

Being better informed

FS regulatory, accounting and audit bulletin



PwC FS Risk and Regulation Centre of Excellence

October 2014

In this month's edition:

- ECB confirms supervision model for Eurozone banks under SSM
- EBA publishes number of BRRD CPs
- EMSA consults on depositary rules for UCITS V
- More benchmarks in regulatory scope?

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.

On 18 September, Scotland voted to remain part of the UK. So we’ll never know if a currency union with the remainder of the UK would have been created or how long it would have taken an independent Scotland to join the EU.

But we now have a far better idea what the new EC will look like. Lord Hill, a UK Conservative peer, will take up the new baton as the Commissioner for Financial Stability, Financial Services and Capital Markets Union within the new EC.

Juncker’s *mission statement* for Hill reveals a central focus will be on creating a capital markets union in the 28 EU states aimed at ensuring SMEs get better access to non-bank finance in future, essentially counterbalancing the current over-reliance on bank funding. Despite a shaky start at the first hearing in the European Parliament on 1 October, Lord Hill came back with persuasive written responses to 23 additional questions posed by ECON by 5 October and then followed up with a convincing performance at a (irregular) second hearing on 7 October. His appointment was approved in the ECON Committee by a sizeable majority vote. However, Lord Hill is not Michel Barnier’s successor: his remit and role has narrowed and he will have to operate within the more ‘collegial’ EC, with a matrix structure, working closely with Jyrki Katainen, the new Vice President for Jobs, Growth, Investment and Competitiveness, amongst

others. Important questions remain as to how it will operate in practice. However, the new EC has to be approved by the EP in its entirety before it can become operational. Issues in respect of other candidates suggest that there may be some delay to the scheduled 1 November start date. This was not the only big news from September.

The EBA Level 2 process on BRRD went into full swing with the issuance of eight consultations in quick succession at the end of the month. These provide crucial operational details for firms, supervisors and resolution authorities but no-one has much time to digest all the new requirements: BRRD goes live from 1 January 2015.

Benchmark reform is also back under the regulatory microscope. The Fair and Effective Markets Review, a joint HMT, FCA and BoE task force, consulted on bringing seven additional benchmarks into the scope of regulation. This means firms contributing to the benchmarks will face greater regulatory scrutiny to ensure they are not fixing the benchmarks. And IOSCO and FSB also published updates on their own benchmarks work, with *IOSCO* reviewing how its principles have been implemented by the WM/Reuters benchmark and the *FSB* proposing a change to the fixing window for the WM/Reuters benchmark.

The ECB has published its *guide to supervision*, setting out how the Single Supervision Mechanism will operate from 4 November 2014. The guide provides information on how direct and indirect supervision of Eurozone banks will be carried out so banks will know what to expect. The 120 banks subject to direct supervision are likely to experience the most change initially. Danièle Nouy has promised intrusive supervision going forward so banks should expect to rapidly interact with the joint supervisory teams, made up of ECB and local regulatory staff, that will be set up to oversee them. Banks subject to indirect supervision may not feel quite the same impact immediately, but as all supervisors will be required to adhere to a common supervisory manual going forward, it should not be long before they too see changes. For UK banks the *FCA* is working towards implementing the MCD, which it must implement by 21 March 2016. Whilst much of MCD is already effective in the UK after the MMR, there is still some process and operational changes that banks must make to get ready. The biggest change will be the regulation of second charge and some buy-to-let mortgages for the first time. The FCA plans to publish its final rules in the first quarter of 2015 so firms will have a year to prepare.

Asset managers didn’t escape attention in September. ESMA published two

consultations that need attention. Its *technical advice* on depositaries under UCITS V will cause a number of strategic and operating model changes across the EU if they come into effect as proposed – but we expect push back from firms in Continental Europe, particularly in France where the proposals relating to the independence of the depositary from the management company will have the greatest impact. And for private equity and venture capital managers the EuSEF and EuVECA *consultation* should be of interest, particularly ESMA’s proposals around how to identify appropriate social investments.

This month’s feature article focuses on changes to the PRA’s *approach* in supervising international (non-EU) banks – in particular when the PRA will require the bank to establish a UK subsidiary rather than using a branch structure. Given the UK’s current interest in attracting new financial services entrants to the market, it is important that firms looking to enter the market know what is expected of them.



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PRA has its eye on foreign banks



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The financial crisis forced regulators to reconsider the way they supervise international banks and how those banks are structured. Experience shows that parent companies can move liquid funds swiftly back to service the core entities within a group when a crisis hits, leaving branch activity exposed. Banks and supervisors now realise that the notion of global capital and liquidity remains a fantasy in times of stress – capital always has a home. Increasingly, regulators are taking the view that the only way to protect their home markets is to establish a strong national regime that grants them control over the resolvability and recovery planning of banks operating in their jurisdictions.

In the US, Foreign Banking Organisations (FBOs) will have to form Intermediate Holding Companies (IHCs) to oversee all of their US FBO activities. The Fed will supervise those IHCs with Enhanced Prudential Standards, which include capital, liquidity and risk management requirements.

In the UK, the government regularly states its desire for the City to remain a global financial centre. Its recent efforts to encourage Chinese investment in the UK are another step in this direction. Yet at the same time, the PRA is increasing its supervisory scrutiny over international banks operating in the UK. It published

CP4/14 Supervising International Banks: the Prudential Regulation Authority's approach to branch supervision on 26 February 2014, and put out its conclusions on 5 September 2014 in *PS8/14* and *SS10/14*. The PRA's new approach is effective immediately.

Under the new regime, the PRA will tighten its supervision of UK branches of non-EEA banks. Branches will face restrictions over the type and scale of business that they can undertake, including a limit on retail deposit-taking.

What's changing for non-EEA branches?

The new approach considers the resolvability of international banks present in the UK, and the equivalence of their home country supervision. The PRA will assess three elements to determine whether or not to permit the international bank to operate as a branch in the UK:

- Home State Supervisor (HSS) equivalence
- presence of Critical Economic Functions (CEFs)
- adequacy of resolution planning for the group and for the UK branch.

If a non-EEA branch satisfies the PRA as to its supervision, resolvability and activities, the PRA will agree a split of prudential

supervisory responsibilities and an appropriate level of information sharing with the HSS on a firm-by-firm basis.

If not, the PRA could cancel the branch's authorisation. The non-EEA bank would then have to subsidiarise its UK operations or withdraw from the UK market. The same approach applies to new applicants – the PRA could refuse new branch authorisation applications if it finds them wanting in any of the three elements.

HSS equivalence

The PRA will determine equivalence by assessing the HSS's rules, powers, consolidated supervision, information sharing, confidentiality, competence and independence of supervision. It will use peer reviews from the IMF, FSAP and the FSB to aid its analysis. While focusing primarily on capital and liquidity regimes, the PRA will also consider any conduct concerns the FCA raises. Equivalence assessments will not be set in stone - the PRA will periodically review all assessments. It will determine the frequency of review based on the number and size of UK branches from that country.

Presence of CEFs

A CEF is a function carried out by the branch whose disruption or withdrawal could have an adverse material impact on UK financial stability. They include retail banking; corporate banking; payments,

clearing, settlement; custody, intra-financial system borrowing and lending; investment banking. UK branches will still be able to undertake those activities, so long as it's at a level that is not critical to the UK economy.

The PRA's HSS equivalence assessment will provide context for the further assessment of the presence of potential CEFs in the activities of branches. If the equivalence assessment notes that the HSS is sufficiently equivalent for general branch authorisation but has weaknesses in relation to a particular CEF, the PRA could propose limitations to the nature of scale of activities performed by the branch to keep its activities under the CEF threshold.

Limiting retail activities for non-EEA branches

The most significant changes proposed by the PRA affect the retail activities of UK branches of non-EEA banks. The PRA expects those entities to focus principally on wholesale banking and to keep their retail banking activities below de minimise levels, unless there is a high level of assurance from the HSS over resolution.

In the final rules, the PRA explains what this means in more detail. The de minimise thresholds are £100 million retail/SME deposits and 5,000 retail and SME customers. In making a final assessment, the PRA will also take into account the substitutability of the products and services provided and the growth plan of the branch.

The PRA indicates that the need for continuity of access to transactional accounts and deposit insurance coverage are the drivers for this low risk appetite. It is concerned that its lack of powers over a UK branch could lead to disruption in access to deposits in the event of insolvency and create uncertainty over the ability of the Financial Services Compensation Scheme (FSCS) to recoup losses from the home state.

