

Being better informed

FS regulatory, accounting and audit bulletin

*PwC FS Risk and
Regulation Centre of
Excellence*

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In this month's edition:

EP signs-off on number of
key texts, including
Banking Union

EC consults on FX
forward transactions

Stress testing
methodology revealed for
banks and insurers

In-depth look at new
PRIIPs Regulation



Executive summary

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



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We are on the verge of a new European Parliament, with elections set to take place across the EU from 22 to 25 May 2014. The new MEPs, particularly the members appointed to the new ECON committee will have a tough act to follow. The current committee negotiated over 60 legislative texts with the Council, often introducing radical amendments to the EC's proposals and holding their ground to ensure key amendments were adopted in the face of sometimes strong opposition. ECON members participated in hundreds of workshops, hearings, coordinators' meetings and trilogue negotiations. They introduced something in the region of 35,000 amendments to proposals within their remit.

The current EP will be a hard act to follow – it has radically reshaped the financial services landscape following the financial crisis. Complex legislative texts and intense negotiations resulted in countless late-night meetings and last minute agreements as MEPs took on the difficult task of re-shaping the financial industry. They formulated new prudential rules for banks (CRD IV) and insurers (Solvency II). They launched a regulatory regime for hedge funds, real estate managers and private equity firms (AIFMD). They have agreed rules to curb speculative trading and make financial markets more transparent (MiFID II), a clearing requirement for standardised OTC derivatives (EMIR) and rules to protect retail consumers (PRIIPs).

While many of the texts were anticipated well in advance, some were conceived as a response to the crisis, notably the Banking Union package launched in June 2012, which saw the creation of the Single Supervisory Mechanism and the Single Resolution Mechanism in record time. The EP signed-off on the last three important elements of the plan during the last plenary on 15 April – BRRD, the SRM and confirmation of the EU-wide guarantee scheme for deposits under €100,000.

New MEPs will still be faced with a mountain of proposed legislation when they take their seats in July. Many reforms remain to be finalised: anti-money laundering, shadow banking (including

MMFs), bank restructuring etc. In parallel, the EP has taken on a significant oversight role in respect of the economic reform process in Member States, which remains critical given the tentative financial recovery throughout the EU.

In our feature article this month we explore the new PRIIPs legislation this month, which takes forward consumer product disclosure by requiring a common form of key information document for products from by different financial sectors.

We hope you'll find the articles that follow informative. Staying current on new regulatory developments remains challenging, and despite the EP taking a hiatus for elections, we expect a busy summer ahead on the regulatory front.

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How to read this bulletin?

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PRIIPs: the new KID on the block



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The EP adopted the PRIIPs Regulation on 15 April 2014, as part of the “super Tuesday” bundle of legislation approved by the EP ahead of the EU elections in May 2014.

Background

In an April 2009 *Communication*, the EC undertook to improve the consistency of disclosures across different financial products offered in the retail market. It hoped to reduce disparities between the information provided to retail consumers in different countries before they invest in a packaged product and the associated potential for regulatory arbitrage.

More than three years later, the EC finally published the initial legislative proposals on 3 July 2012, as part of the EC’s “retail package”, including the draft texts for UCITS V and IMD2. Progress by the Council and the EP on the text was relatively slow, due to more pressing legislative priorities (e.g. CRD IV and the Banking Union), but also because legislators had fundamentally different views on key amendments to the proposal.

The EP wanted to widen the scope of the proposal to capture more products offered to retail investors and more of the product lifecycle (e.g. product design and risk management), rather than focusing purely on the disclosure provided to retail investors. But neither the Council nor the EC supported these extensions, so the

text has not changed significantly from the EC’s original proposals in 2012. The EP, Council and EC finally reached political agreement on 1 April 2014, enabling the EP to approve the measure in the final plenary session of this parliament.

What products are in scope?

PRIIPs takes a broad-brush approach, excluding a limited number of products rather than defining the products that are in scope. Legislators did this to “future proof” the legislation and prevent firms from circumventing the requirements by designing new products that fell outside a limited definition

Products that are definitely out of scope include:

- non-life insurance products included in Annex I of Solvency II
- life insurance contracts where the benefits are only payable on death or incapacity
- deposits (other than structured deposits)
- securities listed in the Prospectus Directive
- certain pension products, including occupational pension schemes.

All other retail products that are “packaged” (i.e. the amount repayable to the investor is subject to fluctuations due to the performance of underlying assets) are in scope. The EC sees four broad types of PRIIPs:

- investment funds (e.g. UCITS and other non-UCITS funds sold to retail investors – such as non-UCITS retail schemes in the UK)

- insurance-based investment products
- retail structured securities
- structured term deposits.

PRIIPs is sufficiently clear about what products are in scope, so product manufacturers should not wait for further guidance. They should begin carrying out their own analysis to identify which of their retail products (offered directly or through intermediaries) will be in scope.

KID contents

PRIIPs adopts the same approach as the KIID for UCITS products. It strictly mandates the layout and contents of the Key Information Document (KID). Details will be further fleshed-out by Level 2 Delegated Acts, including how regularly the KID needs to be reviewed and updated.

