairman Steven Maijoor *spoke to EFAMA on the regulatory challenges facing asset management* on 5 November 2014. He acknowledged industry concerns about ESMA's draft advice on inducements and dealing commissions under MiFID II, including the impact of limiting research access for smaller portfolio managers and discouraging "open architecture" models.

Maijoor also indicated that many of the initiatives collected under the umbrella of UCITS VI are being more productively pursued as individual regulatory initiatives.

Retail products

No independence for UCITS players

ESMA published its *Final report: ESMA's technical advice to the EC on delegated acts required by the UCITS V Directive* on 28 November 2014.

UCITS V better aligns the existing depositary rules for UCITS funds with AIFMD. ESMA is seeking to mirror AIFMD depositary rules but also impose two additional requirements to ensure that: UCITS assets are protected if the custodian becomes insolvent, and to determine how

independent the depositary should be from the UCITS management company.

ESMA made few changes to the original September 2014 insolvency protection proposals, which place most responsibility on depositaries to ensure that third country custodians segregate assets in order to protect them if the custodian becomes insolvent. Industry feedback broadly agreed with ESMA's approach.

ESMA's independence proposals created a greater split in opinion between respondents. ESMA proposed two options – full independence between the management company and depositary or better disclosure of conflicts where the two entities might not be fully independent of each other. This would also require members of both the depositary and management company's management committees to be independent.

ESMA's advice to the ED is the latter proposal, which minimises the market impact and cost. Some UK firms may be disappointed, as the former approach better reflects the current UK approach.

ESMA's advice has been provided to the EC and will form part of the Level 2 Delegated Acts for the UCITS V Directive.

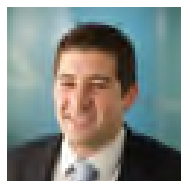
Insurance

In this section:

Regulation	20
Solvency II	20
Conduct	20
EU developments	21
Financial stability	21
Other regulatory	21
Accounting	21



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Regulation

Solvency II

Technical issues on Solvency II

EIOPA published *CP14/042 - A consultation paper on a technical document regarding the risk free interest rate term structure* on 5 November 2014. Under Solvency II liabilities will be valued following market consistent principles based on the risk free interest rate term structure.

EIOPA's technical consultation discusses the process it plans to use to identify and publish the relevant risk free interest rate monthly. EIOPA also explains its choices and provides illustrative examples of the methodology. Whilst it will publish the risk free interest rate term structures that insurers will use under Solvency II, EIOPA has published this technical information so that insurers can replicate the risk free rate calculation in their own risk management systems and for other purposes.

The consultation closed on **21 November 2014**. EIOPA plans to publish the risk free interest rates from February 2015.

New PwC publication

In our publication 'The boardroom agenda: Priming your business for Solvency II' we look at some of the pressing questions facing boards and the options for addressing them. This includes dealing with the impact of new disclosures, how to optimise capital, develop a winning product portfolio and take advantage of emerging deal opportunities. We also look at how to decide what technology is right for your organisation and its strategic objectives.

Where to go for more information

Read more about Solvency II UK on our webpages at www.pwc.co.uk/solvencyII.

Conduct

Intervening on insurance products

EIOPA published a *Consultation paper on product intervention powers under the PRIIPs Regulation* on 27 November 2014. EIOPA (and national regulators) can intervene where they see potential problems in particular insurance-based products.

EIOPA's proposals are based on existing EBA and ESMA product intervention powers, adapted to the specificities of insurance-based products. EIOPA will use

principles when determining whether intervention is needed, including the:

- complexity of the product
- size of the problem or potential detriment
- transparency of the product's underlying investments, risks and charges
- level of leverage
- ease for investors to sell or switch out of the product
- potential threat to wider stability of the financial system.

The consultation closes on **27 February 2015**. EIOPA will then provide its final advice to the EC to take forward.

EU developments

Insurers stressed

EIOPA published the results of the *Insurance stress test 2014* and *Low interest rate environment stock taking exercise 2014* with a *press release* on 30 November 2014. Its work tested the overall resilience of the insurance sector and identified major vulnerabilities. The stress test comprised two modules, a core module addressing market and insurance risks and a low yield module. Insurers estimated a baseline scenario using Solvency II requirements, without internal models, and

on top of that tested a number of severe macro-economic and insurance specific shocks, including a prolonged period of low yields and a sudden reverse in interest rates.