Adequacy of resolution planning for the group and for the UK branch

This criterion is the most important and will determine the PRA's risk appetite.

The PRA will assess both the equivalence of the HSS's resolution regime and the credibility of the bank's resolution plan, including whether the plan covers the UK branch's operations. To that effect, the PRA has introduced a rule in the Incoming Firms and Third Country Firms part of its Rulebook requiring firms to take all steps within their control to ensure that their resolution plans provide adequately for the resolution of UK branches.

PRA supervisory focus

After it deems the supervisory regime of the HSS equivalent to that in the UK, the PRA will require a firm-specific agreement with the HSS, on the split of supervisory responsibilities between it and the PRA. The PRA will focus its approach to supervision on the analysis of business risks, liquidity, capital and risk management, systems and

controls. This analysis could differ by firm even with the same HSS.

On liquidity, the PRA intends to consult separately and propose that whole firm liquidity reporting (rather than branch-only reporting) becomes the rule rather than the exception.

Senior manager SYSC attestation

The rules introduce a new requirement for the senior individual responsible for the UK branch to attest on an annual basis that the branch is compliant with relevant provisions of the SYSC handbook. Each attestation will relate to the preceding 12 months. Because the PRA is requiring the first attestations by 31 March 2015, firms must get comfortable that they have been compliant with SYSC since 1 April 2014.

Management and Governance

Pending implementation of the new UK Senior Managers and Certification regimes, the PRA intends to require incoming non-EEA branches to have at least one individual approved as Overseas Branch Senior Executive Manager. This person will be equivalent to the CEO for the branch.

New reporting requirement delayed

The PRA initially proposed additional data reporting requirements for both EEA and non-EEA branches. The data will help it determine whether or not a branch has CEFs in the UK, and the potential impact of any CEFs on UK financial stability. The ultimate policy intention is for all UK

branches to complete the return every six months.

The PRA has postponed the planned 2015 implementation date for the new return and has not indicated a revised date. It is currently amending the draft return and accompanying guidance notes with the intention of running a second pilot programme in October/November 2014.

Impact for EEA branches

The PRA's approach to supervision of EEA branches (i.e. UK branches of EEA banks) is constrained by the CRD IV framework, under which the HSS has primary supervisory responsibility.

Where an EEA branch has CEFs, the PRA will designate it as 'significant'. It will subject significant branches to increased monitoring and ensure that the resolution plan for the whole bank, and the UK branch in particular, minimises the potential impact on UK financial stability.

If the PRA has concerns about the quality of the bank's HSS, it will notify the supervisor, and/or could ask the EBA to intervene if appropriate. In emergency situations, the PRA might take measures, such as suspension of payments, to protect against financial instability.

Operating UK subsidiaries

Many overseas banks operate through both a UK subsidiary and a UK branch. Where firms operate with both a subsidiary and a branch, the PRA expects the firm to have

appropriate and effective governance in place to oversee and manage the links between entities.

Getting ready for this new approach

The PRA's new policy is immediately applicable to new UK branches seeking authorisation for the first time. The PRA will phase in implementation for the existing branches, focusing on branches and countries with the highest impact on the PRA's objectives. Its priority is likely to be branches with retail deposits over the 'de minimise' thresholds.

While this new approach is unlikely to impact the presence of international banks in the UK at a systemic level, it may be very significant for certain firms. Firms will need to analyse the impact on their strategy and operations now. While some banks won't have to change the way they operate, many foreign firms may have to change their UK operations. Non-EEA branches taking retail deposits may need to move to a subsidiary structure, which is a very significant undertaking.

Wholesale subsidiaries of non-EEA firms may want to consider moving to a branch structure. Even though branches will face greater supervisory scrutiny from the PRA than before, a branch structure still has advantages. A branch will continue to face lower funding costs and governance requirements, and lighter prudential requirements. But wholesale branches will

need to ensure they keep their activities below a level that the PRA considers critical to the UK economy.

New entrants will have to assess their proposed business model to make sure it is consistent with the PRA's risk appetite, and determine whether a branch or subsidiary structure is more appropriate. In that context, they will have to plan carefully their strategy for engaging with the regulators.

Finally, non-EEA branches will also need to get to grips quickly with the new requirement to attest to their compliance with the SYSC elements of the Handbook. These confirmations will require the senior person who signs the attestation to be confident that the UK branch has identified all rules that apply to it, that it has appropriate controls in place, and that they all worked effectively during the preceding year.

Overall the new requirements will level the playing field between UK branches and subsidiaries for non-EEA banks. As a consequence, the supervisory regime for EEA branches may appear more lenient in comparison. Will that trigger an increase in the number foreign banks pass porting into the UK from other EU countries? Time will tell.

Cross sector announcements

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Regulation

Benchmark reform

IOSCO finds unbiased oil benchmarks

IOSCO found no evidence of oil price benchmark manipulation by price reporting agencies in its *Implementation of the Principles for Oil Price Reporting Agencies* report, published 9 September 2014. Oil price reporting agencies have made good progress against the *principles IOSCO released in 2012*, so no further alignment with its principles governing financial benchmarks are proposed.

Reforming FX benchmarks

The FSB published its *Foreign Exchange Benchmarks Final Report* on 30 September 2014, following a July consultation on changes to benchmarks. The FSB proposed reforms to:

- calculating WM/Reuters (WMR) benchmark rates
- implement IOSCO's recommendations for WM fixes
- reference rates published by central banks
- market infrastructure in relation to the execution of fix trades
- the behaviour of market participants around the time of the major FX

benchmarks (primarily the WMR 4pm London fix).

Crucially, the FSB recommended that the fixing window for the WMR benchmark should be widened from its current one minute. The FSB suggested the WM Company should consult with market participants and determine the appropriate width. The FSB supported the findings of the *IOSCO Review of the Implementation of IOSCO's Principles for Financial Benchmarks by WM in respect of the WM/Reuters 4.p.m Closing Spot Rate*, also published on 30 September 2014.

The FSB recommended that asset managers should conduct appropriate due diligence around their foreign exchange execution and use of benchmarks rather than relying on benchmark setters.

IOSCO reviews WM/Reuters benchmark

IOSCO published its *Review of the Implementation of IOSCO's Principles for Financial Benchmarks by WM in respect of the WM/Reuters 4.p.m Closing Spot Rate* on 30 September 2014. IOSCO's Principles for Financial Benchmarks were published on 17 July 2013 and benchmark administrators had a year to confirm their compliance with the principles.

IOSCO assessed the World Markets Company PLC's (WM) compliance with the

benchmarks at 2 May 2014. Although WM has implemented some of the Principles, it needs to do substantial work to implement others. In particular, IOSCO found that WM's oversight and control structure for determining the closing spot rate is informal and insufficiently tailored to its benchmark determination business. IOSCO recommended that WM put in place an oversight function that is tasked with ensuring the integrity of the closing spot rate.

IOSCO noted that WM is already undertaking work to address some of the identified weaknesses. IOSCO plans to carry out a further review of the WM/Reuters 4pm Closing Spot Rate in mid-2015.

Capital and liquidity

ESMA consults on indices

ESMA published a *consultation paper on draft ITS on main indices and recognised exchanges under the CRR* on 29 September 2014. The CRR states that certain equities must be quoted on main indices and recognised exchanges before they can be used as collateral for credit risk mitigation purposes.

ESMA sets out the criteria it suggests should be used when determining whether an exchange should be included in the list of main indices or recognised investment exchanges. A provisional list of main indices

and recognised investment exchanges is included.

The consultation closes on **1 November 2014**.

Credit ratings

EC approves CRA detail

The EC adopted three RTS needed to implement key provisions of CRA3 on 30 September 2014 and submitted them to the Council and the European Parliament for scrutiny. The technical standards outline:

- specific *disclosure requirements* on the content, frequency and presentation of information that the issuer, originator and sponsor of a structured finance instrument will need to jointly submit to ESMA
- the content and format of data on fees CRAs charge their clients to be periodically *reported* to ESMA
- the content and presentation of information that CRAs must *report* to ESMA for the purpose of the European Rating Platform.

CRAs will have to comply with the different RTS by different dates. The reporting on fees requirement begins on the date the legislation enters into force (earliest end of November 2014), the reporting on the European Rating Platform by 21 June 2015 and disclosure on structured finance instruments by 1 January 2017.