The KID must not be longer than three pages, and must include:

- standard title and introduction sentence
- product name, manufacturer contact details, name of the local regulator and date
- a “comprehension alert” stating that “you are about to purchase a product that is not simple and may be difficult to understand” (where applicable)
- type of PRIIP, its objective and policy, what types of investors it is being aimed at and any insurance benefits included
- a summary risk indicator (like the UCITS synthetic risk and reward indicator) with a narrative

explanation of the indicator and relevant risks (including the maximum loss possible)

- a description of whether a guarantee or investor compensation scheme applies (e.g. FSCS)
- information about direct and indirect costs paid by the investor, both the one-off and recurring costs and a statement that (where applicable) intermediaries' fees will be disclosed separately by the adviser
- details of any cooling off or cancellation period, how long an investor should stay invested and any fees and penalties charged for early exit
- complaints information
- other relevant information (e.g. any additional documents that might be provided pre and post-investment).

The KID is not a marketing document and should not refer to other products from the manufacturer or distributor. Any marketing documents must explain that the KID is available and where it can be found. It must be a factual document written in plain language.

Impact on product distribution

Although product manufacturers need to take responsibility for producing the KID, distributors are responsible for disseminating it to investors. Generally the distributors must provide the KID in good time before an investment – they can only provide it after investment if the transaction meets certain requirements (e.g. if the investor contacts the distributor on their own initiative).

In practice, distributors are likely to need a written audit trail demonstrating how they've met this

requirement. Alternatively, they could use tick-box confirmations on websites to demonstrate that the investor has seen the KID before deciding to invest.

Distributors still have to meet other obligations, such as requirement to consider whether a particular product is suitable for an investor and to disclose any other costs they charge.

New intervention powers for insurance products

PRIIPs introduces new product intervention powers, both for EIOPA and local regulators. Both will be able to temporarily ban or restrict certain insurance-based products from being marketed in the EU where they see potential for consumer detriment. EIOPA's powers are similar to the FCA's current product intervention powers.

EU-wide sanctions regime

PRIIPS proposes a number of administrative sanctions, including:

- publicly identifying and censuring a firm
- suspending or prohibiting marketing a PRIIP
- prohibiting the use of a KID that doesn't meet PRIIPs requirements
- temporarily or permanently banning individuals from performing similar roles in future
- imposing fines of at least €5m (or equivalent local currency) for a firm or a maximum of €700,000 for an individual.

Member States can opt out of applying any of the administrative sanctions if criminal sanctions apply for the same offence.

Final legislative steps

We expect PRIIPs to be published in the Official Journal in June and enter into force by July 2014. That means product providers will need to produce KIDs by July 2016. UCITS managers will also have to provide retail investors with KID meeting the PRIIPs requirements, but have a 5 year grace period during which they can continue to use the current KIID.

The EC will review the implementation of PRIIPs regime after four years. It wants the industry to produce an online fund charge calculator to support product comparison. If the industry doesn't develop one before the 2018 review, the EC might mandate the ESAs to do so.

What should firms be doing now?

Now the PRIIPs rules are nearly final, firms should begin assessing the impact on their products and distribution channels. Each product manufacturer should identify all of their in-scope products and begin considering the KID design for each product. Distributors and product manufacturers need to begin liaising about how the KID will be distributed to retail investors. Firms should consider the KID development alongside other product distribution changes arising from MiFID II, RDR and the new platforms regulation. To ensure effective and efficient implementation, firms need to take a holistic approach to distribution changes rather than looking at individual legislative and regulatory changes in isolation. Starting now may give early adopters a strategic advantage.

Cross sector announcements

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Regulation

Capital and liquidity

Controlling large exposures

The Basel Committee published its *Supervisory framework for measuring and controlling large exposures* (large exposure regime) on 15 April 2014.

The large exposure regime is designed to protect banks from significant losses caused by the sudden default of a single counterparty or group of connected counterparties.

Under new rules, a bank's exposures to a single counterparty cannot exceed 25% of Tier 1 capital. This limit also applies to a bank's exposure to identified groups of connected counterparties. A tighter limit of 15% of Tier 1 capital will apply to exposures between banks that have been designated G-SIBs.

This final standard reflects feedback on the original March 2013 proposals:

- increasing the definition and the reporting thresholds to 10% of the eligible capital base (instead of the 5% initially proposed)
- modifying the treatment of a limited range of credit default swaps used as hedges in the trading book to align it more closely with the risk-based capital framework

- replacing the granularity threshold initially proposed for exposures to securitisation vehicles with a materiality threshold related to the capital base of the bank (calibrated at 0.25% of the capital base).

The new rules will take effect from 1 January 2019.

By 2016 the Basel Committee plans to review the appropriateness of setting a large exposure limit for exposures to qualifying central counterparties related to clearing activities, which are currently exempted. It also intends to review the impact of the large exposures framework on monetary policy implementation.

Finalising CCP exposure capital requirements

The Basel Committee published its *capital requirements for bank exposures to CCPs* on 10 April 2014. It has revised the interim framework to reflect conclusions from the joint quantitative impact study and the feedback received from its June 2013 draft consultation.

The final policy includes:

- a new approach for determining the capital requirements for bank exposures to QCCPs
- an explicit cap on the capital charges applied to bank exposures to QCCPs

- detailed treatment for multi-level client structures
- answers to frequently asked questions about the revised policy framework.

Firms are required to hold £1 of capital for every £1 of exposure to a non-QCCP.

The new capital requirements apply from 1 January 2017. Until then the interim capital requirements remain in effect.

