Institute of International Bankers

*Advancing the Interests of the International Banking Community in the United States*

# Global Survey 2018

## Regulatory and Market Developments

**Banking - Securities - Insurance**
**Covering 21 Countries and the EU**

**October 2018**

## OVERVIEW

The Institute of International Bankers (IIB) represents internationally headquartered banking/financial institutions from over 35 countries in connection with U.S. legislative, regulatory, compliance and tax issues that affect their banking, securities and other financial activities in the United States. In the aggregate, IIB members' U.S. operations hold approximately $5 trillion in banking and non-banking assets, fund 25% of all commercial and industrial bank loans made in the U.S. and contribute to the depth and liquidity of U.S. financial markets. IIB members contribute to the employment of hundreds of thousands of employees in the United States, in the financial sector and related service sectors. As providers of credit and other financial services in the United States, the U.S. operations of foreign banks add diversity and competitiveness to the U.S. financial services markets, help U.S. businesses grow and promote U.S. and international financial stability.

This 31st annual *Global Survey of Regulatory and Market Developments in Banking, Securities and Insurance* is part of the IIB's ongoing efforts to contribute to the understanding of global trends in financial regulation and markets. This year's Global Survey covers developments during the period from July 1, 2017 to June 30, 2018 in 21 countries and the European Union (EU). We are very grateful to the banking associations and financial services supervisory authorities from those countries and the EU that have contributed to this year's Survey and without whose participation this publication would not be possible.

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# AUSTRALIA

## OVERVIEW

The Royal Commission is dominating the news cycle and political environment and extensive recommendations and resulting changes to regulation are expected to result from it. To date, the Royal Commission has already caused significant upheaval, the share prices of all major banks have fallen significantly since the Royal Commission was announced and there have been some major departures from senior management and Boards of Directors.

Banks have continued to perform well and pay strong dividends to the predominantly Australian shareholders, who hold around 80 per cent on average of Australia's four major retail banks.

Australia's domestic economy is performing positively, with annual GDP growth to December 2017 of 2.4%. Employment growth has been very strong over the past year, although it has slowed in recent months. The unemployment rate is lower than in early 2017, but has been around 5½ per cent for some months. The unemployment rate is forecast to reach 5¼ per cent by mid 2019. As the labour market tightens, wages growth is expected to pick up gradually. In recent months, the housing market has cooled somewhat with declining prices in major cities.

### *Royal Commission*

In December 2017, the Australian Government established a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Hearings commenced in March 2018, an interim report is expected by the Commissioner by September 2018 and the final report of the results and recommendations from the inquiry are expected by February 2019.

To date there have been three rounds of Royal Commission hearings completed broadly dealing with: consumer lending practices, financial advice, loans to small and medium enterprises. The fourth round of hearings on farm finance commenced on 25 July 2018.

### *Major Bank Levy*

In 2017, the Australian Government introduced a major bank levy on Australia's five largest banks on 1 July 2017. In the 2018-19 Federal Budget no changes were announced to the major bank levy, it is estimated that the levy will collect $1.7bn AUD in 2018-19.

### *Banking Code of Practice*

The ABA's Banking Code of Practice (the Code) sets out the banking industry's key commitments and obligations to customers on standards of practice, disclosure and principles of conduct for their banking services. The Code applies to personal and small business bank customers.

An independent review of the Code commenced in July 2016. The independent review resulted in 99 recommendations, the ABA then commenced the process of redrafting the Code which included implementing the vast majority of those recommendations.

The new version of the Code includes changes including: improvements for small business, changing the way credit cards are offered, better protections for guarantors, greater transparency around fees and giving customers the ability to cancel a credit card online. The new Code has been submitted to the Australian Securities and Investment Commission (ASIC) for approval.

*Remuneration and incentives*

*FASEA*

The Australian Government established the Financial Adviser Standards and Ethics Authority (FASEA) in 2017. FASEA is charged with setting minimum education standards and a mandatory Code of Ethics for financial advisers. Consultation is ongoing and the new education requirements are intended to be in place from January 2019.

*New Payments Platform (NPP)*

Launched in February 2018, the New Payments Platform (NPP) is open access infrastructure for fast payments in Australia. The NPP was developed collaboratively by the industry and enables real-time clearing and settlement between participants. The NPP simplifies payment through PayID which allows users to address payments using registered email addresses or phone numbers, it also allows users to include additional information with payments including text or links. Finally, the NPP also offers the opportunity for third parties to develop and offer overlay services or products to enhance user experience and broaden the user base.

*Open Banking*

The Australian Treasurer has announced the phased introduction of open banking from July 1, 2019. The four major banks will be required to share customers' transaction and credit card data with third parties when requested by customers. Other banks will be required to share data a year later. The Treasurer's tight timeframes has imposed a mammoth task on industry and regulators to design and test technical and compliance regimes.

*Productivity Commission*

Australia's Productivity Commission (PC) which advises the Australian Government on economic reform, released a draft report on Competition in the Australian Financial System in February 2018.

Key observations were:

- Competition in the industry has delivered tangible benefits to the Australian customer. This backs up findings of previous inquiries such as the Financial System Inquiry which recommended certain reforms which have since enhanced competition in the industry.

- Australia has a strong and dynamic banking system that fosters innovation, such as tap and go payments, safe and quick transfer of funds and quick and easy approvals for loans.
- Australia is at the forefront internationally of innovative bank services and payments.

The final report is due to be handed to Government by 1 July 2018.

*Comprehensive Credit Reporting* (*CCR)*

In 2017, the Australian Government announced the Comprehensive Credit Reporting regime. The regime is due to be debated in parliament in June and we expect it to be implemented later this year. CCR is a system where more information is recorded on a person's credit history and shared with credit bureaus. There are benefits for consumers in this change because currently Australia's credit reporting system only includes 'negative' credit history, such as defaults. Including more information about a person's positive financial history can benefit a consumer as they will be in a stronger negotiating position to access credit.

*Australian Financial Complaints Authority* (*AFCA)*

AFCA is a new external dispute resolution scheme to deal with consumer complaints in the financial system. AFCA consolidates the three existing dispute resolution schemes into a one stop shop which will be operational and ready to receive complaints from 1 November 2018.

*Banking Executive Accountability Regime (BEAR)*

The BEAR regime which draws on the Senior Manager Regime in place in the United Kingdom will commence for the four largest authorised deposit taking institutions (ADIs) on 1 July 2018 and for all other ADIs on 1 July 2019. The BEAR is an enhanced accountability framework for ADIs and their directors and senior executives. It strengthens their accountability obligations and imposes additional consequences for breaching those obligations. As part of the implementation of BEAR, the Australian Prudential Regulation Authority (APRA) has been given additional powers. In exercising its new powers, APRA will be able to more easily: impose substantial fines on banks disqualify accountable persons and ensure that remuneration policies include financial consequences for individuals.

*Design and Distribution Obligations and Product Intervention Powers*

The Australian Government has proposed the introduction of two major consumer protection reforms in the form of Design and Distribution Obligations and a Product Intervention Power.

The Design and Distribution Obligations will impose requirements on banks to ensure financial products are targeted and sold to the right customers, as well as empower ASIC to intervene in the distribution of a product to prevent harm. The obligations will apply to products that are sold to retail clients and banks will be required to put in place reasonable controls to ensure products are only distributed in accordance with identified target markets.

The Product Intervention Power will enable ASIC to intervene in the distribution of a financial product where it perceives a risk of significant consumer detriment. ASIC would be able to take actions such as requiring the amendment of product marketing or banning products for a period of up to 18 months. It would also be empowered to ban remuneration practices, where there is a direct link between remuneration and the distribution of a product.

The reforms have been developed as a result of recommendations of the Financial System Inquiry in December 2014. Draft legislation on the changes is expected to be considered by Parliament in the second half of 2018.

*Restricted ADI Framework*

APRA has created a new pathway for entities to become registered as ADIs. The framework is designed to help new entrants to the banking industry, particularly smaller firms with limited financial resources, to navigate the licensing process. Under the new framework, eligible entities can seek a Restricted ADI licence, which allows them to conduct a limited range of business activities for a maximum period of two years while they build capabilities and resources. Following the two year period, Restricted ADIs are expected to progress to a full ADI licence or leave the industry.

*APRA Prudential Standard on cyber security*

In March 2018, APRA released for consultation, a draft prudential standard, *CPS 234 Information Security*, aimed at strengthening the ability of ARA regulated entities to respond to a cyber breach. The proposed standard aims to set minimum standards for the management of information security threats.

*Unquestionably strong*

Australian banks and other authorised deposit-taking institutions (ADIs) have traditionally been well capitalised to withstand risks they have faced. Nonetheless, the 2014 Australian Financial System Inquiry recommended that capital requirements for ADIs should be set such that they are 'unquestionably strong'.[1] The Australian Government subsequently endorsed that recommendation. The Australian Prudential Regulation Authority (APRA) indicated that it would await the outcome of international work to finalise the Basel Committee on Banking Supervision's (BCBS) capital framework reforms (Basel III revisions). This would allow for the international reforms, and the FSI's recommendation to be implemented as a single package.

To address the FSI recommendation, in July 2017 APRA released an information paper, Strengthening banking system resilience—establishing unquestionably strong capital ratios (July 2017 information paper).[2] The paper set out APRA's estimate of the amount by which minimum capital requirements would need to be raised for ADIs to achieve unquestionably strong capital ratios. In February 2018 APRA released a discussion papers for consultation with ADIs on proposed revisions to the capital framework[3]. The paper included proposed revisions to the capital framework resulting from the BCBS finalization of the Basel III revisions in December 2017, as

[1] FSI, Final Report, 7 November 2014, recommendation 1, available at: http://fsi.gov.au/publications/final-report/
[2] https://www.apra.gov.au/sites/default/files/Unquestionably%2520Strong%2520Information%2520Paper_0.pdf
[3] https://www.apra.gov.au/sites/default/files/Revisions%2520to%2520the%2520capital%2520framework%2520for%2520ADIs.pdf

well as other changes to better align the framework to risks, including in relation to housing lending. APRA expects that changes to the capital framework due to the Basel III revisions will be able to be accommodated within the calibration set out in this paper and will not necessitate further increases to requirements (i.e. capital) at a later date.

*ASIC Enforcement Review*

In late 2016, the Australian Government announced a review into ASIC's enforcement regime. The Taskforce's report was provided to the Government in December 2017. The Taskforce made 50 recommendations relating to:

- Self-reporting of contraventions by financial services and credit licensees
- Harmonisation and enhancement of search warrant powers
- ASIC's access to telecommunications intercept material
- Industry codes in the financial sector
- Strengthening ASIC's licencing powers
- ASIC's power to ban individuals in the financial sector
- Strengthening penalties for corporate and financial sector misconduct, and
- ASIC's directions powers.

In April 2018, the Australian Government released their response to the report which agrees, or agrees in principle, to all recommendations made by the Taskforce.

*Financial Advice - Reference Checking & Information Sharing Protocol*

This protocol, developed by the ABA, operates as a reciprocal agreement between subscribers when recruiting financial advisers. The protocol prescribes a process and form for requesting references for financial advisers from their previous employers. The protocol commenced in March 2017. During early 2018, the protocol was reviewed and updated with the intention that it will be reissued in an updated form in late 2018.

*Conduct Background Check Protocol*

The CBC sets minimum processes for subscribing banks to ask a series of fact-based questions about employment history and conduct when hiring an employee, including whether that employee was dismissed or resigned in circumstances relating to misconduct. This protocol commenced in June 2017 and will be subject to a post implementation review in 2018 which commenced in June 2018.

## CANADA

### Executive Summary

Canada's banking system continues to be widely considered one of the safest in the world. Policy-making authority and regulatory oversight for Canada's banks are undertaken by a number of federal bodies. Prudential regulation is conducted by the Office of the Superintendent of

Financial Institutions (OSFI), while consumer-facing market conduct is regulated by the Financial Consumer Agency of Canada (FCAC). Deposit insurance is provided by the Canada Deposit Insurance Corporation (CDIC). The Bank of Canada and OSFI are active members of the Basel Committee on Banking Supervision. Canadian regulators have been active in adopting new and revised global regulatory standards.

Federal financial services legislation, including the *Bank Act* that governs the activities of banks in Canada, is required to be reviewed every five years, and the most recent review was in 2012. The next comprehensive review was scheduled to conclude in 2017, but the 2016 federal budget postponed the conclusion of the review until 2019. The formal review process did commence in 2016, and the Canadian banks provided feedback to the federal government on what modifications to the bank legislative and regulatory regime should take place in the context of the 2019 review, with particular emphasis on measures that will facilitate the policy objectives of modernization and innovation. The federal government's first budget implementation bill for 2018 introduced changes to the *Bank Act* intended to facilitate innovation by easing current restrictions on banks' ability to engage in financial technology ('fintech') activities and invest in fintech companies. The budget implementation bill also extended the review process to 2023 to allow the government to make further changes to the *Bank Act* as they deem appropriate.

## Federal Financial Legislation and Regulations

### *2018-2019 Federal Budget Measures*

The Canadian government's 2018 budget and subsequent budget implementation bill made a number of announcements relevant to the banking industry. In addition to the amendments noted above relating to modernization and innovation, the government announced measures related to strengthening oversight of cybersecurity, introducing potential new consumer protection measures, publicly consulting on open banking, increasing gender equality and confirming the introduction of a new framework for the oversight of retail payments. The budget also confirmed that the government will introduce legislative amendments supporting the implementation of a resolution framework for Canada's systemically important financial market intermediaries. The budget also contained a number of tax-focused measures of direct interest to the industry.

### *AML/ATF Measures*

*Five year review of the The Proceeds of Crime (Money Laundering) and Terrorist Financing Act (PCMLTFA)*

The PCMLTFA is currently going through the legislated five-year Parliamentary review. The legislative requirement to review the Act every five years provides the opportunity to keep the framework current in response to market developments as well as new and evolving risks.

The Department of Finance (Finance) has released a report, *Reviewing Canada's Anti-Money Laundering and Anti-Terrorist Financing Regime (*Report*)*, to support the Parliamentary review. The Report focuses on the following areas:

- Legislative and Regulatory Gaps – this section explores a broad range of issues that could be implemented to improve Canada's anti-money laundering (AML)/anti-terrorist financing (ATF) framework. For consideration are improvements to corporate transparency, and the application of the rules to new business and sectors (e.g. white-label ATM industry, auto dealers, mortgage insurers and non-federally regulated mortgage and lenders) as well as to the legal profession.

- Enhancing the exchange of information between public and private sector entities that includes examining options to improve information sharing through additional disclosure recipients; improving the understanding of information sharing options between the private sector; enhancing information sharing on methods and trends of money laundering (ML) and terrorist financing (TF); and improving information sharing under international legal cooperation agreements.

- Strengthening intelligence capacity and enforcement by giving consideration to whether it is appropriate to place a limit on the amount of bulk cash a person could carry in Canada without a legitimate purpose, implement various border enforcement strategies and amend the requirements for a money laundering offence. One of the most widely recognized difficulties in Canada in investigating and prosecuting ML offences is the legal requirement to link the act of ML to specific knowledge of an underlying criminal offence that produced the illegitimate funds. Section 462.31 of the *Criminal Code* requires that prosecutors establish knowledge or belief that all or part of the property or proceeds was obtained or derived, either directly or indirectly, as a result of the commission of a designated offence. For consideration are other types of offence standards where the knowledge component of the offence is different, such as suspicion or recklessness (showing no regards for the danger or consequences or acting carelessly).

- Modernizing the framework and its supervision by enhancing and strengthening identification methods by remaining flexible and adaptive in an environment of rapid development and emerging technologies.

- Addressing technical issues that would improve the administration and operation of the PCMLTFA and its accompanying Regulations.

*Improving Beneficial Ownership Transparency in Canada*

At the December 2017 meeting of Canada's Finance Ministers, Ministers announced an agreement in principle to pursue amendments to federal, provincial and territorial corporate statutes to (i) ensure that corporations hold accurate and up to date information on beneficial owners that will be available to law enforcement, tax and other authorities; and (ii) eliminate the use of bearer shares and bearer share warrants or options, and to replace existing ones with registered instruments.

The Ministers also agreed to continue assessing potential mechanisms to enhance timely access to competent authorities to beneficial ownership information (e.g. collecting and holding beneficial ownership information in a central government registry) and to assess risks associated with other legal vehicles.

*Proposed Amendments to the PCMLTFA Regulations*

On June 9, 2018, the Department of Finance released proposed amendments to the regulations under the PCMLTFA (proposed amendments). The proposed amendments introduce regulations with respect to virtual currencies, foreign money services businesses and pre-paid products as well as changes to reporting requirements and customer due diligence. There is a 90-day consultation period in which interested persons may make representations on the amendments proposed.

### *Economic Sanctions*

On October 18, 2017, Canada adopted the *Justice for Victims of Corrupt Foreign Affairs Officials Act* and made amendments to the *Special Economic Measures Act* (SEMA). The new law enables Canada to take further action to respond to cases of human rights violations and significant acts of corruption anywhere in the world. Canada will have the ability to impose asset freezes and travel bans on those responsible for these reprehensible acts and their accomplices. Amendments to SEMA allow Canada to impose economic sanctions when gross and systemic violations of human rights are happening in a foreign state, or for acts of significant corruption by foreign public officials or their associates.

## Cybersecurity Threats to Financial Institutions Operating in Canada

Greater involvement and coordination across government, regulators, law enforcement and national security is critical to ensure secure and resilient cyber systems in an increasingly connected digital economy. With cyber risk a growing concern in today's world, the banking industry would like to continue collaboration with the government on cyber security issues to protect Canadians and the economy from cyber threats and attacks. The common goal is to create a more resilient, safer cyber environment for our citizens and businesses.

In the 2018 Federal Budget, the government provide some high-level insights into the new National Cyber Security Strategy including the announcement of a new Canadian Centre for Cyber Security under the Communications Security Establishment (CSE). The industry has long advocated for a single point of contact to provide cyber expertise and the industry has publicly supported this move by the government. In June, Public Safety Canada subsequently released its National Cyber Security Strategy entitled *Canada's Vision for Security and Prosperity in the Digital Age* acknowledging our world continues to be transformed by digital innovation and the importance of cyber security to the Canada's economy and national security. The banking industry would like to see the Canadian government proceed quickly with its implementation to protect Canadians and the economy.

## Housing

Over the last year, the most significant development in housing policy has been the release of the revised B-20 guideline on mortgage underwriting practices and procedures. Furthermore, British Columbia has increased the scope and rate of its non-resident property transfer tax, and has announced plans to introduce a new speculation tax.

- Revised Guideline B-20 – Residential Mortgage Underwriting Practices and Procedures: On January 1, 2018 OSFI's revised Guideline B-20 took effect. The final Guideline focuses on the minimum qualifying rate for uninsured mortgages, expectations around loan-to-value (LTV) frameworks and limits, and restrictions to transactions designed to circumvent those LTV limits. In particular, the guideline includes:

    - A new minimum qualifying rate, or "stress test," for uninsured mortgages (specifically, the greater of the five-year benchmark rate published by the Bank of Canada or the contractual mortgage rate +2%)
    - A requirement that lenders enhance their loan-to-value (LTV) measurement and limits so they will be dynamic and responsive to risk.
    - Restrictions on certain lending arrangements that are designed, or appear designed to circumvent LTV limits

- British Columbia's Non-Resident Property Transfer Tax: Effective February 21, 2018, BC increased its non-resident property transfer tax from 15% to 20% and widened the tax's geographic coverage. BC has also announced that it plans to introduce a new speculation tax targeting foreign and domestic speculators who own residential property in BC but do not pay income taxes in BC, including those who leave their units vacant.

**Finance Canada Payments Advisory Committee (FinPay)**

The most significant policy development over the past year was the federal government's consultation on a proposed oversight framework for the retail payments market in Canada. The current oversight of payments in Canada is focused on the core national payment clearing and settlement system. While financial service providers such as banks and payment card networks are regulated through legislation and codes of conduct, other retail payment service providers (PSPs) are not currently subject to a comprehensive oversight framework. This can create risks and confusion for consumers and other end users who may expect similar levels of protections irrespective of the payment service provider they use. The banking industry in Canada supports rules to promote the safety and stability of the financial system, and that set basic standards of protection for end-users.

The government has indicated that it intends to move forward in implementing a regulatory framework towards the end of 2018, and to also use this framework as a basis for expanding access to the core clearing and settlement system. Canada is in the process of modernizing its payments infrastructure and rolling out a new real-time payments platform, which supports the government's objective of promoting innovation and increasing competition in payments and financial services.

**Basel III in Canada**

Basel III adoption in Canada is progressing well with Canada ranked category 4 (i.e. final rules in force) on many Basel standards (e.g. countercyclical buffer, capital requirements for equity investments in funds, margin requirements for non-centrally cleared derivatives, existing (2014) exposure definitions for the leverage ratio, definition of capital, capital conservation buffer, liquidity coverage ratio, leverage ratio disclosure requirements, G-SIB and D-SIB requirements) in the BCBS's *Fourteenth progress report on adoption of the Basel regulatory framework* (April

2018). OSFI also developed domestic guidance in 2017and 2018 for the Basel III standards highlighted in the report (please see further details below).

**Summary of Financial Crisis Regulatory Actions**
***Imposition of Enhanced Capital and Other Requirements***

Canadian banks implemented the Basel III regulatory capital requirements on an "all-in" basis as of January 1, 2013, forgoing the Basel Committee's six-year transition period. The six Canadian domestic systemically important banks (D-SIBs) (i.e. Royal Bank of Canada, TD Bank Financial Group, The Bank of Nova Scotia, Bank of Montreal, CIBC, and National Bank of Canada) are subject to an enhanced capital requirement of 1% common equity tier 1 (a "D-SIB capital surcharge"). These six banks are also subject to more intensive supervision and are required by OSFI to comply with the Basel Committee's risk data aggregation and risk reporting principles, as well as the Enhanced Disclosure Task Force's (EDTF) disclosure recommendations. On November 21, 2017, the Royal Bank of Canada was added to the list of global systemically important banks by the Financial Stability Board; however, OSFI has not required the bank to hold any additional capital as a result of this designation.

In November 2017, OSFI published updates to its *Capital Adequacy Requirements (CAR) Guideline* that were implemented in Q1 2018. The updates primarily related to the capital treatment of allowances under International Financial Reporting Standard (IFRS) 9 *Financial Instruments*.

In July 2018, OSFI launched a public consultation with further updates to its *CAR Guideline*, which will include:

- Revisions to the capital floor based on the Basel II framework which became effective Q2 2018
- An update to the Credit Risk - Standardized Approach to reflect IFRS 16 *Leases*
- The introduction of the Standardized Approach for Counterparty Credit Risk and updates to the rules for capitalizing exposures to central counterparties
- Revisions to the securitization framework, including for simple, transparent, and comparable (STC) securitizations

***Basel III reforms***

In July 2018, OSFI released a discussion paper on the proposed implementation of the final Basel III reforms in Canada. The discussion paper provides OSFI's preliminary views on the proposed scope and timing of domestic implementation. Notably, OSFI is proposing to implement the output floor at a level of 72.5% starting in the first quarter of 2022 (i.e. no transition period).

***Bail-in Debt Framework***

In June 2016, legislation to implement a bail-in regime for Canada's D-SIBs was passed. Some of the corresponding bail-in regulations came into force in March 2018, while the remainder of the regulations will come into force in September 2018. An OSFI guideline related to Total Loss Absorbing Capacity (TLAC) came into force in April 2018. OSFI's TLAC guideline

requires D-SIBs to meet a minimum risk-based TLAC ratio as well as a TLAC leverage ratio by November 1, 2021. In May 2018, OSFI also published its final TLAC and Capital Disclosure Requirements Guidelines. The Canadian D-SIBs are expected to implement the TLAC disclosures commencing with the quarterly reporting period ending January 31, 2019.

### *Recovery and Resolution Plans (RRPs)*

For several years, the Canadian D-SIBs have been developing RRPs in conjunction with OSFI and the CDIC; D-SIBs work with OSFI on recovery plans and with CDIC on resolution plans. In 2017 CDIC was formally designated as the resolution authority for its members and provided with the authority to require D-SIBs to develop and submit resolution plans. As Canada's resolution authority for large banks, CDIC has by-law making authority with respect to the development, submission, and maintenance of resolution plans by D-SIBs, including specifying the contents of those plans. CDIC conducted a public consultation in early 2018 on D-SIB resolution planning by-law requirements, which contained CDIC's proposals for the contents of this By-law.

### *IFRS 9 Financial Instruments*

The Canadian D-SIBs implemented IFRS 9 on November 1, 2017 as mandated by OSFI, which was earlier than the January 1, 2018 effective date in the standard. The D-SIBs first reported results under IFRS 9 as of January 31, 2018 and continue to engage in discussions around disclosure.

### *Leverage Ratio*

We are expecting OSFI to launch a public consultation process on updates to the leverage ratio requirements guideline. The updates are expected to incorporate consequential amendments related to changes to other OSFI guidelines, such as the Standardized Approach to Counterparty Credit Risk (SA-CCR) and Securitization.

### *Liquidity Risk Framework*

The D-SIBs began to disclose their Liquidity Coverage Ratio (LCR) in May 2015, which was set at 100% (i.e. no phase-in period was permitted). In addition, banks continue to provide data to OSFI to support other liquidity monitoring tools, such as the domestic Net Cumulative Cash Flow (NCCF) measure. The NCCF captures the maturity spectrum between the 30-day LCR and 1-year NSFR and assumes a business-as-usual, non-stressed scenario.

In 2018, OSFI is expected to update its *Liquidity Adequacy Requirements (LAR) Guideline*. OSFI has provided notification to Canadian deposit-taking institutions of their intent to extend the domestic implementation timeline of the NSFR to January 2020. OSFI has made this decision as it is uncertain at this time whether key foreign markets will implement the revised BCBS NSFR standard by the January 2018 deadline. However, OSFI remains committed to implementing the NSFR standards in its LAR Guideline.

### *Regulation of Over-the-Counter Derivatives*

In April 2017, the Canadian Securities Administrators (CSA), an umbrella organization composed of Canada's 13 provincial and territorial securities regulators, issued proposed rules relating to business conduct in derivatives transactions, which allows for banks to meet the proposed requirements through a substituted compliance process where there are equivalent federal rules. The Canadian banks provided comments on the proposed business conduct rules, and their potential impacts on our industry.

The CSA also introduced in April 2018 a proposed derivatives registration regime, which would require banks to register and demonstrate compliance with the CSA requirements around the banks' derivatives businesses. Canadian banks are currently studying the proposed regime with a view to determining impacts on the banks.

The Quebec Court of Appeal issued its decision on the constitutionality of the Cooperative Capital Markets Regulatory System (CCMR), a proposed joint federal-provincial securities and systemic risk regulatory body, in May 2017. The Quebec Court found both the draft provincial and the federal statutes underpinning the CCMR to be unconstitutional. The Quebec Court's decision was appealed to the Supreme Court of Canada. Hearings took place in March 2018, and a decision is expected by year-end.

## CHINA

### Significant Developments in the Banking Industry

- China's new rule on overseas bank card transactions became effective last year. Starting from September 1, 2017, China's banks are required to report all cash withdraws on a daily basis, as well as domestic card transactions worth more than 1,000 yuan (about US$148) at overseas brick-and-mortar and online stores, according to the State Administration of Foreign Exchange (SAFE). The new rule is intended to improve transparency and data quality of overseas bank card transactions to meet the demands of international cooperation to curb money laundering, etc., SAFE said.

- On November 15, 2017, China's banking regulator released special rules for the country's three policy banks (namely China Development Bank, the Export-Import Bank of China, and Agricultural Development Bank of China) for the first time. The new rules contained a capital restraint mechanism that centers on capital adequacy ratios, and set differentiated requirements for each bank. The new rules also included specific items on corporate governance, internal control and capital management.

- The China Banking Regulatory Commission (CBRC) has revised rules for foreign banks, scrapping approval procedures for four items including overseas wealth management products and portfolio investment funds. Banks only need to report their services to authorities rather than obtaining approval in advance. Procedures were also simplified for foreign lenders to set up new branches, appoint executive and issue bonds. The new policies became effective on February 13, 2018.

- On April 27, 2018, China rolled out a set of measures to open its financial sector wider to the world, including expanding business scopes of foreign-funded banks. The new rules will allow foreign-funded banks to conduct business such as the underwriting of government bonds, and will lift foreign ownership limits on banks and financial asset management firms, the China Banking and Insurance Regulatory Commission (CBIRC) said in an online statement.

- China's banking regulator has limited commercial bank's risk exposure to avoid systemic risk. A commercial bank's risk exposure to an interbank client shall not exceed 25 percent of its tier one capital, according to a document released online by the CBIRC. Besides, a bank's total risk exposure to a single non-bank client shall not exceed 15 percent of its tier one capital, etc. The rule, which will take effect on July 1, 2018, allows a three-year transition period for banks to reduce risk exposure to interbank clients until reaching compliance.

- China's central bank has laid out the rules for foreign-invested payment firms over market access and supervision, according to a statement issued by the PBOC on March 21, 2018. Overseas companies providing e-payment services are required to set up foreign-invested businesses in China and acquire payment services licensed. The statement also said that client data and other financial information originated and collected in China must be stored, processed and analyzed within the domestic area.

**Significant Developments in the Securities Industry**

- On September 4, 2017, the People's Bank of China (PBOC), together with the securities and banking regulators and other government departments, issued a statement that China bans individuals and organizations raising funds through initial coin offerings (ICOs), a form of fundraising in which technology startups issue their own digital coins (tokens), to investors to access funds. China's ban on ICOs is part of a broader campaign to curb the country's financial risks.

- China's regulators have taken steps to shut down the country's cryptocurrency exchanges and ban trading of digital cryptocurrency to rein in financial risks. All Beijing-based cryptocurrency exchanges were ordered to halt new user registration by midnight on September 15, 2017, according to a policy document issued by the Beijing branch of a central bank-led committee overseeing online financial risks. And Shanghai bitcoin exchanges were also told to shut down by the end of the month.

- In January 2018, the People's Bank of China (PBOC) issued a regulation in collaboration with the country's banking, securities and insurance regulators that banned financial institutions from engaging in the so-called drawer agreements, a kind of under-the-table deal that enables them to dodge regulatory requirements when it comes to using borrowed money to invest in bonds. Under the regulation, financial institutions were ordered to report to the regulators if the outstanding volume of their bond repurchases and reverse repurchases exceeds certain limits. There will be a one-year period for financial institutions to improve their internal risk control mechanism in compliance with the new regulation, according to the PBOC's statement.

- On June 7, 2018, China's top securities regulator issued rules on a test run of issuance and trading of China Depositary Receipts (CDRs). The rules, effective immediately, lay the institutional foundation for innovative firms to issue CDRs in domestic capital market, said an online statement of China Securities Regulatory Commission (CSRC). The CSRC has released amended rules on initial public offerings (IPO) and a package of measures to support innovative firms in their domestic issuance of stocks or CDRs.