Improving sovereign debt ratings

ESMA published *Technical Advice in accordance with Article 39(b) 2 of the CRA Regulation regarding the appropriateness of the development of a European creditworthiness assessment for sovereign debt* on 17 September 2014.

The sovereign rating market is composed of nine CRAs established in nine different Member States. These nine CRAs exhibit a high level of variation with respect to the type and number of sovereign ratings they assign. Sovereign credit ratings can also be differentiated in various ways, depending on such factors as local/foreign currency, duration of issuance, whether the rating applies to a specific issuer or issuance, and if it is solicited or unsolicited.

ESMA highlights the following conditions which are important in ensuring robust ratings:

- **Independence** – ratings should be provided based on an independent assessment of creditworthiness. Further, the annual review of methodologies should be conducted independently from business lines responsible for credit rating activities.
- **Confidentiality** – all rating sensitive information should be confidential. In addition, pre-rating information should only be available to persons involved in rating activities.

- **Resources** – CRAs should have sufficient resources to conduct a rigorous rating process and maintain ongoing monitoring of ratings.

Sovereign credit ratings play a crucial role from a credit market and financial stability perspective, not least because sovereign governments account for the largest group of borrowers in capital markets in terms of volume. The recent Eurozone sovereign debt crisis has greatly increased concerns about the appropriateness of sovereign debt ratings.

Financial stability

ESRB sees continued recovery

The ESRB published its sixth *risk dashboard* on 25 September 2014. It shows positive real GDP growth for the Euro area in the year to Q2 2014 but with significant variation between countries. Banks' deleveraging continued during the second quarter of 2014 as banking groups in the euro area have strengthened their balance sheets ahead of the ECB's comprehensive assessment.

The ESRB expressed concerns over the 'persistently sluggish' GDP growth in Europe in its *2014 General Board meeting* on 14 September 2014. The ESRB also considered policy responses in the Member States that encountered banking sector problems during the summer, and took note of possible implications of developments in Ukraine.

Regulators identify significant European firms

On 29 September 2014, the EBA published indicators from 28 large institutions in the EU, as provided for in the CRD IV Implementing Technical Standards (ITS) and Guidelines on disclosure rules applicable to institutions whose leverage ratio exposure measure exceeds €200bn.

The EBA sets out uniform requirements for disclosing the values used during the identification and scoring process for G-SIIs: it requires disclosures that are more granular than those required by the Basel Committee both in terms of the granularity of the disclosed information and applicable scope of institutions. The EBA published group-specific templates belonging to institutions or EU subsidiaries that did not contribute to the Basel Committee's G-SIB exercise.

The EBA will identify its first G-SIIs in January 2015. The higher capital requirement for these banks will apply about one year after regulators publish a bank's scoring results.

On 30 September 2014, the ITS setting out the *formats and dates required for disclosing values used to identify G-SIIs* were published in the Official Journal, and will come into force on 20 October 2014. G-SIIs must complete a template detailed the EBA's website. In doing so, G-SIIs will publicly disclose the values of the indicators

used for determining the G-SII score of the institutions per the methodology in CRD IV.

Market infrastructure

Aligning CCP principles

ESMA published its *Guidelines and recommendations regarding the implementation of the CPSS-IOSCO principles for FMIs (PFMIs) for CCPs* on 4 September 2014. CPSS-IOSCO published the PFMIs in April 2012.

ESMA wants to ensure that CCP regulators consistently implement the PFMIs when authorising and supervising CCPs. Regulators that have already implemented the PFMIs should clearly articulate it so that CPSS-IOSCO can carry out a full assessment of the EU's implementation of the PFMIs. CCP supervisors should incorporate the guidelines into their practices. They need to notify ESMA of whether they comply or intend to comply with these guidelines by 4 November 2014.

Other regulatory

FSB's progress update

On 18 September the FSB issued a *press release* outlining the results of its meeting in Cairns in which it considered its ongoing policy work and progress towards its G20 commitments.

The FSB believes that the core of the financial system is strengthening, with overall improvements in bank capital and liquidity, including in the euro area. But it cautions that there are increasing signs of

complacency about risks in financial markets, in part reflecting a search for yield amidst exceptionally accommodative monetary policies. It also notes that leverage has picked up in the non-banking financial system, including in corporate debt markets. It agreed to carry out a number of actions on two of the big topical financial services issues:

- TBTF – it will identify G-SIIs' critical functions and draft their basic capital requirements
- shadow banking – it agreed to consult on applying numerical haircut floors to non-bank-to-non-bank transactions

The FSB also encouraged the International Forum of Independent Audit Regulators' ongoing work to survey audits of G-SIFIs and promote greater consistency in the quality of audits.

No regulatory bars to long-term financing

The FSB published an *Update on financial regulatory factors affecting the supply of long-term investment finance* on 16 September 2014, ahead of the G20 meeting in Perth. The FSB promised at the last G20 summit (in St Petersburg) to provide an update on how regulatory reforms might impact long-term financing. In the intervening period the FSB has:

- surveyed its members to identify any unintended consequences of existing regulatory reform that might impact

long-term financing (or any new reforms that could aid long-term financing)

- engaged with practitioners involved in the long-term finance sector to see how financial regulatory reform has impacted it
- worked with other supranational bodies (e.g. IMF and World Bank) to develop key quantitative indicators to identify types of long-term financing being provided by firms.

The FSB broadly concluded from this work that there is little evidence that suggests regulatory reform alone impacts the provision of long-term financing. Instead it is one of a number of broader economic factors that contribute to a fall in long-term financing, alongside low interest rates and local country-specific investment climate.

The future face of European regulation

Jean-Claude Juncker, EC President-elect, sent a *Mission Letter* to Lord Jonathan Hill, Commissioner-designate for Financial Stability, Financial Services and Capital Markets Union on 10 September 2014.

The Mission Letter sets out Juncker's agenda for financial services, focusing on its contribution to jobs, growth and credit in the real economy. Juncker wants the future Commissioner to press ahead with the implementation of resolution rules and measures to repair banks' balance sheet to stimulate credit growth. He also wants Lord Hill to focus on supporting alternative

sources of non-bank funding to SMEs as well as developing an integrated capital union as a source of financing for long-term investment.

Lord Hill will also be responsible for relations with the ESAs, ESRB and the Single Resolution Board (SRB), which should be operational from 2015, and to ensure that consumer protection is given more prominence within these bodies. He will have to work closely with the Vice-President for Jobs, Growth, Investment and Competitiveness and the Vice-President for the Euro and Social Dialogue in fulfilling his mandate. In total, there will be 7 Vice-Presidents, to whom Juncker will give enhanced powers. The Vice-Presidents will be in charge of a number of well-defined priority projects and will steer and coordinate work across the EC to reduce departmental silos.

All new initiatives will have to be approved by a Vice-President before it is put on the EC's work programme. Lord Hill will work most closely, on a day-to-day basis, with Jyrki Katainen, Vice President for Jobs, Growth, Investment and Competitiveness but also often with Valdis Dombrovskis, Vice President for the Euro and Social Dialogue.

The new EC is subject to EP approval. Scrutiny interviews with candidates took place between 29 September and 7 October, with Lord Hill being interviewed by ECON on 1 October. He was subsequently recalled

for a second interview. The EP will vote on the full EC on 22 October 2014, with the new EC operational from 1 November 2014.

Clarifying the ECB's sanctioning powers

The *Corrigendum to Regulation (EU) No 469/2014 of the European Central Bank of 16 April 2014 amending Regulation (EC) No 2157/1999 on the powers of the European Central Bank to impose sanctions (ECB/1999/4)* was published in the Official Journal on 10 September 2014.

To avoid confusion, the Corrigendum amends the ECB's original sanctioning regulation (Regulation (EC) No 2157/1999) to clarify that that it only applies to non-supervisory central bank tasks. The SSM sanctioning regulation (Regulation (EU) No 468/2014 (ECB/2014/17)) applies to the sanctions in the exercise of the ECB's supervisory tasks.

The Corrigendum came into force on 11 September 2014.

Safeguarding Union Law

The EBA published a *Decision of the European Banking Authority adopting Rules of Procedure for Investigation of Breach of Union Law* on 4 September 2014.

The decision relates to Regulation 1093/2010 which established the EBA. It sets out the rules of procedure for investigating the breach of EU financial services legislation by national supervisors.

The procedures apply to investigation requests that third parties make to the EBA and, to the extent relevant, own-initiative EBA investigations in the absence of a request. The decision came into force on 15 July 2014. It repeals and replaces the EBA decision of 5 July 2012, concerning the internal processing rules on investigation regarding breaches of Union law (EBA/DC/2012/054).