Advising on CRD IV

EBA published an *addendum* to its *2014 work plan* following a series of calls for advice from the EC on 16 April 2014. The additional work is mostly technical advice on topics related to provisions in the CRR/CRD IV, including:

- own funds requirements for covered bonds
- capital requirements on exposures to transferred credit risk
- implementation of the ICAAP and Pillar 2 requirements
- scope of application and exemption of Pillar 1 requirements
- longer-term refinancing operations
- consistency of macro-prudential rules

- prudential filter for fair value gains and losses
- implementing acts on third country equivalence decisions
- appropriateness of the definition of eligible capital related to the Large Exposures regime
- long term financing.

The technical advice will mostly build on work already being done by the EBA, to inform the EC in preparing reports and legislative acts for the EP and Council.

Financial stability

Stability risks still persist

The ESAs published the *Joint Committee Report on Risks and Vulnerabilities in the EU Financial System* on 2 April 2014.

The report identifies a number of potential vulnerabilities and cross-sectoral risks to the stability of the European financial system, including:

- weak and uneven economic recovery
- uncertain outlook in a number of global emerging economies
- asset price imbalances and risks of a sharp adjustment
- increased search for yield in a protracted low interest rate environment

- conduct of business risks
- IT-related operational risks.

Andrea Enria, Chairman of the EBA and current Chairman of the Joint Committee, said that this analysis will help focus the scenarios of the stress tests for banks and insurance companies which will be conducted later this year.

Pensions

Establishing a single personal pensions market

In a *speech* on 14 April 2014, Gabriel Bernardino reaffirmed EIOPA's commitment to an EU single market for personal pensions:

'We believe a strong case is made for a future EU Directive that would establish a single market for personal pensions inter alia through the alignment across the EU of personal pension holder protection measures, capturing also any personal pension providers that are not currently regulated at EU level.'

Bernadino's speech followed the EC 27 March 2014 publication of a *proposal* to amend the IORP Directive (IORP II).

Remuneration

Continued focus on pay

The EBA launched consultations on updating two remuneration reporting requirements on 7 April 2014. In its

consultation on *draft guidelines on the remuneration benchmarking exercise*, the EBA proposes a more granular collection of remuneration data for different business areas, control and corporate functions. Previously this data was included in the 'All other' functions section of the template.

The second consultation on *draft guidelines on the data collection exercise regarding high earners* requires national regulators to collect remuneration information of those bank staff earning more than €1m (in €1m increments). The EBA proposes collecting information on:

- job responsibilities
- the business area
- main elements of the salary, bonus, long-term award and pension contribution.

The €1m bands and job responsibility are supplementary to the previous framework. The EBA provides a reporting template for firms to use.

Both consultations closed on 7 May 2014.

Reporting

COREP reporting delayed

On 16 April 2014, the EBA *postponed* the date for banks to submit the first set of supervisory reports under CRD IV to the end of June 2014, because the EC

adopted the associated *ITS later than expected*. The postponement gives firms a two month grace period from the original date.

It concerns banks' submissions of:

- quarterly reports on own funds, large exposures, leverage ratio, and net stable funding ratio, with reference dates as of 31 March 2014 to end June 2014 (as opposed to end May 2014)
- monthly liquidity reports with reference dates as of 31 March 2014 and 30 April 2014 to end June 2014 (as opposed to April 2014).

The EBA also delayed the implementation of the draft ITS on reporting asset encumbrance. The first reporting reference date for asset encumbrance will be 31 December 2014, and the first remittance date will be 11 February 2015. Further information on new timetable for COREP submissions can be found *here*.

Securities & derivatives

FSB urges G20 to complete margin rules

The FSB published its *OTC Derivatives Market Reforms: Seventh Progress Report on Implementation* on 8 April 2014.

The FSB finds that key international policy standards are complete in most

commitment areas but detailed implementation requirements and effective dates vary considerably between jurisdictions:

- Trade reporting - the FSB expects that only three jurisdictions will not have rules in place by end of 2014.
- Capital - 15 FSB members have implemented Basel III standards. Remaining standards on the treatment of banks' exposures to CCPs are nearly complete.
- Central clearing - only six jurisdictions are expected to have central clearing rules in effect by end of 2014.
- Non-centrally cleared margin requirements - a limited number of jurisdictions have started developing rules to implement the Basel Committee/IOSCO Margin Standards for Non-centrally Derivatives.
- Organised platform trading - only three jurisdictions have rules in force.

The FSB believes that overlapping, duplicative, inconsistent, conflicting international requirements are undermining implementation and the efficiency of the reforms. The FSB supports the work of the OTC Derivative Regulators Group to

continue to coordinate and resolve extra-territorial issues.

The FSB urges all jurisdictions to complete remaining implementation rules by the November 2014 G20 Leaders Summit.

Europe faces €200bn margin bill

The JCESA launched a consultation on *draft RTS for risk-mitigation techniques for OTC-derivative contracts not cleared by a CCP under EMIR* on 14 April 2014.

The consultation covers:

- calculation of initial and variation margin
- collateral eligible for exchange of margin, including measures to ensure diversification and haircuts to take account of market and FX risk
- operational and risk management procedures around calculation, exchange, documentation, etc. of margins
- specific treatment for certain products, such as physically settled FX swaps
- procedures for intragroup derivative contracts
- phased introduction of initial margin requirements (all counterparties with exposures over

€8bn will only be subject to the requirements from 1 December 2019).