**Significant Developments in the Insurance Industry**

- On April 1, 2018, China's new rules on the use of insurance funds, revised by the China Insurance Regulatory Commission (CIRC), went into effective. The implementation of the new rules will make better use of insurance funds to serve the real economy, cutting intermediate links and lowering costs. To prevent outbound investment becoming irrational, China has put a brake on projects in areas including real estate, hotels, cinemas, and entertainment, etc. Shareholders of insurance firms will not be allowed to interfere in the operation of insurance funds, according to the new rules.

- China's insurance regulator has standardized investments by insurance funds in long-term home rental projects. Insurance funds can invest in such projects in both equity and debt. For equity investments, insurance funds should not use the equity of the target projects as collateral to a third party. For debt investment, cash flow of the entities being invested should cover at least the amount of principle and interest of their debt payable. The new rules, effective on May 28, 2018, broaden investment channels for insurance funds and help with real estate controls, the China Banking and Insurance Regulatory Commission (CBIRC) said in an online statement.

## EUROPEAN UNION

### 1- Banking Supervision and Regulation

***Bank Recovery and Resolution Directive***

The Bank Recovery and Resolution Directive (BRRD) came to force since 1 January 2016. In the eurozone countries it applied through the Single Resolution Mechanism Regulation (SRMR) of the Banking Union, not through national regulatory regimes. The European Commission proposed amendments to both the BRRD and the SRMR in November 2016. The changes include:

- the integration of the Financial Stability Board's Total Loss-Absorbing Capacity (TLAC) standard for global systemically important banks (G-SIBS) into the Minimum Requirement for own funds and Eligible Liabilities (MREL) of the BRRD and SRMR; the MREL is designed to ensure there are enough shareholders' and creditors' funds to absorb the losses of failing banks and then to recapitalise them – a process known as "bail-in" – and it now has to incorporate the Financial Supervisory Board's (FSB) TLAC standard by 2019;

- amendments to the MREL rules for banks other than global systemically important banks (G-SIBs).

In parallel, the Commission presented its proposal to amend the SRMR. While the BRRD is binding for all banks in the EU, the SRMR applies to institutions of euro-area Member States only.

The proposed amendment aims to align the international TLAC requirement with the existing MREL standard by avoiding duplication by applying two parallel requirements: It creates a new 'pillar 1 MREL' requirement for global systemically important insurers (GSIIs) in the EU (taking over TLAC); it introduces disclosure requirements and leads to an internal MREL requirement for material subsidiaries of third country GSIIs in the EU. The proposal addresses the need for proportionality of bail-in related rules also by revising Article 55 of the BRRD under which banks have to include in contracts that are governed by the law of a third country a clause by which the creditor recognises the bail-in power of the EU resolution authorities.

On 29 November 2017, the Council published a presidency progress report regarding the banking package (CRR/CRD/BRRD/SRMR). In the ECOFIN Council of 13 March 2018, Ministers were called on to agree on the package of measures aimed at reducing risk in the banking sector, but further work was needed. They achieved agreement on 25 May 2018.

Within the European Parliament, the two legislative proposals amending SRMR and BRRD have been negotiated in parallel. Parliament's Committee on Economic and Monetary Affairs (ECON) adopted its final report on 19 June 2018.

Inter-institutional discussions on the proposals amending the SRMR and the BRRD started in early July. The Euro-Summit on 29 June 2018 raised the expectation for Council and Parliament to conclude the banking reform before the end of the year while preserving the overall balance.

### *Risk Reduction Package*

In 2013, the European Union adopted the so-called 'CRD IV package', the third set of amendments to the original Capital Requirements Directive (CRD), following two earlier sets of revisions adopted in 2009 (CRD II) and 2010 (CRD III). The CRD IV package introduced in the EU law the bulk of the international standards agreed by the Basel Committee on Baking Supervision (BCBS) in 2010, known as Basel III framework. The package is comprised of a Directive (CRD IV) governing the access to banking activities and a Regulation (CRR) establishing the prudential requirements that institutions need to respect.

On 23 November 2016, as part of a comprehensive 'banking reform package', the Commission presented a review of these provisions with the aim of addressing those elements of the Basel III framework that were still to be fully implemented. In particular, the main amendments proposed to CRR set:

- A binding leverage ratio (LR) to prevent credit institutions from using excessive borrowed capital compared to own funds;

- A harmonised standard for how much stable, long-term sources of funding an institution needs (net stable funding ratio, NSFR);
- More risk sensitive capital requirements for institutions that trade extensively in securities and derivatives (fundamental review of the trading book - FRTB);
- New rules to calculate the maximum exposures that an institution can hold to a single client or a group of connected clients (limit to 'large exposures').

In addition, the Commission's review contains provisions that would:

- ease the compliance burden for smaller and non-complex banks without compromising their stability;
- improve banks' lending capacity to small and medium sized enterprises (SMEs) (revised 'SME supporting factor).

In December 2017 the European Parliament and the Council achieved a fast-tracked agreement on the CRR provisions setting out transitional arrangements to prevent unwarranted impact of the introduction of international financial reporting standard (IFRS) 9 on EU banks' regulatory capital. The agreement also touches on the treatment of certain banks' large exposures to public-sector.

On 25 May 2018, the Council (ECOFIN) reached an overall agreement on the 'banking reform package'. Among other things, the Council proposed to implement the fundamental review of the FRTB as a mere reporting requirement in a first stage. It also revised the NSFR requirements for the funding risk generated by derivatives (set at 5%), and those for short term repos and reverse repos. Finally, the Council proposed to remove waivers from the application of capital and liquidity requirements within banking groups on a cross-border basis.

Within the Parliament, the two legislative proposals amending CRR and CRD IV have been negotiated in parallel. The ECON committee adopted its full report on the amending proposals on 19 June 2018.

***Banking Union***

In a Communication on 11 October 2017 the Commission stressed the need to seize the political momentum – reflected not least by the invitation by President Tusk to the Euro Summit in an inclusive format in December 2017– and transform this widely shared ambition into concrete action, completing the banking union by 2019.

On 24 January 2018, ECON adopted its own initiative report. It acknowledges that the banking union plays a key role for the financial stability of the euro area and is an indispensable component of a genuine economic and monetary union; therefore, it needs to be reinforced and completed. Regulation is recommended as the appropriate legislative tool the Commission should

use when proposing banking legislation. The report is divided into three sections reflecting the banking union architecture.

### *Non-Performing Loans (NPLs)*

On 31 May 2017, the Council's Financial Services Committee (FSC) submitted its final report on NPLs where it analyses the situation of NPLs in Europe and the policies implemented so far and proposes to the Council a number of policy options going forward. Based on the recommendations of the FSC report, the ECOFIN Council adopted an action plan to tackle NPLs at its meeting on 11 July 2017.

On 22 November 2016, the European Commission proposed a Directive on insolvency frameworks aiming at facilitating the restructuring of non-performing debt and giving entrepreneurs a second chance.

As for the supervisory side, the European Banking Authority (EBA) has worked to set out a common EU definition of NPLs. On 30 January 2017, the Chairman of the EBA, presented a proposal for an EU-wide asset management company which could free up EU banks from the burden of NPLs. The European Systemic Risk Board (ESRB) has set up a dedicated working group on NPLs, gathering the EU supervisory community and co-chaired by the ECB and the EBA. In March 2017, the ECB published its guidance to banks on tackling non-performing loans. In March 2018, it published an addendum to its guidance, which specifies quantitative supervisory expectations for minimum levels of prudential provisions for new NPLs.

On 14 March 2018 the Commission adopted a comprehensive package of measures to tackle NPLs, which comprises:

- A proposal for a Regulation amending the Capital Requirements Regulation (CRR) and introducing common minimum coverage levels for newly originated loans that become non-performing;
- A proposal for a Directive on credit servicers, credit purchasers and the recovery of collateral;
- A Commission services' staff working document containing a blueprint on the set-up of national asset management companies (AMCs). The document provides non-binding guidance to national authorities on how they can set up AMCs dealing with NPLs.

The proposal for a Regulation aims at ensuring sufficient loss coverage by banks for future NPLs, by amending the existing CRR to establish common minimum levels for money banks need to set aside to cover losses caused by future loans that turn non-performing. The minimum coverage requirement increases gradually depending on how long an exposure has been classified as non-performing. This gradual increase reflects the fact that the longer an exposure has been non-performing, the lower is the probability to recover the amounts due. Different coverage requirements apply depending on the classification of the NPLs as 'unsecured' or 'secured'. In case a bank does not meet the applicable minimum level, deductions from own funds would apply. The minimum coverage levels will act as a statutory prudential backstop for newly originated loans that become non-performing. The Commission further proposes to introduce a common definition of non-performing exposures (NPE), in accordance with the one already used for supervisory reporting purposes.

The European Parliament and the Council are currently reviewing the proposals.

***European Supervisory Authorities (ESAs) Review***

In its work programme of 2015, the European Commission announced its willingness to strengthen banking supervision in its EU-wide dimension. On 30 September 2015, the Commission presented its Capital Markets Union (CMU) action plan and, among other things, announced it would increase supervisory convergence and promote financial stability by improving macro-prudential surveillance. In its mid-term review of the Capital Markets Union of June 2017, the Commission stressed that 'steps are underway to increase the ability of the ESAs to preserve EU orderly markets and financial stability'.

Against this background, a comprehensive package reviewing the European System of Financial Supervision (ESFS) was adopted by the Commission on 20 September 2017.

The package includes:

- a Communication on reinforcing integrated financial supervision;
- a proposal amending Regulations establishing the European Supervisory Authorities (ESAs);
- a proposal amending Regulation establishing the European Systemic Risk Board (ESRB) and two additional proposals amending some supervisory provisions set out, respectively, in Directives MiFID II / Solvency II and the pending proposal amending the European Market Infrastructure Regulation (EMIR) as regards supervision of central counterparties (CCPs).

The main areas covered by the proposal amending Regulations establishing the ESAs are: (1) powers, (2) governance and (3) funding of the ESAs. As regards powers, the proposal recognises a formal role to the ESAs in the ongoing monitoring of the equivalence process, improving their ability to ensure the correct application of Union law, and transfers supervisory powers to the ESAs in targeted areas with predominantly third country or cross-border relevance. As regards governance, it envisages independent members with voting rights in the decision-making process alongside the national competent authorities; it also introduces a new appointment procedure and an enhanced standing for the Chairperson and replaces the Management Board by an independent Executive Board composed of full time members who are externally appointed. Finally, when it comes to funding, the current annual EU contribution to ESAs' budget is maintained, but the amending proposal replaces the residual funding from national competent authorities with private sector contributions.

The measures aimed at improving the ESAs framework are completed by a proposal providing for the transfer to the European Securities and Markets Authority (ESMA) of certain supervisory powers currently attributed to the national competent authorities by the Markets in Financial Instruments Directive (MiFID II) and the Solvency II Directive.

ECON rapporteurs presented their draft report on 10 July 2018.

The Council Working Party on Financial Services started examining the proposal in October 2017. The review is ongoing.

## 2- Financial Markets and Securities

### *Markets in Financial Instruments Directive II (MiFID II)*

On 30 June 2017 ESMA published an opinion on ancillary activity under MiFID II – market size calculation. MiFID II had to be transposed into national laws of EU Member States by 3 July 2017. MiFID II/MiFIR are in force since 3 January 2018. The launch updated existing registers under MiFID I and also provided for new registers under MiFID II/MiFIR. ESMA compiles the registers based on data provided by the National Competent Authorities (NCAs) of the Member States of the European Economic Area (EEA) on and from the 3 January 2018.

Reporting firms have to use legal entity identifiers (LEIs) to report trades under the Markets in Financial Instruments Regulation (MiFIR). The six months period was introduced due to the fact that not all firms succeeded in obtaining LEIs in time for the MiFID II start.

ESMA and NCAs have since observed a significant increase in the LEI coverage for both issuers and clients. Based on these observations, ESMA and NCAs have concluded that there is no need to extend the initial six-month period granted to support the smooth introduction of the LEI requirements under MiFIR. The temporary period will last until 2 July 2018, including.

By 7 June 2018 ESMA had updated its public register with the latest set of double volume cap (DVC) data under the MiFID II. The updates include DVC data and calculations for the period of 1 May 2017 to 30 April 2018 as well as updates to already published DVC periods. Trading under the waivers for all new instruments in breach of the DVC thresholds should be suspended from 12 June 2018 to 12 December 2018. The instruments for which caps already existed from previous periods will continue to be suspended.

The Commission also proposed some amendments to the scope of MIFID II to cover Crowdfunding.

It proposed a Regulation which introduces an optional EU regime which enables crowdfunding platforms to easily provide their services across the EU Single Market and an accompanying Directive which amends the scope of Directive 2014/65/EU (MIFID II) by adding crowdfunding service providers authorised under the proposed Regulation to the list of exempted entities to which the scope of the Directive does not apply.

The legislative initiatives are currently being reviewed by the European Parliament and the Council.

### *The European Market Infrastructure Regulation (EMIR)*

The Regulation on Over-The-Counter (OTC) Derivatives, Central Counterparties and Trade Repositories (known as "EMIR"- European Market Infrastructure Regulation) forms part of the European regulatory response to the financial crisis. It was adopted on 4 July 2012 and entered into force on 16 August 2012. EMIR fulfils, within the EU jurisdiction, the G20 commitments on increasing transparency in derivative contracts traded OTC derivatives agreed in Pittsburgh in September 2009.

Between 2015 and 2016 the Commission carried out an extensive assessment of EMIR.

On that basis, the Commission proposed in May 2017 a Regulation amending and simplifying Regulation (EU) No 648/2012 to address disproportionate compliance costs, transparency issues and insufficient access to clearing for certain counterparties.

On 11 December 2017, the Council published its mandate for negotiations with the European Parliament.

At the Parliament, the relevant ECON Committee adopted its report on 16 May 2018. ECON’s MEPs agreed with the Commission’s proposal to ease the burden for small financial counterparties (SFCs). SFC should be released from the clearing obligation when the volume of OTC derivatives they deal with is too low to present an important systemic risk to the financial system and too low for central clearing to be economically viable. Similarly, non-financial counterparties, which are less interconnected and often active in only one class of OCT derivative presenting therefore have less of a systemic risk, should be subject to the clearing obligation only when they exceed the clearing threshold. MEPs also agreed that the financial counterparty is solely responsible for reporting on OTC derivative contracts entered into with a non-financial counterparty that is not subject to the clearing obligation. Furthermore, transactions between affiliates within the group where at least one of the counterparties is a non-financial counterparty should be exempt from the reporting obligation, regardless of the place of establishment of the non-financial counterparty.

The report was subsequently discussed in plenary on 11 June 2018. On 12 June, it was decided to start the trilogue negotiations with the Council and the Parliament. They are still on-going.

A phased-in implementation period of margin requirements for non-centrally cleared OTC derivatives that started in 2017 will be completed in 2019. In 2019 the revised EMIR is expected to entry into force.

### *CCP Recovery and Resolution Regulation*

The Commission published a proposal for a Regulation on the recovery and resolution of CCPs on 28 November 2016. Under the legislative proposal for a Regulation on CCP recovery and resolution, authorities will be required to enforce CCPs' contractual obligations before using any resolution tools, subject to limited exemptions.

The proposed new EU rules require (i) CCPs to prepare recovery plans envisaging measures to be taken in the event of financial difficulties exceeding the risk management defences under EMIR; (ii) national supervisors to review and approve these plans; (iii) national authorities to lay down resolution plans in the event of a CCP's failure (preparation and prevention tools). The proposal also provides national authorities with powers to step in when a CCP faces financial difficulties and to instruct a CCP to take actions in its recovery plan or other steps (early intervention tools). Finally, it sets out resolution tools to be applied by national authorities to a failing CCP, when it is in the public interest. Such tools include the power to sell a CCP's entire or critical functions, to create a publicly controlled bridge CCP and to allocate losses among owners and participants.

On 24 January 2018 ECON adopted its final report.

The Council has published a first presidency proposal on 28 April 2017 and another one on 19 December 2017. The review is still ongoing. The adoption of the Commission's proposal is anticipated for 2020.

### *Capital Markets Union (CMU)*

The European Commission launched its Action Plan for a CMU to help build a true single market for capital across the EU in 2015. The Action Plan is a key pillar of the Investment Plan for Europe, the so-called "Juncker Plan". A single capital market will be beneficial for all EU Member States, but will particularly strengthen the Economic and Monetary Union, by fostering cross-border private risk-sharing in the euro area. This is crucial to absorb systemic economic shocks.

It is built around the following key principles:

- Deepening financial integration and increasing competition
- Creating more opportunities for investors
- Connecting finance to the real economy by fostering non-bank funding sources
- Ensuring a stronger and more resilient financial system.

On 12 March 2018 the Commission proposed common rules – consisting of a Directive and a Regulation – for covered bonds. Covered bonds are financial instruments backed by a segregated group of loans. They are considered beneficial not only because they fund

cost-effective lending, but also because they are particularly safe. However, the EU market is currently fragmented along national lines with differences across Member States. The proposed rules aim to enhance the use of covered bonds as a stable and cost-effective source of funding for credit institutions, especially where markets are less developed. They will also give investors a wider and safer range of investment opportunities. At the same time, the proposal seeks to reduce borrowing costs for the economy at large. The Commission estimates that the potential overall annual savings for EU borrowers would be between EUR 1.5 billion and EUR 1.9 billion.

Cross-border distribution of investment funds: The proposal aims to remove regulatory barriers that currently hinder the cross-border distribution of investment funds, making cross-border distribution simpler, quicker and cheaper. Increased competition will give investors more choice and better value, while safeguarding a high level of investor protection.

Law applicable to cross-border transactions in claims and securities: The assignment of a claim refers to a situation where a creditor transfers the right to claim a debt to another person. This system is used by companies to obtain liquidity and access credit. At the moment, there is no legal certainty as to which national law applies when determining who owns a claim after it has been assigned in a cross-border case. According to the proposal, as a general rule, the law of the country where assignors have their habitual residence would apply, regardless of which Member State's courts or authorities examine the case. The Commission has also adopted a Communication to clarify which country's law applies when determining who owns a security in a cross-border transaction.

The Commission is committed to put in place all building blocks of CMU by mid-2019. On 8 March 2018 the Commission proposed further measures to develop and integrate EU capital markets, and the remaining proposals were presented by May 2018 so that, with the necessary political will, legislation can be adopted before the European Parliament elections in 2019.

The Commission also proposed additional measures to develop new products and labels and to integrate capital markets:

- A European label for investment-based and lending-based crowdfunding platforms ('European Crowdfunding Service Providers for Business') that enables cross-border activity and addresses risks for investors in a proportionate manner. It will help crowdfunding service providers scale up across the Single Market, thereby increasing access to finance for entrepreneurs, start-ups and small and medium-sized companies in general. This is also a first concrete deliverable of the FinTech Action Plan, which aims to create an environment where innovative products and solutions can easily emerge and scale-up across the EU, without compromising financial stability and consumer protection.
- An EU enabling framework for covered bonds - Covered bonds proved a stable and cost-effective source of financing during the financial crisis and should be further developed, drawing on the good practices of existing national systems. This framework will support the funding of the economy while giving investors a wider and safer range of investment opportunities and preserving financial stability.

- Measures to reduce the regulatory barriers to the cross-border distribution of investment funds in the EU. This will reduce the cost of going cross-border and support a more integrated single market for investment funds. Increased competition will give investors more choice and better value, while safeguarding a high level of investor protection.

***Prospectus Directive***

As part of CMU action plan, in June 2017 the EU adopted a Regulation (EU) 2017/1129 to improve the prospectus regime. The Regulation aims to:

- make it easier and cheaper for smaller companies to access capital;
- introduce simplification and flexibility for all types of issuers, in particular for secondary issuances and frequent issuers which are already known to capital markets and
- improve prospectuses for investors by introducing a retail investor-friendly summary of key information, catering for the specific information and protection needs of investors.

On 20 July 2017 after its publication in the Official Journal on 30 June 2017, the new Prospectus Regulation ("PR3") entered into force. PR3 provisions will begin applying on a rolling basis, with full application from 21 July 2019. Some specific provisions applied from 20 July 2017 or will apply from 21 July 2018. From 21 July 2019 the existing Prospectus Directive regime will cease to have effect. PR3 will replace the previous EU Directive 2003/71/EC (the "Prospectus Directive").

The following are some headline points in respect of the new rules:

- Bonds issued in €100,000 denominations will still be exempt from the ‘public offer’ trigger;
- The wholesale disclosure regime is being retained, along with the €100,000 denomination distinction, and wholesale bond prospectuses will be exempt from the summary requirement;
- The scope of the wholesale disclosure regime will be widened to include issues of debt securities that are admitted to a specific segment of a regulated market where access is limited to qualified investors;
- A potentially less onerous ‘EU Growth’ prospectus will be available for SMEs and in certain cases non-SMEs for eligible issues up to €20 million;
- Potentially lighter disclosure requirements will apply to secondary issuers where an issuer is already admitted to a regulated market or SME growth market;
- Risk factors will need to be categorised depending on their nature, with the most material risk factors being mentioned first in each category;
- Summaries may pose a challenge, as they will be shortened to seven sides of A4 sized paper and more prescriptive in content and the number of risk factors that can be included in the summary will be capped at 15;

- From 21 July 2018 no prospectus will be required for issues below €1 million, which fall outside the scope of the legislation; and
- From 21 July 2018 the threshold beyond which a prospectus is mandatory is increasing from €5 million to €8 million; however, Member States will have the discretion to exempt issues of between €1 million and €8 million or establish other disclosure requirements for issues below €8 million.

On 6 July 2017, ESMA issued three consultation papers for technical advice which closed on 28 September 2017. The three consultation papers were: Consultation Paper on the format and content of the prospectus (ESMA31-62-532); Consultation Paper on EU Growth prospectus (ESMA31-62-649); and Consultation Paper on scrutiny and approval (ESMA31-62-650). A final report was published on 28 March 2018.

On 15 December 2017, ESMA issued a further consultation paper on regulatory technical standards (RTS) under the Prospectus Regulation. The further consultation covers: key financial information that should appear in the prospectus summary; data and machine readability of information to be sent to ESMA in order to provide free access to the public; advertisements for public offers or admissions to trading; instances which require the publication of a supplement to a prospectus; and publication of a prospectus. Comments closed on 9 March 2018.

In addition, on 24 April 2018, the EU Commission issued a Roadmap on a simplified prospectus for companies and investors in Europe with a deadline of 22 May 2018.

On 28 March 2018, ESMA published a Final Report on technical advice under the Prospectus Regulation. This Final Report relates to the three consultations published in July 2017.

On 20 September 2017, the European Commission published a proposal for a Regulation ("Omnibus 3") which would make changes to various EU Regulations. If adopted in its current form, it would make significant changes to some key elements of Prospectus Regulation (EU) 2017/1129. The proposal as drafted would come into force in July 2019 with transitional provisions over 3 years. Changes include centralising approval of certain prospectuses so that ESMA would be the competent authority.

***Securitisation Regulation***

The Securitisation Regulation was adopted on 12 December 2017 and will entry into force on 1 January 2019. The Regulation is part of the European Commission's on-going work to build an efficient CMU in the EU. It repeals and replaces securitisation provisions in sector-specific legislation, including the Alternative Investment Fund Managers Directive (AIFMD) and introduces rules for issuing simple, transparent and standardised (STS) transactions. The Securitisation Regulation imposes due diligence and risk retention requirements on 'institutional investors', the definition of which includes AIFMs.

The Securitisation Regulation will apply in respect of:

- securities relating to securitisation transactions issued on or after 01 January 2019, and
- securitisation transactions issued prior to 01 January 2019 where new securities are issued on or after 01 January 2019.

Securities issued in respect of securitisation transactions before 01 January 2019 can use the STS designation provided (a) that ESMA is notified of such an election and (b) the criteria set out in the Regulation are met.

The EBA and ESMA have both published consultations on Level 2 measures under the Regulation. These closed in March 2018 and final draft advice will be sent to the Commission later in the year.

## 3- Taxation

### *Corporate Tax Reform Package*

The Corporate Tax Reform Package proposal published on 25 October 2016 includes three new proposals with the intention to provide for a more modern and fairer tax system for business, to close loopholes between EU countries and non-EU countries and to provide new dispute resolution rules to relieve problems with double taxation for businesses.

Firstly, the Commission proposed to re-launch the Common Consolidated Corporate Tax Base (CCCTB). The CCCTB aims to overhaul the way in which companies are taxed in the Single Market, to ensure a fairer, more competitive and more growth-friendly corporate tax system. The re-launched CCCTB will be implemented in two steps:

- the Common Corporate Tax Base which is aimed at harmonising the corporate tax base in the EU;
- the Consolidated Corporate Tax Base which is a grouping approach.

It also contains important new elements to improve its anti-avoidance and growth-promoting capacities. The CC(C)TB proposals are particularly supported by France and Germany, whilst there are reservations in quite a number of other Member States.

Secondly, the Commission proposed an improved system to resolve double taxation disputes in the EU. Under the proposal, current dispute resolution mechanisms will be adjusted, to better meet the needs of businesses. In particular, a wider range of cases will be covered, and Member States will have clear deadlines to agree on binding solutions to cases of double taxation. This proposal gives the possibility to the taxpayer to initiate a mutual agreement procedure (within clear timelines), under which Member States have to reach an agreement in principle within a timeframe of two years (with the possibility to extend it with one year). It also sets out a clear process and timeline for the Members States to acknowledge receipt of a complaint and to take a decision on the acceptance or rejection of the complaint. If the involved Member States fail to reach an agreement, the arbitration procedure is launched to resolve the dispute within specified

timelines. An advisory panel of independent arbitrators will provide a binding opinion for eliminating the double taxation unless the Member States involved agree to an alternative solution. During its meeting on 23 May 2017, the ECOFIN Council reached a political agreement on the proposal. Once the EP has given its opinion on the Directive and the Council has given its final vote, the Directive has to be transposed by 30 June 2019 in national law and will apply to complaints submitted after this date (in relation to questions to the tax year starting on or after 1 January 2018). Nevertheless, Member States can apply the Directive to earlier tax years if they are willing to do so.

Thirdly, the package also included a proposal to close down 'hybrid mismatches' with the tax systems of third countries (amendment to the Anti-Tax Avoidance Directive - ATAD2). The aim is to prevent corporate groups from exploiting the disparities between two or more tax jurisdictions to reduce their overall tax liability. The Council adopted the Directive in May 2017.

### *Transparency for intermediaries*

On 21 June 2017, the Commission proposed new transparency rules for intermediaries that design or sell potentially harmful tax schemes. Intermediaries are firms or persons, such as consulting firms, banks, lawyers, tax advisors, accountants, etc. which can help their clients to set up schemes to reduce their tax bills. Most services provided by intermediaries are legitimate. However, recent cases, such as the Panama Papers, exposed the role that some of these intermediaries may play in international tax avoidance and evasion by designing schemes that are specifically set up to help their clients escape taxation.

The Commission’s proposal aims to provide tax authorities with information about existing potentially aggressive tax planning schemes. Intermediaries will have to report any cross-border arrangement that contains one or more of the specified hallmarks which might indicate that the arrangement is set up to avoid paying taxes. The Member State in which the arrangements are reported must automatically share this information with all other Member States, in a standard format, through a centralised database and on a quarterly basis. The Commission will have limited access to the information exchanged between Member States, in order to monitor the implementation of the rules.

On 25 May 2018 the Council adopted the European Commission's proposal from June 2017 on new transparency rules for intermediaries that design or sell potentially harmful tax schemes. It is foreseen that the new reporting requirements would enter into force on 1 January 2019, with the Member States obliged to exchange information every 3 months after that.

## 4- **Financial Reporting**

### *IFRS9 impact on capital – transitional approach*

In July 2014, the International Accounting Standards Board (IASB) published the International Financial Reporting Standard (IFRS)9.

On 23 November 2016, the European Commission adopted its review of the current legislation on banks' capital requirements (CRD 4 and CRR). The package included transitional arrangements aimed at preventing unwarranted impact of the introduction of IFRS 9 on EU banks' regulatory capital.

The European Commission proposed a five-year phase-in period, based on decreasing reliefs in the additional provisioning requirements arising from the application of IFRS 9. The phasing-in period would also provide time to observe the possible pro-cyclicality effects of the revised approach, as well as to agree internationally harmonised prudential treatment of the expected credit losses under IFRS 9 and the US equivalent, the revised generally accepted accounting principles (GAAP) standard on financial instruments, which will enter into force in 2020. As the new arrangements should have entered into force before the start of the mandatory application of IFRS 9 (1 January 2018), the European Parliament and the Council agreed to treat the relevant provisions separately from the remainder of the proposal and adopt them through a fast-track procedure.

The European Parliament relevant ECON Committee report was voted on 11 July 2017. In parallel, the Council Working Party completed its review of the proposal on 15 June 2017.

Following trilogue discussions, the Parliament and the Council reached a compromise on 25 October 2017, which confirms the five-year phase-in period, during which banks will be allowed to add a portion of the additional provisions due to the application of IFRS 9 back to regulatory capital (Common equity tier 1, CET1).

The European Parliament adopted the text in plenary on 30 November 2017. The Council adopted the act on 8 December and the final act was signed on 12 December 2017.

In parallel, the EBA released a consultation paper providing with guidelines on uniform disclosures as regards the transitional period for mitigating the impact on own funds of the introduction of IFRS 9. The guidelines were applicable since 1 January 2018 until the end of the transitional period.

## 5- Retail Financial Services and Payments

### *Consumer Financial Services' Action Plan*

On 23 March 2017, the European Commission published an Action Plan setting out a strategy to strengthen the EU single market for retail financial services. The actions planned by the European Commission for 2018 are the following:

- Study on the need for a deeper Single Market for consumer credit and consider how to better address over-indebtedness;

- Improvement of the quality and reliability of comparison websites for consumer financial services;
- Work towards more transparent currency conversion when paying in another EU country;
- Review of national consumer protection rules to ensure they are fair and simple
- Review of the practices of digital providers to make sure that online selling requirements remain adequate;
- Look into ways to make it easier to switch financial products and providers and
- Common criteria to assess consumers' creditworthiness and minimum set of data to be exchanged between national credit registers.

***Revised Payment Services Directive (PSD2)***

The PSD2 aims to modernise Europe's payment services to the benefit of both consumers and businesses, so as to keep pace with this rapidly evolving market.

The new rules:

- Prohibit surcharging, which are additional charges for payments with consumer credit or debit cards, both in shops or online;
- Open the EU payment market to companies offering payment services, based on them gaining access to information about the payment account;
- Introduce strict security requirements for electronic payments and for the protection of consumers' financial data;
- Enhance consumers' rights in numerous areas. These include reducing the liability for non-authorised payments and introducing an unconditional ("no questions asked") refund right for direct debits in euro.

PSD2 scope extends to innovative payment services and new providers in the market, such as FinTechs. These players are also called third party payment services providers (TPPs). TPPs include:

- Payment initiation services providers (PISPs): these initiate payments on behalf of customers. They give assurance to retailers that the money is on its way.
- Aggregators and account information service providers (AISPs): these give an overview of available accounts and balances to their customers.