EIOPA concluded that:

- the insurance sector is in general sufficiently capitalised in Solvency II terms
- 14% of companies (representing 3% of total assets) have a SCR ratio below 100%
- the sector is more vulnerable to a “double hit” stress scenario that combines decreases in asset values with a lower risk free rate
- in a prolonged low yield scenario, 24% of insurers would not meet their SCR and certain companies could face problems in meeting their promises in 8-11 years' time.

EIOPA also published a detailed set of *recommendations from Stress Test 2014* aimed at addressing the issues identified in the stress test.

Preventing crises

EIOPA published its *opinion on sound principles for crisis prevention, management and resolution preparedness of NCAs* on 24 November 2014. It undertook a survey of the current

approaches to crisis prevention, management and resolution by NCAs across the EU in 2013. In response EIOPA has developed 14 principles related to specific powers, tools and institutional features that NCAs are expected to take into account to enhance their crisis prevention measures.

The Opinion emphasises a range of issues including the organisational setup and the emergency plans for crisis prevention and management, the development of recovery and resolution plans, the need to design early warning systems and to define triggers for intervention, as well as to have adequate resolution powers and communication strategies in place. EIOPA also stresses the need to cooperate and share information with other relevant authorities.

Financial stability

FSB postpones G-SII decision

On 6 November 2014 the FSB, in consultation with the IAIS and national authorities, *decided* not to change the list of nine G-SIIs identified in 2013. The decision on whether reinsurers are G-SIIs was postponed until the G-SII methodology is further developed. The IAIS plans to do this by November 2015.

IAIS's new methodology will better address all types of insurance and reinsurance, and other financial activities of global insurers, and should be applied from 2016 to G-SIIs.

Other regulatory

IAIS updates procedures

The IAIS published *Revised draft procedures on meeting participation and the development of supervisory and supporting material and draft policy for consultation of stakeholders* on 17 November 2014. The IAIS is revising its procedures to meet new responsibilities not included in its current five-year strategic plan, such as assisting in designating G-SIIs and developing global insurance capital standards. This second consultation follows on from a previous consultation in July 2014.

The consultation closes on **17 December 2014**.

Accounting

Insurance Contracts project update

At *IASB meeting on 19 November 2014* representatives of the European Insurance CFO Forum were asked to present a paper explaining their alternative proposal for the accounting for participating contracts. This would replace the proposals in the 2013 exposure draft to apply a ‘mirroring approach’ to participating contracts, which was largely rejected by respondents.

The IASB asked a large number of questions related to the alternative proposal, but

made no decisions. Instead it plans to evaluate the alternative proposal in the coming months and take tentative decisions for an approach to the accounting for participating contracts in early 2015.

Updating IFRS 4

As IFRS 4 Phase II may be effective in 2018 or 2019 with comparatives required from the end of 2016 (or even earlier for SEC reporters), insurers need to ensure they use the remaining preparation time effectively. It is important that insurers plan early, identify resources, consider the linkages with other reporting regimes such as Solvency II (and other global / local developments) and understand the potential financial impacts.

Appropriately considering each of these factors will better place companies to effectively manage the long term impacts of this significant new accounting standard. Our publication *Ready or not here it comes* summarises the status of the IASB re-deliberations on the IFRS for insurance contracts, where we go from here and what insurers should be doing in preparation.

Monthly calendar

Open consultations

Closing date for responses	Paper	Institution
19/12/14	<u>Consultation paper – draft RTS on prospectus related issues under the Omnibus II Directive</u>	ESMA
22/12/14	<u>Consultation paper – draft guidelines on the determination when the liquidation of assets or liabilities under normal insolvency proceedings could have an adverse effect on one or more financial markets under BRRD and draft guidelines on factual circumstances amounting to a material threat to financial stability and of the element related to the effectiveness of the sale of business tool under the BRRD</u>	EBA
22/12/14	<u>Consultation paper – draft guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail</u>	EBA
22/12/14	<u>Consultation paper – draft guidelines on triggers for use of early intervention measures under BRRD</u>	EBA
02/01/15	<u>Consultation paper – draft guidelines on the minimum list of qualitative and quantitative recovery plan indicators</u>	EBA
02/01/15	<u>Consultation paper – draft guidelines on payment commitments under DGSD on deposit guarantee schemes</u>	EBA
03/01/15	<u>Consultation paper – draft guidelines concerning the interrelationship between the BRRD sequence of write-down and conversion and CRR/CRD IV</u>	EBA
03/01/15	<u>Consultation paper – draft guidelines on the application of simplified obligations under the BRRD</u>	EBA
04/01/15	<u>Consultation paper – draft RTS and draft guidelines specifying the conditions for group financial support under the BRRD and draft ITS on the form and content of disclosure of financial support agreements under of BRRD</u>	EBA
05/01/15	<u>Consultation paper on guidelines on the application of C6 and C7 of Annex I of MiFID</u>	ESMA