The JCESA proposals have been adjusted to also adhere closely to international standards issued by the Basel Committee and IOSCO in September 2013, while remaining consistent with CRR.

The consultation closes **14 July 2014**. After considering the consultation feedback the ESAs plan to submit their final proposals to the EC before the end of 2014.

Unblocking the ABS market

The ECB and the BoE published a joint paper on *The impaired EU securitisation market: causes, roadblocks and how to deal with them* on 11 April 2014. They outline:

- the aims and benefits of securitisation
- the current situation in Europe
- some policy solutions for advancing the securitisation market.

They are very supportive of securitisation, arguing that it can provide a source of funding for SMEs and provide capital relief to banks by transferring risk to non-bank institutions.

The ECB and BoE note that public issuances of ABS remain very low in the

EU. Most of them originate in a limited number of countries such as Germany, Netherlands and the UK. Securitisation has been stigmatised as a consequence of misaligned incentives in the years prior to the crisis. Among the problems currently associated with securitisation are:

- regulatory treatment, such as high capital charges
- a reliance on CRAs, particularly issues such as sovereign ratings impacting ABS downgrades
- lack of transparency and harmonisation.

The ECB and BoE believe that the BCBS' and IOSCO's plans to review developments in securitisation markets and to promote the concept of 'high-quality securitisation' will help revitalise the securitisation market. They also argue that authorities should continue to improve the availability of data, to facilitate investment in all ABS across a broader base of investors.

Supervising TRs

ESMA published its *Trade Repository Supervision Work Plan 2014* on 1 April 2014. TRs play an important role in enhancing the transparency of derivative markets and reducing risks to financial stability. From 12 February 2014, CCPs are required report their

derivative trades to registered TRs in line with EMIR.

ESMA is responsible for supervising and authorising TRs and has registered six firms so far to collect and maintain the records of derivative trades. ESMA is currently in the process of developing a risk-based approach to supervision for TRs which should be completed later this year. It believes that the bulk of its supervisor duties will be desk-based in 2014, including:

- monitoring and assessing periodic information received from TRs
- monitoring and assessing TR's notifications of material changes to their conditions for registration
- analysing external information received from authorities or complainants.

However, ESMA will also use its on-site inspections and investigations powers if it identifies specific problems that require intervention.

Clarity needed on FX forwards

The EC published a Consultation document on FX forward transactions on 11 April 2014. ESMA and the EC recently exchanged letters about Member State regulators taking different interpretations of the MiFID definition of financial instruments. These differences have given rise to different views on the scope of EMIR

because some Member States, including the UK, consider FX forwards entered into for commercial purposes to be outside the scope of MiFID.

The EC has previously expressed the view that the commercial purpose exemption is intended to apply only to commodity derivatives but it is seeking more information about the use of FX forwards in this consultation. The consultation closed on 9 May.

SSM

Supervising under SSM

The ECB published its *Regulation establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities* on 25 April 2014.

The Regulation details the institutional framework underpinning decisions on authorisation, assessment of acquisitions and disposals of qualifying holdings when the ECB takes charge of prudential supervision of Eurozone banks from 4 November 2014. It also sets out day-to-day supervisory tasks in the framework covering the establishment and workings of joint supervisory teams. The framework addresses direct supervision and co-operation procedures between the ECB and national supervisors on issues such

as macro-prudential tasks and tools, supervisory reporting, supervisory decisions and sanctioning powers.

In a related *press release*, the ECB indicates that it will announce names of significant banks which will be subject to direct supervision by in September 2014.

Tax

UK's FTT challenge rejected - for now

The ECJ *rejected* the UK's challenge against the proposed FTT on technical grounds on 30 April 2014. The UK objects to the proposed scope of the FTT (which eleven Member States are currently developing using EU Enhanced Cooperation Procedure) on the grounds that it allowed those Member States to tax UK firms and activities taking place in the UK.

Because the FTT is not yet finalised the ECJ found that it was premature for the UK to challenge the scope. The ECJ did not rule out the possibility of the UK making a further challenge, once the FTT has been finalised. The current ruling does not prejudice the outcome of any future ruling.

Other regulatory

Preparing for Brisbane

On 4 April 2014 the FSB chairman sent a *letter* to G20 Finance Ministers and Central Bank Governors on their plans

for the November 2014 G20 summit in Brisbane.

The FSB intends to publish a consultation on 'gone-concern loss-absorbing capacity' (GLAC), an exercise which assesses the capacity of G-SIFIs to absorb losses when they fail. The FSB will be seeking agreement at the Brisbane Summit on three issues:

- the criteria that liabilities should meet to be considered as GLAC
- the appropriate amount of GLAC banks should hold
- where this should be held in the banks' group structure.

The new framework will be applied to the list of 29 G-SIFIs after the consultation is completed and a 'comprehensive' impact assessment is finalised. For the insurance industry, the IAIS will use the Brisbane Summit to finalise the basic capital requirement on which high loss absorbency for G-SIIs will be built.

On cross-border resolution, the FSB is working with the financial industry to establish a contractual approach to temporary stays ahead of the Brisbane summit. It is going to call on National Finance Ministers to 'empower' their resolution authorities to 'co-operate fully' with their counterparts in other countries, partly by recognising foreign resolution actions and ensuring that

debt issued under foreign law includes contractual recognition provisions so that bail-in is effective in a cross-border context.