The Directive is applicable since 13 January 2018, except for the security measures outlined in the regulatory technical standards (RTS). These will become applicable in September 2019.

RTS make strong customer authentication (SCA) the basis for accessing one's payment account, as well as for making payments online.

The RTS also allow for exemptions from strong customer authentication. This is to avoid disrupting the ways consumers, merchants and payment service providers operate today. It is also because there may be alternative authentication mechanisms that are equally safe and secure. However, payment service providers that wish to be exempted from SCA must first apply mechanisms for monitoring transactions to assess if the risk of fraud is low.

All payment service providers will need to prove the implementation, testing and auditing of the security measures.

The RTS also specify the requirements for common and secure standards of communication between banks and third-party providers.

Banks will have to put in place a communication channel that allows TPPs to access the data that they need. This communication channel will also enable banks and TPPs to identify each other when accessing customer data and communicate through secure messaging at all times. Banks may establish this communication channel by adapting their customer online banking interface. They can also create a new dedicated interface (API) that will include all necessary information for the payment service providers. The rules also specify the contingency safeguards that banks have to put in place when they decide to develop a dedicated interface (the so-called "fall back mechanisms"). The objective of such contingency measures is to ensure continuity of service as well as fair competition in this market.

Banks can be exempted from setting up a fall-back mechanism, if they put in place a fully functional dedicated communication interface responding to the quality criteria defined by the regulatory technical standards. National authorities will grant the exemption to individual banks by national authorities.

Transition period: A transition period is in place between the application date of PSD2 (13 January 2018) and the application date of the RTS (18 months after publication of the delegated act in the Official Journal of the EU). This means that the PSD2 provisions on strong customer authentication and on secure communication, which are directly specified in the RTS, are not applicable immediately.

***Cross-border payments***

Since the introduction of the euro, the European Union has launched various initiatives to significantly reduce the cost of cross-border transactions.

In March 2018, the Commission presented a proposal amending the Regulation 924/2009 which aims at achieving:

- cheap cross-border payments in euro everywhere in the Union.
- more transparency in currency conversion practices.

As regards cross-border payments, the Commission proposal extends the benefits of cheap cross-border euro transfers –currently enjoyed by euro area citizens and businesses– to non-euro

area residents and businesses. This will allow all consumers and businesses in the EU to fully reap the benefits of the Single Market when they send money, withdraw cash or pay abroad.

As regards currency conversions, the Commission proposal aims to establish additional transparency obligations in line with the Payment Service Directives. When consumers make card payments or withdraw cash while abroad, they can choose whether to pay in the local currency or in their home country. Currently, consumers do not know what fees apply when making this choice. After the proposal, fees will need to be transparent, and consumers will be able to make an informed choice and choose the cheapest offer. The proposal will establish also a temporary cap on currency conversion costs until the transparency measures devised by the EBA take effect.

In the European Parliament, the dossier has been assigned to the ECON Committee. Review is on-going.

On 27 June 2018, the Council agreed on a negotiating mandate for the trilogues with the European Parliament.

## 6- Corporate Governance and Financial Crime

### *Anti-Money Laundering (AML)*

The 5th Anti-Money Laundering Directive, (AMLD) which amends the 4th AMLD was published in the Official Journal of the European Union on 19 June 2018. Member States must transpose this Directive by 10 January 2020.

The proposal was presented by the Commission in July 2016 in the wake of terrorist attacks and the revelations of the Panama Papers scandal, and is part of the Commission's Action Plan of February 2016 to strengthen the fight against terrorist financing. The 5th AMLD is expected to:

- Enhance the powers of EU Financial Intelligence Units and facilitating their increasing transparency on who really owns companies and trusts by establishing beneficial ownership registers;
- Prevent risks associated with the use of virtual currencies for terrorist financing and limiting the use of pre-paid cards;
- Improve the safeguards for financial transactions to and from high-risk third countries;
- Enhance the access of Financial Intelligence Units to information, including centralised bank account registers;
- Ensure centralised national bank and payment account registers or central data retrieval systems in all Member States.

According to the provisions of the 5$^{th}$ AMLD:

- The beneficial ownership registers for legal entities, such as companies, will be public;
- Access to data on the beneficial owner of trusts will be accessible without any restrictions to competent authorities, Financial Intelligence Units, the professional sectors subject to AML rules (banks, lawyers…) and will be accessible to other persons who can demonstrate a legitimate interest;
- The national registers on beneficial ownership information will be interconnected directly to facilitate cooperation and exchange of information between Member States - Member States will have to put in place verification mechanisms of the beneficial ownership information collected by the registers to help improve the accuracy of the information and the reliability of these registers;
- Member States will be required to set up centralised bank account registers or retrieval systems to identify holders of bank and payment accounts.

The rules will now apply to entities which provide services that are in charge of holding, storing and transferring virtual currencies, to persons who provide similar kinds of services to those provided by auditors, external accountants and tax advisors which are already subject to the 4th AMLD and to persons trading in works of art. These new actors will have to identify their customers and report any suspicious activity to the Financial Intelligence Units.

As part of its obligations under the EU's AMLD, the European Commission is periodically obliged to draw up a list of "high-risk third countries". For many months, the list has been a source of disagreement between the European Commission and the European Parliament.

***Data protection***

The data protection reform package which is applicable as of May 2018 includes the General Data Protection Regulation (GDPR) and the Data Protection Directive for the police and criminal justice sector.

The GDPR updates and modernises the principles enshrined in the 1995 Data Protection Directive to guarantee privacy rights. The new rules address the following:

- A "right to be forgotten": When an individual no longer wants her/his data to be processed, and provided that there are no legitimate grounds for retaining it, the data will be deleted. This is about protecting the privacy of individuals, not about erasing past events or restricting freedom of the press.
- Easier access to one's data: Individuals will have more information on how their data is processed and this information should be available in a clear and understandable way. A right to data portability will make it easier for individuals to transmit personal data between service providers.
- The right to know when one's data has been hacked: Companies and organisations must notify the national supervisory authority of data breaches which put individuals at risk and communicate to the data subject all high-risk breaches as soon as possible so that users can take appropriate measures.

- Data protection by design and by default: ‘Data protection by design' and ‘Data protection by default' are now essential elements in EU data protection rules. Data protection safeguards will be built into products and services from the earliest stage of development, and privacy-friendly default settings will be the norm – for example on social networks or mobile apps.

- One-stop-shop: The 'one-stop-shop' will streamline cooperation between the data protection authorities on issues with implications for all of Europe. Companies will only have to deal with one authority, not 28. It will ensure legal certainty for businesses. Businesses will profit from faster decisions, from one single interlocutor (eliminating multiple contact points), and from less red tape.

- Sanctions: The GDPR establishes a range of tools for enforcing the new rules, including penalties and fines.

## 7- <u>Others</u>

### *Sustainable Finance*

In 2017, the Commission appointed a High-Level Expert Group on sustainable finance to elaborate a comprehensive set of recommendations for the financial sector to support the transition to the low-carbon economy. Inspired by their final report, the Commission proposed on 8 March 2018 an EU strategy on sustainable finance setting out a roadmap for further work and upcoming actions covering all relevant actors in the financial system. These include:

- Establishing a common language for sustainable finance, i.e. a unified EU classification system – or taxonomy – to define what is sustainable and identify areas where sustainable investment can make the biggest impact;

- Creating EU labels for green financial products on the basis of this EU classification system: this will allow investors to easily identify investments that comply with green or low-carbon criteria;

- Clarifying the duty of asset managers and institutional investors to take sustainability into account in the investment process and enhance disclosure requirements;

- Requiring insurance and investment firms to advise clients on the basis of their preferences on sustainability;

- Incorporating sustainability in prudential requirements: banks and insurance companies are an important source of external finance for the European economy. The Commission will explore the feasibility of recalibrating capital requirements for banks (the so-called green supporting factor) for sustainable investments, when it is justified from a risk perspective, while ensuring that financial stability is safeguarded;

- Enhancing transparency in corporate reporting: we propose to revise the guidelines on non-financial information to further align them with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).

In May 2018, the Commission adopted a package of measures implementing several key actions announced in its action plan on sustainable finance. The package includes:

- A proposal for a Regulation on the establishment of a framework to facilitate sustainable investment. This Regulation establishes the conditions and the framework to gradually create a unified classification system ('taxonomy') on what can be considered an environmentally sustainable economic activity. This is a first and essential step in the efforts to channel investments into sustainable activities.

- A proposal for a Regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU)2016/2341. This Regulation will introduce disclosure obligations on how institutional investors and asset managers integrate environmental, social and governance (ESG) factors in their risk processes. Requirements to integrate ESG factors in investment decision-making processes, as part of their duties towards investors and beneficiaries, will be further specified through delegated acts.

- A proposal for a Regulation amending the Benchmark Regulation. The proposed amendment will create a new category of benchmarks comprising low-carbon and positive carbon impact benchmarks, which will provide investors with better information on the carbon footprint of their investments.

In addition, from 24 May to 21 June 2018, the Commission was seeking feedback on amendments to delegated acts under the MiFID II and the Insurance Distribution Directive to include ESG considerations into the advice that investment firms and insurance distributors offer to individual clients.

The Commission organised a high-level conference on 22 March 2018 to discuss the Action Plan.

### *Fintech*

On 8 March 2018, the European Commission published an Action Plan on how to harness the opportunities presented by technology-enabled innovation in financial services (FinTech).

The FinTech Action Plan sets out 19 steps to enable innovative business models to scale up, support the uptake of new technologies, increase cybersecurity and the integrity of the financial system, including:

- The Commission will host an EU FinTech Laboratory where European and national authorities will engage with tech providers in a neutral, non-commercial space;

- The Commission has already created an EU Blockchain Observatory and Forum. It will report on the challenges and opportunities of crypto assets later in 2018 and is working on a comprehensive strategy on distributed ledger technology and blockchain addressing all sectors of the economy. A distributed ledger is an information database that is shared across a network. The best-known type of distributed ledger is blockchain.

- The Commission will consult on how best to promote the digitisation of information published by listed companies in Europe, including by using innovative technologies to interconnect national databases. This will give investors far easier access to key information to inform their investment decisions.

- The Commission will run workshops to improve information-sharing when it comes to cybersecurity;

- The Commission will present a blueprint with best practices on regulatory sandboxes, based on guidance from ESAs. A regulatory sandbox is a framework set up by regulators that allows FinTech startups and other innovators to conduct live experiments in a controlled environment, under a regulator's supervision. Regulatory sandboxes are gaining popularity, mostly in developed financial markets.

The Action Plan is part of the European Commission's efforts to build a CMU and a true Single Market for consumer financial services. It is also part of its drive for a Digital Single Market.

## FRANCE

### Regulation and Supervision of Banks

France, as a member of the European Union, follows the ongoing discussions at the Council and the European Parliament on the revision of the European supervisory and resolution framework. The aim is to transpose the international standards in Europe which were published before December 2017 (i.e. those endorsed by the Basel Committee and by the Financial Stability Board).

The European revision of internal models developed by banks (i.e. TRIM exercise) is continuing under the responsibility of the SSM (Single Supervision Mechanism – ECB).

The European Central Bank, alongside EBA, have published several texts in order to intensify the decrease of non-performing loans (NPL) in Europe and improve its management.

The French macro-prudential authority APCR has introduced limitations to the amount lent by credit institutions to highly indebted non-financial companies as well as a countercyclical buffer.

### Regulation and Supervision of Non-Bank Financial Institutions

The European Commission has published the final text for the introduction in Europe of simple, transparent and standardized (STS) securitization. This new label for securitization will enter into force in January 2019.

**Derivatives**

French banks continue to work on EMIR and MiFID 2 implementation. Most of EMIR entered into force in 2014, however some requirements such as collateral requirements for non-centrally cleared derivatives entered into application in various steps, notably during the course of 2017.

The application of MiFID II, which entered into force as of January 2018, was a challenge for French and European banks since the new framework imposes new trading obligation for securities and (sufficiently liquid) cleared derivatives. MIFID II also increases reporting and transparency obligation for equity, equity like, derivatives and bond instruments. The implementation of these heavy requirements is an ongoing process.

**Anti-Money Laundering Developments**

The 4th Anti-Money Laundering Directive (EU) n° 2015/849 (AMLD) has been implemented in France by two legal texts: an order dated 1st December 2016 and a decree dated 18th April 2018.

Under the 4th AMLD, a key role is accorded to the principle of risk analysis and the corresponding adequate safeguards. The ESAs have issued guidelines for the Member States and the relevant entities with respect to which specific simplified or enhanced measures are to be taken to reduce or prevent the identified risks. The ACPR (the French Banking supervisor) has declared that she intends to comply with these guidelines. The ESAs have also promulgated Regulatory Technical Standards on the measures credit institutions and financial institutions shall take to mitigate the risk of money laundering and terrorist financing where a third country's law does not permit the application of group-wide policies and procedures.

The 4th AMLD no longer differentiates between politically exposed persons (PEPs) which reside in the same country as the relevant entity or in another country. Further, special obligations apply with respect to PEPs classified as beneficial owner.

It is also worth mentioning the entry into force in June 2017 of the Regulation (EU) 2015/847 of 20 May 2015 on information accompanying transfers of funds and repealing Regulation (EC) No 1781/2006. One should also mention the ESA guidelines on the measures payment service providers should take to detect missing or incomplete information on the payer or the payee, and the procedures they should put in place to manage a transfer of funds lacking the required information, which entered into force on 16th July 2018.

The 5TH Anti-Money laundering Directive (EU) 2018/843 has been adopted on 30th May 2018 and is currently being transposed.

**Cybersecurity**

Regulatory changes, currently being implemented in the Member States or under discussion in the European authorities, represent one of the most significant factors on the European digital market. The most important developments are of course the General Data

Protection Regulation (GDPR), the Proposal of Regulation on Privacy and Electronic Communications (e-Privacy), and the Electronic Identification Authentication and trust Services (e-IDAS) regulation. Transposed into national laws across the European Union, all these texts must protect consumers' personal data and interests while guaranteeing a level playing field. They also aim to strengthen the security of data flows and information systems and contribute a stronger regulatory framework with regards to anti-money laundering, terrorism financing and fraud prevention.

**Treatment of Non-Domestic Financial Institutions**

The treatment of non-domestic financial institutions by French institutions has not changed in the recent years. However, the ongoing Brexit negotiations will have an impact on the treatment of non-domestic institutions and institutions licensed in the UK which will not benefit from the EU passport anymore and which will need to apply for a European license after Great Britain leaves the EU. Brexit may also require market infrastructure providers currently based in the UK (trading venues, CCP, etc…) to apply for equivalence status to the European Commission should they wish to continue to provide services to EU banks and asset managers.

Furthermore, the revision of the European Regulation of Market Infrastructure (EMIR review) is currently under discussion as the European level proposes to reinforce CCP supervision. This text currently proposes the relocation to the Eurozone of super systemic third country CCPs if they want to remain equivalent and if they want to keep operating with EU counterparties.

## GERMANY

In 2017 the German economy grew for the eighth consecutive year since the severe recession of 2009. In this positive economic climate, the financing terms for enterprises and households in Germany are still very favorable, with low levels of credit risk and volatility.

However, the prolonged low-interest phase and the challenging competitive environment continue to force banks to cut spending and lead to an ongoing consolidation process. According to numbers published by the German Bundesbank, 19 new openings and 84 closures were recorded in 2017, leading to a total overall number of 1,823 credit institutions. Of these closures, 57 were due to mergers in the cooperative sector and 14 to mergers in the savings bank sector, with 13 saving banks and one Landesbank each merging with a separate institution from the same banking group.

The significant net decline in the number of branches continued in all German banking sectors. After a drop by 2,019 branches in 2016, the number of domestic branches fell by 1,900, or 5.9%, to 30,126 in 2017. These numbers not only reflect the ongoing need for cost cutting but also the continuing trend of digitalization in Germany.

**New Developments in Insolvency Law**

A law facilitating the management of corporate group insolvencies was passed in April 2017 and came into effect on 21 April 2018. This is intended to prevent corporate groups from falling into a disorderly insolvency and to preserve the chances of restructuring. The law creates a new group venue for group insolvencies and generally relies on coordination and cooperation. There is

no consolidation of the group's assets. The law gives each group-affiliated debtor the right to apply for a single group venue. If the insolvency court grants a group venue, this will also be the venue for companies in the group which would otherwise have had another venue.

In addition, 2018 sees the continuation of an evaluation launched in 2016 of the insolvency law reform implemented in 2012 by the German Act on Further Facilitating the Restructuring of Companies (*Gesetz zur weiteren Erleichterung der Sanierung von Unternehmen*). This may conflict with the European Commission's proposal for a Directive on Insolvency, Restructuring and Second Chance, published on 22 November 2016 in the context of capital markets union (CMU).

**Revision to the German Minimum Requirements for Risk Management**

In October 2017, the Federal Financial Supervisory Authority (BaFin) published a revision of Germany's Minimum Requirements for Risk Management (MaRisk). MaRisk flesh out the requirements of Pillar 2 of the Basel Framework in a principles-based manner and in line with the principle of proportionality. The revised requirements essentially focus on implementing BCBS 239 (risk data aggregation and risk reporting), risk culture and outsourcing.

Supervisory expectations of the design of banks' internal capital adequacy assessment process (ICAAP) have been revised in this context and BaFin has published a new version of its guideline. One of the purposes of the changes was to reflect developments at European level.

The guideline is aimed at less significant institutions, which are supervised by BaFin. In accordance with Pillar 2, a key role is played by the principle of proportionality and banks are free to select their own method of assessment. In consequence, the document is to be understood as guidance rather than as a set of prescriptive requirements. In future, banks will have to apply two approaches when assessing their risk-bearing capacity: a normative (compliance with all regulatory requirements) and an economic (preservation of the bank's assets). The normative perspective will be complemented by capital planning for a three-year horizon which also has to consider adverse developments.

The issue of outsourcing is being revisited both in Germany and in the EU. In December 2017, the EBA published new guidelines on outsourcing to cloud service providers and intends to revise the CEBS guidelines on outsourcing, which date back to 2006. The EBA plans to consult the industry in summer 2018. The new guidelines are scheduled to take effect from 2019.

According to German supervisors, outsourcing with respect to the revised MaRisk of October 2017 may be understood as follows.

All requirements concerning outsourcing are strictly geared to banking operations. Banking operations are to be understood as business for which a banking licence from BaFin is

required pursuant to section 1 of the German Banking Act, for example. Section 25b of the German Banking Act sets out how outsourced banking operations have to be handled. Details are spelled out in section AT 9 of MaRisk.

This basically means that all activities and processes which are not related to banking operations do not represent outsourcing within the meaning of section AT 9 of MaRisk but are to be considered services supplied by a third party. Examples of such services are running a canteen for the staff of bank, delivering electricity, or providing legal or tax advisory services. The risks associated with third-party services nevertheless also have to be assessed: details are set out in section 25a of the German Banking Act.

So if a bank in Germany outsources activities or processes for the purpose of, or necessary for, carrying out banking operations or providing financial services, the requirements of section AT 9 of MaRisk apply. The quality of the requirements depends on the bank's own internal assessment of whether the outsourcing is "significant" or "insignificant".

It should be borne in mind that MaRisk are minimum requirements. Banks can regard them as guidance and diverge from them. The important point is that banks put suitable measures and procedures in place to deal with the specific individual risks associated with "their" outsourcing.

Under the single supervisory mechanism (SSM), banking supervisors at the ECB are also issuing outsourcing guidelines in 2018. Banks licensed in Germany and under the direct supervision of the SSM may then have to observe three sets of guidelines on outsourcing (those of the EBA, BaFin and the SSM).

**Tax Developments: Signing the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument" [MLI])**

On 7 June 2017 over 67 countries, including Germany, signed the multilateral instrument. The MLI allows signatory states to adapt existing double taxation treaties (DTTs) to the measures specified in the OECD BEPS project without needing to renegotiate DTTs bilaterally. In particular, the MLI contains provisions on the minimum standards of BEPS Action 6 (preventing treaty abuse) and Action 14 (dispute resolution mechanisms), and also on Action 2 (hybrid arrangements) and Action 7 (definition of permanent establishments [PEs]).

The MLI is only applicable to DTTs specifically identified by the signatories (so-called covered tax agreements, or CTAs). The signatories are not required to implement all of the provisions of the MLI as it contains a number of alternatives and optional provisions.

Only the actions classified as minimum standards in the BEPS project, i.e. preventing treaty abuse (Articles 6 and 7 of the MLI) and improving dispute resolution (Articles 16 and 17 of the MLI) are mandatory. The MLI also makes recommendations; in these cases, application is

optional or may be made subject to reservations. A current list of German reservations and notifications can be found at http://www.oecd.org/tax/treaties/beps-mli-position-germany.pdf.

The MLI was scheduled to enter into force on 1 July 2018 after five countries deposited their instruments of ratification with the OECD Secretary General.

In Germany, the MLI is regarded as a treaty under international law and consequently requires a legislative procedure to transpose it into national tax law before it can enter into force. The MLI is expected to be ratified during the current legislative period. For the initial application of individual CTAs, Germany has reserved the right to first implement an internal procedure for introducing provisions of the convention such as an implementation act (Article 35(7)(a) of the MLI). Consequently, a CTA will generally only take effect for taxes levied for assessment periods commencing on 1 January of the year beginning after a period of six months starting on the 30th day after the date of receipt of the latest notification regarding the internal procedure.

The Federal Ministry of Finance (BMF) expects the first amendments to German CTAs to be applicable as early as from 2019 onwards. How further implementation will proceed remains to be seen.

**Tax Developments: Federal States' Draft Disclosure Rules for Tax Planning Arrangements**

On 25 May 2018, the EU Council adopted an amendment to the European Mutual Assistance Directive on Administrative Cooperation in the Field of Taxation (2011/16/EU). The amendment introduces disclosure rules for tax planning arrangements.

Germany's federal states agreed in May 2018 on a first draft bill for such rules at national level. This draft bill diverges from the directive in several significant respects and also introduces some new provisions.

As in the European directive, the disclosure rules affect the intermediary, i.e. any person that markets, makes available for implementation, designs, organizes or manages for others the implementation of tax planning arrangements. These activities are spelled out in more detail by a non-exhaustive list of examples, such as confidentiality clauses and remuneration in relation to the tax benefit. Fulfilment of the "main benefit test" is sufficient to trigger a disclosure obligation.

Also as in the directive, it is not only the intermediary, but also the taxpayer that will be obliged to submit a report if it turns out that the taxpayer intends to use a tax planning arrangement (e.g. if such an arrangement has been designed by a firm's in-house tax department). When an intermediary discloses an arrangement, the Federal Central Tax Office (*Bundeszentralamt für Steuern – BZSt*) will issue the intermediary with a registration number, which must be passed on the relevant taxpayer to let them know that disclosure has taken place.

The draft bill provides for two exemptions over and above those in the directive:

- no disclosure rules if the taxpayer is an individual with income below a certain threshold;
- no disclosure if the taxpayer has already filed an application for a binding ruling on the tax planning arrangement in question.

Unlike in the European directive, the existence of a tax benefit under the draft bill constitutes a general attribute and is incorporated into an abstract definition of a "tax planning arrangement". This definition is fleshed out with positive and negative examples. Among the positive examples are transactions which can also be found in the directive (e.g. the conversion of certain income into another type of income which is taxed at a lower rate). Furthermore, the draft bill targets certain arrangements which are a thorn in the side of German lawmakers (e.g. cum/cum transactions, the "Goldfinger" scheme). By contrast, a tax planning arrangement is explicitly exempt from disclosure if it has been individually designed for a single taxpayer or if the envisaged tax benefit does not exceed EUR 50,000. Negative examples of this kind are not found in the directive.

Like in the European directive, the deadline for disclosure is 30 days. Disclosures have to be filed with the Federal Central Tax Office. Unlike in the directive (which contains a detailed list of reportable information), the draft bill merely requires an abstract description of the arrangement and of its effects on tax. However, the BMF is authorized to specify the form and content of the disclosure with the consent of Germany's upper legislative chamber, the Bundesrat. The explanatory memorandum accompanying the draft bill states that it is not necessary to name the taxpayer. By contrast, this information is explicitly listed as reportable information in the directive.

With respect to sanctions in the event of non-compliance with the disclosure rules in the European directive, Germany's federal states have opted for monetary sanctions. Willful or negligent failure to disclose, incomplete disclosure or belated disclosure may lead to a fine of up to EUR 100,000; in the event of a belated disclosure, a fine of at least EUR 200 will be levied for each full day past the deadline.

The Federal Central Tax Office will forward the received disclosures, together with an initial appraisal, to the BMF and the supreme tax authorities of the federal states, which will then examine the tax planning arrangements more closely with respect to their legal admissibility.

The criticisms of the European directive also apply to the draft bill. The draft bill imposes a unilateral obligation to provide information with no provision for feedback to the taxpayer about the admissibility of the tax planning arrangement in question.

How further implementation will proceed remains to be seen.

**Tax Regulation: Act to Counter Tax Avoidance and to Amend Further Tax Provisions**

The Act to Counter Tax Avoidance (*Steuerumgehungsbekämpfungsgesetz*), dated 23 June 2017 (Federal Law Gazette – BGBl. I 2017, 1682), is the response of German lawmakers to the so-called "Panama Papers", which were leaked in April 2016. The act introduces additional reporting and cooperation obligations on the one hand and new investigatory powers on the other with the aim of establishing transparency concerning the controlling business relationships between domestic taxpayers and so-called domiciliary companies. The new legislation is also intended to have a preventive effect by increasing the likelihood of tax offences being detected.

Section 30a of the German Tax Code (*Abgabenordnung* – AO) – tax secrecy for bank customers – has been abolished.

The scope of section 93 (1a), sentence 1 of the Tax Code has been expanded with respect to the automated retrieval of account information and so-called collective requests for information (*Sammelauskunftsersuchen*). This enables the tax authorities to request pertinent information from persons other than those involved in the tax assessment proceedings. Under section 93 (1a), sentence 2 of the Tax Code, a collective request for information requires that there be sufficient grounds for the investigation and that other reasonable fact-finding measures have no prospect of success.

Furthermore, section 93b (2) in conjunction with section 93 (7) and (8) of the Tax Code authorizes the tax authorities to retrieve account information from credit institutions.

The notification obligations for domestic taxpayers pursuant to section 138 (2) of the Tax Code have been amended and harmonized overall. Now, among other things, acquisitions of a participation of at least 10% in a foreign corporation, association or estate will be notifiable, as will disposals of the same. What is more, direct and indirect participations will be added up. On the other hand, the deadline for such notifications has been extended until the relevant income tax or corporate income tax return is filed, though notifications should in no event be submitted later than 14 months after the end of the applicable assessment period.

The extended reporting and cooperation obligations are above all targeted at so-called third-country companies. Section 138 (3) of the Tax Code defines "third-country company" as a partnership, corporation, association or estate with its seat or management neither in the EU nor in EFTA. Pursuant to section 138 (2), no. 4 of the Tax Code, taxpayers are now obliged to notify the competent tax office if they may – either alone or together with related parties within the meaning of section 1 (2) of the German Foreign Tax Act (*Außensteuergesetz*) – for the first time directly or indirectly exert a controlling or decisive influence on the corporate governance, or financial or business affairs of a third-country company. The assumption of a controlling or decisive influence does not require a corporate shareholding in the third-country company.

Under section 138b of the Tax Code, the extended reporting and cooperation obligations are also directed against banks in Germany or a German PE of a foreign bank which have introduced/built or arranged/brokered relations between clients and third-country companies if they have knowledge of the client's controlling or decisive influence on the third country company. For corporate shareholding of 30% no specific knowledge is needed; it is assumed that the bank "has to know". The notification obligation corresponds to section 2 (1), nos. 1 to 1-3 and 6 of the German Money Laundering Act (*Geldwäschegesetz* – GWG)

The retention requirements for taxpayers in connection with their participation in third-country companies have been extended pursuant to section 147a (2) of the Tax Code. Section 170 (7) of the Tax Code specifies that, for such cases, the assessment period will begin at the earliest at the end of the calendar year in which the relationship with the third-country company is notified or becomes otherwise known, but at the latest ten years after the end of the calendar year in which the tax liability arises.

Criminal law: section 370 (3) of the Tax Code has been extended to the effect that a particularly serious case of tax avoidance will generally be deemed to exist if the offender "uses a third-country company (…) to conceal tax relevant facts, thus continuously evading tax or gaining unjustified tax benefits".

**Tax Regulation and Administrative Order: Amendments to the German Regulation on Documentation of Profit Allocation (*Gewinnabgrenzungsaufzeichnungs-Verordnung – GAufzV*) and Tax Authorities Circular**

The Regulation of the Type, Content and Scope of Documentation within the Meaning of Section 90 (3) of the German Tax Code (*Gewinnabgrenzungsaufzeichnungs-Verordnung* – GaufzV) implements the necessary amendments to the classification of transfer pricing documentation into country-specific, company-related documentation on the one hand and a master file on the other hand. These amendments are mainly the result of the so-called BEPS-1 Act (Federal Law Gazette – BGBl. I 2016, 3000). The regulation also introduces editorial and clarifying amendments. In particular, the taxpayer's overall selection process has to be transparent and verifiable at the time of the tax audit.

The regulation took effect on 19 July 2017 and will apply to financial years starting after 31 December 2016. The old GaufzV of 13 November 2003, last amended on 26 June 2013, simultaneously ceased to be force.

Administrative order: on 11 July 2017 the Federal Ministry of Finance (BMF) published a BMF circular (Federal Tax Gazette – BStBl. I 2017, 974) on the requirements for country-specific reporting of multinational groups of companies. Enterprises subject to country-by-country reporting pursuant to section 138a of the German Tax Code have to submit reports to the Federal Central Tax Office for the first time for fiscal years beginning after 31 December 2015, using the designated official data format (XLM format). In its annex, the BMF circular now specifies the information to be provided in the reports.

**Tax Regulation and Administrative Orders: New Investment Tax Law as of 1 January 2018**

The beginning of January 2018 saw the entry into force of the German Investment Tax Reform Act dated 19 July 2016 (Federal Law Gazette BGBl. I 2016, 1730) and amended by the Act to Counter Tax Avoidance dated 23 June 2017 (Federal Law Gazette – BGBl. I 2017, 1682 – *Investmentsteuergesetz* 2018 – InvStG 2018).

The new term "investment fund" basically ties in with the regulatory term "investment estates" (section 1 (2), sentence 1 of InvStG 2018), but now also includes so-called single-investor funds. Partnerships, comparable foreign legal forms (with the exception of UCITS within the meaning of section 1 (2) of the German Capital Investment Code – *Kapitalanlagegesetzbuch*) and pension funds within the meaning of section 53 of InvStG 2018 are exempted from the scope of the new act, however.

In contrast to the previous legal situation under the old, 2014 version of the act, InvStG 2018 only differentiates between investment funds (chapter 2 of InvStG 2018) and special investment funds (chapter 3 of InvStG 2018).