Amending prospectus requirements

ESMA issued *Draft Regulatory Technical Standards on prospectus related issues under the Omnibus II Directive* on 25 September 2014.

The Omnibus II Directive requires ESMA to submit draft RTS on procedures for approving prospectuses, incorporation by reference of information, publication of prospectuses and dissemination of advertisements relating to offers to the public and admissions to trading. ESMA is required to submit the RTS to the EC by 1 July 2015.

The consultation closes on **19 December 2014**.

Securities and derivatives Mutual recognition of OTC rules lagging

In September 2013, G20 leaders agreed to defer to another jurisdiction's OTC regulatory regime, where outcomes are similar. But countries have been slow to implement deferral regimes.

In May 2014, Mark Carney, Chairman of the FSB, wrote to all FSB members to request information for building an internationally agreed framework for assessing equivalence between countries' OTC derivative rules.

The FSB published responses from 19 jurisdictions in *Jurisdictions' ability to defer to each other's OTC derivatives markets regulatory regimes* on 18 September 2014.

- While 14 jurisdictions have the authority to exercise deference for infrastructure providers, few can defer on rules governing market participants.
- Most jurisdictions report that they will not look for identical rules, instead considering outcomes of the foreign regulatory regime, compliance with CPMI-IOSCO Principles for Financial Market Infrastructures (PFMIs) and other relevant international standards.
- The authority, standards and processes for making determinations vary across jurisdictions and, in some instances, within jurisdictions, depending on the entity requesting deference or the scope of deference sought.

Only Australia, Canada and the US report having some deference arrangements in place as of July 2014. Many jurisdictions report that they will make decisions only after their own OTC derivative reform rules are implemented.

Valuation risk merits investor attention

ESMA published its *Report on Trends, Risks and Vulnerabilities No.2 2014*, and the *Risk Dashboard for 2014* on 3 September 2014. ESMA said that valuation risks in key market segments are rising and deserve attention from investors. ESMA's analysis of European securities markets showed significant gains amid low volatility. It argued that this underscored positive market sentiment in a low interest rate environment, which motivated investors to search for yield.

ESMA's European asset management analysis identified that the industry continued to expand with assets under management growing by about 6.7% in the first half of 2014. Investment fund returns were relatively low, though moving slightly upward.

Supervisory approach Improving supervisory coordination

The Joint Forum of BCBS, IOSCO and IAIS published a report on *supervisory colleges for financial conglomerates* on 3 September 2014. It presented findings on how well supervisory colleges address cross-sectorial issues and highlighted the progress colleges have made since it last surveyed them in 2011, particularly with regards to cooperation, coordination and information-sharing.

But the Joint Forum also identified several gaps and issues with coordination. Not all

jurisdictions have a supervision framework for financial conglomerates in place, or coordination agreements with other supervisors. Gaps also exist in the processes for taking coordinated enforcement actions against a conglomerate. And the Joint Forum found insufficient mechanisms for cooperation and coordination in periods of crisis or stress, which could hinder effective intervention.

Accounting

IFRS

Revenue recognition

The FASB and IASB issued their long-awaited converged standard on revenue recognition on 28 May 2014. Almost all entities will be affected to some extent by the significant increase in required disclosures. But the changes extend beyond disclosures, and the effect on entities will vary depending on industry and current accounting practices. See our *In depth* publication for a full analysis of the new standard.

Our *asset management industry supplement* published on 24 September 2014 highlight some of the areas that could create the most significant challenges for US GAAP reporters in the asset management industry as they switch to the new standard.

IFRS News – September 2014

The *September 2014 edition of IFRS News* covers:

- Alternative performance measures: Time for ground rules
- IFRIC activity: The ‘NIFRIC’
- Spotlight on IASB: Interview with Amaro Gomes
- Cannon Street Press:
 - o IAS 27 narrow scope amendment
 - o Exposure draft on IAS 12 narrow scope amendment
 - o IASB Work plan
- Questions and answers: ‘S’ is for service concession arrangements

Measuring joint operations

Measurement of a joint operation (JO) is largely unaddressed in IFRS 11, ‘Joint arrangements’, and as such, some diversity in practice has developed. Our *In depth* publication looks at some common JO measurement issues and approaches observed under this guidance. The recent amendment to IFRS 11, which requires the application of IFRS 3 to transactions where an investor obtains an interest in a JO that constitutes a business, is also addressed. The guidance is mandatory from January 2016, prior to which a policy choice is available and must be applied consistently for each arrangement.

IFRS 10 and IAS 28 amendments

The IASB has issued amendments to IFRS 10, ‘Consolidated financial statements’ and IAS 28, ‘Investments in associates and joint

ventures’. These address an inconsistency between the requirements in IFRS 10 and those in IAS 28 in dealing with the sale or contribution of assets between an investor and its associate or joint venture.

The main consequence of the amendments is that a full gain or loss is recognised when a transaction involves a business (whether it is housed in a subsidiary or not). A partial gain or loss is recognised when a transaction involves assets that do not constitute a business, even if these assets are housed in a subsidiary. The amendments will be effective from annual periods commencing on or after 1 January 2016 subject to EU endorsement.

For further details see our *In brief* publication.

Annual improvements to IFRSs 2012–2014 cycle

IASB has published annual improvements 2014 (2012–2014 cycle). These amendments are effective from 1 July 2016 (subject to EU endorsement) and impact:

- IFRS 5, ‘Non-current assets held for sale and discontinued operations’ regarding methods of disposal
- IFRS 7, ‘Financial instruments: Disclosures’, (with consequential amendments to IFRS 1) regarding servicing contracts
- IAS 19, ‘Employee benefits’ regarding discount rates

- IAS 34, ‘Interim financial reporting’ regarding disclosure of information.

Our *In brief* publication looks at the details.

IFRS and UK GAAP quarterly updates

Our publication *Year-end accounting reminders – IFRS and UK GAAP September 2014* looks at reporting requirements and other topical issues as at 30 September 2014. These include new standards, interpretations and other guidance that apply at this date and any IFRS standards that are published but effective at later dates, and hence have to be disclosed by IFRS reporters plus a summary of the latest topical issues.

Fair value quoted investments

The IASB published *ED2014/4 Measuring quoted investments in subsidiaries, joint ventures and associates at fair value* on 16 September 2014. The IASB propose amendments to IFRS 10, ‘Consolidated financial statements’, IFRS 12, ‘Disclosure of interests in other entities’, IAS 27, ‘Separate financial statements’, IAS 28, ‘Investments in associates and joint ventures’, and IAS 36, ‘Impairment of assets’.

The ED closes for comments on **16 January 2015**.

Rate regulation reporting

The IASB published *DP2014/2 Reporting the financial effects of rate regulation* on 17 September 2014. Rate regulation is the practice of governments regulating the

supply and pricing of particular types of activity by entities. These activities usually involve providing goods or services that are considered to be essential to customers in that jurisdiction, including transport services, some types of insurance policies, and utilities such as gas, electricity and water.

Some forms of rate regulation can significantly affect not only the amount of revenue and profit that a rate-regulated entity can earn, but also the timing of the related cash flows. The IASB considers a type of rate regulation that contains elements of both cost recovery and incentive approaches known as defined rate regulation. The discussion paper closes on **15 January 2015**.

New SME accounting standards

The FRC issued *Consultation Document: Accounting standards for small entities - Implementation of the EU Accounting Directive* on 1 September 2014. The FRC is proposing to issue a new accounting standard for micro-entities. Following the implementation of the EU Accounting Directive, micro-entities, who are companies typically turning over less than £632,000 a year, need to include less information in their accounts and fewer mandatory disclosures. The Financial Reporting Standard for Micro-entities (FRSME) will make accounts for these entities simpler.

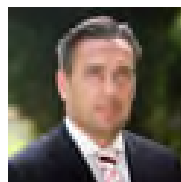
The FRC is proposing to introduce a new section into FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland for small entities*, for entities turning over less than £10.2million. In future, the underlying accounting by small entities will be consistent with the standard for financial reporting used by other unlisted companies, subsidiaries of listed companies and public benefit entities such as charities, but the presentation and disclosure requirements for small entities may be more straightforward. As a result the FRC's existing Financial Reporting Standard for Smaller Entities (FRSSE) will be withdrawn.