Reiterating the importance of co-operation, the FSB plans to start information sharing on shadow banking with authorities in May and to report initial findings in Brisbane. It intends to finalise the framework for haircuts and haircut floors in repo and securities financing transactions before the summit. The FSB will launch a peer review on national implementation of its *Policy Framework for Strengthening Oversight and Regulation of Shadow Banking Entities* (August 2013) after the summit.

The OTC Derivatives Regulators Group (ODRG) will report in September and November on how it will approach problems on the cross-border implementation of reforms. The FSB plans to publish a report in September on the 'established processes' in each country to enable deferral to the OTC derivative rules of others where these achieve similar outcomes. Finally, the FSB intends to publish a report on approaches to aggregating and sharing derivatives data amongst authorities.

The FSB surveyed its members and found little appetite to change its membership structure to a consistency-

based membership structure. Members feared this type of structure would make discussions more 'rigid'. The survey found little support for considering the exit of any member country or making room for new types of institutions.

FSB looks at supervision

On 7 April 2014 the FSB published *Final Guidance on Supervisory Interaction with Financial Institutions on Risk Culture: A Framework for Assessing Risk Culture* to help national supervisors strengthen risk management practices in financial institutions. The guidance should assist both financial institutions and their supervisors in understanding whether firms' risk cultures support appropriate behaviours and judgments.

The FSB also published *Supervisory Intensity and Effectiveness: Progress report on enhanced supervision* on 7 April 2014. This report describes the changes in supervisory practices since the financial crisis and identifies areas that require further work. For example, the FSB wants supervisors to continue to stress the importance of strengthening risk management and measurement to financial institutions even in the current environment of regulatory reform. It also wants supervisors to develop methods to judge supervisory effectiveness in the

light of the changes implemented within supervision so far.

Both papers form part of the FSB's initiative to increase the intensity and effectiveness of supervision. The FSB aims to support well-informed and forward-looking risk decisions by institutions.

Harmonising point of sale disclosures

The Joint Forum (BCBS, IAIS and IOSCO) published a *final report* on point of sale disclosure in the insurance, banking and securities sectors on 30 April 2014. The Joint Forum identified differences in point of sale disclosure requirements across different sectors and jurisdictions.

In light of its findings, the Joint Forum issued eight recommendations, including that firms should:

- provide customers with point of sale information free of charge before the time of purchase
- include the same type of information to facilitate the comparison of products.

Recognising the diverse nature of practices observed, the Joint Forum is aiming for the recommendations aim to apply in a wide range of sectors and jurisdictions.

Accounting

Discussion paper on macro hedging

On 17 April 2014 the IASB published a *discussion paper* exploring an approach to better reflect entities' dynamic risk management activities in their financial statements (known as macro hedging). The paper is relevant for all entities that use dynamic risk management strategies for open portfolios. The outcome of this project will replace the current fair value hedge accounting of interest rate risk in IAS 39.

The discussion paper closes for comments on **17 October 2014**. See our *Straight away* publication for more details.

Banking and capital markets

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Regulation

Capital and liquidity

New Basel FAQs on LCR

On 16 April 2014, the Basel Committee issued *frequently asked questions (FAQs)* on Basel III's liquidity coverage ratio (LCR), elaborating on the text published in January 2013. To promote consistent global implementation of those requirements, the Committee has agreed to periodically review FAQs and publish answers along with technical details on the rules and interpretative guidance.

Mortgage risk-weighting confirmed

On 4 April 2014, the EBA confirmed how lenders should assign a preferential risk weight to the part of a loan that is secured by a mortgage. Under CRR, lenders should assign a 35% risk weight to the net exposure (net of credit risk adjustments and collateral). But if a default has occurred, the 35% risk weight no longer applies, and the lender should apply a 100% risk weight to the net exposure.

Other regulatory

Regulating Bitcoin

EU authorities are considering how to respond to virtual crypto-currencies, such as Bitcoin. In a response to a *parliamentary question* on 7 April 2014, Commissioner Barnier indicated

that the EBA is leading a dedicated taskforce on the matter supported by representatives from ESMA, EC and ECB. The taskforce will investigate how such currencies should be defined and assess whether regulation is required.

So far, authorities have remained wary of virtual currencies. Some have banned them (e.g. China and Brazil), some have declared them property rather than currencies, and many are considering the appropriate tax treatment for persons trading these currencies.

In December 2013, the EBA issued a *warning* on a series of risks deriving from buying, holding or trading virtual currencies such as Bitcoin, which was followed by similar announcements by many EU central banks and financial supervisors.

Competing on card payments

The ECB released a report on *card payments in Europe* on 29 April 2014, providing an overview of the status of card payments in the EU. It also looked at the rationale behind the new SEPA regime, which is to create a harmonised, integrated and competitive EU card payments area.

Separating card schemes and card payment processing entities is a core element in increasing competition and efficiency in card payments. The ECB also believes business practices and

rules need to change and interoperability has to improve to increase competition.

Stress testing

Banks get stressed

The EBA published the *methodology* and the macroeconomic scenarios for its 2014 EU-wide stress test on 29 April 2014. The macroeconomic scenarios include the *baseline*, *adverse*, *market risk* and *securitisation* scenarios.

The common methodology covers a wide range of risks including:

- credit and market risks
- exposures towards securitisation
- sovereign and funding risks.