Chapter 2 funds are subject to an opaque taxation regime. Income will be taxed at fund level first before being taxed at investor level as investment income within the meaning of section 16 of InvStG 2018. At investor level, the investment income (i.e. distributions, capital gains from the disposal of fund units and the so-called advance lump sum amount) will be subject to taxation under section 16 (1) of InvStG 2018. There is a partial exemption regime, under which investment income is partially tax-exempt if the chapter 2 fund qualifies as a stock, mixed or real estate fund. Otherwise, the investment income is subject to 25% withholding tax (plus solidarity surcharge).

By definition and unlike chapter 2 funds, chapter 3 funds have to meet the requirements of the trade tax exemption pursuant to section 15 (2) and (3) of InvStG 2018 (section 26, first half-sentence of InvStG 2018). The trade tax exemption generally requires that a fund's purpose be limited to the investment and administration of its resources for the collective account of the unit or shareholders and that the fund does not actively and commercially manage its assets to any significant extent (section 15 (2) of InvStG 2018). These requirements are considered fulfilled if the income from active commercial activity does not exceed 5% of the total income of a business year (section 15 (3) of InvStG 2018). Furthermore, taxation at fund level can be avoided altogether, for example by exercising the so-called transparency option for German source participation income and other German source income subject to withholding tax with the result that, for tax purposes, the investors will be considered creditors of the respective income (section 30 (1), section 31 (1), sentence 1 of InvStG 2018). At investor level, investors are subject to taxation of their special investment income (i.e. distributions, deemed distributed income and capital gains from special investment income).

Transitional provisions: units held in investment funds, corporation-like investment companies (section 19 of InvStG 2018) and any other entities falling within the scope of InvStG 2018 for the first time are deemed to have been disposed of by 31 December 2017 and acquired on 1 January 2018. The capital gains will be determined on the basis of the previous legal situation and will be taxed at the applicable tax rate when the units are actually sold (section 56 (2), sentence 1, and (3), sentence 1 of InvStG 2018). The InvStG 2018 was partially revised before coming into force in the context of the Act to Counter Tax Avoidance. The major changes were to the provisions regarding real estate transparency with respect to multilevel fund structures pursuant to section 33 of InvStG 2018 and the transitional provisions pursuant to section 56 (7) to (9) of InvStG 2018.

Administrative orders: several Ministry of Finance draft circulars

Several BMF draft circulars have been published with respect to the new investment tax legislation. The core element is the so-called Investment Tax Decree (*Anwendungsfragen zum Investmentsteuergesetz*). The most recent, second draft was issued on 11 August 2017. The final Investment Tax Decree is scheduled for publication in summer 2018. The draft decree concerns, in particular, the scope of application of InvStG 2018, the taxation of chapter 2 funds and their investors, and the transitional provisions.

**Administrative Orders: Cum/Cum Transactions**

A new provision in section 36a of the German Income Tax Act (*Einkommenssteuergesetz* – EStG) is intended to prevent so-called cum/cum transactions as of 1 January 2016.

The Ministry of Finance deals with the tax treatment in two circulars:

- circular dated 3 April 2017 (Federal Tax Gazette – BStBl. I 2017, 726),
- circular dated 17 July 2017 (Federal Tax Gazette – BStBl. I 2017, 986.

The circular dated 3 April 2017 addresses the requirements of the new provision of section 36 and comments on questions of interpretation. Among other things, it goes into the new tax credit requirements, especially with respect to the calculation of the minimum holding period of 45 days as set forth in section 36a (2) of the Income Tax Act and with respect to the minimum risk of a change in value to be borne by the taxpayer pursuant to section 36a (3) of the act. In addition, the circular explains the legal consequences of a failure to meet the extended tax credit requirements and the application of the provision with respect to partnerships, for example, or fiscal unities for income tax purposes.

The circular dated 17 July 2017 sets out general principles for the tax treatment of cum/cum transactions; these are especially important for periods prior to the applicability of section 36a of the Income Tax Act. The tax authorities consider a cum/cum transaction to be a transaction in shares under which the contractual agreement is concluded "cum dividend entitlement" and the legal ownership of the shares is subsequently also acquired "cum dividend entitlement". In this context, delivery "cum dividend entitlement" means that the legal ownership of the shares will be made available to the acquirer prior to, or at the latest on, the dividend record date. The BMF considers a cum/cum scheme to be any cum/cum transaction under which non-resident taxpayers, in particular, avoid a definitive withholding tax burden on dividend distributions by transferring their domestic shares to a domestic person entitled to deduct withholding tax (e.g. a domestic bank) prior to the dividend record date on the understanding that these shares will then be transferred back to them after the distribution of the dividend. In the opinion of the BMF, it is always necessary to assess whether a cum/cum scheme constitutes abusive tax structuring within the meaning of section 42 (2) of the German Tax Code.

The circular dated 17 July 2017 also lists examples of certain facts and circumstances, especially relating to securities loans if the term of the loan is less than 45 days and the lender is a non-resident taxpayer.

If the requirements of section 42 of the German Tax Code are met, a so-called tax-induced percentage (usually three fifths of the withholding tax = 15%) will not be credited to the resident taxpayer and will be deducted upon determination of the income. Withholding tax either not deducted or refunded after withholding has to be paid separately for the tax-induced amount.

The circular dated 17 July 2017 generally has to be applied to all pending cases, while for cum/cum-schemes with shares with a dividend record date before1 March 2016, a correction of the withholding tax credit will additionally require that the non-resident taxpayer is not resident in the EU/EEA, but in a third country.

**Administrative Order: Cum/Cum Treaty Shopping**

Parallel to section 36a of the German Income Tax Act, legislation against so-called cum/cum treaty shopping was implemented in section 50j of the act and took effect on 1 January 2017. This provision targets practices in which the recipient of a dividend derived from Germany uses an artificial arrangement to pay a lower withholding tax rate under a double taxation treaty.

On 13 October 2017, the German Ministry of Finance published a circular commenting on the application of section 50j. In June 2017, the Federal Central Tax Office published explanatory notes on the rejection of relief from withholding tax in certain circumstances and on special obligations to disclose capital income which is taxed at a lower rate than 15% (http://www.bzst.de).

**Administrative Order: Limited Tax Liability and Cross-border Licensing of Software and Databases**

On 27 October 2017, the German Ministry of Finance published a circular commenting on the limited tax liability and the obligation to deduct withholding tax at source with respect to the cross-border licensing of software and databases (Federal Tax Gazette, BStBl. I 2017, 1448). The circular lays down the administrative principles pursuant to which the licensing of software and databases by foreign-based providers to domestic customers is subject to a limited tax liability and, possibly, deduction of withholding tax at source. The circular is to be applied to all open cases. The main points are:

- <u>Software:</u>
- If there is no connecting factor for limited tax liability on the basis of a domestic permanent establishment of the foreign company/provider or a permanent representative appointed in Germany, income from the licensing of rights is generated only if the user is granted comprehensive rights to use the software for commercial exploitation. This particularly refers to the right to reproduce, the right to modify, the right to distribute or the right to display. The tax evaluation is independent of whether the licensed software is provided on data media or via the internet. The requirements for a comprehensive right of use for commercial exploitation are normally not met in cases of contractually agreed licensing transactions if the consent of the copyright holder to the specific use is not required under copyright law.
- Such income is not deemed generated where the licensing of the functionality of the software is the key subject matter of the agreement. This is the case where solely the intended use of a piece of software is the subject matter of the agreement. It is of no importance whether so-called “standard software” or “customized software” is concerned. The intended use includes, in particular, the installation of the software, the download of the software into the main memory, the application of the software, and any necessary adaption or reproduction provided that there is no link to any commercial exploitation. Where the provider agrees to provide maintenance, support or updates of the software besides the licensing of the software for intended use, the remuneration for such additional services is also not subject to limited taxation.

- The remuneration for transactions involving the cross-border licensing of rights of use, entitling to the onward licensing of the software within a corporate group also does not constitute income on the part of the foreign-based provider if the right of use is limited to the onward licensing of the software for the intended use within the corporate group. This applies regardless of whether the corporate group covers the full costs or whether compensation exceeding the costs incurred is paid.
- Limited tax liability is deemed applicable only if the licensed rights are exploited in any domestic PE or other facility. "Exploitation" means targeted commercial activities aimed at deriving financial benefits from the licensed rights (commercial exploitation). This is not the case if only the results of the functional application of a software program are commercially used (e.g. use of sheets created by means of presentation software in the context of an event that is subject to a fee).
- Databases:
- A limited tax liability only arises if the domestic user has been granted comprehensive rights of use for commercial exploitation. This applies to the database as a whole as well as to individual content, e.g. transactions where the user is granted the right to publicly display a qualitatively or quantitatively substantial part of the database, the right to grant sublicenses to third parties (outside the company/group), the right to publish copyright protected analyses.
- However, the mere use of findings gained from the database content within the scope of entrepreneurial activity does not constitute a licensing transaction. Income from licensing of rights is not to be assumed to the extent that the domestic user is merely granted those rights required for accessing and conventionally using the elements of the database (access, read and print functions).

## HONG KONG

### Banking Industry Overview

The Hong Kong banking sector remains safe and sound. Locally incorporated authorized institutions (AIs) continued to be well capitalised. The consolidated total capital ratio of locally incorporated AIs edged down to 19.1% at the end of 2017 from 19.2% at the end of 2016, while the Tier 1 capital ratio rose slightly to 16.6% from 16.4% during the same period. The average Liquidity Coverage Ratio of category 1 institutions was 155.1% in the fourth quarter of 2017, well above the statutory minimum requirement of 80% applicable in 2017. The average Liquidity Maintenance Ratio of category 2 institutions was 49.4% in the last quarter of 2017, also well above the statutory minimum requirement of 25%. Meanwhile, the classified loan ratio of the banking sector stayed at a healthy level of 0.67% at the end of December 2017.

### Belt and Road Initiative

The Infrastructure Financing Facilitation Office (IFFO) of the Hong Kong Monetary Authority (HKMA) continues its work to facilitate infrastructure investments and financing. The number of IFFO partners has grown from 41 at inception in 2016 to 90 as of July 2018. Once

again, on 15 May 2018, IFFO co-hosted with the Hong Kong Association of Banks (HKAB) a seminar which was attended by over 150 bankers, project finance experts, risk officers and professionals and aimed to explore sustainable infrastructure financing opportunities under the Belt and Road Initiative.

The IFFO's work to-date contributed to a number of successful outcomes. This includes the HKMA's agreement with the International Finance Corporation (IFC) in September 2017 whereby the HKMA committed United States Dollar (USD) 1 billion to support the IFC's financing projects across more than 100 countries through the innovative Managed Co-Lending Portfolio Program debt mobilisation platform for emerging markets.

**Green Finance**

To encourage more investors and issuers from countries along the Belt and Road to use the Hong Kong capital markets in financing green projects, the Financial Secretary of Hong Kong announced on 28 February 2018 in the Budget for 2018-2019 that the Hong Kong Government will launch a green bond issuance programme with a borrowing ceiling of Hong Kong Dollar (HKD)100 billion to support green public works projects of the government. Further, the Hong Kong Quality Assurance Agency launched its Green Finance Certification Scheme (Scheme) in January 2018, which provides third-party certification services for potential green bond issuers. As at the end of March 2018, the Scheme successfully completed three certifications. The government also announced that it will introduce a Green Bond Grant Scheme to subsidise qualified green bond issuers in using the Scheme, a Pilot Bond Grant Scheme to subsidise bond issuance in Hong Kong and Enhancement of the Qualifying Debt Instrument scheme to provide tax concession for bond investment in Hong Kong.

Furthermore, the HKMA has successfully bid to co-host its first International Capital Markets Association Green and Social Bond Principles Annual General Meeting and Conference on 14 June 2018 in Hong Kong to promote green finance in the region. On the following morning, the HKMA and the People's Bank of China (PBOC) organised a joint seminar on Mainland-Hong Kong green finance opportunities.

**Renminbi (RMB) Banking Business**

The development of offshore RMB business in 2017 is highlighted below:

| **Offshore RMB banking statistics** | **As of end 2017 (RMB billion)** | **Growth against (end-2016)** |
|---|---|---|
| RMB deposits and certificates of deposit | 618.4 | -1.06% |
| RMB trade settlement transactions | 3913.9 | -13.70% |
| Outstanding RMB loans | 144.5 | -51.00% |

Following a slight decline in the first half of 2017, Hong Kong's offshore RMB liquidity regained strength in the second half of the year on the back of improved market sentiment towards the RMB exchange rate movement. Hong Kong's RMB financing activities stayed weak with RMB loans declining by 50% over the year. This was partly attributable to the higher RMB funding cost relative to those in the USD and the HKD. Despite this, Hong Kong remained the

global hub for offshore RMB business, processing about 70% of RMB payment activities worldwide according to SWIFT statistics.

The HKMA and the PBOC jointly launched Bond Connect in July 2017. Northbound trading came into operation in the first phase, enabling overseas institutional investors to invest in the interbank bond market in Mainland China through cross-border financial infrastructure linkages between the Central Moneymarkets Unit of the HKMA and other institutions of Mainland China and Hong Kong.

The PBOC announced on 4 July 2017 the increase of Hong Kong's Renminbi Qualified Foreign Institutional Investor (RQFII) quota to RMB 500 billion (from RMB 270 billion). The daily quota under the Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect had also been expanded four times from 1 May 2018.

The PBOC also announced on 18 May 2018 certain measures to further enhance cross-border fund flow management. These include adjusting the required reserve ratio of RMB deposits placed by Hong Kong's RMB business clearing bank in the settlement account in PBOC's Shenzhen sub-branch to zero percent, and further enhancing the currency conversion mechanism for the Stock Connect Schemes.

The establishment and extension of the various mutual market access schemes illustrated Hong Kong's position as an international financial centre and are significant steps for the further internationalisation of the RMB. Hong Kong's offshore RMB business is expected to benefit from the progress in Mainland China's capital account liberalisation and enhanced regional economic co-operation under the Belt and Road Initiative.

**Financial Technologies (Fintech)**

The HKMA announced on 29 September 2017 the launch of seven new initiatives with a view to preparing Hong Kong to move into a new era of smart banking. The seven initiatives include:

- Faster Payment System (FPS): The FPS, which is scheduled for launch in September 2018, will enable real-time round-the-clock funds transfers and payment services in HKD and RMB with ease, through using mobile phone numbers or email addresses, among users of banks and stored value facilities.
- Fintech Supervisory Sandbox (FSS) 2.0: the HKMA upgraded the FSS to version 2.0 in September 2017 to introduce three new features: a Fintech Supervisory Chatroom (Chatroom) to provide regulatory feedback at the early stage of fintech projects, direct access by technology firms to the Chatroom, and a single point of entry for cross-sector fintech products by linking up the sandboxes of the HKMA, the Securities and Futures Commission (SFC) and the Insurance Authority.
- Promotion of virtual banking: The HKMA commenced a public consultation on the revised Guideline on Authorization of Virtual Banks (Guideline) in February 2018 and the consultation ended in mid-March 2018. After analysing the comments received, the HKMA issued the final Guideline in late May 2018. The HKMA has received a significant number of enquiries and indications of interest to operate a virtual bank. Accordingly, it has set up a dedicated team to answer enquiries of virtual bank applicants and provide assistance to them during the application process.
- Banking Made Easy initiative: The HKMA set up a new task force in October 2017 to work with

the banking industry and Tech sector to minimise regulatory frictions in customers' digital experience, focusing on areas relating to remote onboarding, online finance and online wealth management. Specific progress made include: (i) amendment of the anti-money laundering laws and regulatory guideline so as to allow a more flexible approach, including the use of technology, when obtaining and verifying customers' information; (ii) issuance of a circular allowing the industry to adopt innovative technology to manage credit risks related to personal lending business; (iii) issuance of guidelines by the SFC on online distribution and advisory platforms as well as robo-advisory investment services for SFC-regulated products, and consulting the industry on a risk-based approach to non-SFO-regulated structured investment products.

- Open Application Programming Interfaces (Open API): The HKMA published a consultation paper in January 2018 to propose an Open API framework comprising a selection of Open API functions and deployment timeframes, technical standards, third-party service provider governance, facilitation measures and maintenance models. The finalized framework was published on 18 July 2018, which aims to facilitate the development and wider adoption of API by the banking sector in Hong Kong.
- Closer cross-border collaboration: The HKMA collaborated with the Monetary Authority of Singapore to jointly develop the Global Trade Connectivity Network, a Distributed Ledger Technology (DLT) based cross-border infrastructure connecting the trade platforms between Hong Kong and Singapore to digitalise banks' trade finance processes, and signed co-operation agreements with relevant authorities of Singapore, Dubai IFC, Switzerland and Poland to foster fintech collaboration.
- Enhanced research and talent development: The HKMA published the second whitepaper on DLT in October 2017 to deliver findings from Proof-of-Concept (PoC) trials in applying DLT in trade finance, digital ID management and mortgage loan applications and provide advice from experts on implementation. Riding on the success in the trade finance PoC work, banks have decided to commercialise the prototype into Hong Kong Trade Finance Platform, which digitalises and shares trade documents, automates processes and reduces errors and risks of fraud. For fintech talent development, the HKMA launched the upgraded Fintech Career Accelerator Scheme to offer an entrepreneurship summer boot camp, a Shenzhen summer internship programme, a gap year full-time placement programme and a full-time graduate programme to target young fintech talents of various stages of career development.

**Implementation of Basel III in Hong Kong**

The HKMA continues to implement the Basel III reform package in Hong Kong in accordance with the timetable set by the Basel Committee on Banking Supervision (BCBS):

- On 10 January 2018, the HKMA increased the Countercyclical Capital buffer rate for Hong Kong to 2.5% with effect from 1 January 2019.

- The Banking (Capital) (Amendment) Rules 2017 and Banking (Liquidity) (Amendment) Rules 2017 took effect from 1 January 2018. These rules implement the Basel III Leverage Ratio and Net Stable Funding Ratio requirements, the Basel revised securitisation framework and an interim capital treatment of expected loss provisioning under Hong Kong Financial Reporting Standard 9.

- The Banking (Amendment) Ordinance 2018 was gazetted on 2 February 2018 to amend the Banking Ordinance (BO). The amendments provide rule-making power to the HKMA to

implement the new framework on large exposures by BCBS and to fully align the recovery planning requirements with standards set by the Financial Stability Board (FSB).

- On 2 May 2018, the HKMA issued a circular informing all AIs that the timeline for local implementation on Interest Rate Risk in the Banking Book will be further revised by an additional six months (i.e., AIs to report the end-June 2019 positions based on the new framework starting1 July 2019) in order to provide sufficient time for the required updates to their risk management and information technology systems.

- The Banking (Disclosure) (Amendment) Rules 2018 (Rules) took effect on 30 June 2018 to ensure that the disclosure framework for AIs is brought up to date with the latest international regulatory standards. The Rules incorporated into local legislation BCBS' second phase of the revised disclosure requirements, enhancing the requirements in terms of transparency, comparability and user-relevance of bank disclosures.

**Over-the counter (OTC) Derivatives Market Regulation**

On 27 June 2017, the HKMA and the SFC published conclusions on a joint consultation paper which proposed to: (i) exclude products traded on additional stock markets and futures markets or cleared through additional clearing houses from the scope of the OTC derivative products regulated under the SFO; and (ii) exclude Delta One Warrants from the definition of "OTC derivative product" under the SFO. The consequential legislative amendments were gazetted in February 2018 and came into operation as of 27 April 2018.

On 1 July 2017, the Phase 2 mandatory reporting requirements under the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) (Amendment) Rules 2016 came into force, expanding the reporting scope to cover OTC derivative transactions in product types under five asset classes, namely interest rate, foreign exchange, equities, credit and commodities; as well as post-trade events and daily valuations of all reported transactions.

On 20 December 2017, the SFC issued a consultation paper which covered (i) refinements to the scope of the regulated activities, requirements in relation to OTC derivative risk mitigation, client clearing, record-keeping and licensing matters; and (ii) proposed conduct requirements to address risks posed by group affiliates.

On 27 June 2018, the HKMA and the SFC issued conclusions to a joint consultation paper on enhancements to the OTC derivatives regime for Hong Kong to: (i) mandate the use of Legal Entity Identifier in trade reporting applicable to the identification of entities that are on a reporting entity's side of a transaction; (ii) expand the clearing obligation to include certain standardised Australian Dollar interest rate swaps; and (iii) adopt a trading determination process for identifying which products are appropriate to be subject to a platform trading obligation in Hong Kong.

The FSB released its peer review of Hong Kong on 28 February 2018. The review found good progress being made in recent years to reform the OTC derivatives market as regulators put in

place a well-defined legal and regulatory framework in terms of scope, assignment of responsibilities and enforcement to implement the G20 commitments.

**Resolution – FSB Key Attributes Implementation**

The Financial Institutions (Resolution) Ordinance (FIRO) came into operation on 7 July 2017. It is designed to meet international standards set by the FSB in its "Key Attributes of Effective Resolution Regimes for Financial Institutions" (Key Attributes). The FIRO confers statutory powers and responsibilities on the Monetary Authority (MA) to manage the failure of a bank in an orderly manner, establishing a new line of defence for financial stability in Hong Kong. This progress has been recognised by the FSB in its peer review report of Hong Kong released on 28 February 2018, which found that Hong Kong has legal powers and safeguards for resolution of financial institutions consistent with the requirements of the Key Attributes, and noted that Hong Kong is "one of the few FSB jurisdictions with a fully cross-sectoral resolution regime". This reflects Hong Kong's strong commitment to implementing international standards, necessitated by its status as a well-established international financial centre.

As a resolution authority, the MA may publish guidance relating to the functions given to it by the FIRO, including the communication of resolution standards which AIs are expected to meet in order to for resolution to be both feasible and credible. To date three code of practice chapters have been issued by the MA to: (i) clarify the operational independence of the HKMA as a resolution authority; (ii) set out the HKMA's approach to the resolution planning for AIs; and (iii) provide guidance on the information requirements that an AI is expected to provide to the HKMA for it to determine the preferred resolution strategy for that AI.

One of the key resolution tools under the FIRO is the ability for the MA as resolution authority to 'bail-in' certain liabilities of a failing AI. This will allow for the institution to be restored to viability by imposing losses on shareholders and certain creditors, avoiding the need for any injection of public funds. However, in order to ensure that the bail-in power can be used effectively to support orderly resolution, AIs need to have sufficient loss-absorbing capacity (LAC), i.e. liabilities that can be readily bailed in. To this end, the HKMA launched a public consultation on 17 January 2018 on a set of rules setting out detailed proposals on LAC requirements for AIs to ensure effectiveness of the resolution authority's bail-in power provided under FIRO to restore a failing AI to viability.

More broadly, the HKMA continues to advance its structured bilateral resolution planning programmes, prioritising those AIs that could pose the greatest systemic risk in Hong Kong should they fail. It has been reported in the HKMA's 2017 Annual Report that considerable progress was made by these AIs to implement structural changes to their legal, financial and operational arrangements in order to enhance the feasibility and credibility of the authorities' preferred resolution strategies. The HKMA's 2017 Annual Report also notes examples of these changes including establishment of new legal holding structures, issuing loss-absorbing debt instruments, setting up dedicated service companies and incorporating resolution-proof clauses into internal and external service agreements. To enhance close co-ordination with foreign authorities, the HKMA also reported it led regional resolution planning for a global systemically important bank (G-SIB) which has its Asia Pacific headquarters in Hong Kong and continued to participate in

cross-border resolution planning of 12 G-SIBs through its membership of Crisis Management Groups.

**Recovery Planning**

The Banking (Amendment) Ordinance 2018 was made effective on 2 February 2018 to amend the BO to provide for recovery planning by AIs and to provide explicit powers to the HKMA to require AIs to maintain recovery plans and make changes in those recovery plans to address deficiencies to their implementation.

The HKMA also published in July 2017 further guidance on the application of the HKMA's recovery planning requirements as set out in the SPM module, RE-1 "Recovery Planning", in respect of overseas incorporated AIs with branch operations in Hong Kong and smaller locally incorporated AIs.

**Prevention of Money Laundering and Terrorist Financing**

Enhancing the effectiveness of anti-money laundering and counter-terrorist financing (AML/CFT) controls of AIs remained a key focus for the HKMA.

The Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Ordinance 2018 (the Amendment Ordinance) came into operation on 1 March 2018. It serves to align Hong Kong's AML/CFT regime with international standards by: (i) extending the statutory customer due diligence and record-keeping requirements to some non-financial sectors (including solicitors, accountants, real estate agents, and trust or company service providers); and (ii) introducing a licensing regime operated by the Companies Registry for trust or company service providers. Moreover, certain changes are made to align the legislative requirements with the latest international requirements and to facilitate financial institutions in implementing the risk-based approach. The HKMA issued two sets of revised guidelines on AML/CFT (for AIs and for Stored Value Facility Licensees respectively) also effective as of 1 March 2018, taking into account enhancements provided under the Amendment Ordinance.

The Companies (Amendment) Ordinance 2018 commenced on 1 March 2018 to impose requirements on certain Hong Kong incorporated companies to keep registers of persons who have significant control over the companies. The enactment helps to enhance transparency of legal persons in Hong Kong.

The United Nations (Anti-Terrorism Measures) (Amendment) Ordinance 2018 was gazetted on 29 March 2018 to combat the threats posed by foreign terrorist fighters and enhance the freezing mechanism on terrorist property.

The Government on 30 April 2018 published the Hong Kong Money Laundering and Terrorist Financing Risk Assessment Report (the Report), which concluded that the banking sector in Hong Kong faces high money laundering and/or terrorist financing (ML/TF) risks, which is consistent with the situation in other major financial centres. The vulnerabilities exist across various segments and banking products/ services including private banking, trade finance, international funds transfer and retail and corporate banking. The HKMA issued a circular on 2

May 2018 reiterating its continual efforts to work closely with other authorities and AIs to address these risks in the banking sector, including strengthening the understanding of ML/TF threats; providing stronger encouragement for AIs to adopt a risk-based approach; strengthening public-private partnership, particularly for intelligence sharing; strengthening cooperation with regulatory authorities in other jurisdictions; and supporting innovation by AIs and exploring the greater use of technology in supervisory work. Moreover, the HKMA also organized an industry seminar to strengthen the understanding of the ML/TF risks to banks in June 2018.

In light of geopolitical developments, sanctions compliance of AIs remains a supervisory priority for the HKMA. Various measures include (i) industry seminar in July 2017 and circulation of guidance to raise awareness of proliferation financing (PF) and the importance of developing a greater understanding of the specific types of PF activities; (ii) industry seminar in April 2018 and circulation of key observations and good practices that have been identified in the thematic review of the financial sanctions screening systems of AIs; and (iii) the first in a series of roundtable meetings held in March 2018 for industry representatives, the HKMA and other stakeholders to discuss the types of customers and transactions more vulnerable to being involved in PF activities, and to share cases and typologies.

The HKMA has been working together with the Joint Financial Intelligence Unit (JFIU), the Hong Kong Police Force and the banking sector in two work streams, among others, to strengthen public-private information and intelligence sharing on serious financial crimes and ML/TF activities. In May 2018, the HKMA issued a revised Annex "Quality and Consistency in Suspicious Transaction Reports" which is included in a new release of the "Guidance Paper on Transaction Screening, Transaction Monitoring and Suspicious Transaction Reporting", having taken into account recent experience and, in particular, analysis and comments from the JFIU. The HKMA has also been actively supporting the Fraud and Money Laundering Intelligence Taskforce which is a public-private partnership for sharing information on cases and typologies which will assist law enforcement agencies, the HKMA and AIs in the detection, prevention and disruption of crime in a more targeted way, thereby enhancing the integrity of the financial system by developing a greater collective understanding of risks.

To meet the needs of a continuously changing AML/CFT landscape, the HKMA launched a new Professional Level of the Enhanced Competency Framework on AML/CFT in April 2018 for more experienced banking practitioners.

**Retail Payment Industry**

The HKMA continued to promote the safety and efficiency of the retail payment industry through the implementation of the regulatory regime for stored value facilities (SVFs) and retail payment systems (RPSs) in accordance with the Payment Systems and Stored Value Facilities Ordinance (PSSVFO). The SVF industry saw significant growth in the past year. As at the end of Q4/2017, the SVF accounts in use was 46.73 million, representing a 15.4% increase year-on-year. During the quarter, the total transaction volume was 1.5 billion and the total transaction value was HKD38.7 billion, up 6% and 27.7% year-on-year respectively. On RPSs, the HKMA on 4 August 2017 designated four RPSs operated by Visa, Mastercard, UnionPay International and American Express for the processing of payment transactions involving participants in Hong Kong under the PSSVFO.

### Guideline on Barrier-free Banking Services

To provide barrier-free banking services to customers with physical disabilities, visual impairment and hearing impairment, HKAB released a new guideline in March 2018 with recommended good banking practices. The principles are applicable across all banking delivery channels and are supported by the HKMA.

## INDIA

### KEY DEVELOPMENTS IN BANKING INDUSTRY

### Government and RBI Initiatives

As per the Reserve Bank of India (RBI), India's banking sector is sufficiently capitalised and well-regulated. Credit, market and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well. The government and the regulator have undertaken several measures to strengthen the Indian banking sector which is reeling around the stressed asset problems during the FY 2017-18. Indian banking industry has recently witnessed the roll-out of innovative banking models like payments and small finance banks. The unorganised retail sector in India has huge untapped potential for adopting digital mode of payments, as 63 per cent of the retailers are interested in using digital payments like mobile and card payments, as per a report by Centre for Digital Financial Inclusion (CDFI). RBI's new measures may go a long way in helping the restructuring of the domestic banking industry.

### Initiatives of Government of India and RBI

- A two-year plan to strengthen the public sector banks through reforms and capital infusion of Rs 2.11 lakh crore (US$ 32.5 billion), has been unveiled by the Government of India that will enable these banks to play a much larger role in the financial system and give a boost to the MSME sector. In this regard, the Lok Sabha has approved recapitalisation bonds worth Rs 80,000 crore (US$ 12.62 billion) for public sector banks, which will be accompanied by a series of reforms, according to Mr Arun Jaitley, Minister of Finance, Government of India.
- A new portal named 'Udyami Mitra' has been launched by the Small Industries Development Bank of India (SIDBI) with the aim of improving credit availability to Micro, Small and Medium Enterprises' (MSMEs) in the country.
- Mr Arun Jaitley, Minister of Finance, Government of India, introduced 'The Banking Regulation (Amendment) Bill, 2017, which will replace the Banking Regulation (Amendment) Ordinance, 2017, to allow the Reserve Bank of India (RBI) to guide banks for resolving the problems of stressed assets.
- RBI has made its Prompt Corrective Action (PCA) measures more stringent for banks in stress. These measures include sacking of management and superseding the Board of Directors if the Tier 1 capital falls below 3.625%, against the stipulated minimum of 6.75%. Infusion of capital has been made compulsory for promoters and parent companies of foreign banks when banks face negative ROA (Return on Assets) for two consecutive years. The PCA framework will apply to all banks operating in India, including small finance banks and foreign banks operating through

branches or subsidiaries. A bank will be placed under the PCA framework based on the audited annual financial results and the supervisory assessment made by RBI. The provisions of the revised framework are effective from April 1, 2017 based on the financials of the banks for the year ended March 31, 2017. The framework would be reviewed after three years.