The consultation closes on **30 November 2014**. The FRC expects the new and amended accounting standards to be effective from the same date as the changes in legislation are effective, expected to be accounting periods beginning on or after 1 January 2016.

Banking and capital markets

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Regulation

Capital and liquidity

Treatment of stock-index futures

The *Commission Implementing Regulation (EU) No 945/2014 of 4 September 2014 laying down implementing technical standards with regard to relevant appropriately diversified indices according to the CRR* was published in the Official Journal on 5 September 2014.

The CRR states that stock-index futures which are both exchange traded and ‘appropriately diversified’ only pose general risk for an institution and do not incur an additional capital charge. The regulation defines what a diversified index is and lists 34 indices that it considers to be appropriately diversified. The EBA plans to update this list of indices annually.

The regulation came into force on 24 September 2014.

Deposit guarantee schemes

How to safeguard deposits

The EBA published *consultation - draft guidelines on payment commitments under the DGSD* on 25 September 2014. In order to reach the required target level (0.8% of covered deposits by 2024), payment commitments may be included in the ‘available financial means’.

The guidelines identify:

- the main terms to be included in contractual or statutory arrangements
- the DGS’ powers at the occurrence of an enforcement event
- the delivery terms of low-risk assets provided as collateral by the credit institution
- the criteria enabling the DGS to assess the inexistence of third party rights on low-risk assets provided as collateral
- the criteria for eligibility and management of collateral, including the haircut to be applied to low-risk assets provided as collateral.

Regulators must mitigate against any possible advantage arising the prudential treatment of payment commitments, as compared to cash.

The consultation closes on **2 January 2015**. The EBA has announced on its website that a public hearing will be held on 21 November 2014.

Financial stability

Bank supervisors progress post-crisis reforms

Banking supervisors and central bankers discussed the BCBS’s post-crisis reform agenda at the *18th international conference of banking supervisors* on 22 September

2014. The ECB's SSM and Indonesia's Financial Services Authority joined the Basel Committee as members for the first time. Representatives from Chile, Malaysia and the United Arab Emirates also joined the Committee as observers.

The BCBS reviewed an updated list of G-SIBs based on end-2013 data. The FSB plans to publish the list of G-SIBs in Q4 2014 in conjunction with the BCBS. Banks identified as G-SIBs have to hold an additional capital buffer from the beginning of 2016. The BCBS endorsed the final details of Basel III's liquidity NSFR, and plans to release the final standards in Q4 2014, which will take effect from the start of 2018.

The BCBS revised its securitisation standard and agreed the remaining significant policy details, due for publication by the end of 2014. It also noted the work that is being jointly conducted with IOSCO to review securitisation markets, in particular the development of criteria that could help identify simple and transparent securitisation structures. It will consider how to incorporate the final criteria into the securitisation capital framework during 2015.

The BCBS considered a range of policy and supervisory actions taken to address excessive variability in risk-weighted assets. These include a review of the standardised approaches, the introduction of capital floors, greater restrictions on modelling parameters and assumptions, and improved

disclosure. It plans to elaborate on these measures in its report to the November 2014 G20 Summit.

Assisting global resolutions

The FSB launched a consultation on measures to improve *cross-border recognition of resolution action* on 29 September 2014. The FSB wants to remove obstacles to, and enhance legal certainty in, cross-border resolution, including bail-in and temporary stays on swaps termination rights. It proposes removing derivatives users' immunity from any automatic stay on liabilities in the event a counterparty enters bankruptcy. In the consultation the FSB proposes:

- elements that countries should consider in their statutory cross-border recognition frameworks to facilitate effective cross-border resolution
- contractual approaches to temporary restrictions or stays on early termination and cross-default rights in financial contracts
- contractual approaches to the 'bail-in' of debt instruments that are governed by the laws of a jurisdiction other than that of the issuing entity.

The FSB's proposals accompany ISDA's work to introduce text into the majority of OTC bilateral derivatives contracts to address the enforceability of stays. Together these measures address the risk that resolution triggers a cascade of termination

events in derivatives contracts which leads to wider market disruption.

FSB members confirmed they will seek to ensure swap derivatives entered into by G-SIBs include text giving effect to cross-border stays in resolution by the end of 2015. The consultation closes on **1 December 2014**.

Mortgages

Insuring against indemnity obligations

The *Delegated Regulation on RTS on the minimum monetary amount of professional indemnity insurance (PII) or comparable guarantee for mortgage credit intermediaries* was published in the Official Journal on 19 September 2014. The RTS is required by the Mortgage Credit Directive.

The RTS sets the minimum PII requirement for intermediaries at €460,000 per claim, and €750,000 in aggregate in a calendar year. It came into force on 9 October 2014.

Recovery and resolution

The EBA published a number of consultations on draft ITS, RTS and guidelines in September for implementing different aspects of BRRD. We summarise these below.

Simplified Obligations under the BRRD

The EBA launched a *consultation - draft guidelines on the application of simplified obligations under the BRRD* on 25 September 2014.

BRRD allows regulators to apply simpler requirements to some firms, in line with the proportionality principle, in relation to the:

- RRP content
- date for drawing up the first RRP
- frequency for updating RRP
- content and details of the information required from institutions and the level of detail for the assessment of resolvability.

Regulators have to assess the impact of the failure of the institution against a set of prescribed criteria before applying simpler requirements. The draft guidelines explain how to measure the impact against each of the criteria listed in the BRRD.

On the same date the EBA also published *consultation - draft ITS on the uniform formats, templates and definitions for the identification and transmission of information by competent authorities and resolution authorities to the EBA for BRRD*. This includes three proposed templates that national regulators would use to confirm how they apply BRRD's simplified obligations.

Both consultations close on **3 January 2015**.

Failing firms' critical functions

The EBA published *consultation - guidelines on the minimum list of services or facilities that are necessary to enable a recipient to operate a business transferred*

to it under the BRRD on 24 September 2014. The EBA sets out the minimum list of necessary critical services that a regulator may require from a resolving institution (i.e. the purchaser after a sale of business, a bridge bank or the transferee after a transfer of assets).

The EBA suggests these critical services might include:

- human resources support
- information technology
- transaction processing, including legal transactional issues, in particular anti-money laundering
- legal services and compliance functions
- treasury-related services
- risk management and valuation
- accounting
- cash handling.

The EBA stresses that regulators need not require an institution going through resolution to maintain all these services. But this is only a minimum list so regulators could require an institution to maintain additional services on top of the core list. The EBA suggests that financial services activities need to be included as critical services to prevent the cost of resolution of these services from falling on the taxpayer.

The consultation closes on **22 December 2014**.

Early Intervention under BRRD

The EBA launched a *consultation - draft guidelines on triggers for use of early intervention measures under BRRD* on 22 September 2014.

The EBA provides guidance for regulators on when to consider the application of early intervention measures on institutions and how to identify triggers for this within the proposed common European supervisory and examination process (SREP) framework, and then how to tackle them.

The EBA also recognises the possibility that early intervention measures may be triggered by events not covered immediately by the SREP (e.g. material deterioration or indicator monitoring anomalies) or by 'significant events' outside the institution.

The consultation will close on **22 December 2014**. The EBA has announced on its website that a public hearing will be held on 10 November 2014.

Identifying failing institutions

The EBA launched *consultation – draft guidelines on the interpretation of the different circumstances when an institution shall be considered as failing or likely to fail under BRRD* on 22 September 2014.

A 'failing or likely to fail' determination by regulators or resolution authorities is one of three cumulative conditions triggering action by resolution authorities. It is also one of two cumulative conditions determining that the institution is no longer

viable and that resolution authorities should exercise the write-down or conversion power in BRRD.

The EBA provides a list of objective elements on the basis of which the relevant authorities could make this determination. However, it also stresses that the list is not exhaustive and that each determination should be made on the basis of a comprehensive assessment of both qualitative and quantitative objective elements, taking into account all other circumstances and information relevant for the institution.

The consultation will close on **22 December 2014**. The EBA has announced on its website that a public hearing will be held on 10 November 2014.

Avoiding instability in failing institutions

The EBA published a joint consultation setting out *draft guidelines on the factual circumstances amounting to a material threat to financial stability and of the elements related to the effectiveness of the sale of business tool and guidelines on the determination when the liquidation of asset or liabilities under normal insolvency proceedings could have an adverse effect on one or more financial markets* (known as the sale of business tools and the asset separation tool) on 24 September 2014.