The adverse scenario, designed by the ESRB, reflects the systemic risks that are viewed as the most “pertinent threats” to financial stability, such as an increase in bond yields, deterioration in credit quality and a lack of progress in balance sheet repairs. The negative impact of the shocks is substantially global in scope.

The test, which will be conducted this summer, is designed to assess banks' resilience to hypothetical external shocks, and will identify remaining vulnerabilities in the EU banking sector. It will be conducted on a sample of 124 EU banks which cover at least 50% of each national banking sector,

and will be run at the highest level of consolidation.

Directly following the EBA's announcement, the BoE published, *Stress testing the UK banking system: key elements of the 2014 stress test* on 29 April 2014. While the BoE's discussion paper in October, *A framework for stress testing the UK banking system* indicated that it might use its own methodology, the UK stress exercise will now be “built” on the EU-wide stress test. The BoE plans to add a number of additional UK layers to the EBA stress test (UK variant) which explore particular vulnerabilities facing the UK banking system. For example, banks will be tested against a number of shocks including a 35% fall in residential property prices and a 30% slump in commercial property prices, after a sharp rise in interest rates. It will also increase the scope of the exercise beyond the four banks which are caught under the EBA's exercise to include eight of the largest UK banks and building societies.

Asset management

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Asset Management



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Regulation

Too big to fail

Asset managers - too big to do nothing

Andrew Haldane, Executive Director at the BoE spoke about *the age of asset management* on 4 April 2014, emphasising the importance of asset managers to the current and future economy. We recently *predicted* asset managers will have assets under management (AUM) of \$100 trillion by 2020. Haldane suggests this figure will increase to \$400 trillion by 2050.

Haldane considers whether or not asset managers are too big to fail. He admits that the failure of asset managers is not a concern, stating that whilst they are not “insolvency-immune” (due to reputational and organisational risks) they are “insolvency-remote”. But he concludes that they are perhaps “too big”, noting that Blackrock, the biggest asset manager, is a third larger than the ICBC, the largest bank.

Like banks, asset managers can experience a “run” if investor sentiment turns against them or they are focused on a particular asset class. Large redemptions or sales from a fund could cause market instability through the

sale of assets in quick succession. Haldane admits that history does not show failing funds wreaking havoc in markets – but he also noted that past performance is no indicator of the future.

So Haldane considers three regulatory tools that could be used to tackle asset managers being too big:

- tools focused on the liquidity risk posed by asset managers, such as imposing minimum liquid asset requirements or redemption restrictions
- widening macro-prudential policy to capture the impact asset managers have on market swings by acting together to invest/divest in a particular asset class
- introducing a new high-quality securitisation product which receives preferential regulatory treatment to increase asset manager incentives to invest in long-term financing and decreasing companies’ reliance on banks for this investment.

Some of these measures may be introduced through the FSB/IOSCO work on non-bank non-insurer G-SIFIs. Haldane also outlined current

international efforts to bring about the new securitisation product, which the BoE supports. We’ll be watching to see how regulators balance the competing goals of incentivising asset managers to provide banking-like financing and more closely regulating shadow banking activities.

Insurance

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Insurance



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Regulation

Solvency II

Stress testing insurers

On 30 April 2014, EIOPA published the *detailed technical specifications* for Solvency II interim reporting during 2014 and 2015, offering crucial insight into the likely final Solvency II requirements. Significantly, the technical specifications include fundamentally new requirements around the long-term guarantee package. Whilst the technical specifications have increased clarity in some areas, a significant number of significant questions remain unanswered. Addressing these questions is vital when assessing the impact of the long-term guarantee package, and firms will have to develop their own "house view" around the key areas of subjectivity.

Alongside these technical specifications EIOPA also formally launched a *stress testing exercise* to be conducted in Q2 and Q3 2014, with results expected in November 2014. This exercise will involve participants from life and general insurance, and the PRA is likely to ask many of the largest and medium sized insurance groups to take part.

EIOPA's announcement of their next stress testing exercise is another important milestone in the journey towards Solvency II implementation. The technical specifications it released will form the basis for the forthcoming stress-testing exercise, and for Solvency II interim reporting during 2014 and 2015. This announcement had been eagerly anticipated by the insurance industry, which had hoped that clarity would emerge on key remaining areas of uncertainty, most notably around how insurers should interpret and apply the long-term guarantee package.

The technical specifications have not changed significantly from those used for the long-term guarantee assessment in January 2013. This is good news for many insurers which will not need to significantly re-build existing models or alter existing methodologies. But it also means that individual firms will have to develop and apply their own 'house view' on remaining key areas of uncertainty, such as the admissibility of callable bonds and mortgage assets for the matching adjustment.

This stress testing exercise is the first one EIOPA has conducted since 2011. Market risk remains a key area of focus. Firms will be particularly interested in the addition of a sovereign spread

stress, because to date many firms have treated sovereign debt as equivalent to risk-free instruments with their internal models. Now that EIOPA has finalised the long-term guarantee package, these stress tests will be more insightful for firms as well as regulators.

See our Hot Topic publication for details.

Getting more Solvency II detail

EIOPA published a *Public consultation on Set 1 of the Solvency II ITS* on 1 April 2014. Under powers granted by the Omnibus II Directive, EIOPA can issue ITS to assist firms and supervisors in preparations for the Solvency II approval processes planned to start on 1 April 2015. This consultation covers:

- approval process for matching adjustment
- approval process for internal models
- joint decision process for group internal models
- approval process for undertaking-specific parameters
- approval process for the use of ancillary own-fund items
- special purpose vehicles.