- In order to help banks deal better with potential stressed assets, RBI has asked them to install board approved policies to provide for standard assets at rates higher than the regulatory minimum, based on evaluation of risk and stress in various sectors. With the telecom sector reporting stressed financial conditions, with interest coverage ratio less than one, RBI has advised bank-boards to review the telecom sector latest by June 30, 2017, and consider making provisions for standard assets in it, at higher rates. The review may include quantitative and qualitative aspects such as debt-equity ratio, interest-coverage ratio, profit margins, ratings upgrade to downgrade ratio, sectorial nonperforming assets/stressed assets, industry performance and outlook, and legal/regulatory issues faced by the sector. The reviews may also include sector-specific parameters.
- The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017 Bill has been passed by Rajya Sabha and is expected to strengthen the banking sector. The bill has diluted some of stringent provisions of ordinance. It seeks to strike balance in trade-off between punishing wilful defaulters and ensuring a more effective insolvency process. It also allows asset reconstruction companies (ARCs), alternative investment funds (AIFs) such as private equity funds and banks to participate in bidding process.
- In February 2017, RBI withdrew debt restructuring schemes like SDR, S4A, and sets banks 180-day timeline for bad loan resolution. With the tightened norms for bad loan resolution by setting timelines for resolving large NPAs, failing which banks will have to mandatory refer them for insolvency proceedings. It also withdrew existing debt restructuring schemes such as SDR and S4A. According to the new rules, for such accounts, where the banking sector’s aggregate exposure is Rs2,000 crore above, lenders must implement a resolution plan within 180 days, starting 1 March 2018.
- In order to improve India's credit culture, Dr. Viral Acharya, Deputy Governor, RBI has suggested that the apex bank should set up a Public Credit Registry (PCR), an extensive database of credit information for India that is accessible to all stakeholders. The registry can be managed by a public authority such as RBI or the banking supervisor, and reporting of loan details to the PCR by lenders and/or borrowers are mandated by law. This initiative is also intended to help improve ease of doing business and control delinquencies.
- In order to boost foreign investments further, RBI has raised the cap on aggregate FPI investments in any gilt from 20% to 30%. There would be no auction for FPI limits, but utilization limits shall be monitored online after June 1.
- RBI has directed all regulated entities, including banks, not to provide any services to businesses dealing in virtual currencies like bitcoins. Entities already providing such services have been given three months to stop their activities. This move is to protect consumer interest and check money laundering.

Favourable demographics and rising income levels, strong GDP growth, enhanced spending on infrastructure, speedy implementation of projects and continuation of reforms are expected to provide further momentum to growth. All these factors suggest that India’s banking sector is also poised for robust growth as the rapidly growing business would turn to banks for their credit needs.

## KEY DEVELOPMENTS IN INSURANCE INDUSTRY

The insurance industry of India consists of 57 insurance companies of which 24 are in life insurance business and 33 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are six public sector insurers.

Government's policy of insuring the uninsured has gradually pushed insurance penetration in the country and proliferation of insurance schemes are expected to catapult this key ratio beyond 4 per cent mark by the end of 2017-18.

### Budget provisions

The Union Budget of 2017-18 has made the following provisions for the Insurance Sector:

- Pradhan Mantri Fasal Bima Yojana (PMFBY), A Govt. sponsored crop insurance program, covered 50.9 million farmers in India in 2016-17. The Budget has made provisions for paying huge subsidies in the premiums of PMFBY and the number of beneficiaries will increase to 50 per cent in the next two years from the present level of 20 per cent. As part of PMFBY, Rs 9,000 crore (US$ 1.35 billion) has been allocated for crop insurance in 2017-18.
- By providing tax relief to citizens earning up to Rs 5 lakh (US$7500), the government will be able to increase the number of taxpayers. Life insurers will be able to sell them insurance products, to further reduce their tax burden in future.
- Demand for insurance products may rise as people's preference shifts to formal investment products post demonetisation.
- The Budget has attempted to hasten the implementation of the Digital India initiative. As people in rural areas become more tech savvy, they will use digital channels of insurers to buy policies.

**The Government / IRDA (Insurance Regulatory Development Authority of India) has taken a number of initiatives to boost the insurance industry. Some of them are as follows**:

- India's leading bourse Bombay Stock Exchange (BSE) will set up a joint venture with Ebix Inc. to build a robust insurance distribution network in the country through a new distribution exchange platform.
- The Union Cabinet has approved the public listing of five Government-owned general insurance companies and reducing the Government's stake to 75 per cent from 100 per cent, which is expected to bring higher levels of transparency and accountability, and enable the companies to raise resources from the capital market to meet their fund requirements.
- In June 2017, IRDA deferred the effective date for implementation of Ind-AS accounting model in the insurance sector to April 2020 from April 2018. The IRDA has, with the deferment of Ind AS road map, paid heed to the requests of a number of insurance companies and tried to avoid two major changes in accounting framework for the insurance sector.
- IRDA has formed a 10-member steering committee to help implement the new risk-based capital (RBC) regime that will also enhance protection to policy-holders by March 2021. A shift in regime is felt because the current solvency based rules do not help in assessing whether the capital held is adequate enough for the risks inherent in the insurance business.
- IRDA has cleared the way for setting up of IFSC (International Financial Services Centre) Insurance Offices (IIOs). With this, it has put in place the process of registration and operation of

insurers and re-insurers in IFSC Special Economic Zones, in alignment with the objectives of IFSC-SEZ.

- Government of India launches Pradhan Mantri Vaya Vandana Yojana; a pension scheme which will provide guaranteed 8 per cent annual return to all the senior citizen above 60 years of age for a policy tenure of 10 years.
- IRDA plans to issue redesigned initial public offering (IPO) guidelines for insurance companies in India, which are to looking to divest equity through the IPO route.
- IRDA has allowed insurers to invest up to 10 per cent in additional tier 1 (AT1) bonds that are issued by banks to augment their tier 1 capital, in order to expand the pool of eligible investors for the banks.

The future looks promising for the life insurance industry with several changes in regulatory framework which will lead to further change in the way the industry conducts its business and engages with its customers. India with 3.42 per cent penetration rate in the insurance sector offers greater penetration potential when compared to global average of 6.2 per cent. Demographic factors such as growing middle class, young insurable population and growing awareness of the need for protection and retirement planning will support the growth of Indian life insurance.

## KEY DEVELOPMENTS IN CAPITAL MARKET

The Capital market in India has major players comprised of commercial banks, insurance companies, non-banking financial companies, co-operatives, pension funds, mutual funds and other smaller financial entities. India has a diversified financial sector undergoing rapid expansion, both in terms of strong growth of existing financial services firms and new entities entering the market.

The Mutual Fund (MF) industry in India has seen rapid growth in Assets under Management (AUM). Total AUM of the industry increased 25.79 per cent year-on-year to hit a record Rs 22 lakh crore (US$ 342.91 billion) at the end of February 2018. At the same time the number of Mutual fund (MF) equity portfolios reached a record high of 2.27 billion in February 2018.

Along with the secondary market, the market for Initial Public Offers (IPOs) has also witnessed rapid expansion. A total of 153 initial public offers (IPOs) were issued in the Indian stock markets in 2017, which raised a total of US$ 11.6 billion. Over the past few years India has witnessed a huge increase in Mergers and Acquisition (M&A) activity.

### Government/SEBI (Securities Exchange Board of India) Initiatives

- In the Union Budget 2017-18, the Government of India has announced a few key reforms like abolishment of Foreign Investment Promotion Board in 2017-18, Introduce bill for curbing illicit deposit schemes, Establish a Computer Emergency Response Team for financial sector (CERT-Fin) and set aside Rs 10,000 crore (US$ 1.5 billion) towards recapitalisation of banks.
- In April 2017, Capital market regulator the Securities and Exchange Board of India (SEBI) announced the much-awaited commodity market reform of permitting exchanges to launch options contracts. The move would deepen the domestic commodity market and provide farmers

and other participants a new hedging tool, in a more cost-effective manner. SEBI also announced a single-licence regime, allowing stockbrokers to deal in commodities and vice versa. It said within a year, it would allow a single licence for exchanges as well.

- SEBI has permitted the security exchanges to launch options contracts in the commodity market, which would provide a new cost effective hedging tool to the farmers and others market participants.
- SEBI has allowed mutual funds, alternate investment funds and portfolio managers, operating in IFSCs (International Financial Service Centre), to invest in securities listed in such centres. They can also invest in securities issued by companies incorporated in IFSC, apart from investing in securities issued by firms incorporated in India or companies belonging to foreign jurisdiction. These investments are subject to conditions specified by RBI and government from time to time.
- SEBI has allowed exchanges in India to operate in equity and commodity segments simultaneously, starting from October 2018.
- To help companies raise funds through green bonds for investment in renewable energy space, the SEBI has put out disclosure norms for issuance and listing of such bonds. The move aims to help meet the huge financing requirements worth $2.5 trillion for climate change actions in India by 2030.
- SEBI plans to allow investors to make mutual funds transactions worth up to Rs. 50,000 (US$ 750) a month through digital wallets, as part of its efforts to digitise the distribution processes for all financial products. It also plans to allow immediate credit to customer's bank accounts on liquid mutual funds redemption to attract retail customers as well as boost inflows.
- With an aim to deepen the corporate bond market, the Securities Exchange Board of India (SEBI) has drafted a new framework for consolidation in debt securities on minimizing the number of ISINs (International Securities Identification Numbers). Under the new framework, an issuer will be permitted a maximum of 17 ISINs maturing per financial year and a maximum of 12 ISINs only for plain vanilla debt securities.
- SEBI has raised the Foreign Portfolio Investor (FPI) investment limit in central government securities (G-Secs) to Rs.1,87,700 crore (from the earlier Rs.1.85 lakh crore) to boost inflow of foreign funds into Indian capital markets. SEBI has also revised the limit for investment by long-term FPIs (sovereign wealth funds, insurance funds, pension funds and foreign central banks) in G-Secs to Rs.54,300 crore from Rs.46,099 crore.
- SEBI has relaxed disclosure, promoters' share lock-in and listing related compliance requirements for listed firms undertaking 'schemes of arrangement' viz. mergers and demergers, including those involving subsidiaries and their divisions. The move aims to expedite the processing of draft schemes.

India is today one of the most vibrant global economies, on the back of robust banking and insurance sectors. The relaxation of foreign investment rules has received a positive response from the insurance sector, with many companies announcing plans to increase their stakes in joint ventures with Indian companies.

# ITALY

## Significant Market Developments

The economic recovery in Italy is gaining pace, mainly supported by domestic demand. The GDP grew sharply in 2017 (from 0.9% in 2016 to 1.5% in 2017). It is expected to grow at the same level in 2018. The improved outlook is translating into higher consumption and investment, which will be beneficial for the whole economy and for the banks.

The ongoing economic recovery is helping Italian banks to strengthen their balance sheets and accounts. In 2017, with the precautionary recapitalisation of Banca Monte dei Paschi di Siena and the orderly liquidation of Banca Popolare di Vicenza and Veneto Banca, the headline risks have been removed and the perception of the market on the solidity and the positive perspective of the Italian banking sector has improved.

Lending to private sector has been expanding again since the end of 2016. Latest figures show total loans to households and firms are growing at around 2.5% yoy. Customer funding remains a strength for Italian banks. Deposits continue to increase, at an annual growth rate of approximately 5%, while medium and long-term bond funding declines. Credit risk is falling to pre-crisis levels.

The flow of new non-performing loans (NPLs), which has been decreasing since 2014, stands at about 1.7% of total loans, below the pre-crisis average. The stock of NPLs is also diminishing at a remarkable pace, also due to massive disposals of NPLs. At April 2018, net bad loans or *sofferenze nette* fell to €51.0 billion, 41% less than the amount at year end 2016. The volume of total net NPLs amounts to around €120 billion. The reduction of NPLs inflows combined with the increasing outflows determine a strong improvement in the asset quality. The gross NPL ratio is expected to fall under 10% by mid-2019 and under 8% by year end 2020. The coverage ratio for NPLs is over the European average and grew from 50.4% at December 2016 to 52.7% at year-end 2017.

Capital adequacy has also increased and is well above the prudential minimum target. Common equity tier 1 ratio stood around 13.3% at year-end 2017 for the Italian Significant Institutions (up from 10.4% in 2016) and at around 13.8% for the whole banking sector.

The profitability of the Italian banks, even if still lower than the cost of capital as for many of the other European banks, is improving. In 2017 the aggregated ROE rose to 7% (from -10.4% in 2016), buoyed mainly by extraordinary components; net of these items the ROE it would have amounted to around 4%.

## Local regulation of securities firms, insurance firms, commodities firms and other nonbank financial firms

As it regards the developments in the Italian local regulation, the period under scope of analysis saw an important reorganization of the Italian Consolidated Law on Finance ("Testo Unico della Finanza", TUF, namely the Legislative Decree n. 58 of 24 February 1998), specifically those Parts comprising provisions on investment firms, investment services, markets

structure, transparency and reporting requirements, and the powers of Italian Competent Authorities. The main changes were aimed at aligning the TUF to the provisions of i) the Directive 2014/65/EU on Markets in Financial Instruments (i.e. MiFID2) and ii) the Regulation (EU) n. 600/2014 (i.e. MiFIR). As the entire MiFID2 legislative framework is composed of over 40 Delegated and Implementing Acts (directly applicable in the entire European Union), the vast majority of technical and implementing provisions is enshrined in these EU pieces of legislation. Hence, Italian MiFID1-related implementing measures, enshrined by the following two local regulations (the "Markets Regulation" or namely "*Regolamento Mercati"* and the "Intermediaries Regulation" or namely *Regolamento Intermediari*"), were updated with MiFID2-related level 3 implementing measures (and, in particular, quite extensively the local "Markets Regulation"). The overall legislative framework entered into force on and was applicable since 3 January 2018.

At the same time, the Italian Financial Services Authority, CONSOB, adopted some further implementing national measures of the Regulation (EU) 1286/2014 on PRIIPs (Packaged Retail Investment Products), aimed at regulating the methods of notification of the KID (Key Information Document) related to PRIIPs marketed in Italy.

By the end of June 2018, it is also expected (the relevant process is nearly ended) the adoption of the legislative decree providing the national legislative provisions to comply with the Directive on Insurance Distribution (so called IDD), which will entry into force on 1 October 2018.

**Regulation and supervision of Banks**

**Creditor hierarchy - senior unsecured non-preferred in the BRRD2**

As provided for by the BRRD2 (creditor hierarchy part), the 2018 Budget Law introduced into the Italian Banking Act (TUB) a new class of liabilities, called "second-level unsecured debt instrument" (i.e. senior unsecured non-preferred in the BRRD2). These instruments, reserved to qualified investors and eligible for the purpose of TLAC and MREL, create an additional "buffer" of securities aimed at diversifying and strengthening the banking liability structure, as well as at reducing the likelihood that resolution authorities use their powers to write-down / to convert obligations of an entity under resolution.

ABI underlined the need of a rapid transposition of the BRRD2 (creditor hierarchy part) into the national legal framework to allow Italian banks to issue the new funding instrument, thereby bridging the gap with some other European countries, that had already permitted the issuance of such liabilities.

**Payment Services Directive (PSD2)**

On 13 January 2018, Legislative decree 218/2017 was published on the Official Journal and it entered into force the same day. It implemented in Italy the so called "EU payments

legislative package", namely both Directive 2366/2015 (PSD2)[4] and Regulation 751/2015 (IFR)[5]. Specifically, the legislative decree introduced the following changes into Italian legislation:

- The Consolidated Law on Banking (Legislative decree 385/1993, so called *Testo Unico Bancario*) was amended to introduce the new provisions relating to authorisation of payment and e-money institutions, and in particular the new regime for payment services providers (PSP) offering the new services regulated by PSD2: payment initiation services (PIS) and account information services (AIS), as well as changes in transparency requirements.

- Legislative decree 11/2010, which implemented the first Payment Services Directive, was amended to bring the legislative framework in line with PSD2 for what concerns the definitions and the rights and obligations, including liabilities, of PSPs and of payment service users especially with respect to the newly regulated PISP and AISP.

It was further complemented by a new section which aims at activating the Member State options envisaged by IFR, and namely the possibility, for national debit card transactions, to apply a weighted average interchange fee of no more than the equivalent of 0.2 % of the annual average transaction value of all domestic debit card transactions within each payment card scheme.
It also provided that the interchange fee for transactions up to 5 Euro shall also be lower than that for transactions higher than 5 Euro, and repealed the so called "merchant fee regulation" introduced in Italy since 2014 to enhance the use of cards at POS.

- Legislative decree 135/2015 concerning sanctions to the SEPA Regulation (Regulation 260/2012) was replaced by updated sanctions on PSP.

- Legislative decree 218/2017 envisages that Bank of Italy is the national competent authority for the respect of PSD2, while the Antitrust authority is the competent authority for the respect of the rules concerning surcharge by the merchants as well as some aspects of IFR.

Bank of Italy is expected to issue several secondary legislation provisions in the area of authorisation, transparency and security.

**Payment Accounts Directive (PAD)**

Following the implementation of Directive 92/2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features (the so-called Payments Account Directive – PAD) by means of Legislative decree 37/2017, Bank of Italy and the Ministry of the Economy issued a series of secondary provisions on:

[4] Directive 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC.

[5] Regulation 2015/751 of the European Parliament and of the Council of 29 April 2015 on interchange fees for card-based payment transactions.

- Standardised terminology: on 27 April 2018, the Bank of Italy published on its website the list of the most representative services linked to a payment account using the Union standardized terminology defined at European level. Payment services providers (PSPs) shall use the standardized terminology in any kind of communication and information document, as well as in the contracts, addressed/provided to consumers by the end of January 2019.
- Payment account switching due to mergers and acquisitions: on 3 August 2017, the Bank of Italy amended the rules on "Transparency and fair treatment in transactions between financial intermediaries and customers" in order to define transparency obligations and other operational duties in the event of switching due to mergers and acquisitions.

Other secondary legislation provisions are expected in the area of comparability and transparency.

**Cheque Image Truncation (CIT)**

Legislative decree 70/2011 amended the Cheque Law (the Royal Decree of 21 December 1933, n. 1736), recognizing legal value to the electronic copies of cheques; afterwards Banca d'Italia issued an implementing Regulation, providing for a complete new framework. To reap the efficiency benefits allowed by this new regime, a new Cheque Image Truncation procedure (CIT) was launched at interbank level as from 29th January 2018.

CIT is an image-based cheque clearing system, which replaces the physical cheque clearing system with electronic information, throughout the interbank cycle. This process eliminates the physical exchange of cheques allowing cost reduction in handling and transportation as well as delays in processing. In addition, CIT also offers better reconciliation for banks and a better fraud prevention system for cheques.

**Anti-money laundering developments**

In April 2018, the Bank of Italy launched a public consultation on two documents containing instructions for the Know your Customer due diligence and for procedures, organizations and controls.

The document on "Know your Customer" is aimed at implementing: i) the provisions on the Know Your Customer Due diligence contained in the legislative decree 21 November 2007, n. 231, as amended by Legislative Decree 25 May 2017, n. 90; ii) the Guidelines issued jointly by the European Supervisory Authorities (EBA, ESMA and EIOPA) on simplified and strengthened customer due diligence measures and risk factors, published on January 4, 2018 (hereinafter "the Joint Guidelines").

The document on procedures, organizations and controls is aimed at implementing the provisions on the organization, procedures and internal controls to combat money laundering and terrorist financing, contained in the legislative decree 21 November 2007, n. 231, as amended by Legislative Decree 25 May 2017, n. 90 for the implementation of the so-called fourth anti-money laundering directive. Actually, the Decree – in line with the IV Directive – encourages a more systematic use of the risk-based approach as a key principle guiding the choices of intermediaries

in identifying, assessing and managing the risks associated with money laundering and terrorist financing and requires intermediaries to conduct a self-assessment exercise. The Public Consultations expired the 12th of June 2018.

**Protection of whistleblowers**

Law no. 179 of November 30th, 2017, "Provisions for the protection of whistleblowers who report offences or irregularities which have come to their attention in the context of a "public or private employment relationship", introduces protective measures also for workers of the private sector who report offences or irregularities which have come to their attention in the context of the employment relationship and makes some amendments to Legislative Decree 231/2001, which concerns the administrative liability for legal persons, companies and associations (the "Decree 231").

The amendments are related to the protection of employees/collaborators of the private sector who report offences or who acknowledge violations relevant pursuant to the Decree 231 Crime List, of which they become aware for reasons of their office.

Pursuant to the Law n. 179, a "231 Compliance Program" adopted by a private entity for being compliant with the whistleblowing scheme outlined by the Law shall now provide for: i) more than one channels that, while guaranteeing the confidentiality of the identity of the whistleblower, allow top manager and their subordinates to submit detailed reports of illegal conduct or violations of the 231 Compliance Program; one of these reporting channels must be via informatics tool; ii) anti-retaliation measures; iii) adequate sanctions for those who violate the anti-retaliation measures and for those who – intentionally or negligently – carry out reports that prove to be unfounded.

**NIS Directive adoption**

In Italy, the Directive on Network and Information Security – Directive (EU) 2016/1148 of the European Parliament and of the Council – has been adopted with the Legislative Decree May 18, 2018 n.65, which was published in the Official Journal on June 9, 2018 and will enter into force on June 26, 2018.

The Decree is the result of a soft approach, through which the country has incorporated in its national framework the NIS Directive recommendations. As an example, regulated sectors are precisely those specified in the European Directive – including the banking sector, whilst countries have been given the chance to extend the Directive applicability to other sectors.

Concerning the institutional model, the Italian Government opted for a quite decentralized system, with five Ministers that have been designated as NIS competent authorities, among which the MEF (Minister of Economy and Finance), in collaboration with Bank of Italy and Consob. The national governance in the field of network and information security will be strengthen by updating the national Security Framework for cyber space security and the related Plan for cyber protection and information security. Furthermore, there will be just one national CSIRT, which is going to substitute and unify the current National CERT and CERT-PA.

Authorities and stakeholders involved in the national cyber governance must however proceed with the Directive implementation process. For example, operators of essential services will be identified within November 9, 2018 (for the banking sector they have been already selected) and a specific decree to regulate CSIRT organization and functioning is expected shortly.

## JAPAN

### Economic Policy

In December 2017, the Cabinet passed a resolution on a new economic policy package which incorporates specific policy packages addressing falling birthrate and aging population by promoting both the Supply System Innovation and Human Resources Development Revolution as the two wheels on an axle towards 2020. The following is an overview of such policy packages that are closely related to the financial areas in particular.

*Supply System Innovation of SMEs and small-scale entrepreneurs*

- In order to encourage demonstration of appropriate financial intermediary functions by financial institutions, the government will establish and publish objective Key Performance Indicators (KPI) that indicate the status of financial intermediation by the summer of 2018.

*Supply System Innovation through improved profitability and investment promotion of corporations*

- Corporate governance revolution through, among other things, necessary review of the corporate governance code

*Supply System Innovation through societal implementation of Society 5.0 and disruptive innovation*

- Institutionalization of regulatory "sandbox"
- The government will start consideration to revise the Financial Instruments and Exchange Act and other relevant regulations in order to transform the current industry-by-industry legal systems into function-by-function and cross-industrial legal systems while striking a balance between promotion of innovation and protection of users.
- In order to improve users' convenience, strengthen companies' growth potential, and realize a cashless society, the government will consider how to promote use of FinTech.
- The government will prepare a definite plan of specific measures and processes for realizing one-stop online procedures for starting a business before the end of this fiscal year

### Regulation and Supervision

*Initiative of studying the new financial system in Japan*

In June 2018, the Study Group on the Financial System published an interim note. As the unbundling and re-bundling of financial services are expanding against the backdrop of IT advancement, since its establishment in November 2017, the study group has been discussing challenges associated with the existing legal system, such as a situation where laws are established based on business types and therefore applicable rules differ depending on the entity (business types) even though their services have similar functions and risks. The summary of the interim note is as below.

1. Necessity to consider a shift to function-based, cross-sectoral financial regulations
   • It is critical to incorporate function-based, cross-sectoral elements more to the regulatory framework and to apply the same rules to activities with the same functions and risks
2. Categorization of financial "functions"
   • To address the challenge specified in 1. above, temporarily classify financial functions into the 4 categories "payment and settlement", "lending", "investment", and "risk transfer" and to reconsider those functions based on these categories .
3. Benefits that should be attained in each financial "function" and rules to attain such benefits
   • Identify benefits that should be attained in each financial function and consider the direction of future discussions about financial regulation by taking into account the relation with each benefit
4. Approach to entity-based regulations (i.e. regulations on scope of permissible business safety nets etc.) under the function-based, cross-sectoral financial regulations
   •Amid blurring boundaries between financial services and non-financial services, current strict entity-based regulations (i.e. regulations on scope of permissible business, safety nets, etc.) related to banks and banking groups should be appropriately reviewed if there are any excessive requirements based on the concept of establishing function-based, cross-sectoral financial regulations
5. Approach to rules for the process of providing products and services

*Basic policy of inspection and supervision*

In June 2018, the Financial Services Agency of Japan (JFSA) issued a report "JFSA's supervisory approaches -Replacing checklists with engagement-". This policy specifies how future policies on inspection and supervision should be proposed going forward in addition to the establishment of this policy, proposing, for example, the repeal of the Inspection Manuals after the end of fiscal year 2018, retention of the Supervisory Guidelines and publication of theme-specific discussion papers for deeper engagement.

In light of the above, as part of its initiatives to supplement "JFSA's supervisory approaches" for more specific issues and areas under supervision, the JFSA has 1) established a Study Group on Supervisory Approaches to Lending Practices" and 2) published discussion paper "JFSA's supervisory approaches -Aiming to stabilize the financial system – (Basic approach on the prudential policy) (Draft)."

*Summary Points from Strategic Directions and Priorities in relation to SDGs*

In July 2018, the FSA has published a material that explains "Summary Points from Strategic Directions and Priorities and SDGs." This material provides the following two actions as FSA's basic approach.

- The SDGs meet the goal of Strategic Directions and Priorities, which is to contribute to the national welfare by securing sustainable growth of national economy and wealth, and hence the FSA will actively undertake initiatives to promote the SDGs
- Each economic unit, including corporates, investors and financial institutions, should proactively engage with SDGs. If, however, such activities are hindered for any reasons, and an external diseconomy would occur, the FSA, as authorities, needs to help facilitate the activities

with a view to achieving the most appropriate balance from the perspectives of overall economy.

*Prudential regulation*

- Revision of the policy on the establishment of the total loss-absorbing capacity framework
  - In April 2018, the JFSA revised its approach on the introduction of the total loss-absorbing capacity (TLAC) framework in Japan. With this revision, the TLAC regulation in Japan will be applied to not only Japanese G-SIBs but also those Japanese D-SIBs which are deemed of particular need for a cross-border resolution arrangement and of particular systemic significance to Japanese financial system if they fail. This revised policy has also indicated that the JFSA would, as part of its actions as a host authority, separately designate, and apply the regulation on, those foreign G-SIBs' subsidiaries in Japan which are considered to require having a loss-absorbing capacity in light of the international agreement. In addition, the JFSA presented its policy on the TLAC holdings regulation applicable to Japanese banks in consideration of the "TLAC holdings – Amendments to the Basel III standard on the definition of capital" published by the Basel Committee on Banking Supervision (BCBS) in October 2016.

In addition to the above, the prudential regulations based on the following international agreements were implemented in Japan in March 2018.

- BCBS "Interest Rate Risk in the Banking Book (IRRBB)"
- BCBS "The standardised approach for measuring counterparty credit risk exposures (SA-CCR)"
- BCBS "Capital requirements for bank exposures to central counterparties"
- BCBS "Revised Pillar 3 disclosure requirements (Phase I)"
- BCBS "Pillar 3 disclosure requirements – consolidated and enhanced framework (Phase II)" (partial implementation)

**Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism**

In February 2018, the JFSA finalized the Guidelines for Anti-Money Laundering and Combating the Financing of Terrorism.

The JFSA deems it significant to strengthen the whole Japanese regime also in consideration of the FATF fourth round of mutual evaluations scheduled in 2019 to ensure that its financial system is immune from money laundering and terrorist financing, by collaborating with the private sectors. The Guidelines clarify the basic stance on risk management practices against money laundering and terrorists financing in order to encourage financial institutions to develop their organizational structures to effectively prevent money laundering and terrorists financing.

**Establishment of a study group on virtual currency exchange, etc.**

In March 2018, the JFSA announced the establishment of a study group on Virtual Currency Exchange, etc.

In Japan, there was an incident in the beginning of 2018 where a Virtual Currency Exchanger Coincheck, Inc. was hacked and lost customers' assets and subsequent on-site investigation revealed

deficiencies in the internal management framework of deemed registered entities and registered entities. In addition, while volatility in virtual currency prices is prompting the use of virtual currencies as a tool for speculation, rather than as a settlement tool, some are pointing out insufficiency of investor's protection. Other relevant movements include launching of new transactions, such as virtual currency transactions using margin and funding activities using virtual currencies

In light of these situations, the study group was established in order to consider institutional actions to be taken on various issues associated with the virtual currency exchange, etc.

**Digitalization**

*Revision to the Banking Act*

In June 2018, the Act for Partial Revision of the Banking Act and Other Acts. (the Act) has taken effect.

The Act intends to respond to global acceleration of FinTech (Finance x IT) movements therefore to establish an institutional framework that ensures protection of users and at the same time promotes open innovation (innovation through cooperation and collaboration) by financial institutions and FinTech firms. To this end, the Act introduces a registration requirement for "Electronic Payment Service Providers" (EPSPs) and sets out necessary measures to be taken, including the establishment of an appropriate organizational structure and safety management measures by EPSPs, their conclusion of contracts with financial institutions and measures to be taken to promote open innovation by financial institutions. In this context, EPSPs mean an intermediary entity which acts as a link between depositors and financial institutions and is entrusted by the depositors with, among other things, issuing payment/wire transfer instructions to financial institutions or obtaining account information through open API, etc. on behalf of the depositors (they are equivalent to AISPs and PISPs under the PSD2 in EU).

**Establishment of "FinTech PoC (Proof-of-Concept) Hub"**

In September 2017, the JFSA established "FinTech PoC (Proof-of-Concept) Hub". This hub was established to eliminate the hesitation and concern that FinTech firms and financial institutions are inclined to have in conducting unprecedented tests.

FinTech PoC Hub provides ongoing support to FinTech firms and financial institutions in addressing issues that they seek to solve through experiment by mobilizing a dedicated team within the JFSA for each experiment. Such issues include compliance, risks associated with compliance with supervisory requirements and practical challenges in interpreting applicable laws that may occur when providing services to general users.