Local regulators must market a failing institution so that it, or parts of it in resolution, can be sold. The EBA believes

this might lead to a material threat to financial stability, so sets out some specific factual circumstances where it believes the sale of business tool could be used, including when:

- systemic crisis or contagion where a number of firms could be failing and need early intervention
- discontinuance of critical functions
- withdrawal of short term funding or deposits
- decreases in share prices/prices of assets
- funding reductions
- impairment in the interbank funding market.

The EBA defines situations where the normal insolvency proceedings could have an adverse effect on financial markets which would make it necessary to use the asset separation tool. The EBA believes regulators should at least assess:

- whether the market for these assets is impaired
- the impact of a disposal of these assets on the markets where they are traded
- the situation of the financial markets.

The consultation will close on **22 December 2014**. The EBA has announced on its website that a public hearing on 28 November 2014.

State aid to recapitalise banks

On 22 September the EBA published *Guidelines on the types of tests, reviews or exercises that may lead to government capital injections in solvent banks that do not meet the criteria of failing or likely to fail.* The BRRD recognises that use of public money to recapitalise a bank does not necessarily mean that a bank is failing, or is likely to fail (so needing to be resolved).

The EBA set out tests, reviews or exercises to determine when such state intervention might be needed. These would include:

- **Stress tests** – coordinated at the national, SSM or EU level, designed to assess the resilience of a group of institutions against hypothetical adverse market developments.
- **Asset quality reviews** – coordinated at the national, SSM or Union level, designed to assess the quality of the accounting or prudential framework applied by a group of institutions, including an assessment of the risk management framework, loan classification, collateral valuation and loan origination and arrears management.
- **Other EU-wide exercises** – tests or reviews coordinated at the EU level and conducted on a population of institutions over multiple jurisdictions.

The EBA must now translate these final guidelines into the official languages of the

EU. Once these translations have been published EU regulators have two months to confirm they are complying with the updated guidelines or explain why they are not.

Writing your recovery plan

Institutions must develop and maintain recovery plans which outline measures to be taken to restore their financial position. The EBA published *consultation – draft guidelines on the minimum list of qualitative and quantitative recovery plan indicators* on 26 September 2014. The EBA identifies points at which appropriate actions referred to in the recovery plan should be taken. These must be quantitative and qualitative. A minimum list of categories that should be included in all recovery plans includes:

- capital
- liquidity
- profitability
- asset quality.

Firms should also include information on macroeconomic and market based indicators – unless they can justify that they are not relevant.

The EBA identify specific indicators to be included in each category of recovery plan, unless an institution can justify they those sub-indicators are not relevant to their legal structure, risk profile, size and/or complexity (i.e. a rebuttable presumption).

But the EBA also notes that institutions should not limit their recovery plans to this minimum list. An illustrative list of additional indicators to help institutions to determine the indicators most relevant to them which may not be covered by the minimum list, such as return on investment, is included.

The consultation closes on **2 January 2015**. The EBA has announced on its website that a public hearing will be held on 25 November 2014.

SSM

ECB to directly supervise 120 banks

The ECB published the *List of significant supervised entities and the list of less significant institutions* that it will supervise on 4 September 2014. The ECB will directly supervise 120 significant Eurozone credit institutions, or almost 85% of total banking assets in the Eurozone. The significance assessment was based on banks' year-end 2013 figures, including:

- value of assets
- importance to the domestic economy
- whether it received or requested public support.

In the future, significance assessments will take place annually, after the publication of banks' full year results. In the case of mergers, the ECB will carry out ad hoc assessments. It can change a bank's status from less significant to significant at any

time. It will also change a bank's status from significant to less significant if it hasn't met the criteria for three consecutive years.

Supervisory approach

Non EEA bank branches face stricter supervision

On 5 September 2014, the PRA finalised its approach to supervising international banks (*PS8/14* and *SS10/14*). It plans to significantly tighten supervision of non EEA branches and will also restrict a branch's type and scale of business.

The PRA will assess three elements to determine whether or not it will permit the international bank to operate as a branch in the UK:

- Home State Supervisor (HSS) equivalence
- presence of Critical Economic Functions (CEFs)
- adequacy of the group and UK branch's resolution planning.

If the HSS is equivalent, the bank doesn't perform CEFs and its resolution planning is satisfactory, the PRA will agree a split of prudential supervisory responsibilities with the HSS. If not, it will cancel the branch authorisation and require the bank to transfer its business to a UK subsidiary or withdraw from the UK market. Similarly, the PRA could refuse new branch authorisation applications from new

entrants if they do not meet its expectations in these areas.

The PRA made some changes to its policy to reflect industry feedback:

- clarifying the criteria for HSS equivalence
- defining the Critical Economic Functions
- introducing a new definition of ‘de minimis’ retail deposits with quantified thresholds of £100 million and 5,000 customers
- delaying the filing requirement for semi-annual Branch Returns.

Perhaps the greatest challenge for banks will be the new annual SYSC attestation requirement, which must be signed by the senior person responsible for the branch. The first attestations must be submitted by 31 March 2015.

The new supervisory approach is effective immediately. See this month’s feature article for more analysis of the impact these new requirements might have on existing UK operations and new entrants.

Asset management

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Regulation

Alternative investments

Identifying social investments

ESMA published *Consultation paper: technical advice to the EC on the implementing measures of the Regulations on European Social Entrepreneurship Funds (EuSEFs) and European Venture Capital Funds (EuVECAFs)* on 26 September 2014.

The EuSEF Regulation requires EuSEFs to invest in social enterprises, which include companies that produce their goods or services in line with their own social objectives. ESMA is consulting on what goods and services, and methods of producing goods and services might embody a social objective. ESMA proposes some high level principles that EuSEF managers could use to assess whether an investment meets the objective of producing its goods and services in line with its social objective. This includes considering for whom the goods and services are provided and whether they address a social or environmental issue.

ESMA also provides technical advice on three other issues:

- How EuSEF and EuVECA managers identify and prevent conflicts of interest – ESMA suggests managers should establish written policies and disclose any conflicts they are unable to mitigate.
- How EuSEF managers measure the social impact of their investments – ESMA suggests managers might follow a generally accepted existing methodology (without suggesting one as the best option) such as Social Return on Investment or Impact Reporting and Investment Standards.
- Information to provide to EuSEF investors – ESMA suggests EuSEF managers should make a wide range of information available to investors including the social investments they have chosen, their social impact (as measured above) and the entities providing services to the EuSEF.

The consultation closes on **10 December 2014**. ESMA aims to provide its final technical advice to the EC by April 2015.

Updated AIFMD Q&A

ESMA updated its *Q&A: application of the AIFMD* on 30 September 2014. The new answers focus on regulatory reporting and delegation.

ESMA confirms that:

- non-EU AIFMs must report to competent authorities in each Member State where they have existing investors (even if they no longer proactively market in that country)
- non-EU AIFMs should report at a frequency related to their aggregated assets under management for all the AIFs they market in the EU
- if a final NAV is not available the AIFM should use an estimate and subsequently update this if the final NAV differs
- AIFMs should include cash accounts when reporting on their total number of open positions
- bank overdrafts should be treated as short positions.

ESMA also confirmed that AIFMs should assess at the level of an individual AIF whether delegations become a letterbox entity (by delegating activities to third parties). This could result in an AIFM being a letterbox entity for only some AIFs.

ESMA frequently updates the Q&A to reflect the latest industry questions on very specific areas of AIFMD implementation.

Retail funds

Strict depositary independence proposed

ESMA published *Consultation paper: technical advice to the EC on delegated acts required by the UCITS V Directive* on 26 September 2014. The UCITS V Directive makes changes to the existing depositary rules for UCITS funds to better align them to AIFMD requirements and to deal with the fallout from issues such as the Madoff scandal. The Directive asks ESMA to develop technical advice that mirrors the Delegated Acts for AIFMD to promote market consistency and ease implementation. But the UCITS Directive goes further than AIFMD in two areas, with are the subject of the current technical advice.

When a depositary delegates custody to a third party, that third party must make sure it keeps the UCITS's assets segregated from its own, to protect the UCITS in case the third party falls insolvent. ESMA proposes technical advice on steps the third party and UCITS depositary should take to ensure segregation. For the third party this could include taking legal advice (if located outside the EU) to verify that the local laws recognise the UCITS's segregation from other assets. If this is not possible ESMA suggests the depositary should find a new delegate. Inside the EU it should not be

such an issue since ESMA expects changes to recognise that UCITS assets are segregated from other assets in case of insolvency.