Closing date for responses	Paper	Institution
08/01/15	<i><u>Call for evidence: AIFMD passport and third country AIFMs</u></i>	ESMA
09/01/15	<i><u>Consultation paper: draft guidelines on national provisional lists of the most representative services linked to a payment account and subject to a fee</u></i>	EBA
30/01/15	<i><u>Consultation paper: guidelines on asset segregation under the AIFMD</u></i>	ESMA
02/02/15	<i><u>Consultative document: adequacy of loss-absorbing capacity of G-SIBs in resolution</u></i>	FSB
05/02/15	<i><u>Consultation paper: draft RTS on the contractual recognition of write-down and conversion powers under the BRRD</u></i>	EBA
06/02/15	<i><u>Consultation paper: draft RTS on valuation under the BRRD</u></i>	EBA
06/02/15	<i><u>Consultation paper: draft guidelines on the rate of conversion of debt to equity in bail-in</u></i>	EBA
06/02/15	<i><u>Consultation paper: draft guidelines on the treatment of shareholders in bail-in or the write-down and conversion of capital instruments</u></i>	EBA
10/02/15	<i><u>Consultation paper: draft guidelines on product oversight and governance arrangements for retail banking products</u></i>	EBA
11/02/15	<i><u>Consultation paper: draft guidelines on methods for calculating contributions to deposit guarantee schemes</u></i>	EBA
12/02/15	<i><u>Consultative document: standards and processes for global securities financing data collection and aggregation</u></i>	FSB
13/02/15	<i><u>Consultation paper: review of the technical standards on reporting under Article 9 of EMIR</u></i>	ESMA
17/02/15	<i><u>Discussion paper: key information documents for PRIIPs</u></i>	ESAs
27/02/15	<i><u>Consultation paper: draft RTS on criteria for determining the minimum requirement for own funds and eligible liabilities under</u></i>	EBA

**Closing date
for responses****Paper****Institution***the BRRD*

12/03/15

Consultation paper: draft RTS on the specification of the assessment methodology for competent authorities regarding compliance of an institution with the requirements to use the IRB approach under the CRR EBA

Forthcoming publications in 2014

Date	Topic	Type	Institution
<i>Financial crime, security and market abuse</i>			
Q4 2014	Market Abuse Review	Technical advice	ESMA
<i>Insurance</i>			
TBD 2014	Institutions for Occupational Retirement Provision	Legislative proposals	EC
TBD 2014	Advice or technical standards for IMD2	Technical advice or technical standards	EIOPA
<i>Securities and markets</i>			
Q4 2014	Harmonised transaction reporting	Guidelines	ESMA
Q4 2014	Exchange-traded derivatives reporting	Guidelines	ESMA
Q4 2014	Technical standards following the revision of MiFID (MiFID II and MiFIR)	Technical standards	ESMA
Q4 2014	Transparency Directive and Prospectus regime	Technical standards	ESMA
Q4 2014	Credit Rating Agencies Regulation	Guidelines	ESMA
TBD 2014	Securities Law Directive	Legislative proposals	EC
TBD 2014	Revision of the Transparency Directive	Discussion papers	ESMA
TBD 2014	Close-out netting	Legislative proposals	EC

Date	Topic	Type	Institution
<i>Products and investments</i>			
Q4 2014	European Social Entrepreneurship Funds	Technical advice	ESMA
Q4 2014	European Venture Capital Funds	Technical advice	ESMA
Q4 2014	Packaged Retail Investment and Insurance-based Products	Technical standards	ESMA/EIOPA
Q4 2014	Undertakings For The Collective Investment of Transferable Securities V	Technical advice	ESMA
Q2 2015	Money market funds	Technical standards	ESMA
TBD 2014	Development of high level principles for the product approval process	Principles	ESAs
TBD 2014	A framework for the activities and supervision of personal pension schemes	Advice	EIOPA
<i>Recovery and resolution</i>			
TBD 2014	EU framework for recovery and resolution plans	Technical advice	EBA
<i>Solvency II</i>			
TBD 2014	Solvency II – draft Level 2 delegated acts	Level 2 text	EC
TBD 2014	Solvency II Level 3 measures	Level 3 text	EIOPA
<i>Supervision, governance and reporting</i>			
Q4 2014	Alternative performance measures	Guidelines	ESMA

Main sources: ESMA 2014 work programme; EIOPA 2014 work programme; EBA 2014 work programme; EC 2014 work programme;