**Publication of the "Cashless Vision" and the "API Guidelines for Utilization of Credit Card Data" by the "Study Group for API-based Collaboration Involving Credit Card Utilization" established by METI**

In April 2018, the "Study Group for API-based Collaboration Involving Credit Card Utilization" (the Study Group) established by the Ministry of Economy, Trade and Industry (METI) published the "Cashless Vision" and the "API Guidelines for Utilization of Credit Card Data" (API Guidelines).

The main contents of the Cashless Vision and the API Guidelines are as described below.

In order to realize a cashless society, the Cashless Vision presents recommendations on the directions of efforts contributing to solving challenges faced by both credit-card affiliated stores and consumers as well as measures to be taken. As part of its future efforts, the Study Group has announced the "Declaration of Payment Reform", declaring to achieve the goal of 40% cashless settlement ratio ahead of the initial schedule set in the Future Strategy 2017 in preparation for the Osaka-Kansai Japan Expo 2025 and also aiming to raise this ratio to the world's highest level of 80% in the future. These actions will be undertaken under the leadership of a commission that will be newly established, "Commission for Promotion of Cashless Settlement (tentative name)", and through cooperation among the industry, academia and government sectors as an all-Japan initiative.

The API Guidelines sets forth the direction of API specifications and measures for security and user protection as a normative model, with the aim of encouraging business operators involved in API-based collaboration to improve the efficiency of their credit card services as well as to create a safe and secure environment for the use of credit cards.

## Taxation

*Approval of the Outline of Tax Reform 2018*

In December 2017, the "Outline of Tax Reform 2018" (the Outline) was approved by the Cabinet. The Outline seeks to achieve the following: (i) review the individual income taxation; (ii) take tax measures to drive improvement in wage and productivity and to promote capital investments by local SMEs in order to overcome deflation and achieve economic revitalization; (iii) expand and enhance the business succession taxation system to facilitate business succession of SMEs; (iv) review the international taxation system and (v) promote the computerization of tax procedures.

The following is an overview of the main bank-related items addressed in the Outline:

- Enable immediate opening of a NISA account and allow a purchase on the same day. (Effective date: January 1, 2019)
- In order to prevent double taxation at home and abroad, allow adjustments so that foreign taxes paid through publicly offered investment trusts, etc. may be deducted from the amount of withholding tax on distributions of that publicly offered investment trusts, etc. (Effective date: January 1, 2020)
- Extend the period of tax exemption applicable to interest on margin relating to OTC derivatives transactions by three years (until March 31, 2021).
- With regard to the special method for determining effectiveness, etc. in hedging as defined in the Order for Enforcement of the Corporation Tax Act, set the deadline for submitting an application for approval at the "day three months prior to the filing deadline for the initial business year intending to apply the special method" and then enable application from that business year. (Effective date: April 1, 2018)

- In determining whether consumption tax on transfer of foreign securities, etc. is levied in Japan or abroad, if such securities are paperless securities, etc. handled by book-entry transfer institutions or any foreign organizations equivalent thereto (collectively, "book-entry transfer institutions, etc."), make the determination based on the location of the book-entry transfer institutions, etc. In the case of other paperless securities, etc., make the determination based on the location of the head office, principal office or any other equivalent of the entity relevant to the paperless securities, etc. (Effective date: April 1, 2018)
- Allow digitization of a confirmation of year-end loan balance issued by financial institutions to their customers for purposes of housing loan tax credit (however, a paper-based confirmation can still be issued). (Effective date: October 1, 2020)

## Financial Market

*Implementation of the JBA TIBOR reform*

In July 2017, the General Incorporated Association JBA TIBOR Administration implemented the TIBOR reform in order to realize a "benchmark that is more anchored in actual transactions" in response to international financial benchmark reforms. The main points are to intergrade and clarify the process of calculating and determining reference banks' reference rates, to defer the timing of publication by one hour, and to discontinue the two-month tenor and to suspend the simultaneous publication of individual submission from April 2019.

*Progress on financial benchmarks*

The "Study Group on Risk-Free Reference Rates" determined not to schedule the next meeting at the meeting in March 2018 as its following primary objectives were achieved: (i) the identification of the Japanese yen risk-free rate; and (ii) the completion of the guide on Japanese yen OIS.

It is planned to establish a new body consisting of market participants, including a broad set of users of financial benchmarks, to discuss best practices for the use of Japanese yen financial benchmarks according to products and transactions and a transition plan.

## Corporate Governance

*Revision to the Corporate Governance Code*

In June 2018, the JFSA formulated the Guidelines for Investor and Company Engagement (Engagement Guidelines) and the Tokyo Stock Exchange revised Japan's Corporate Governance Code.

The Engagement Guidelines compiles those topics that are expected to be discussed intensively in dialogues between institutional investors and companies in order to promote effective "comply or explain" of Japan's Stewardship Code and Japan's Corporate Governance Code. Necessary revisions have been made to Japan's Corporate Governance Code to deepen corporate governance reforms to a more substantive level.

Major revisions to Japan's Corporate Governance Code include additions to requirements for disclosing policies and approaches to reduce cross-shareholdings and for assess and disclosing the

appropriateness of cross-shareholdings after the board of directors specifically examines the purpose of individual cross-shareholdings and benefits and risks from each holding.

## Personal Information

*Initiation of provision of My Number of deposits and savings account*

From January 2018, financial institutions are required to manage customer information associated with deposits and savings accounts in a way that such information can be searched based on My Number (so-called provision of My Number of deposits and savings account). This mechanism will be used to ensure smooth withdrawal of savings and deposits in the event of bank's bankruptcy or when responding to tax investigation and means tests relating to public assistance, etc.

## Policy-based Finance

*METI's study group for discussing the future of Shoko Chukin Bank published recommendations*

Administrative actions were taken twice on Shoko Chukin Bank in May and October 2017 in connection with its misconduct in the screening process for crisis-response loans. In light of fraudulent incidents, the study group for discussing the should-be model of Shoko Chukin Bank was established under the direction of the Minister of Economy, Trade and Industry in order to discuss the future of Shoko Chukin Bank, including prevention of recurrence of such misconduct, thorough enhancement and implementation of governance, review of Shoko Chukin Bank's business activities relating to crisis-response loans and the direction of its 'to-be' business model. After the meeting in January, the study group published recommendations on four issues: (i) 'to-be' business model; (ii) review of business activities relating to crisis-response loans; (iii) enhancement of governance to realize a sustainable business model; and (iv) full privatization.

## Resolution

*Deposit Insurance Corporation of Japan determined a change in the deposit insurance premium rate*

The Deposit Insurance Corporation of Japan (DIC) considered the deposit insurance premium rate for the fiscal year 2018 based on the "basic concept" and "inspection framework" determined as a common understanding regarding the "level of policy reserve and deposit insurance premium rate over the medium to long term" at its meeting when setting the deposit insurance premium rate for the fiscal year 2015. As a result, DIC decided to change the current rates (i.e. effective rate: 0.037%; general deposits, etc.: 0.036%; and deposits used for settlements: 0.049%) to 0.034%, 0.033% and 0.046%, respectively, which were approved by the relevant authorities on March 30.

## Matters related to foreign financial institutions operating in Japan

*Initiatives by Tokyo Metropolitan Government*

In November 2017, the Tokyo Metropolitan Government (TMG) announced the "Global Financial City: Tokyo' Vision - Toward the Tokyo Financial Big Bang -", aiming to become a global financial city that: (i) serves as an Asia's financial hub; (ii) attracts financial talent, funds, information

and technologies; (iii) focuses on the growth of asset management companies and FinTech firms; and (iv) contributes to solving social challenges.

In September 2017, with the cooperation of the JFSA, the TMG compiled and published for the first time the English Guidebook titled "Guidance to the Asset Management Industry in Japan" which explained, among other things, Japan's financial laws and regulations and filing procedures for registration as a financial business operator in an easy-to-understand manner.

In December 2017, the TMG signed a Memorandum of Understanding between the City of London to cooperate in the financial services sector.

## LATVIA

During the period under review, Latvia's Financial and Capital Market Commission (FCMC) continued to improve the regulatory framework governing the activities of the participants of the financial and capital market. Regulatory changes referred to fields such as AML/CFT, asset quality assessment and the formation of provisions, application of the International Financial Reporting Standard 9, introduction of the *Solvency II* regime, remuneration policy, establishment of governance systems, as well as a number of other fields.

### Money Laundering and Terrorism Financing Regulations

The FCMC has paid particular attention to strengthen the AML/CFT requirements in the financial sector. Latvia has implemented the forth AML Directive and additionally a set of regulations has been elaborated by the FCMC to establish stringent AML/CFT requirements for the banking sector. The latest amendments to the AML/CFT Law were adopted in November 2017 and April 2018. These amendments included requirements for more detailed and comprehensive customer due diligence regulation and internal control system, increasing requirements for identifying and registering the beneficial owners, requiring all legal persons to identify their beneficial owners, as well as implementing a prohibition for the financial sector to establish and maintain business relationships or perform occasional business transactions with a customer-shell arrangement.

### Regulation in the Field of Audit Services

Starting from 2017, a new regulation in the field of audit services took effect – in addition to the directly applicable EU legal act Regulation (EU) No. 57/2014 (has already been applicable since June 2016), new provisions of the Law *On Audit Services* have been adopted, considerably changing the regulation of audit services and laying down the rights and obligations of the competent authorities, as well as the audit service providers, introducing the requirement for all enterprises that are public-interest entities (PIE) to observe the conditions on the establishment of the audit committee. New requirements have also been set in the *Financial Instruments Market Law* with respect to the formation of the audit committee, operation and supervision thereof. To facilitate the best possible understanding of the PIE and the actions with respect to the establishment of the audit committee and the operation thereof, in the first half of 2017, the FCMC

took part in the development of the guidelines for the establishment of the audit committees and the operation thereof.

**Regulations on the Calculation of Solvency Capital Requirement and Own Funds for Insurers and Reinsurers**

In 2017, regulations were drafted to replace regulations previously approved by the FCMC with respect to the calculation of solvency capital requirement and own funds, preserving the requirements prescribed therein, as well as supplementing them with detailed requirements with respect to separate aspects of the determination of capital adequacy in accordance with that which is stated by the EIOPA. The new regulations contain new requirements, in order to identify the shareholding of the insurer or reinsurer in the capital of the financial institutions and credit institutions for the purposes of calculating own funds, and in order to determine the solvency capital requirements of the associated company, the transparency access requirements for the market participants prescribed by Regulation (EU) No. 2015/35 are supplemented, as well as the requirements with respect to setting other venture capital requirements, if contributions in securities (for example, catastrophe bonds) do not meet the criteria for the application of risk mitigation methods. The regulations prescribe additional requirements with respect to the base risk, application of the life insurance underwriting risk modules, determination of the value of benefits to be paid out, implementation of the long-term guarantee measures, classification of instruments of own funds and other requirements.

**Regulations on the Self-Assessment of Risks and Solvency of Insurers and Reinsurers**

To introduce the EIOPA guidelines, the regulations have been developed, ensuring a uniform understanding of the market participants regarding the process of self-assessment of risks and solvency of insurance and reinsurance companies. The regulations lay down a number of requirements, including the requirements with respect to the periodicity of the process of self-assessment of risks and solvency, documentation thereof, prescribe the aspects to be considered, in addition to that which is stated in Regulation (EU) No. 2015/35, when carrying out the general solvency assessment, as well as adjust the elements to be assessed when determining whether the insurer or reinsurer is able to meet the technical reserves and capital requirements.

**Regulations for Establishing the Governance System**

In 2017, the regulations promoting the harmonisation of the requirements set for the governance systems took effect, setting detailed criteria and conditions for insurance and reinsurance companies and non-Member State insurance branch offices with respect to the assessment of the appropriateness and suitability of individuals, risk management, prudential contribution principles, internal control, outsourcing, as well as group governance.

**Packaged Retail and Insurance-Based Investment Products *(PRIIP)***

Starting from 2018, the requirements of Regulation (EU) No. 1286/2014 with respect to the packaged retail and insurance-based investment products (*PRIIP*) took effect. The *PRIIP* regulation imposes a duty on the developer, advisor and seller thereof to provide private investors with the key information document in a standardised form, thus not only promoting the

understanding of the non-professional investors regarding the investment risks, but also ensuring the comparability of various products.

### *International Financial Reporting Standard 9 ( IFRS 9)*

Starting from 2018, the IFRS 9 "Financial Instruments" must be applied in financial accounting. The application of this standard affects those financial and capital market participants, who prepare financial statements in accordance with the international accounting standards and international financial reporting standards. The most significant changes refer to the calculation of the financial instruments impairment losses, providing an estimate of the amount of the expected credit losses over the next 12 months or the amount of the expected credit losses during the entire term of the agreement, if a considerable increase of a credit risk is observed, and to correspondingly form provisions for such potential losses. The new standard also provides for changes in the classification of financial instruments, stating that financial instruments shall be classified according to a business model and nature of cash flows.

### Regulations for Asset Quality Assessment and the Formation of Provisions

At the beginning of 2018, regulations were adopted in the new wording and they adjust the requirements of the supervisory authority in the asset quality assessment and formation of provisions after the IFRS 9 took effect on 1 January 2018. The regulations prescribe detailed requirements for the estimate of future cash flows, to be applied for the determination of the credit amount to be recovered, the need to verify the conformity of the formed provisions to the actual losses on a regular basis and to introduce corrections to the estimates to minimise the differences. More stringent requirements are also set for the appraisers and the process of appraisal of the real estate serving as the security for non-performing loans, conditions are set for the application of indexation methods, requirements are prescribed for the timely write-off of the irrecoverable assets or the irrecoverable part thereof from the balance sheet of the institutions, as well as the minimum level of provisions is set for prudential needs and a number of other requirements, based on the ECB’s instructions on accounting non-performing loans and the guidelines issued by the EBA on credit institutions’ credit risk management practices and accounting for expected credit losses.

### Regulations on the General Principles of the Remuneration Policy for the Managers of Investment Management Companies and Alternative Investment Funds

The regulations lay down the requirements in more detail with respect to the remuneration policy and practice, which were not put in more detail in the Law on Investment Management Companies, as well as introduce the guidelines of Directive 2014/91/EU amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions and the ESMA guidelines regarding the remuneration policy and practice. The regulations lay down uniform requirements for both alternative investment fund managers and investment fund managers, as well as concurrently supplement the requirements for the establishment of an internal control system in the field of remuneration for investment management companies in accordance with the above mentioned guidelines.

**Regulations on the Correction of the Modified Duration of Debt Instruments**

The regulations prescribe the procedure for the introduction of corrections to the modified duration calculation set out in Article 340 (3) paragraph 2 of Regulation (EU) No. 575/2013. Corrections to the calculation of modified duration are necessary, in order to take into account the risk of pre-payment of debt instruments classified in the sales portfolio. Correspondingly, laws and regulations adjust the cases when the corrections of the calculation of modified duration of debt instruments are to be carried out, set out the procedure for calculation, as well as supplement the terminology.

**Regulations for the Assessment of the Fulfilment of the Conditions for the Provision of Financial Support**

The regulations set out the information to be annexed to the notification of the credit institutions and investment brokerage firms on the decision to provide intra-group financial support, in more detail - substantiation of the purposes of providing financial support, substantiation of the ability of the entity receiving the financial support to correspondingly pay the remuneration for receipt of the support and repay the loan within the term set in the agreement, substantiation of the impact of the provision of financial support on the financial stability of the Republic of Latvia or another Member State, substantiation of the ability of the entity providing the financial support to comply with, as well as not to infringe upon the operational regulatory requirements binding on it due to the provision of the financial support and the substantiation.

## THE NETHERLANDS

The Dutch Banking Association (Nederlandse Vereniging van Banken, or 'NVB')[6] strives to achieve a strong, healthy and internationally competitive banking system for the approximately 70 Dutch and foreign banks and credit institutions operating in the Netherlands. The NVB is the link between the banking sector, the government and the public and contributes to a vital and sustainable sector. We want to bridge the gap between the banks and the public by facilitating dialogue between all parties involved in the sector. Together, we work on innovation, security, stability and transparency.

**Dutch Banking Sector**

The Dutch banking sector is characterised by its relatively large size, high level of concentration and its international orientation. Measured against the size of the Dutch economy, the Dutch banking sector is relatively large from an international perspective. Nonetheless, the Dutch banking sector has shrunk considerably in the past years. The size of the assets relative to the GDP of the Netherlands has decreased from 600% in 2008 to 364% in 2016.

The Dutch banking sector is increasingly regulated on a European Union level, in particular with regard to prudential and financial markets legislation. Most of this legislation requires the national implementation of EU laws, in which national authorities and policy makers

[6] For more information on the Dutch banking sector in English see : https://www.nvb.nl/2240/english.html

have some scope to adjust the EU standards to the national context and to complement it with specific national legislative measures.

The Netherlands being a member of the Eurozone is subject to additional European banking legislation compared to those EU-countries that use other currencies than the euro. The Banking Union project established a Eurozone-wide banking supervision and resolution mechanism. Seven banks in the Netherlands are under the direct supervision of the Single Supervisory Mechanism, which is part of the European Central Bank (ECB).

The Dutch banking sector is rapidly adjusting to the new challenges, one of the major challenges is the innovation in financial services. Dutch consumers usually use computers, tablets or smart phones to transfer money. In 2016, 91% of the Dutch used online banking and 54% a mobile banking app. Because of the strong digital infrastructure in the Netherlands standards are high and new start-ups (Fintech) and traditional banks seeking cooperation are at the same time competing to deliver excellent financial services.

**Oath and Discipline Law**

Along with the introduction of a social charter and updating the Banking Code, the Dutch banking industry has also taken the initiative to implement an ethics statement. The Dutch banks intend this to show that everyone working in the industry is bound by the codes of conduct for the ethical and careful practice of this profession. Employees have personal responsibility for complying with those codes of conduct and can be held accountable for non-compliance.

The bankers' oath is a so-called "ethics statement" subscribed to by all employees working at bank offices in the Netherlands. It has the aim for banking employees to be fully aware of and keep into mind their special role in society, ensuring that they always carefully weigh the interests of all stakeholders with the interests of the customer taking a central place. The most important parts of the bankers' oath concern:

- Integrity and diligence;
- Careful weighing of interests with the customers' interests taking a central place;
- Compliance with laws, rules and code of conduct;
- Confidentiality and no abuse of knowledge;
- Transparency and responsibility;
- Preservation of trust in the financial industry.

If there is a violation of the code of conduct, a report regarding the relevant employee is submitted to an independent Bank Disciplinary Law Foundation (Stichting Tuchtrecht Banken) especially set up for this purpose. The Bank Disciplinary Law Foundation carefully reviews whether there was a violation and if it was serious enough to bring to the Disciplinary Commission. This Commission can impose penalties.

Since April 1 2015 the oath and the Disciplinary Law are effective and implemented in the Dutch Financial Supervision Act ("Wft").. Since April 1 2015, approximately 87,000 employees working in the Dutch banking industry are obliged by law to take the Banker's Oath. At the heart of this oath lies the Code of Conduct. Oath takers who break one of the rules enshrined in the code can be persecuted by the Disciplinary Commission. Disciplinary sanctions range from reprimands

to severe fines – up to a maximum of €25,000 – and/or a three year moratorium on working anywhere in the Dutch banking industry. Anyone can file a complaint against a banker suspected of breaking a rule in the Code of Conduct. This must always be done by using the form on this website. Since its inception there were 29 rulings.

**Sustainability**

Banks in the Netherlands take into account the social and environmental impact of their financing and investment decisions. They have non-financial risk management systems in place, as well as policies to stimulate better non-financial performance among their clients.

In addition, Dutch banks aim to contribute to solving today's larger societal challenges, such as climate change, scarcity of raw materials and human rights infringements. Both on their own account and collectively, Dutch banks engage in projects enabling the transition to a carbon neutral economy, such as the National Energy and Climate Agreements and various initiatives promoting the circular economy.

Transparency and disclosure are seen as important elements. The Dutch Banking Association has drawn up a protocol that offers banks a tool to report in detail on all outstanding loans on the balance sheet and many of its members have reported accordingly. The aim is to show customers and other stakeholders what type of economic activities are financed by banks. Dutch banks also generally publish their overall and sector-specific sustainability policies.

In 2016, the Dutch banking sector initiated a multi-stakeholder agreement with a view to improving the human rights outcomes of project finance and corporate lending: the Dutch Banking Sector Agreement on International Responsible Business Conduct Regarding Human Rights. This is a unique partnership between banks, the Dutch government, NGOs and trade unions. Parties pool and share expertise and experience in order to achieve a material positive impact for people (potentially) facing an adverse human rights situation. Recently, the parties published their first results, including an analysis of human rights risks and opportunities in the cocoa value chain.

Recently, eight Dutch banks, together with other financial institutions, pledged to estimate and publish annually the carbon emissions associated with their financing and investment activities, and to reduce their 'carbon footprint' in line with the Paris Climate Agreement.

**Prudential Requirements**

On 1 January 2014 various amendments to the Dutch Bank Act and the Dutch Financial Supervision Act came into effect. With the European Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV) having entered into force, DNB in 2014 imposed additional capital requirements, the so-called Systemic Risk Buffer of 3% of risk- weighted assets on ING Bank, Rabobank and ABN AMRO Bank and 1% on Volksbank. The Systemic Risk Buffer is a macro-prudential tool, which the Dutch Central Bank set much higher than the average of other European banks. In general the Dutch banking sector is in a very good shape, with capital having doubled, capital ratios already being above the 2019 requirements and a low amount of non-performing loans.

## Resolution Planning

On 1 January 2016 the Single Resolution Mechanism has become fully operational, and is regarded as an important step towards the European Banking Union, indispensable in developing the European Economic and Monetary Union and to prevent bank bail-outs. Resolving failing banks can be expensive for the society as a whole. Based on the Bank Recovery and Resolution Directive, the Single Resolution Mechanism will ensure that any resolution costs must first be borne by a bank's shareholders and creditors.

In the Netherlands, pursuant to the EU's Single Resolution Mechanism (SRM) Regulation the Dutch Central Bank (DNB) has been the designated National Resolution Authority (NRA). The European Single Resolution Board (SRB), in charge of deciding when to place a bank in resolution, is fully operational since 1 January 2016. The SRB consists of representatives from the relevant national authorities (those where the bank has its headquarters as well as branches and/or subsidiaries). It has the powers to decide whether and when to place a bank into resolution and sets out, in the resolution scheme, a framework for the use of resolution tools and the Single Resolution Fund (SRF). Under the supervision of the SRB, the NRA is in charge of the execution of the resolution scheme.

Furthermore, together with the DNB have prepared recovery plans for events of default. In the Netherlands the final implementation of the Banking Recovery and Resolution Directive (BRRD) has been finalised November 2015. The Dutch banks will contribute approximately EUR 550 million in 2016 and in total EUR 4.5 bln (in 8 years). The whole euro area fund will in 2023 consist of EUR 55 billion.

## MIFID II/MIFIR (Markets in Financial Instruments Directive & Regulation)

The revision of the Markets in Financial Instruments Directive and the new Markets in Financial Instruments Regulation (respectively referred to as MiFID & MIFIR) entered into force on 3 January 2018. These laws govern the provision of investment services in financial instruments by banks and investment firms and the operation of traditional stock exchanges and alternative trading venues. MiFID II and MIFIR contain more stringent rules in order to encourage efficient, competitive and transparent European financial markets. The new rules also aim to increase the protection of investors.

## EMIR

The European Market Infrastructure Regulation (EMIR) which was adopted on 4 July 2012, entered into force on 16 August 2012. EMIR has introduced central clearing and reporting obligations. The clearing obligation applies to standardized classes of OTC derivative contracts that have been specified as being subject to this obligation. The first derivatives that are to be centrally cleared are specific classes of interest rate derivatives in the G4 currencies. The regulations governing this mandatory clearing (Commission Delegated Regulation (EU) 2015/2205) were published on 1 December 2015. The clearing obligation for these interest rate derivatives are implemented in stages, depending on the status of the parties involved. There are several categories for different parties; the first of which (clearing members) were subjected to the clearing obligation from 21 June 2016 onwards. The last category consisting of non-financial

counterparties, will be the last to come under the clearing obligation, from 21 December 2018 onwards.

The Netherlands Authority for the Financial Markets (AFM) and the Dutch central bank (DNB) are carrying out the supervision of the obligations under EMIR.

In 2018, two central counterparties (CCP's) established in the Netherlands are authorised under the European Markets Infrastructure Regulation (EMIR): ICE Clear Netherlands and EuroCCP NV.

**Remuneration**

The Dutch Act on the Remuneration Policies Financial Undertakings has come into effect on 7 February 2015. The Act is part of the Dutch government's endeavours aimed at a sound and sustainable Dutch financial sector. Remuneration rules are included in the Capital Requirement Directive (CRD4) in which a 1:1 ratio is set between fixed and variable remuneration. The Dutch Act is more restrictive with a bonus cap of 20%. The Act also introduces all-encompassing legislation that requires financial undertakings to maintain sound remuneration policies and sets out rules with respect to the type of remuneration, as well as malus and claw-back provisions.

**Cybersecurity**

The EU has agreed on the Directive on security of network and information systems (NIS Directive), which is the first piece of EU-wide legislation on cybersecurity which entered into force on August 2018. The Directive sets minimum security standards for digital networks, services and services and is compulsory for certain sectors that provide essential services. Each Member State will determine what these sectors are. For the Netherlands this is expected to include financial services.

The cybersecurity law in the Netherlands that implements the NIS Directive (which is called the Wet beveiliging netwerk- & informatiesystemen or Wbni) has passed parliament on the 29th of May 2018. The law will be effective after it has passed the Senate which is expected before the end of 2018. For banks the implication of the new legislation is expected to be limited.

The Dutch government published its overview of cybersecurity risk in August 2018 (Cyber Security Assessment Netherlands 2018). CSAN 2018 shows the scope and severity of digital threats facing the Netherlands are still considerable and continue to evolve. National security remains under constant threat of digital attacks. The Dutch economy and broader Dutch society have become entirely dependent on digital resources.

In April 2018 the Ministry of Justice and Security presented the National Cyber Security Agenda. It comprises seven ambitions that contribute towards the following objective: The Netherlands is capable of capitalizing on the economic and social opportunities of digitalisation in a secure way and of protecting national security in the digital domain. One of the ambitions is to realize an integrated and strong public-private approach to cybersecurity. For this the Ministry took the initiative to set up the Cyber Security Alliance that consists of public and private partners.

# NORWAY

Norway is not a member of the EU, but participates in EU's internal market under the European Economic Area Agreement (EEA). According to this agreement Norway is obliged to implement all EU directives and regulations that relate to financial institutions and markets, such as the CRR/CRD IV, MiFID, Prospectus Directive, Solvency II etc. This ensures Norwegian financial institutions the same rights and obligations as institutions established within the EU. When it comes to EU's structure for supervision of financial markets, the EFTA Surveillance Authority (ESA) is responsible for decisions that are binding for Norwegian companies.

The new European capital adequacy regime was introduced in Norway in 2013, with a gradual introduction of new buffer requirements along with a requirement for banks to hold capital against risks not covered by the minimum and buffer requirements. Norwegian institutions are currently obliged to have a CET1 ratio of minimum 12 percent. This includes a required countercyclical capital buffer of 2 percent. The level of the buffer is decided by the Ministry of Finance based on a recommendation from the Norwegian Central Bank (Norges Bank) and should be between 0 and 2.5 percent. The central bank delivers its comments on the level of the buffer 4 times a year, when it publishes its Monetary Policy Report. The advice is confidential until the Ministry of Finance has reached a decision. Norwegian banks also face an extra capital requirement through Pillar 2 decided by the Norwegian FSA

Financial institutions regarded as systemically important (SIFI) must hold an additional CET1 of 2 percentage points. DNB, Kommunalbanken and Nordea were defined as systemically important banks already in 2014, but the latter became a branch of the Swedish parent bank (Nordea Bank AB) as of 2 January 2017. To become a SIFI, at least one of the following criteria must be met:

- By the end of the previous year, total assets must have been equivalent to over 10 percent of GDP for Mainland – Norway.
- By the end of the previous year, market share for domestic lending to the general public needs to have been higher than 5 percent.

The Ministry of Finance implemented the leverage ratio on 30 June 2017. Banks, credit institutions etc. are faced with a 3 percent requirement, but an additional 2 percent buffer applies for banks. Systemically important banks will also need to have an extra 1 percent, i.e. a total of 6 percent.

When it comes to liquidity, the LCR (Liquidity Coverage Ratio) requirement was fully phased in (100 percent) on 31. December 2017. This implies that banks etc. are required to have liquid reserves which is equal to net liquidity outflow in a given stress period of 30 days.

The Ministry of Finance decided that the LCR requirement will apply for each significant currency (debt in one currency that exceeds 5 percent of total debt) from 30 September 2017, with Norwegian kroner (NOK) as an exception. Institutions with EUR or USD as a significant currency will face a LCR requirement in NOK of 50 percent. Those who do not have EUR or USD as a significant currency will not have an explicit LCR requirement in NOK. The institutions are however required to report LCR for all significant currencies.

**New Tax on Financial Companies**

As of 2017, a specific tax on financial companies has been implemented. The tax has been initiated due to the sector being exempted from value added tax (VAT) and consists of two parts. The first part implies that financial companies will not be affected by the lowering of the corporate tax in general, from 25 percent to 23 percent, whereas the second part is the application of an additional tax of 5 percent based on the wage base. The Norwegian Parliament has recently announced that the latter (i.e. additional tax on employment) should be replaced by a different measure. The Government will present its suggestion for the Parliament in autumn 2019.

**Cybersecurity**

In Norway, there is high attention regarding the prevention of cybercrime and increasing the financial sectors robustness towards such risks. Norwegian legislation includes requirements on the use and outsourcing of IT-systems and services. The Norwegian financial infrastructure is considered as solid, with adequate stability. However, new technological solutions are developed and implemented rapidly. This may contribute to vulnerability and threats which the financial sector continuously will have to manage.

To strengthen the Nordic financial industry's resilience to cyber-attacks, Nordic Financial CERT was established in 2017. It enables Nordic financial institutions to respond quickly and efficiently to cyber security threats and online crime. It also implies that members can work together, sharing information and creating a coordinated response to threats.

**Housing Market Regulation**

On 15 June 2015, the government announced a new strategy for the housing market. The objective of the strategy was to simplify regulations and bureaucracy to increase housing supply in relevant areas, as well as tighten credit regulations to dampen the growth in house prices and household debt. The latter led to a change in regulation which was temporary and set to last until 31 December 2016. On 14 December 2016, the Ministry of Finance announced a further continuation of the mortgage credit regulation including new measures which became effective from 1 January 2017. In June 2018 the regulation was extended further with some minor adjustments. It will expire on the 31. December 2019 and includes the following requirements for borrowers:

- Maximum loan-to-value (LTV) of 85%,
  - It is possible with higher LTV if one has additional security in the form of other property or others provide a personal guarantee,
- Maximum debt-to-income at 500%,
- Mandatory instalments for loans with LTV over 60%,
  - Set to 2.5% annually or the equivalent to instalments on an annuity loan with 30-year duration,
- Credit lines up to maximum 60% of market value,
- Borrowers must be able to withstand an increase in the mortgage interest rate of 5 percentage points,
- To ensure some flexibility, banks are able to deviate from the above requirements in certain cases. The limit is set to 10% of granted loans each quarter.