More controversially, particularly for continental European asset managers are the proposals around ensuring independence between the UCITS management company and the depositary. The UK already bans the two parties from being in the same group: ESMA's technical advice proposes this as an option for its technical advice. An alternate option is that groups would need to implement specific governance and organisational measures if the depositary and management company are both in the same group to ensure they act independently of each other.

The consultation closes on **24 October 2014**. The rather short deadline reflects that the EC asked for this technical advice by mid-October. ESMA notes it will miss this deadline but aims to deliver to the EC by the end of November.

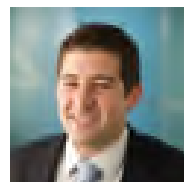
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Regulation

EU Developments

EIOPA updates risk dashboard

EIOPA published its *Risk Dashboard September 2014 (based on second quarter 2014 data)* on 17 September 2014. EIOPA concludes that the risk environment for insurers is broadly unchanged. But there were some signs of improvement in respect of credit risk and also improved liquidity and funding with catastrophe bond issuance reaching an all-time high.

EIOPA's general progress report

EIOPA published a *Statement* by Gabriel Bernardino, Chairman of EIOPA, at the ECON hearing on 23 September 2014. This summarises EIOPA's work over the last 12 months and the challenges ahead.

International developments

Global insurance regulation update

The IAIS is undertaking a project to introduce global capital requirements for insurers. See our Hot Topic *G-SII – a new era of global insurance regulation* for background information. The IAIS' first step was to develop a Basic Capital Requirement (BCR) for G-SIIs. G-SIIs are defined by the

FSB as insurers 'of such size, market importance, and global interconnectedness that their distress or failure would cause significant dislocation in the global financial system and adverse economic consequences across a range of countries.'

The IAIS has considered feedback from its two *consultations on the BCR for G-SIIs*. In this the IAIS is proposing that BCR required capital will be calculated on a consolidated group-wide basis, with all holding companies, insurance legal entities, banking legal entities and any other service companies included in the consolidation. The proposed BCR reflects major categories of risks impacting the businesses of G-SIIs and account for on- and off-balance-sheet exposures. It is constructed in three basic components, an insurance component, a banking component and a component for other non-insurance activities (financial and material non-financial) not currently subject to regulatory capital requirements. The proposed BCR is determined using a factor-based approach with 15 factors applying to defined segments within the main categories of insurers' activities, namely Traditional Life insurance, Traditional Non-Life insurance, Non-Traditional (NT) insurance, Non-Insurance

(NI) activities, and Assets. The IAIS is due to deliver its BCR proposals to the G20 summit in November 2014. The current BCR proposal for endorsement by the G-20 in 2014 is aimed at the G-SIIs only.

There were some important developments on these issues in September 2014. Here we look at new principles for G-SIIs and IAIGs and a ComFrame update.

HLA for G-SIIs

The next stage in the project is the development of Higher Loss Absorbency (HLA) for G-SIIs. The HLA will build initially on the BCR to address additional capital requirements for G-SIIs reflecting their systemic importance in the international financial system. The IAIS published the *HLA principles* that it plans to follow in the development of HLA for G-SIIs on 22 September 2014. The IAIS is planning to consult on the HLA in December 2014.

The HLA is due to be completed by the end of 2015 and it is proposed that G-SIIs should hold capital in excess of the BCR plus HLA from 2019. The HLA capital requirement is to be met by the 'highest quality capital'.

Risk-based global ICS for IAIGs

The third step in the development of global capital requirements for IAIGs is the

introduction of the risk-based global insurance capital standard (ICS), to be applied to IAIGs. IAIGs are insurance groups that exceed thresholds set by the IAIS on size (by assets and premium) and international activity. IAIGs will fall under the remit of the IAIS' Common Framework (ComFrame) for the Supervision of IAIGs which concerns the on-going supervision of IAIGs and is not focused on whether or not an insurance group is systemically important. There will therefore be many more IAIGs than G-SIIs.

The IAIS published *ICS principles* for developing the ICS on 22 September 2014 (dated 12 September 2014). The standard will reflect all material risks to which an IAIG is exposed. It will include valuation principles for assets and liabilities, a definition of qualifying capital resources and a risk-based capital requirement. The IAIS is planning to consult on the ICS in December 2014. The ICS is due to be completed by the end of 2016 and applied to IAIGs from 2019.

The IAIS is proposing to transfer the foundation of the HLA from the BCR to the ICS once it has been finalised i.e. G-SIIs will then be required to hold capital in excess of the ICS plus HLA rather than BCR plus HLA. The exact timing of the transition of the foundation of HLA from BCR to ICS will depend upon the adoption date of the ICS

by the IAIS and upon the time required for jurisdictions to develop and implement the necessary legislative frameworks for implementation of the ICS. The scheduled ICS adoption date is October 2018. The calibration of the HLA may need to be revised once the ICS has been adopted.

ComFrame update

The IAIS published a *revised draft of ComFrame* on 19 September 2014. The IAIS has revised ComFrame for ICS developments. The ICS will be included within ComFrame to provide an objective group-wide measure of capital adequacy for IAIGs comparable across jurisdictions.

Quantitative field testing of ComFrame started in March 2014 to support the development of the ICS and approaches to valuation. Qualitative field testing will start in the third quarter of 2014 based on this revised draft of ComFrame. The IAIS plans to consult on ComFrame measures to address crisis management and resolution by the end of 2014.

Solvency II

EIOPA updates Solvency II Q&A

EIOPA updated its *Answers to questions on Submission of Information to NCAs* in September 2014. The Q&A gives firms more information about how to implement EIOPA's Solvency II guidelines.

Where to go for more information

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

Accounting

IFRS

Insurance contracts project update

The *IASB meeting on 23 September 2014* continued to discuss insurance contracts with participating features.

The IASB focused on the merits and deficiencies of both the book yield and effective yield approaches for presentation of interest expense in profit or loss for contracts with participation features. The IASB also considered the presentation of changes in discount rates. No final decisions were taken on participating contracts.

The IASB made two decisions on the premium allocation approach. Revenue should be recorded on the basis of the passage of time and the expected number of contracts in force. But if the expected pattern of risk release differs significantly from the passage of time, then revenue would be earned on the basis of expected timing of incurred claims and benefits.

The IASB also decided that when an entity presents the effect of changes in discount

rates in other comprehensive income, the discount rate used to determine the interest expense for the liability for incurred claims in the premium-allocation approach should be the rate which was locked-in at the date the claim was incurred.

The IASB will continue its re-deliberations on the Insurance Contracts project at the October 2014 meeting.

Monthly calendar

Open consultations

Closing date for responses	Paper	Institution
23/10/14	<i>Implementation of the fair end effective markets review's recommendations on benchmarks to bring into UK regulatory scope</i>	HMT
24/10/14	<i>Consultation paper – ESMA's technical advice to the EC on delegated acts required by the UCITS V Directive</i>	ESMA
24/10/14	<i>Consultation paper – ESMA's technical advice to the EC on the implementing measures of the Regulations on EuSEFs and EuVEECAs</i>	ESMA
30/10/14	<i>Implementation of the EU mortgage credit directive</i>	HMT
31/10/14	<i>CP14/13 – strengthening accountability in banking: a new regulatory framework for individuals</i>	FCA/PRA
31/10/14	<i>CP14/14 – strengthening the alignment of risk and reward: new remuneration rules</i>	FCA/PRA
31/10/14	<i>Consultation paper on periodic information to be submitted to ESMA by Credit Rating Agencies</i>	ESMA
01/11/14	<i>Consultation paper on draft ITS on main indices and recognised exchanges under the CRR</i>	ESMA
05/11/14	<i>CP14/18: Quarterly consultation No.6</i>	FCA
06/11/14	<i>GC14/6 – Social media and customer communications: The FCA's supervisory approach to financial promotions in social media</i>	FCA
06/11/14	<i>Consultation paper on the clearing obligation under EMIR (no. 3)</i>	ESMA
07/11/14	<i>CP16/14 – Transposition of Solvency II: Part 3</i>	PRA