The consultation closes on **30 June 2014**.

Solvency II webcast

According to our recent poll, 68% of insurers are still less than half way through their Pillar 3 reporting journey. They see technology, data sources and reporting time frames as their top three challenges for the coming year.

Join our Solvency II *webcast* on Monday 19 May 2014 to find out more. Our expert panel will share their views on these key issues and how they will impact your ability to report under Pillar 3 in 2015. Drawing upon our discussions at our last breakfast briefing we will explore:

- the key Pillar 3 and Balance Sheet priorities when preparing for Solvency II reporting
- the main considerations when choosing the right technology solution
- how Pillar 3 could change the way in which your firm is viewed by the market.

Where to go for more information

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

Other regulatory

Operating colleges of supervisors

EIOPA published *CP-14/010 'CP on the Guidelines on the operational functioning of colleges of supervisors'* on 2 April 2014 (dated 14 March 2014). The Guidelines aim to clarify and improve cooperation among competent authorities supervising cross-border insurance or reinsurance groups and to aid the running of supervisory colleges.

They address issues such as cooperation between competent supervisory authorities for cross-border groups, information-sharing among supervisors and communication to (re)insurance groups.

The consultation closes on **30 June 2014**.

Highlighting future EU developments

EIOPA's Gabriel Bernardino set out his vision of how a true European single market in financial services will become a reality in his speech *'The road to a true single market in financial services'*, at the AILO 2014 conference. He considered the obstacles to unity and how to address them.

Eurofi published a *newsletter from their 2014 high level seminar in Athens* covering European financial services

regulatory issues including implementing Solvency II and defining global insurance regulations. It includes a number of insurance articles from EIOPA's Gabriel Bernardino (*Infrastructure projects – improved data is needed to support the reassessment of risk* and *Global capital standards will reinforce the international level playing field*) and EIOPA's Carlos Montalvo (*The Re-calibration dilemma*).

Accounting

IFRS

Reviewing the Insurance Contracts project

On 7 April 2014, the IASB published a *Project Overview* for the insurance contracts project, including tentative decisions from the latest IASB meeting in March 2014. The presentation sets out steps the IASB took in 2013 and what we should expect over the coming months.

IASB March meeting

At their *March education session and meeting* (published in April 2014) the IASB discussed two of the five key areas for re-exposure: unlocking the contractual service margin (CSM) and

recognising changes in discount rates in other comprehensive income (OCI).

The IASB confirmed the proposals in the revised ED to unlock the CSM for changes in cash flows related to future coverage and other services. Revising the ED, the IASB decided that favourable changes in estimates that relate to future coverage or other services and arise after losses have been recognised in profit or loss should be recognised immediately in profit or loss to the extent that they reverse those prior losses. It agreed to another revision to the ED whereby the CSM would be unlocked for changes in the risk adjustment related to future coverage and other services.

The IASB also revised its view on recognising changes in cash flows due to changes in discount rates. While the ED mandated OCI treatment, the Board tentatively voted to allow an option between OCI and profit or loss. But the Board raised questions about the appropriate unit of account for the option and whether the portfolio level suggested by the staff was at too granular a level. The chairman directed the staff to work on the wording to ensure that there would be discipline around the option and sufficient

restrictions around changes in the option.

...and its April meeting

At their *April 2014 education session and meeting* the IASB discussed the proposal for insurance contract revenue and a list of topics that will be discussed at future meetings. The Board confirmed the proposal in the revised ED to require the presentation of insurance contract revenue for all insurance contracts in accordance with a prescribed calculation. Investment components are excluded from revenue because these amounts will have to be repaid to the policyholder.

The Board also tentatively decided to prohibit the presentation of premium information in the statement of comprehensive income, because it is not consistent with commonly understood notions of revenue. This decision implies that entities will not be able to start the statement of comprehensive income with premiums written or due and then reconcile that number to revenue as proposed in the revised ED.

The IASB agreed the list of topics (outside the five key areas for re-exposure) to be re-debated at future meetings:

- fixed fee service contracts
- significant insurance risk guidance
- the portfolio definition and unit of account
- the discount rate for long term contracts and unobservable market data
- asymmetrical treatment of reinsurance contracts
- the recognition of contracts acquired through portfolio transfer or business combination
- the allocation pattern for the contractual service margin (CSM).

The Board doesn't plan to reopen discussions on other topics voluntarily commented on by respondents to the revised ED (e.g. other aspects of the determination of the discount rate and the confidence level disclosure requirement).

IASB insurance contracts paper

The IASB published a staff paper '*Effect of redeliberations on the ED insurance contracts*' on 16 April 2014, discussing where and how the proposals in the ED on insurance contracts would change as a result of the IASB's tentative decisions to date. So far, only three of

the five points in the exposure draft have been re-deliberated:

- adjusting the unearned profit from insurance contracts.
- presentation of insurance contract revenue and expenses.
- presentation of interest expense between profit or loss and the other comprehensive income.

IFRS News

The *April 2014* edition of IFRS news considers:

- Leases: A nail in the coffin for convergence
- Have you lost control? IFRS 10 practise issues
- OCI - here to stay? Feedback from the Conceptual Framework Discussion Paper
- Cannon Street Press (*including EU backs IFRS foundation, joint agreement implementation issues and equity method in separate financial statements*).