Due to the development in Norway's capital Oslo, borrowers buying a home in this area also face a requirement of maximum 60% LTV for secondary homes. In addition, banks' deviation limit from the above requirements is set to 8% of granted loans each quarter.

**Solvency II**

Solvency II entered into force for Norwegian insurance companies on 1 January 2016. The main elements of the Solvency II-framework are implemented in Norwegian legislation through a new law for financial institutions (in force on 1 January 2016). The law is complemented by a regulation based on the implementing measures (Level 2) to the Solvency II framework Directive. This regulation was adopted on 25 August 2015 by the Norwegian FSA, and includes several of the permanent and transitional measures for long-term guaranteed products under Solvency II that were introduced by the Omnibus II-Directive in 2013. On 21 December 2016, the Ministry of Finance made some amendments in the regulation to adapt it to delegated regulation 2016/467.

For life insurers, there exists a transitional period until 31 December 2031 subject to approval from the Norwegian FSA. This implies a phase in period of the full Solvency II technical provisions. However, this measure is made subject to a national limitation, capping much of the effect.

Solvency II is mandatory for both life and non-life insurers. On the 8 June 2018, the Ministry of Finance announced that a simplified Solvency II-requirement has been established for pension funds. The legislation will be effective from 1 January 2019, but key elements will be gradually phased in towards 2032.

According national legislation, insurance companies and pension funds are prevented from owning more than 15 percent of a company which is not directly linked to insurance or pension. Since Solvency II implies more risk sensitive capital requirements the Ministry of Finance has proposed to repeal this requirement for insurers.

**Life Insurance and Pensions**

For several years, there has been a trend in Norway of transmission from defined benefit pension schemes (DBs) to defined contribution schemes (DCs) in private sector, regarding old-age pensions. Lower interest rates, higher longevity risk and the introduction of Solvency II supports this development even further. This trend is an increasing challenge for life insurance companies, due to the increasing amount of paid-up policies. Paid-up policies are up-earned pension rights for employees who quit a company with a DB scheme or work in a company that changes the pension schemes from a DB to DC. The capital linked to paid-up policies in life insurance companies are around 305 billion NOK, and has an average annual interest rate guarantee from 3-4 per cent.

Almost all new pension schemes in the Norwegian market in private sector are drawn as DC plans, and almost none of the new private plans established in the past couple of years were DB plans.

The hybrid pension product ("target benefit pensions") was a new competitive old-age pension scheme introduced by new legislations from 2014. However, the first hybrid pension schemes occurred the first time in 2015, and has still a small market share (around 13.000 employees) in Norwegian market, which is dominated by defined contribution pension schemes (around 1.4 million employees have DC plans). Around 100.000 employees have DB plans.

Due to high capital requirements for DB schemes and paid-up policies under Solvency II, insurance companies are no longer willing to receive a DB product or paid-up policies from other life insurance companies.

From 1 September 2014, the legislature introduced a new product called "paid-up policies with investment choice". The new product makes it possible for existing holders of paid-up policies with guarantees, to convert paid-up policies into unit-linked policies (if they relinquish the guarantees). Paid-up policies with investment choice amounts to around 15 billion NOK.

The Ministry of Finance is currently reviewing the legislative framework for guaranteed life insurance products. The aim is to identify possible regulatory changes that would substantially increase customer's returns on their pension savings, with a moderate increase in risk. The review was scheduled to be finished in May 2018, but is somewhat extended.

On 3 March 2018, the Ministry of Labor and the employee organizations agreed on a new public pension scheme from 2020 for employees born in 1963 and later. Public occupational pensions for public employees are transformed into lifelong social security schemes that come in addition to the National Insurance Scheme. All years of work shall provide pension benefits. As general rule, the pension can be taken out fully or in parts from 62 years and combined with income from employment without shortening the pension. The new arrangements shall apply to those born in 1963 or later. Older cohorts keep today's scheme and continue to earn a pension in today's system.

## PORTUGAL

The Portuguese economy strengthened its recovery in 2017. Gross Domestic Product grew 2.7% (vs. 1.6% in 2016). It benefited from a greater contribution from domestic demand, mainly due to acceleration in investment, and from exports of goods and services (+7.8%). According to the 2018-2022 Stability Programme, GDP is expected to increase by 2.3% in 2018. There were upgrades in Portugal's credit rating to investment grade throughout 2017 and this had a positive impact on the country's government bond yields and market sentiment.

At the end of the year, the Portuguese banking system comprised 152 institutions, 61 of which were banks (29 branches of foreign banks), 87 mutual agricultural credit banks and four savings banks. As a result of its ongoing deleveraging process, the Portuguese banking system reduced its ratio to the country's GDP from 310.6% in 2010 to 203.7% in 2017. The five largest banks accounted for around 79% of the sector's total assets.

**Developments in the banking sector**

In 2017, several key events took place that had a significant impact on the reinforcement of the stability and strengthening of the Portuguese banking system:

- In September 2017, Caixa Geral de Depósitos, Millennium BCP and Novo Banco signed a memorandum of understanding for the creation of "Plataforma de Gestão de Créditos Bancários, ACE." This platform will be responsible for the integrated management of exposures to economically viable NFCs, classified as NPEs.
- In October 2017, Novo Banco announced the completion of the sale of Novo Banco[7] to Lone Star. According to the terms of the deal, Lone Star injected a total of €1 billion into Novo Banco. As a result, Lone Star now holds 75% of the share capital of Novo Banco and the national Resolution Fund holds the remaining 25%.
- In December 2017, the acquisition and merger by incorporation of Banco Popular Portugal by Banco Santander Totta took place, following authorisation from the European Central Bank.

Furthermore, although it continued operating in a challenging environment, the Portuguese banking sector's solvency and liquidity metrics continued to improve, thereby contributing to the sector's overall resilience.

Solvency levels stand above regulatory requirements, having increased in 2017 as a result of capital increase operations undertaken by several banks. By the end of the year, the CET1 ratio reached 13.9% (11.4% in 2016), which represents a substantial improvement on the Core Tier 1 ratio of 8.7% in 2011.

The sector's leverage ratio stood at 7.8%, which is above the minimum requirement of 3%, currently anticipated as the expected minimum regulatory level in the future.

In terms of funding, the Portuguese banks kept a comfortable position, with their loan-to-deposit ratio standing at 92.5%. This is well below the 120% threshold recommended by Banco de Portugal and compares favourably with the maximum of 159% reached in June 2010. Deposits rose by 1.7% YoY and remain the most important source of bank funding (72% at the end of 2017 versus 69% in 2016). Furthermore, the Portuguese banks have continued to reduce their dependence on ECB funding, with borrowings from the Eurosystem representing 6.3% of total assets, as opposed to 12.6% in June 2012.

The Portuguese banking system's liquidity coverage ratio (LCR) was 173.4% at the end of 2017, well above 100% and over twice the 80% requirement for the year. As for operational efficiency, the cost-to-income ratio was 52.9%, as opposed to the peak level of 71% in 2013.

The NPL ratio decreased significantly from 17.2% in 2016 to 13.3% in 2017, which corresponds to a €9.3 billion drop. This improvement in all segments, particularly among NFCs

[7] Following the resolution of Banco Espírito Santo (BES) in August 2014, its general activity, healthy assets and deposits were transferred to a bridge bank, Novo Banco. Troubled assets, subordinated liabilities and own funds remained with BES, which is currently being liquidated.

(-€5.9 billion), mostly reflects the banks' own NPL reduction programmes supported by the positive developments in the Portuguese economy. The NPL coverage ratio increased from 45.3% in 2016 to 49.4% in 2017. Even though the NPL ratio remains high, the banking sector continues to provide lending to the economy on very favourable terms (the weighted average interest rate for newly granted corporate loans stands at 2.2%, the lowest since 2011).

**Legislative and regulatory framework**

In addition to the implementation of several European Directives, a number of legislative initiatives were adopted in 2017 to tackle specific national issues.
The following national laws implemented European Directives in 2017:

- Decree Law 74-A/2017, of 23 June, which implemented Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010;
- Law 83/2017, of 18 August, which implemented Directive 2015/849/EU of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC;
- Law 98/2017, of 24 August, which implemented Directive 2016/881/EU of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation;
- Decree Law 107/2017, of 30 August, which implemented Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features;
- Law 104/2017, of 30 August, which implemented Directive 2014/91/EU of the European Parliament and of the Council of 23 July 2014, amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions;
- Decree Law 127/2017, of 9 October, which implemented Directive 2014/51/EU of the European Parliament and of the Council of 16 April 2014, amending Directives 2003/71/EC and 2009/138/EC and Regulations (EC) 1060/2009, (EU) 1094/2010 and (EU) 1095/2010 in respect of the powers of the European Supervisory Authority (European Insurance and Occupational Pensions Authority) and the European Supervisory Authority (European Securities and Markets Authority).

The following national legislation was passed:

**Credit Intermediaries**

Decree-Law 81-C/2017, of 7 July, establishes the Credit Intermediaries Legal Regime, regulating both the activity of credit intermediaries and consultancy services regarding credit agreements.

According to this framework, credit intermediation is any of the following activities: (i) offering of credit agreements to consumers, (ii) assisting consumers with credit agreements presented to them by other entities and (iii) representing lenders in credit agreements. The framework also states that credit consultancy means providing borrowers with recommendations on credit agreements when these recommendations are made outside the scope of services in the capacity of credit intermediary.

The framework establishes three categories of credit intermediaries: (i) bonded intermediaries, (ii) non-bonded intermediaries and (iii) accessory intermediaries.

Bonded intermediaries act solely and exclusively in representation of a lender or group of lenders. Non-bonded intermediaries are not bonded to any particular lender or group of lenders. Accessory intermediaries sell goods or provide services and, in tandem, act as intermediaries of a single lender or group of lenders for the sole purpose of financing the acquisition of these goods or services.

In addition to creating several categories of credit intermediaries, the Regime also implements the provisions on mortgage credit intermediation from Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property. The remaining provisions from the Directive regarding mortgage credits per se were implemented by above-mentioned Decree Law 74-A/2017 of 23 June.

The decree-law also sets out the rules governing the right of establishment in Portugal by credit intermediaries from other Member States that want to provide mortgage credit agreement services and the establishment of Portuguese credit intermediaries in other Member States for the purpose of rendering these services.

Decree-Law 81-C/2017 entered into force on 1 January 2018.

**Credit recovery funds**

Law 69/2017, of 11 August, laid down the legal regime for Credit Recovery Funds, whose purpose is to enable investors that were victims of mis-selling of financial products, to recover at least some of their losses.

Credit Recovery Funds are made up of credits arising from debt instruments underwritten by non-professional clients that were issued or distributed by credit institutions that were later resolved or were issued by entities of the same group of companies as the distributing credit institution, and later resolved as well.

Eligible credits include those arising from financial instruments issued by an entity that was insolvent at the time they were underwritten, if the investor had no knowledge of the issuer's

insolvency status, or if there is evidence that the financial intermediary responsible for the distribution of those financial instruments did so while in breach of its information duties regarding the status of the issuing entity.

These funds are set up as investment funds represented by recovery units, which are underwritten by directly assigning the credits arising from the above-mentioned financial instruments.

**Limits on cash payments**

Law 92/201, of 22 August set the following limitations on payments:

- Cash payments are only allowed up to €3,000 (or €10,000 in the case of non-residents when said payments are not connected to commercial or business activities); and

- Payments of amounts of at least €1,000 made by legal persons subject to corporate tax with organised accounting must be made using a method that allows for the identification of the beneficiary (i.e. bank transfer, order cheque or direct debit).

This regime is not applicable to payments made in favour of entities that are registered or authorized to provide banking, payment, e-currency issuance or currency exchange services. In addition, the above mentioned limitations are not applicable to payments made in connection with judicial decisions or orders.

**Management suitability criteria**

Law 109/2017, of 30 August, amended the Portuguese Credit Institution Legal Regime by imposing additional suitability criteria on the appointment of members of banks' corporate bodies.

Appointment of a member of a bank's corporate body may be rejected by the supervisor if the person in question has ever had a business relationship with a company or entity directly or indirectly related to the said bank and the supervisory authority considers that potential conflicts of interests may arise from this business relationship.

The law also eliminated the few exceptions where credit agreements between banks and members of specific corporate bodies were legally admissible.

**Conversion of bearer securities to nominative securities**

Following the ban on bearer securities issued in Portugal (under Law 15/2017, of 3 May), Decree-Law 123/2017, of 25 September, established the mandatory procedure by which all bearer securities ought to be converted to nominative securities.

According to this decree-law, the issuers of bearer securities had to issue a public notice informing the holders of those securities of how and when the conversion would take place.

The conversion of securities registered with central securities depositories would be carried out on a date determined by their respective managing entities.

Securities that were not registered with a central securities depository could only be converted if the original securities were delivered to the issuer (or a financial intermediary appointed for that purpose) until 31 October, in order to allow the amendment or replacement of the original securities by nominative ones.

As of 31 October 2017, the holders of any unconverted bearer securities cannot benefit from the rights attached to those securities. They cannot vote or receive any type of attached income until such a time as the securities are converted to nominative securities.

According to the decree-law, any type of income attached to unconverted bearer securities is to be deposited in a current bank account in the issuer's name, until such a time as the securities are converted to nominative. Any interest income on the current account's balance will revert to the issuer.

After 31 October 2017, the holders of unconverted bearer securities may benefit again from attached rights if they request their conversion to nominative ones, in accordance with the above mentioned procedures.

**Capital buffers**

In November 2017, Banco de Portugal announced its decision to extend the phase-in period for the implementation of the O-SII buffer applicable to Portuguese O-SIIs from the initial two-year period to a four-year period. The phase-in of the O-SII buffer was then set as follows: 25% on 1 January 2018, 50% on 1 January 2019, 75% on 1 January 2020 and 100% on 1 January 2019. This revision takes account of the challenges facing the Portuguese banking system at a time when interest rates remain very low.

**Conversion of credits into share capital**

Law 7/2018, of 2 March, established the legal framework for the conversion of credits into share capital.

Under this framework, the creditors of a company may propose the conversion of their credits into share capital provided that:

- The company's equity is lower than its share capital and
- They are the holders of unsubordinated credits that are at least 90 days past due, and whose amount corresponds to at least 10% of the company's total unsubordinated credits.

The proposal must be underwritten or approved by creditors whose claims represent at least two-thirds of the company's total liabilities and the majority of the company's unsubordinated credits. The proposal must be accompanied by: (i) a statutory auditor's report certifying that the above-mentioned conditions are fulfilled and (ii) a proposal to amend the company's articles of association and the share capital allocation as a result of the conversion of credits.

The amendments to the company's share capital by reason of conversion of credits are treated as share capital increases in kind. The share capital increase may be preceded by a share capital reduction in order to cover losses. If necessary for the conversion, the company's legal type may also be changed.

After the proposal has been submitted, the company's General Meeting has 60 days to vote on it. If the company's shareholders reject the proposal, the creditors may request court intervention to decide on the matter. The court's decision, if in favour of the conversion, can be used as authorisation to make the necessary amendments to the company's legal structure, including the exclusion of the current shareholders if the conversion proposal included such a provision.

The proposal's validity expires if the company is declared insolvent at any time, including during court intervention.

This legal framework does not apply to financial institutions (banks, investment firms or insurance companies), listed companies, state-owned companies or privately held companies with a annual turnover of less than one million euros.

**Macroprudential measures applicable to new consumer credit agreements**

Last January, Banco de Portugal approved a recommendation (Banco de Portugal Recommendation on new consumer credit agreements) placing limits on some of the criteria used by banks to assess borrowers' creditworthiness. It covers the granting of new loans on residential immovable property, credit secured by a mortgage or equivalent guarantee, and consumer credit agreements. Limit types include limits to LTV and DSTI ratios and the maturity of loans.

This macroprudential measure applies to agreements concluded as of 1 July 2018. The aim of the measure is to ensure that credit institutions and financial companies do not take excessive risks in granting new loans and that borrowers have access to sustainable financing.

## ROMANIA

During the period under review, the following developments were recorded in the field of prudential regulation:

**Recent developments**

The draft of the new law in the area of *money laundering and terrorism financing,* for transposing into the national legislation the provisions of the *Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing* (in collaboration with National Office for Prevention and Control of Money Laundering, Ministry of Justice and other national authorities), was completed and is now going through the approval procedure.

The draft of the legislative acts transposing *Directive (EU) 2015/2366 on payment services in the internal market* (that amends the existing EU directive in this field) were completed and are now going through the approval procedure. NBR has actively participated in the inter-institutional transposition group (lead by the National Authority for Consumer Protection) in order to finalize the transposition.

In order to ensure the compliance with the *EBA Guidelines on remuneration policies and practices related to the sale and provision of retail banking products and services (EBA/GL/2016/06)* and to protect customers from the negative effects that may result from the remuneration policies applied to the employees in the sale department, the legislation was supplemented by issuing the NBR Instructions from 18.10.2017.

Prudential requirements have been applied to those non-bank financial institutions whose activity may generate increased risks (by focusing on short-term lending and high costs for individuals-borrowers), as well as increasing the own funds requirement for exposures arising from high-cost loans. (*NBR Regulation no. 1/2017 for the modification and completion of the NBR Regulation no. 20/2009 on non-banking financial institutions).*

In January 2018, the NBR issued Regulation no. 1/2018 which (1) amended the Regulation no. 5/2013 on prudential requirements for credit institutions, by imposing banks to take the necessary steps in order to avoid keeping the beneficial terms granted under remuneration packages for clients who are no longer part of the bank's employees and (2) repealed the NBR Regulation no. 16/2012 of the National Bank of Romania on classification of loans and investments and the establishment and use of prudential value adjustments (due to Article 481(1) of CRR which allowed own funds deductions decided at national level until 31 December 2017 only).

In March 2018, the NBR issued the Regulation no. 2/2018 amending and supplementing the NBR Regulation no. 25/2011 on credit institutions' liquidity, which envisages the modification of the treatment of loan commitments given to the non-financial clients for which estimated drawing schedules are not provided. Also, the regulation removes the obligation of observing the limit of the liquidity ratio for the first maturity band, up to one month, considering that at the EU level, the required minimum standards of LCR ratio for short-term (of up to 30 days) liquidity requirements, have been fully introduced starting with 1 January 2018.
In December 2017, the NBR issued NBR Order no. 12/2017, according to which, starting with the 1st of January 2018, credit institutions authorized in Romania and identified as O-SII by the National Bank of Romania, on the basis of the data collected for the first quarter of 2017, have to maintain an O-SII buffer of 1% of their total risk exposure amount.

In 2018, according to the NBR Order No.12/2015, the capital conservation buffer must consist in Common Equity Tier 1 capital equal to 1.875% of the total risk exposure amount. According to the same NBR Order, the countercyclical capital buffer is set at 0%.

In May 2018, the NBR issued NBR Order no. 4/2018 regarding the systemic risk buffer, according to which, starting with the 30th of June 2018, credit institutions have to maintain a systemic risk buffer, calibrated according to a specified methodology.

## Ongoing Financial Regulatory Reform Efforts

An objective in the regulation field is to update the secondary regulatory framework in line with the new developments in the national legislative framework in the area of money laundering and terrorism financing, payment institutions and electronic money institutions.
Also, an objective is to review the national framework applicable to credit institutions in areas such as licensing, changes in the situation of credit institutions, mergers/divisions, licensing of the bridge - credit institution, corporate governance, outsourcing, risk management.
NBR will finalize the analysis on the need to revise the legal framework that applies to the non-banking financial institutions sector.

In order to ensure the harmonization of national legislation with guidelines and recommendations issued by European Banking Authority, the National Bank of Romania is constantly updating the prudential regulatory framework. Areas in which the EBA guidelines and recommendations were transposed into Romanian regulations refer to liquidity coverage ratio (LCR) disclosure, disclosure requirements under Part eight of Regulation (EU) no.575/2013, modified duration of debt instruments, acquisitions and qualifying holdings, operational risk (ICT risk assessment), connected clients, recovery and resolution, disclosure the impact of the transition to IFRS 9, and outsourcing.

The National Bank of Romania will also implement the recommendations made by the International Monetary Fund and the World Bank as a result of Financial Sector Assessment Program in Romania (2017 – 2018).

Moreover, National Bank of Romania has continued to actively participate in the negotiation process of the risk reduction measures package ("RRM package"), published by the European Commission on 23 November 2016.

Likewise, National Bank of Romania takes part in the negotiation process conducted at the level of the Council of the European Union, regarding the legislative proposals issued by the European Commission in the field of covered bonds and non-performing loans.

## Developments in the Accounting Regulation Field

Taking into consideration the Ministry of Public Finance reporting requirements, in order to ensure the comparability of the information covered by the semi-annually accounting reports at the national level, the Semi-annually accounting reporting system, applicable to the entities under the National Bank of Romania accounting regulation scope, was updated by the National Bank of Romania in August 2017 by issuance of the following order:

- Order no.7/2017 amending Order no.10/2012[8], modifying the template of one of the semi-annually accounting reporting forms - code 30 – „Informative data”, for all the categories of entities under the scope of the NBR Order no.10/2012, according to the reporting requirements set out in the *Ministry of Public Finance Order no. 895/2017*

[8] National Bank of Romania Order no.10/2012 for the approval of the Semi-annually accounting reporting system, applicable to the entities under the National Bank of Romania accounting regulation scope

*approving the Accounting reporting system on the 30th of June 2017 for the economic entities, as well as for the regulation of certain accounting aspects.*

In order to ensure the regulation framework regarding the bookkeeping according to the new accounting treatments set out within IFRS 9 - *Financial Instruments* (which replaces IAS 39 Financial Instruments - *Recognition and measurement* and changes fundamentally the way financial instruments are accounted for, introducing the new concept of expected credit losses) and in order to update some other accounting provisions requirements, Order no.27/2010[9] was amended by the National Bank of Romania by issuance of the following order:

- Order no.8/2017 (applicable starting with 01.01.2018), the main aspects envisaged thereby being: introducing / modifying/ restructuring some accounts to ensure the accounting evidences necessary to observe the new accounting treatments set out within IFRS 9 (which regards, mainly, the recognition of the expected credit losses for financial instruments and the classification of the financial assets) and the new disclosure requirements set out within IFRS 7 (as amended by IFRS 9), as well as to facilitate the accomplishment of the reporting requirements set out within the new FINREP framework; introducing the bookkeeping rules for giving in payment operations and for the negative interest of the financial assets and liabilities, introducing a new account for recording the advances representing the loan instalment equivalent received from clients that do not keep current accounts opened at credit institutions.

Following the changes in the International Accounting Standards (IFRS 9), in order to ensure the implementation, for solo FINREP reports, of the provisions of the new FINREP consolidated reporting framework, approved by the EBA in November 2016 and adopted at EU level by the Regulation (EU) no. 1443/2017[10], the National Bank of Romania issued in November 2017:

- Order no.9/2017 (repealing Order No. 6/2014[11] and applicable starting with the reference date for reporting 31.01.2018), the main aspects envisaged thereby being:
  - ✓ the correlation of the FINREP individual reporting framework with the amendments brought to the FINREP consolidated reporting framework, as follows: the classification and measurement of financial instruments, the new impairment model based on the expected credit losses, the new requirements on hedge accounting, other changes, mainly on the definition of the gross carrying amount of the financial assets and the reporting of information on non-performing and forborne exposures;
  - ✓ the elimination from the forms of the indicators specific to consolidated reporting, as well as other changes to the reporting forms/instructions generated in particular by the application of the dirty price convention by Romanian credit institutions;

[9] National Bank of Romania Order no.27/2010 approving the Accounting regulations according to International Financial Reporting Standards, applicable to the credit institutions

[10] Regulation (EU) no. 1443/2017 amending the Regulation (EU) no. 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to Regulation (EU) No 575/2013 of the European Parliament and of the Council, as subsequently amended and supplemented

[11] National Bank of Romania Order no.6/2014 for the approval of the Methodological rules regarding the preparation of FINREP individual financial statements, according to International Financial Reporting Standards, applicable to the credit institutions for prudential supervision purposes

- ✓ the drawing – up of the mapping of the chart of accounts to the reporting forms (similar to the approach in the regulation in force, but also considering the new accounts stipulated by the Order no.8/2017);
- ✓ introducing the correlations within/ between individual FINREP forms, by accordingly updating the validation rules related to the new FINREP consolidated reporting framework (approach that has been applied so far); and
- ✓ ensuring the internal information needs for exercising the individual supervision.

With a view of ensuring the comparability of the financial and accounting statistical information related to Romanian branches of credit institutions having their headquarters in other Member States, needed for performing analyses and studies at the National Bank of Romania level, with the similar information reported by the credit institutions in the FINREP reports, Order no.10/2017 was issued in November 2017 (repealing Order No. 5/2014[12] and applicable starting with the reference date for reporting 31.01.2018).

For ensuring a unified treatment with that provided for the economic operators in the regulation issued by the Ministry of Public Finance[13] and to meet the information needs for that authority, Order no.1/2013[14] was updated in May 2018 by issuance of the following order:

- Order no.3/2018, amending the template of the annual accounting reporting form code 30 - "Informative data", according to the Ministry of Public Finance requirements.

## SINGAPORE

### Key Developments in Prudential Regulation/Accounting Conventions

MAS Notice 612

On 29 December 2017, the MAS issued the revised MAS Notice 612 on *Credit Files, Grading and Provisioning* (which took effect on 1 January 2018) in relation to the implementation of Singapore Financial Reporting Standard ("SFRS") 109 *Financial Instruments* or SFRS (International) ("SFRS(I)") 9 *Financial Instruments* for banks listed on the Singapore Exchange. Banks in Singapore are to measure and recognise loss allowances for expected credit losses in accordance with the requirements of SFRS109/SFRS(I) 9. Under the revised MAS Notice 612, Singapore-incorporated banks which are designated by the MAS as D-SIBs are required to maintain a minimum level of loss allowances for selected non-credit-impaired exposures i.e. minimum regulatory loss allowance (MRLA), of 1% of their gross carrying amount, net of collaterals. Where the accounting loss allowance falls below the 1% MRLA, the D-SIB is required

[12] National Bank of Romania Order no.5/2014 for the approval of the Methodological rules regarding the preparation of the periodic reports containing financial and accounting statistical information applicable to Romanian branches of credit institutions having their headquarters in other Member States

[13] Order of the minister of public finance no.470/2018 regarding the main aspects related to the preparation and submission of the annual financial statements and accounting reports of the economic operators to the territorial units of the Ministry of Public Finance and amending and supplementing certain accounting regulations.

[14] National Bank of Romania Order no.1/2013 for the approval of the Methodological rules regarding the preparation of the annual reporting for Ministry of Public Finance information needs, applicable to the credit institutions

to recognise additional loss allowances to meet the 1% MRLA, by establishing a non-distributable regulatory loss allowance reserve through appropriation of its retained earnings.

MAS Notice 652

On 10 July 2017, the MAS issued a new MAS Notice 652 to implement the Basel Committee's standards on the Basel III Liquidity Rules - Net Stable Funding Ratio (NSFR). MAS Notice 652 applies to D-SIBs and took effect from 1 January 2018, except for the provision on the Required Stable Funding add-on for derivative liabilities. A D-SIB incorporated and headquartered in Singapore must maintain a consolidated all-currency Group NSFR of at least 100% on an ongoing basis.

Amendments to the Monetary Authority of Singapore ("MAS") Act

In July 2017, the Monetary Authority of Singapore (Amendment) Bill 2017 was passed in Parliament. The Bill introduces amendments to the MAS Act to, inter alia, enhance the legislative framework for the recovery and resolution of distressed financial institutions. Specifically, the amendments empower the MAS to:

- impose recovery and resolution planning requirements on FIs, and to require them to address deficiencies in their recovery plans and remove impediments to resolvability;
- impose temporary stays on early termination or acceleration rights of counterparties to contracts entered into with an FI in resolution;
- convert into equity or write down unsecured subordinated liabilities of an FI;
- recognise actions taken by foreign resolution authorities on FIs in Singapore;
- establish a framework to compensate creditors who are made worse off by a resolution than they would have been in a liquidation; and
- establish resolution funding arrangements to support costs incurred in implementing resolution measures.

The Deposit Insurance and Policy Owners' Protection Schemes (Amendment) Bill 2018 was read in Parliament for the first time on 17 May 2018. The Bill proposed amendments to the Deposit Insurance Scheme ("DI Scheme") and the Policy Owners' Protection Scheme ("PPF Scheme) to strengthen protection for depositors and insurance policy owners and to improve operational efficiency of the schemes. Key amendments proposed in the Bill includes:

- raising the DI Scheme coverage limit from S$50,000 to S$75,000 per depositor;
- introducing a definition for "personal" insurance policy;
- introducing caps on compensation payouts for certain types of general insurance policies[15];
- including voluntary winding up as a trigger for compensation payout under the schemes to expedite the compensation process;
- expanding legal protection for officers of the administrator of the scheme, the Singapore Deposit Insurance Corporation (SDIC);
- requiring the liquidator to cooperate with SDIC to facilitate prompt compensation payouts under the schemes.

[15] Examples of policies where caps will be introduced are own property damage motor claims for personal motor insurance policies and property damage claims for personal property (structure and contents) insurance policies.

The Bill is expected to be passed in Parliament by 3Q2018.

Anti-commingling framework

On 29 September 2017, MAS issued a consultation paper seeking feedback on proposed refinements to the anti-commingling framework for banks. The proposed refinements are in two key aspects – streamlining the conditions and requirements under regulation 23G of the Banking Regulations so as to make it easier for banks to conduct or invest in permissible non-financial businesses that are related or complementary to their core financial businesses, and allowing banks to engage in the operation of digital platforms that match buyers and sellers of consumer goods or services, as well as the online sale of such goods or services.

Large exposures framework

On 3 January 2018, the MAS released a Consultation Paper on Proposed Revisions to the Regulatory Framework for Large Exposures of Singapore-incorporated Banks. The proposed revisions incorporate relevant aspects of the "Supervisory framework for measuring and controlling large exposures" published by the Basel Committee in April 2014 and will apply only to Singapore-incorporated banks In particular, the MAS has proposed to tighten the large exposures limit from 25% of eligible total capital to 25% of Tier 1 capital. The MAS has proposed implementing the revised framework with effect from 1 January 2019.

**Key Developments Around Non-Bank Financial Institutions**

SGX RegCo

The Singapore Exchange Limited ("SGX") established Singapore Exchange Regulation Pte. Ltd. ("SGX Regco") as an independent regulatory subsidiary with effect from 15 September 2017. The segregation of regulatory functions from commercial activities strengthens the governance of SGX as a self-regulatory organisation. SGX Regco is governed by a board that comprises majority independent directors. SGX Regco has been active in discharging its regulatory duties, which include conducting a strategic review of its rules to support the development of the market while maintaining regulatory robustness.