Closing date for responses	Paper	Institution
24/11/14	<i><u>CP18/14 – CRD IV: compliance with the EBA’s guidelines on disclosure of encumbered and unencumbered assets</u></i>	PRA
01/12/14	<i><u>Consultation paper on conflicts of interest in direct and intermediated sales of insurance-based investment products</u></i>	EIOPA
01/12/14	<i><u>Consultative document – cross-border recognition of resolution action</u></i>	FSB
19/12/14	<i><u>Consultation paper – draft RTS on prospectus related issues under the Omnibus II Directive</u></i>	ESMA
22/12/14	<i><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></i>	EBA
22/12/14	<i><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></i>	EBA
22/12/14	<i><u>Consultation paper – draft guidelines on triggers for use of early intervention measures under BRRD</u></i>	EBA
29/12/14	<i><u>CP14/20 – implementation of the MCD and the new regime for second charge mortgages</u></i>	FCA
02/01/15	<i><u>Consultation paper – draft guidelines on the minimum list of qualitative and quantitative recovery plan indicators</u></i>	EBA
02/01/15	<i><u>Consultation paper – draft guidelines on payment commitments under DGSD on deposit guarantee schemes</u></i>	EBA
03/01/15	<i><u>Consultation paper – draft guidelines concerning the interrelationship between the BRRD sequence of write-down and conversion and CRR/CRD IV</u></i>	EBA
03/01/15	<i><u>Consultation paper – draft guidelines on the application of simplified obligations under the BRRD</u></i>	EBA
04/01/15	<i><u>Consultation paper – draft RTS and draft guidelines specifying the conditions for group financial support under the BRRD and draft ITS on the</u></i>	EBA

**Closing date
for responses****Paper****Institution**

form and content of disclosure of financial support agreements under of BRRD

05/01/15

Consultation paper on guidelines on the application of C6 and C7 of Annex I of MiFID

ESMA

Forthcoming publications in 2014

Date	Topic	Type	Institution
Client Money			
TBD 2014	Review of the client money rules for insurance intermediaries	Policy statement	FCA
TBD 2014	Regulated client money regime for consumer credit companies	Consultation paper	FCA
Consumer protection			
TBD 2014	National Depositor Preference and UK depositors	Policy statement	PRA
TBD 2014	Mortgage Market Review: Arrears and Approved Persons – final rules	Policy statement	FCA
Financial crime, security and market abuse			
Q4 2014	Market Abuse Review	Technical advice	ESMA
Insurance			
TBD 2014	Institutions for Occupational Retirement Provision	Legislative proposals	EC
TBD 2014	Advice or technical standards for IMD2	Technical advice or technical standards	EIOPA
Securities and markets			
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

Date	Topic	Type	Institution
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
<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
Q4 2014	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

Date	Topic	Type	Institution
<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
Q4 2014	Electronic reporting format and access to regulated information	Regulatory technical standards	ESMA

Main sources: ESMA 2014 work programme; EIOPA 2014 work programme; EBA 2014 work programme; EC 2014 work programme; FCA policy development updates

Glossary

2EMD	The Second E-money Directive 2009/110/EC	BIS	Bank for International Settlements
ABC	Anti-Bribery and Corruption	BoE	Bank of England
ABI	Association of British Insurers	BRRD	Bank Recovery and Resolution Directive
ABS	Asset Backed Security	CASS	Client Assets sourcebook
AIF	Alternative Investment Fund	CCD	Consumer Credit Directive 2008/48/EC
AIFM	Alternative Investment Fund Manager	CCPs	Central Counterparties
AIFMD	Alternative Investment Fund Managers Directive 2011/61/EU	CDS	Credit Default Swaps
AIMA	Alternative Investment Management Association	CEBS	Committee of European Banking Supervisors (predecessor of EBA)
AML	Anti-Money Laundering	CET1	Core Equity Tier 1
AML3	3rd Anti-Money Laundering Directive 2005/60/EC	CESR	Committee of European Securities Regulators (predecessor of ESMA)
ASB	UK Accounting Standards Board	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
BCR	Basic capital requirement (for insurers)	CMA	Competition and Markets Authority
BIBA	British Insurance Brokers Association	CoCos	Contingent convertible securities

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

Executive summary	PRA has its eye on foreign banks	Cross sector announcements	Banking and capital markets	Asset management	Insurance	Monthly calendar	Glossary
FATCA	Foreign Account Tax Compliance Act (US)			FSOC	Financial Stability Oversight Council		
FATF	Financial Action Task Force			FTT	Financial Transaction Tax		
FC	Financial counterparty under EMIR			G30	Group of 30		
FCA	Financial Conduct Authority			GAAP	Generally Accepted Accounting Principles		
FDIC	Federal Deposit Insurance Corporation (US)			G-SIBs	Global Systemically Important Banks		
FiCOD	Financial Conglomerates Directive 2002/87/EC			G-SIFIs	Global Systemically Important Financial Institutions		
FiCOD1	Amending Directive 2011/89/EU of 16 November 2011			G-SIIs	Global Systemically Important Institutions		
FiCOD2	Proposal to overhaul the financial conglomerates regime (expected 2013)			HMRC	Her Majesty's Revenue & Customs		
FMI	Financial Market Infrastructure			HMT	Her Majesty's Treasury		
FOS	Financial Ombudsman Service			IAIS	International Association of Insurance Supervisors		
FPC	Financial Policy Committee			IASB	International Accounting Standards Board		
FRC	Financial Reporting Council			ICAS	Individual Capital Adequacy Standards		
FSA	Financial Services Authority			ICB	Independent Commission on Banking		
FSB	Financial Stability Board			ICOBS	Insurance: Conduct of Business Sourcebook		
FS Act 2012	Financial Services Act 2012			IFRS	International Financial Reporting Standards		
FS Reform Bill 2012	Financial Services (Bank Reform) Bill 2012			IMA	Investment Management Association		
FSCS	Financial Services Compensation Scheme			IMAP	Internal Model Approval Process		
FSI	Financial Stability Institute (of the BIS)			IMD	Insurance Mediation Directive 2002/92/EC		
FSMA	Financial Services and Markets Act 2000			IMD2	Proposal for a Directive on insurance mediation (recast) COM(2012) 360/2		

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	MTF	Multilateral Trading Facility
JCESA	Joint Committee of the European Supervisory Authorities	MoJ	Ministry of Justice
JMLSG	Joint Money Laundering Steering Committee	NAV	Net Asset Value
JURI	Legal Affairs Committee of the European Parliament	NBNI G-SIFI	Non-bank non-insurer global systemically important financial institution
LCR	Liquidity coverage ratio	NFC	Non-financial counterparty under EMIR
LEI	Legal Entity Identifier	NFC+	Non-financial counterparty over the EMIR clearing threshold
LIBOR	London Interbank Offered Rate	NFC-	Non-financial counterparty below the EMIR clearing threshold
LTGA	Long-Term Guarantee Assessment	NSFR	Net stable funding ratio
MAD	Market Abuse Directive 2003/6/EC	OECD	Organisation for Economic Cooperation and Development
MAD II	Proposed Directive on Criminal Sanctions for Insider Dealing and Market Manipulation (COM(2011)654 final)	Official Journal	Official Journal of the European Union
MAR	Proposed Regulation on Market Abuse (EC) (recast) (COM(2011) 651 final)	OFT	Office of Fair Trading
MCD	Mortgage Credit Directive	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)
Member States	countries which are members of the European Union	ORSA	Own Risk Solvency Assessment
MiFID	Markets in Financial Instruments Directive 2004/39/EC		

OTC	Over-The-Counter	SSM	Single Supervisory Mechanism
PERG	Perimeter Guidance Manual	SSR	Short Selling Regulation EU 236/2012
PRA	Prudential Regulation Authority	T2S	TARGET2-Securities
Presidency	Member State which takes the leadership for negotiations in the Council: rotates on 6 monthly basis	TR	Trade Repository
PRIIPs Regulation	Proposal for a Regulation on key information documents for investment and insurance-based products COM(2012) 352/3	TSC	Treasury Select Committee
RAO	Financial Services and Markets Act 2000 (Regulated Activities Order) 2001	UCITS	Undertakings for Collective Investments in Transferable Securities
RDR	Retail Distribution Review	XBRL	eXtensible Business Reporting Language
RRPs	Recovery and Resolution Plans		
RTS	Regulatory Technical Standards		
RWA	Risk-weighted assets		
SCR	Solvency Capital Requirement (under Solvency II)		
SEC	Securities and Exchange Commission (US)		
SFT	Securities financing transactions		
SFD	Settlement Finality Directive 98/26/EC		
SFO	Serious Fraud Office		
SIPP	Self-invested personal pension scheme		
SOCA	Serious Organised Crime Agency		
Solvency II	Directive 2009/138/EC		

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