Glossary

2EMD	The Second E-money Directive 2009/110/EC	BCR	Basic capital requirement (for insurers)
ABC	Anti-Bribery and Corruption	BIBA	British Insurance Brokers Association
ABI	Association of British Insurers	BIS	Bank for International Settlements
ABS	Asset Backed Security	BoE	Bank of England
AIF	Alternative Investment Fund	BRRD	Bank Recovery and Resolution Directive
AIFM	Alternative Investment Fund Manager	CASS	Client Assets sourcebook
AIFMD	Alternative Investment Fund Managers Directive 2011/61/EU	CCD	Consumer Credit Directive 2008/48/EC
AIMA	Alternative Investment Management Association	CCPs	Central Counterparties
AML	Anti-Money Laundering	CDS	Credit Default Swaps
AML3	3rd Anti-Money Laundering Directive 2005/60/EC	CEBS	Committee of European Banking Supervisors (predecessor of EBA)
AQR	Asset Quality Review	CET1	Core Equity Tier 1
ASB	UK Accounting Standards Board	CESR	Committee of European Securities Regulators (predecessor of ESMA)
Banking Reform Act (2013)	Financial Services (Banking Reform) Act 2013	Co-legislators	Ordinary procedure for adopting EU law requires agreement between the Council and the European Parliament (who are the 'co-legislators')
Basel Committee	Basel Committee of Banking Supervision (of the BIS)	CFT	Counter Financing of Terrorism
Basel II	Basel II: International Convergence of Capital Measurement and Capital Standards: a Revised Framework	CFTC	Commodities Futures Trading Commission (US)
Basel III	Basel III: International Regulatory Framework for Banks	CGFS	Committee on the Global Financial System (of the BIS)
BBA	British Bankers' Association	CIS	Collective Investment Schemes

CMA	Competition and Markets Authority	Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act (US)
CMU	Capital markets union	D-SIBs	Domestic Systemically Important Banks
CoCos	Contingent convertible securities	EBA	European Banking Authority
Council	Generic term representing all ten configurations of the Council of the European Union	EC	European Commission
CRA1	Regulation on Credit Rating Agencies (EC) No 1060/2009	ECB	European Central Bank
CRA2	Regulation amending the Credit Rating Agencies Regulation (EU) No 513/2011	ECJ	European Court of Justice
CRA3	proposal to amend the Credit Rating Agencies Regulation and directives related to credit rating agencies COM(2011) 746 final	ECOFIN	Economic and Financial Affairs Council (configuration of the Council of the European Union dealing with financial and fiscal and competition issues)
CRAs	Credit Rating Agencies	ECON	Economic and Monetary Affairs Committee of the European Parliament
CRD	'Capital Requirements Directive': collectively refers to Directive 2006/48/EC and Directive 2006/49/EC	EEA	European Economic Area
CRD II	Amending Directive 2009/111/EC	EEC	European Economic Community
CRD III	Amending Directive 2010/76/EU	EIOPA	European Insurance and Occupations Pension Authority
CRD IV	Capital Requirements Directive 2013/36/EU	EMIR	Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EC) No 648/2012
CRR	Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms	EP	European Parliament
CTF	Counter Terrorist Financing	ESA	European Supervisory Authority (i.e. generic term for EBA, EIOPA and ESMA)
DFBIS	Department for Business, Innovation and Skills	ESCB	European System of Central Banks
DG MARKT	Internal Market and Services Directorate General of the European Commission	ESMA	European Securities and Markets Authority
		ESRB	European Systemic Risk Board

EU	European Union	FSCS	Financial Services Compensation Scheme
EURIBOR	Euro Interbank Offered Rate	FSI	Financial Stability Institute (of the BIS)
Eurosystem	System of central banks in the euro area, including the ECB	FSMA	Financial Services and Markets Act 2000
FASB	Financial Accounting Standards Board (US)	FSOC	Financial Stability Oversight Council
FATCA	Foreign Account Tax Compliance Act (US)	FTT	Financial Transaction Tax
FATF	Financial Action Task Force	G30	Group of 30
FC	Financial counterparty under EMIR	GAAP	Generally Accepted Accounting Principles
FCA	Financial Conduct Authority	G-SIBs	Global Systemically Important Banks
FDIC	Federal Deposit Insurance Corporation (US)	G-SIFIs	Global Systemically Important Financial Institutions
FiCOD	Financial Conglomerates Directive 2002/87/EC	G-SIIs	Global Systemically Important Institutions
FiCOD1	Amending Directive 2011/89/EU of 16 November 2011	HMRC	Her Majesty's Revenue & Customs
FiCOD2	Proposal to overhaul the financial conglomerates regime (expected 2013)	HMT	Her Majesty's Treasury
FMI	Financial Market Infrastructure	IAIS	International Association of Insurance Supervisors
FOS	Financial Ombudsman Service	IASB	International Accounting Standards Board
FPC	Financial Policy Committee	ICAS	Individual Capital Adequacy Standards
FRC	Financial Reporting Council	ICB	Independent Commission on Banking
FSA	Financial Services Authority	ICOBS	Insurance: Conduct of Business Sourcebook
FSB	Financial Stability Board	IFRS	International Financial Reporting Standards
FS Act 2012	Financial Services Act 2012	IMA	Investment Management Association
		IMAP	Internal Model Approval Process