Monthly calendar

Open consultations

Closing date for responses	Paper	Institution
30/05/14	<u>ESMA consults on major shareholders disclosures</u>	ESMA
07/06/14	<u>Consultation on draft technical standards on data waiver</u>	EBA
10/06/14	<u>IOSCO Report compares, analyses prudential standards in the securities sector</u>	IOSCO
12/06/14	<u>EBA, ESMA and EIOPA consult on supervisory practices for financial conglomerates</u>	Joint Committee of the ESAs
30/06/14	<u>EIOPA consults on Set 1 of its Implementing Technical Standards for Solvency II</u>	EIOPA
30/06/14	<u>EIOPA consults on operational functioning of colleges of supervisors</u>	EIOPA
14/07/14	<u>Draft RTS on risk mitigation techniques for OTC Derivatives contracts not cleared by a CCP under Article 11(15) of EMIR</u>	Joint Committee of ESAs

Forthcoming publications in 2014

Date	Topic	Type	Institution
Consumer protection			
Q2 2014	An EU framework for collective redress	Legislative proposals	EC

Date	Topic	Type	Institution
Q2 2014	Investor Guarantee schemes – revision	Legislative proposals	EC
<i>Financial crime, security and market abuse</i>			
Q4 2014	Market Abuse Review	Technical advice	ESMA
<i>Insurance</i>			
Q2 2014	Technical standards for Omnibus II	Technical standards	ESMA
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>			
Q2 2014	OTC Derivatives, CCP Requirements, Trade Repositories and CCP Interoperability (EMIR)	Guidelines	ESMA
Q2 2014	Guidelines on the enforcement of EMIR provisions on OTC derivatives	Guidelines	ESMA
Q2 2014	Joint technical standards on Article 11 of EMIR (exchange of collateral)	Technical standards	ESAs
Q2 2014	Bilateral margins	Technical standards	ESMA
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

Date	Topic	Type	Institution
TBD 2014	Revision of the Transparency Directive	Discussion papers	ESMA
TBD 2014	Close-out netting	Legislative proposals	EC
Products and investments			
Q4 2014	European Social Entrepreneurship Funds	Technical advice	ESMA
Q4 2014	European Venture Capital Funds	Technical advice	ESMA
Q4 2014	Packaged Retail Investment 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
Recovery and resolution			
Q2 2014	Rescue and restructuring of financial institutions in Europe	Guidelines	EC
TBD 2014	EU framework for recovery and resolution plans	Technical advice	EBA
Solvency II			
TBD 2014	Solvency II – draft Level 2 delegated acts	Level 2 text	EC
TBD 2014	Solvency II Level 3 measures	Level 3 text	EIOPA
Supervision, governance and reporting			
Q2 2014	Corporate reporting	Guidelines/recommendations	ESMA

Date	Topic	Type	Institution
Q2 2014	EU corporate governance and company law	Action plan	EC
Q2 2014	The equivalence of CRA rules in a number of third countries	Technical advice	ESMA
Q2 2014	Framework on the establishment of the common supervisory culture on financial information	Guidelines	ESMA
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.

Glossary

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

CGFS	Committee on the Global Financial System (of the BIS)	EC	European Commission
CIS	Collective Investment Schemes	ECB	European Central Bank
CMA	Competition and Markets Authority	ECJ	European Court of Justice
Council	Generic term representing all ten configurations of the Council of the European Union	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
Dodd-Frank Act	Dodd-Frank Wall Street Reform and Consumer Protection Act (US)	ESRB	European Systemic Risk Board
D-SIBs	Domestic Systemically Important Banks	EU	European Union
EBA	European Banking Authority	EURIBOR	Euro Interbank Offered Rate

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

IMA	Investment Management Association	MAD II	Proposed Directive on Criminal Sanctions for Insider Dealing and Market Manipulation (COM(2011)654 final)
IMAP	Internal Model Approval Process	MAR	Proposed Regulation on Market Abuse (EC) (recast) (COM(2011) 651 final)
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	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	RWA	Risk-weighted assets
Official Journal	Official Journal of the European Union	SCR	Solvency Capital Requirement (under Solvency II)
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
		SFD	Settlement Finality Directive 98/26/EC
		SFO	Serious Fraud Office
ORSA	Own Risk Solvency Assessment	SII	Solvency II Directive 2009/138/EC
OTC	Over-The-Counter	SIPP	Self-invested personal pension scheme
PCBS	Parliamentary Commission on Banking Standards	SOCA	Serious Organised Crime Agency
PRA	Prudential Regulation Authority	SREP	Supervisory Review and Evaluation Process
PPI	Payment Protection Insurance	SSM	Single Supervisory Mechanism
Presidency	Member State which takes the leadership for negotiations in the Council: rotates on 6 monthly basis	SSR	Short Selling Regulation EU 236/2012
		T2S	TARGET2-Securities
PRIIPs Regulation	Proposal for a Regulation on key information documents for investment and insurance-based products COM(2012) 352/3	TR	Trade Repository
RAO	Financial Services and Markets Act 2000 (Regulated Activities Order) 2001	TSC	Treasury Select Committee
RDR	Retail Distribution Review	UCITS	Undertakings for Collective Investments in Transferable Securities
RRPs	Recovery and Resolution Plans	XBRL	eXtensible Business Reporting Language
RTS	Regulatory Technical Standards		

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