IMD	Insurance Mediation Directive 2002/92/EC	Member States	countries which are members of the European Union
IMD2	Proposal for a Directive on insurance mediation (recast) COM(2012) 360/2	MiFID	Markets in Financial Instruments Directive 2004/39/EC
IMF	International Monetary Fund	MiFID II	Proposed Markets in Financial Instruments Directive (recast) (COM(2011) 656 final)
IORP	Institutions for Occupational Retirement Provision Directive 2003/43/EC	MiFIR	Proposed Markets in Financial Instruments Regulation (EC) (COM(2011) 652 final)
IOSCO	International Organisations of Securities Commissions	MMF	Money Market Fund
ISDA	International Swaps and Derivatives Association	MMR	Mortgage Market Review
ITS	Implementing Technical Standards	MREL	Minimum requirements for own funds and eligible liabilities
JCESA	Joint Committee of the European Supervisory Authorities	MTF	Multilateral Trading Facility
JMLSG	Joint Money Laundering Steering Committee	MoJ	Ministry of Justice
JURI	Legal Affairs Committee of the European Parliament	MoU	Memorandum of Understanding
LCR	Liquidity coverage ratio	NAV	Net Asset Value
LEI	Legal Entity Identifier	NBNI G-SIFI	Non-bank non-insurer global systemically important financial institution
LIBOR	London Interbank Offered Rate	NFC	Non-financial counterparty under EMIR
LTGA	Long-Term Guarantee Assessment	NFC+	Non-financial counterparty over the EMIR clearing threshold
MAD	Market Abuse Directive 2003/6/EC	NFC-	Non-financial counterparty below the EMIR clearing threshold
MAD II	Proposed Directive on Criminal Sanctions for Insider Dealing and Market Manipulation (COM(2011)654 final)	NSFR	Net stable funding ratio
MAR	Proposed Regulation on Market Abuse (EC) (recast) (COM(2011) 651 final)	OECD	Organisation for Economic Cooperation and Development
MCD	Mortgage Credit Directive	Official Journal	Official Journal of the European Union

OFT	Office of Fair Trading	SEC	Securities and Exchange Commission (US)
Omnibus II	Second Directive amending existing legislation to reflect Lisbon Treaty and new supervisory infrastructure (COM(2011) 0008 final) – amends the Prospectus Directive (Directive 2003/71/EC) and Solvency II (Directive 2009/138/EC)	SFT	Securities financing transactions
ORSA	Own Risk Solvency Assessment	SFD	Settlement Finality Directive 98/26/EC
OTC	Over-The-Counter	SFO	Serious Fraud Office
p2p	Peer to Peer	SIPP	Self-invested personal pension scheme
PERG	Perimeter Guidance Manual	SOCA	Serious Organised Crime Agency
PRA	Prudential Regulation Authority	Solvency II	Directive 2009/138/EC
Presidency	Member State which takes the leadership for negotiations in the Council: rotates on 6 monthly basis	SSM	Single Supervisory Mechanism
PRIIPs Regulation	Proposal for a Regulation on key information documents for investment and insurance-based products COM(2012) 352/3	SSR	Short Selling Regulation EU 236/2012
PSR	Payment Systems Regulator	T2S	TARGET2-Securities
RAO	Financial Services and Markets Act 2000 (Regulated Activities Order) 2001	TLAC	Total Loss Absorbing Capacity
RDR	Retail Distribution Review	TR	Trade Repository
RFB	Ring Fenced Bank	TSC	Treasury Select Committee
RRPs	Recovery and Resolution Plans	UCITS	Undertakings for Collective Investments in Transferable Securities
RTS	Regulatory Technical Standards	XBRL	eXtensible Business Reporting Language
RWA	Risk-weighted assets		
SCR	Solvency Capital Requirement (under Solvency II)		

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