Consultation papers on new multi-tier regime for market operators and product notification

On 22 May 2018, MAS issued two consultation papers to improve market operators' business flexibility when establishing new centralized trading facilities and speed to market when launching new products.

In the Consultation Paper on Review of the Recognised Market Operators Regime, MAS proposes to expand the existing Recognised Market Operators (RMO) regime from a single tier to three separate tiers (namely RMO Tier 1, RMO Tier 2 and RMO Tier 3) to better match regulatory requirements to the risks posed by different types of market operators. RMO Tier 1 is a new tier for market operators that serve a limited base of retail investors, while RMO Tier 2 is for market operators that qualify under the existing RMO regime. Such market operators are not allowed to serve any retail investors. RMO Tier 3 is a new tier for market operators that have a significantly

smaller scale of business compared to more established operators under the existing RMO regime. A multi-tier RMO regime with gradated requirements can better accommodate the emergence of new business models such as blockchain-based or peer-to-peer trading facilities, and lower the cost of entry for start-up operators.

In the Consultation Paper on Draft Notice on Product Notification Regime, MAS also set out its intention to replace the current approval regime for the launch of new derivatives products traded on exchanges or centralised trading facilities with a notification regime[16]. The proposed new regime has two key benefits. First, it will give market operators a greater incentive to conduct more thorough due diligence on their product offerings. These market operators will now be required to self-certify that the risks pertaining to the product (e.g. risks of disorderly trading, risks of market manipulation, and risks pertaining to physical delivery of the underlying) are adequately addressed. Second, it will provide market operators more certainty on product launch timelines and hence provide them more flexibility in planning product launches.

**Key Developments around Conduct of Business**

FX Global Code and The Singapore Guide to Conduct and Market Practices for the Wholesale Financial Markets ("Blue Book")

The FX Global Code, a set of global principles of good practice in the wholesale FX market, has been adopted by wholesale FX market participants in Singapore. MAS, the Singapore Foreign Exchange Market Committee (SFEMC), as well as key FX players in the sell-side and buy-side, have pledged support for the Code by signing Statements of Commitment. With the adoption of the Code, the Blue Book, which also included good practice guidance for the wholesale market, was reviewed substantively to cover:

- supplementary guidance for the wholesale FX market in Singapore;
- good practices for the non-FX asset classes (e.g. debt securities and money market instruments); and
- benchmark rate setting.

The revised Blue Book incorporates high-level principles from the Code, such as ethics and governance, and has expanded in scope to include buy-side in addition to sell-side entities. The revised Blue Book was published by the SFEMC on 12 April 2018.

In July 2014, the Financial Stability Board ("FSB") Official Sector Steering Group ("OSSG") published a report on *"Reforming Major Interest Rate Benchmarks"*.[17] The report built upon the July 2013 IOSCO Principles for Financial Benchmarks ("IOSCO Principles")[18], which sets out international standards for improving the robustness and integrity of financial benchmarks. A key recommendation of the FSB OSSG report was for benchmark administrators of the major

[16] As set out in the Securities and Futures (Amendment) Act 2017 which was passed in Parliament on 9 January 2017.
[17] See FSB OSSG Report, "Reforming Major Interest Rate Benchmarks", 22 July 2014, <http://www.fsb.org/wp-content/uploads/r_140722.pdf>.

[18] See IOSCO Report, "Principles for Financial Benchmarks", July 2013, <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>.

Interbank Offered Rates ("IBORs")[19] to strengthen the IBORs by anchoring them to actual transaction data, to the extent possible.

In Singapore, the Association of Banks in Singapore ("ABS") and the Singapore Foreign Exchange Market Committee ("SFEMC") implemented several key initiatives in July 2013 to enhance the financial benchmark setting processes in Singapore, including to:

- Discontinue benchmarks that were not widely used;[20]
- Transition Singapore Dollar Swap Offer Rate ("SOR") and other FX benchmarks to a fully transaction-based methodology;[21] and
- Develop industry good practice on benchmark rate setting activities in the Blue Book[22], which strengthened the governance around the rate submission process.

Following FSB OSSG's recommendations, ABS Co. and SFEMC ("ABS-SFEMC") formed a working group in 2015 to analyse the profile of the SGD funding markets, to develop proposals to enhance SIBOR in line with international standards. ABS-SFEMC subsequently issued a public consultation in December 2017 on the proposal to implement a waterfall-type methodology for SIBOR, similar to developments in the key IBORs globally. The main change from the current approach was the proposal to reference a broader set of banks' borrowing transactions beyond those in the interbank market. This recognises the evolution in banks' key funding sources over the years, and strengthens SIBOR's reliance on transaction data. The implementation of a waterfall methodology would also provide more explicit guidance to panel banks, to ensure consistency in practices across the panel banks. The public consultation closed in February 2018, and ABS-SFEMC will respond to feedback from the consultation in Q3 2018.

Consultation paper on individual accountability and conduct guidelines

MAS has proposed guidelines to strengthen individual accountability of senior managers and raise standards of conduct in financial institutions. The proposed guidelines are a key part of MAS' broader efforts to foster a culture of ethical behaviour and responsible risk-taking in the financial industry. The proposed guidelines reinforce financial institutions' responsibilities in three key areas: (a) promote individual accountability of senior managers who are responsible for functions which are core to the management of the institution's affairs, (b) strengthen oversight of employees in material risk functions, and (c) embed standards of proper conduct among all employees. The proposed guidelines complement existing legislation and guidelines, which already address many elements of the accountability and conduct regimes in other jurisdictions.

## Key Developments in AML/CFT

[19] Major IBORs refer to LIBOR, EURIBOR and TIBOR.

[20] The 2-month and 9-month SIBOR, the 1-week, 2-month, 9-month, 12-month SGD SOR, VND and MYR spot FX rates, SGD interest rate swap rates, THB and IDR SOR, and USD SIBOR were discontinued.

[21] SGD SOR, SGD spot FX and THB spot FX

[22] The Blue Book is formally known as the "Singapore Guide to Conduct & Market Practices for Treasury Activities". It is a set of industry good practices, which seeks to foster a high standard of business conduct for the wholesale treasury market. The Blue Book can be found here: www.sfemc.org/blue.asp. Guidance related to the setting of financial benchmarks can be found in Chapter XII of the Blue Book.

Significant uptick in focus on combating proliferation financing

Consistent with the position taken by international community in combating proliferation financing, Singapore has seen an uptick in regulatory scrutiny, and private sector resourcing, focused on detecting and preventing evasion typologies. Through a series of supervisory visits and dialogues, as well as circulars and other communication platforms, banks now have a greater awareness of evasion typologies, particularly through front/shell companies, and appropriate actions to be taken around client due diligence, transaction monitoring, front office training and client communications. This has led to greater and more focused efforts by banks at preventing and detecting proliferation financing.

AML/CFT Industry Partnership ("ACIP")

ACIP, which was mentioned in the IIB 2017 Global Survey chapter on Singapore, has released its first two industry best practice papers. The first paper is on preventing the abuse of legal persons (such as shell companies and private investment funds). The second is on trade-based money laundering. Both papers contain up to date "red flags", case studies and suggested best practices by leading industry members for consideration by the rest of the industry. ACIP has also formed a workgroup to share its members' collective experience in data analytics, and provide practical insights on acquiring, building or co-creating AML/CFT analytics solutions. In addition, the workgroup will identify areas where closer collaboration between the industry and government could lead to substantive change. The workgroup is expected to publish its results in the second half of 2018.

Singapore national corporate "KYC" utility

As referenced in the IIB 2017 Singapore Global Survey, work is underway by a group of 6 banks (3 local, 3 international) to develop a corporate "KYC" utility, which would mutualise KYC processes across banks and integrate "best in class" screening capabilities. Achievements to date include successfully conducting a Proof-of-Concept (POC) for the utility's target operating model and KYC policy that is aligned across the banks, and appointing a "lead integrator" to operationalise the utility. In so doing, it is intended that the national utility contributes to an overall uplift in regulatory standards for AML/CFT in Singapore, as well as innovate by speeding up the efficiency of the onboarding experience for customers, particularly those who hold multiple bank accounts.

**Key Developments in Payment Systems**

In November 2017, MAS launched a second consultation on its proposed payments regulatory framework, known as the Payment Services Bill (the "Bill"). The Bill will streamline the regulation of payment services under a single legislation, expand the scope of regulated payment activities to include virtual currency services and other innovations, and calibrate regulation according to the risks posed by these activities.

When the new Bill is enacted, payment firms will only need to hold one licence under a single regulatory framework to conduct any or all the seven specified payment activities. The Bill

will differentiate regulatory requirements according to the risks that specific payment activities pose and will also empower MAS to regulate payment services for money-laundering and terrorism financing risks, strengthen safeguards for funds, set standards on technology risk management and enhance interoperability of payment solutions.

The Payments Council was established in August 2017, comprising representatives from banks, payment service providers, trade associations and businesses. The objective of the Council is to encourage collaboration among different stakeholders in the payments ecosystem, to promote dialogue among the providers and users of payment solutions, and develop strategies to drive e-payment adoption in Singapore.

In July 2017, ABS and the banking industry successfully launched PayNow. PayNow leverages off FAST, which is Singapore's 24/7 real-time retail payment system, which enables users to seamlessly and securely transfer funds by using the recipients' NRIC and/or mobile numbers. ABS and the industry are currently working on PayNow Corporate, which would allow corporates to register their UEN (unique entity number) for PayNow and also enables customers to make payments to these corporates (P2B) using their Banking Apps.

Separately, banks, e-wallet providers and payment schemes are working together with MAS and IMDA on the specifications for a common Quick Response (QR) code for Singapore, which can accept e-payments from domestic and international payment schemes.

**Key Developments in Cyber Security**

Recent high profile cyber-attacks on financial institutions have amplified attention on the need to strengthen cyber security. Among financial institutions, banks have the most public-facing online services and thus are significantly exposed to cyber-attacks. Consequently, cyber risk has become a major area of focus for Bank's senior management and board of directors.

Given the interconnectedness of digital economies, hackers can opportunistically exploit and launch cyber-attacks from under-protected and vulnerable infrastructure from any location in the world against their target. Hence there is an urgency for financial regulators globally to agree on common and consistent approach in cyber risk management, and to counter cyber threats through proactive sharing of cyber threat intelligence.

Recognising the risk and impact of cyber-attacks in Singapore, the government and the MAS have over the years proactively established various organizations and working committees to bolster our cyber defences and resiliency, such as Singapore Computer Emergency Response Team (SingCERT), Cyber Security Agency (CSA) and Steering Committee of Cyber Security (SCCS) under The Association of Banks in Singapore (ABS).

The role of CSA is to ensure protection of Critical Information Infrastructure (CII) against prevailing cyber threats. A number of local and international banks have been designated as operators of CII within the financial sector. A new Cyber Security Bill was also enacted in February 2018 which focuses on 1) Strengthening protection of CII, 2) Provisioning of preventative measures and response actions, 3) Establishing a framework for sharing of cyber threat information and 4) A licensing framework for cyber security service providers.

MAS supports CSA directives and had set up a sectorial security operation centre to facilitate cyber surveillance, monitoring, and intelligence-sharing in the financial services sector. To strengthen bilateral and multi-lateral sharing of cyber threat information across different jurisdictions, MAS also partnered with Financial Services – Information Sharing and Analysis Centre (FS-ISAC) to develop a platform that would provide a trusted and efficient mechanism for financial authorities and central banks to exchange information about cyber threats reported by their regulated entities.

Given that financial services sector is a lucrative target for cyber criminals, there is a worrying trend that the wider ecosystems of the financial services sector, including the supply chain, will become victims to cyber intrusions, phishing scams, impersonation and data compromise. Therefore, it is imperative that financial institutions continue to strengthen their cyber resiliency and enhance readiness in dealing and recovering from a cyber-attack.

**Other Material Issues Identified by ABS around Fintech/Open Banking Systems**

Regulatory equivalence

One trend that has been noted is the ability of Fintech (or Techfin) operators to effectively perform many of the functions of a bank while not holding a full banking licence (subject to regulatory requirements including capital and liquidity). These functions include payments, lending and wealth management/financial advice. While competition in general is welcomed, ABS considers it important to maintain a level playing field – and so, similar business models need to be subject to similar regulation. ABS considers this issue to be of systemic significance and deserves consideration on a global platform.

Open banking initiatives

Another conversation in progress is a need to take a balanced approach to open banking initiatives – that is, allowing customers to permission the provision of bank data to third party financial services providers. While the theoretical benefits are understood, primarily facilitating financial inclusion and innovation, there are 2 primary considerations that are being discussed. The first is a potential increase in cybersecurity risk given data proliferation and possible infrastructure connectivity, and the second is unintended consequences – including whether customers expect continuity of service in the event of the insolvency of a third party financial services provider (i.e. not the bank whose data was provisioned). These issues deserve full consideration even as open banking initiatives continue.

# SOUTH AFRICA

## Significant Developments

*Financial Sector Regulation Act 9 of 2017*

The Financial Sector Regulation Bill was enacted on 22 August 2017. The Minister of Finance made the Financial Sector Regulations in terms of section 304 and section 61(4) of the Financial Sector Regulation Act 9 of 2017 (**FSRA**) with an effective date of 1 April 2018. The Regulations facilitate the smooth implementation of the FSRA, the establishment of the financial sector regulators and the Tribunal; and provide for the process of selection of persons for the appointment of the Commissioner and Deputy Commissioners of the Financial Sector Conduct Authority (**FSCA**).

The FSRA provides a broad mandate and scope for the FSCA to ensure improved market conduct outcomes in the South African financial sector. The FSCA's objectives are to:

- protect financial customers by promoting their fair treatment by financial institutions, providing financial education programs, and promoting financial literacy;
- enhance and support the efficiency and integrity of financial markets;
- and assist in maintaining financial stability.

More importantly, the FSCA is required to support overall policy objectives of financial inclusion and the transformation of the financial sector.

The next phase of the development of the Conduct of business framework, which will be the Conduct of Financial Institutions Bill (CoFI), is well underway and the first draft of the Bill is expected to be released for public comment during the course of 2018. CoFI will further entrench the "Treating Customers Fairly" (TCF principles) into legislation. The bill will create a consolidated conduct of business framework where the conduct of business components from the current sectoral laws will be collapsed into a single overarching piece of legislation.

*Financial Sector Levies Bill*

The Financial Sector Regulation Act sets, inter alia, the establishment of the financial sector regulators and the Tribunal. The third version of the Financial Sector Levies Bill, along with a supplementary impact study of the Twin Peaks reforms, was published in April 2018 for public consultation. This Bill seeks to provide for the imposition and collection of levies for the funding of the Prudential Authority, the Financial Sector Conduct Authority, the Financial Services Tribunal, the Ombud Scheme, the Office of the Pension Funds Adjudicator and the Office of the Ombud for Financial Services Providers

*Resolution framework*

The draft resolution bill seeks to provide for the establishment of a framework for the resolution of banks, systemically important non-bank financial institutions and holding companies of banks or systemically important non-bank financial institutions to ensure that the impacts and

potential impacts of a failure of a bank or a systemically important financial institution on financial stability are managed appropriately. In addition, the bill seeks to establish a deposit insurance scheme. A discussion document on "Designing a deposit insurance scheme for South Africa" motivates for the need for an explicit, privately funded deposit insurance scheme (**DIS**) for South Africa.

*Financial conglomerate supervisory framework*

The South African Reserve Bank (**SARB**) published a discussion document setting out the proposed financial conglomerates supervisory framework. Following industry commentary, the SARB set out working groups to discuss: (i) Capital requirements; (ii) Large exposures and risk concentration; (iii) Intragroup exposures; (iv) Corporate governance and risk management and (v) Reporting. The Prudential Authority of the SARB has published draft prudential standards, reporting templates, as well as Guidance Document on designating a financial conglomerate, for industry consultation.

*Southern African Development Community (**SADC**) Payment Systems*

The regional real time gross settlement system known as the SADC Integrated Regional Electronic Settlement System (**SIRESS**) reached a further milestone at the end of March when the millionth message passed over the system.

Work is well underway to include the US Dollar in the system. By and large intra-regional transactions are still primarily transacted in US Dollars and the inclusion of dollar transactions in SIRESS could double the number and value of transfers processed via this infrastructure. This initiative should assist a number of banks in the region who are subject to the issues around de-risking in correspondent banking.

On the retail payment front, participants in the Low Value Credit Transfers Scheme where transactions are cleared on an immediate basis, have completed the two phases of Proof of Concept (POC) testing. A small number of participants are now in final testing to be ready for go live. Upon successful final testing the scheme will be opened up to all other participants who wish to partake in this initiative.

This scheme aims to ensure these low value transfers are done in a well-regulated, safe, secure and efficient manner which should provide the opportunity for such payments to be made at a low cost thereby benefitting end clients, particularly those that are un-banked.

*National Payments System Act Review*

Work commenced to review and amend the National Payment System Act during 2017. The primary drivers for the review are stated to be: -

- The alignment with international requirements (i.e. The Principles for Financial Market Infrastructure, World Bank General Principles for International Remittance Services etc.);
- Adoption of the Twin Peaks Regulatory Framework;
- Southern African Development Community Harmonisation;

- The Payment System Management Body and Payments Association of South Africa (**PASA**) Review;
- 2008 Competition Commission Banking Enquiry; and
- The Reserve Bank's Vision 2025.

The revisions of the Expert Committee to the draft Policy document were presented to the Standing Committee in December 2017.

## Regulation of derivatives and securities products

*Financial Markets Act (**FMA**)*

The following Conduct Standards will be submitted to the Transitional Management Committee (**TMC**) for approval in due course:

- The reporting obligations in respect of transactions or positions in over-the-counter derivatives.
- Licensing requirements and additional duties of the Trade Repository
- Code of Conduct for Over-The-Counter Derivative Providers (**ODP**s)

The Criteria for authorisation for ODPs was approved by the TMC and published on 27 July 2018.

The margin requirements will be tabled in Parliament for a 30-day period.

*New Exchange and Central Securities Depository (CSD)*

As of 01 June 2018 the Authority has granted the following licensed exchanges:

- JSE Limited
- ZAR X (Pty) Ltd (ZARX) (granted an exchange licence on 31 August 2016)
- 4 Africa Exchange (Pty) Ltd (4AX) (granted an exchange licence on 31 August 2016)
- A2X (Pty) Ltd (granted an exchange licence on 6 April 2017)
- Equities Express Securities Exchange (Pty) Ltd (EESE) (granted an exchange licence on 11 September 2017)

Granite CSD Proprietary Limited was granted a CSD license on 18 May 2018.

## Market Developments

*Market Infrastructure*

Strate's Debt Instrument Solution (DIS) project replaced Strate's legacy UNEXCor system with a new BaNCS platform for the South African bonds market, and went live on 26 September 2017.

National Treasury is in the process of implementing an electronic trading platform (**ETP**) for the Primary Dealers (**PD**s) where the secondary market quoting obligations under the Primary

Dealer contract will need to be satisfied on the ETP. The primary reasons for this decision are to enhance the transparency within the South African Bond Market and to enable National Treasury to more accurately monitor the activities of the PDs. The ETP went live on 18 July 2018.

*Draft Code of Conduct for Parties to Securities Financing Transactions in the South African Securities Markets*

The draft Code was published on 19th October 2017 for public comment until 20th November 2017. However, the Registrar decided to extend the comment period until the 31st December 2017. The Authority is currently considering the comments.

**Anti-Money Laundering**

Anti-money laundering (**AML**), including Terrorist Financing (**TF**) remains a high priority for the South African banking industry. For this reason, the industry and regulatory authorities continuously strive to bring South Africa's AML legislation in line with global standards determined by the Financial Action Task Force (**FATF**). To this end, the Financial Intelligence Centre Act was amended during 2017, and compliance with the new provisions remains a high priority.

The much-awaited Financial Intelligence Centre Amendment Act was signed into law in 2017 to comply with the global standard set by the FATF, which is the intergovernmental body responsible for the global standard in anti-money laundering and combating financing of terrorism (AML/CTF). The key objective of this law is to improve the protection of the integrity of South Africa's financial system and strengthen its ability to prevent and punish financial crimes like money laundering, illicit capital flows, tax evasion, corruption and bribery, and financing of terrorism.

The FSCA issued a letter requiring all accountable institutions to submit their plans on how they intend to apply the new FIC laws. The Prudential Authority and the FSCA will be responsible for monitoring the implementation.

The Ministry of Finance amended the Money Laundering and Terrorist Financing Control **(MLTFC**) Regulations and withdrew Exemptions made in terms of the Financial Intelligence Centre Act, 2001 (FIC Act), effective 2 October 2017. The amendments are contained in South African Government Gazette No. 41154.

This provides the legal basis for a shift in the measures to protect the integrity of the South African financial system to a risk-based approach, which modernises the manner institutions undertake customer due diligence and encourages innovation in the way they deal with their customers.

Interbank collaboration to share information about typologies and trends, best practices and criminal *modus operandi* continues through the South African Banking Risk Information Centre (**SABRIC**) hosted Regulatory Crime Risk Expert Working Group formed in January 2018. (This structure is a more senior interbank group that replaces the previous Money Laundering Forum at SABRIC.) This workgroup has identified Illicit Flow of Funds, investment scams,

corruption and terrorist financing as priority areas for 2018/19. In consultation with expert stakeholders, South African typologies for each of these areas will be developed over the next 18 months. Whilst these threats are global, the intent is to identify indicators that relate to local manifestation of the threats based on practical operational experience of banking subject matter experts.

The identified shortage of analytic skill has also led to an initiative to develop interbank training material in partnership with BankSeta who will assist to promote AML investigations and analytics as career paths within the banking industry.

The South African banks recognise that collaboration within the industry and with Government is essential to contribute to national money laundering control objectives and ultimately impacts positively on the levels of organised crime in both the jurisdiction and globally.

## Cyber

*Cybercrime and cybersecurity Bill*

The Department of Justice and Constitutional development published a Cybercrimes and Cybersecurity Bill 2017 which primarily aims to deal with cybercrimes and cybersecurity. The Bill criminalises cyber-facilitated offences such as fraud, forgery and extortion, which were adapted specifically for the cyber environment. The Bill is still being deliberated at Parliament and the banking industry continues to proactively participate in the process. Great strides have been made in the last year to address concerns raised by various interest groups including the banks. During September 2017, Parliamentary hearings were held which have resulted in a further version of the Bill being released in February 2018.

The current version of the Bill includes, amongst other amendments, a definition for cybercrime and cybersecurity which is welcomed by all. It proposes to criminalise unlawful and intentional acts relating to personal and financial information which will enable prosecution of criminals for possession of such information which is expected to be a deterrent, once enacted. The Bill further imposes obligations on financial institutions who are aware of, or become aware of the fact that their computer systems are involved in the commission of any category or class of offences and to report such offences to the South African Police Service and to preserve any information which may be of assistance to the South African Police Service to investigate such offences. Non-compliance with the clause is criminalised.

Our laws in general afford broad jurisdiction to criminal acts which affect national security in the Republic of South Africa. The Department of Justice and Constitutional Development has been mandated in terms of the Bill to review and align the cybersecurity laws of the Republic to ensure that these laws are aligned with the National Cybersecurity Policy Framework (**NCPF**) for South Africa. The NCPF, which was approved by Cabinet in 2012, is aimed at developing measures to address national security in cyberspace; measures to combat cyber warfare, cybercrime and other cyber irregularities; the development, review and updating of existing substantive and procedural; laws; and measures to build confidence and trust in the secure use of Information Communications Technologies.

The Bill also deals with the establishment of nodal points (structures which receive and distribute information regarding cybersecurity incidents) and the recognition of private sector computer security incident response teams (expert groups that handle cybersecurity incidents). In so far as it relates to the financial services sector, the Bill now provides that consultation with the Minister of Finance and the South African Reserve Bank as the regulator is required, which is welcomed by the banks. Protection of critical information infrastructure is also dealt with in the Bill and again the governance structures in place for the financial services sector, are acknowledged in the applicable sections.

It is anticipated that the Parliamentary process will be finalised soon and that the Bill will be passed in 2018.

*Cyber resilience*

The Committee on Payments and Market Infrastructures (**CPMI**) and the board of the International Organization of Securities Commissions (**ISOCO**) issued guidance on the cyber resilience for financial market infrastructures (**FMI**s). The CPMI-IOSCO cyber-resilience guidance for FMIs was released to highlight the importance of their safe and efficient operation to maintaining and promoting financial stability as well as economic growth. Cyber resilience greatly contributes to operational resilience. Five primary risk management categories are outlined, with three overarching components that should be addressed across any cyber resilience framework. The five primary risk management categories are outlined are: governance, identification, protection, detection and response and recovery. The overarching components are: testing, situational awareness and learning and evolving. The SARB has now emphasized that cyber risk should form part of the enterprise risk management processes, practices and procedures, and board-approved policies of banks. The South African bank industry has been assigned the task of matching their current processes, practices and policies against the CPMI-IOSCO Cyber resilience guidance principles.

**Insurance Regulatory Framework**

*Insurance Act 18 of 2017*

The Insurance Act No.18 of 2017 was enacted on 18 January 2018. The envisaged effective date of the Act is 1 July 2018.

*Amendments to Regulations and Policyholder Protection Rules (PPRs)*

As indicated during public consultation on the amendments to the Regulations and the replacement of the PPRs made under the Long-term Insurance Act, 1998 (**LTIA**) and Short-term Insurance Act, 1998 (**STIA**), Phase 1 of the insurance conduct of business reforms will go into effect in two tranches:

1. Tranche 1 of the amendments to the Regulations made under the LTIA and STIA were promulgated on 15 December 2017 in the Government Gazette No. 41334, effective 1 January 2018 with certain regulations subject to transitional arrangement. These amendments give effect to a number of regulatory reforms focusing on conduct of

business, including amendments to the Binder Regulations and certain RDR Phase 1 proposals.

On 23 March 2018 the Minister of Finance published for public comment proposed amendments to the Regulations under the LTIA and STIA respectively. The proposed amendments focus mainly on aligning the Regulations with the Insurance Act and on improving the premium collection framework. Comments on the proposed draft amendments were due by 23 April 2018. The proposed amendments to the Regulations were revised taking into account all comments received through the public comment process, and the Regulations will be tabled with Parliament during the course of June 2018.

2. The replacement of the Policyholder Protection Rules (**PPR**s) made under the LTIA and STIA giving effect to a number of conduct of business regulatory reforms were promulgated on 15 December 2017 in the Government Gazette No. 41321 and 41329, effective 1 January 2018 with certain Rules subject to transitional arrangement. These replacement PPRs include, amongst others, detailed requirements relating to the fair treatment of policyholders, product design, cooling-off rights, advertising and marketing, appropriate disclosures, data management and complaints management. In order to give effect to the second tranche of the regulatory reforms, the FSB (predecessor to the FSCA) on 2 March 2018 released the proposed amendments to the PPRs made under the LTIA and STIA for public comment. These proposed amendments to the PPRs are necessary to:
   - align the PPRs with the Insurance Act;
   - provide for certain conduct of business related requirements that will be repealed from the LTIA and the STIA through Schedule 1 to the Insurance Act, once the latter Act commences, as these conduct requirements are better placed in subordinate legislation; and
   - provide for microinsurance product standards by giving effect to the National Treasury's Microinsurance Policy Document released in July 2011.

   Comments on the draft amendments to the PPRs were due by 13 April 2018. The proposed amendments to the PPRs were revised taken into account all comments received through the public comment process, and the revised PPRs were tabled with Parliament on 16 May 2018 as is required in terms of section 103 of the Financial Sector Regulation Act, 2017 (Act No 9 of 2017).

*Micro-insurance Product Standards*

The Insurance Act introduces the microinsurance regulatory framework proposed in the National Treasury Policy Document intended to create a dedicated microinsurance license that will promote financial inclusion, encourage entrance of new providers into the market and enhance consumer protection through appropriate prudential and business conduct regulation. Micro-insurance product standards were published for public comment in the proposed amendments to the PPRs and the final regulatory proposals have been tabled with Parliament as set out above. The draft microinsurance prudential standards were released for public comment by the

SARB on 9 March 2018 and tabled with Parliament on 30 April 2018. The effective date of the Prudential Standards is set to coincide with the effective date of the Insurance Act.

*FAIS Fit and Proper Requirements*

The new Determination of Fit and Proper Requirements for Financial Service Providers were published on 15 December 2017 with the Regulatory Response Document on comments received, as well as the KPMG report on the impact assessment that was commissioned to evaluate and analyse the impact of the proposed new continuous professional development and class of business training requirements and how that compares to the existing regulatory requirements. The new requirements, except certain provisions with a later commencement date, came into effect on 1 April 2018.

**Payments Systems**

*Project Future*

Early in 2017, PASA, together with Bankserv Africa commissioned a piece of research that compared the modernisation work that was done in nine other jurisdictions, with the pathway and choices South Africa was prioritising. The report, published in mid-2017, highlighted a few interesting international trends and aspects of payments modernisation. About ten common goals were driving modernisation across all nine jurisdictions- these ranged from commercially driven goals through to policy driven goals.

Whilst different levers and features were selected per country, the landscape, challenges and selected payments strategies were remarkably similar. This piece of work, which also provided a perspective of South African Stakeholders' views on the priority of these goals, was also discussed with the Reserve Bank, which contributed to the crystallisation and finalisation of Vision 2025. This important document will set a vision for payments modernisation in South Africa for the next few years.

As a result of the research and the final expected Vision 2025 document, it was decided late in 2017, that South Africa needs to crystallise a Future Payments Blueprint for electronic payments in South Africa, that would be more specific about the combination of features, levers and the selected priority use cases that would form part of a target state architecture and pathway for South African electronic payments. The approach agreed to develop such target state architecture involved:

- Strategy deduction whereby inputs from the South African Reserve Bank's (SARB's) Vision 2025 policy document and the abovementioned research initiative would be used to deduce the strategic direction required in the establishment of the target state architecture;
- Business architecture whereby the future business capability and operating models would be developed in order to establish the business concept of the target state architecture;
- Technology architecture whereby current and future technologies are assessed to determine whether they support the proposed business architecture;
- The development of a high-level cost benefit analysis to support the case for change for modernisation; and

- The development of a transformation plan which provides a roadmap to attain the target state.

The final deliverable of Project Future will also serve as input towards the development of the National Payment Plan (**NPP**) which is the industry response to Vision 2025 and provides guidance to the industry on how the goals set out in Vision 2025 will be attained.

*Authenticated Collections*

The Authenticated Collections programme remained a high priority items and found itself at a critical junction during the past year. The project has far more complexity than was originally anticipated and being a first of its kind in the world meant that there was no prior experience against which challenges, and progress could be benchmarked. Additionally, the introduction of the ISO20022 standard brought about further unanticipated complexities.

Despite many disappointments on past delivery commitments, sometimes outside the control of the greater interbank programme, the project has been reorganised to progress the programme and prepare for Ramp-Up during the third quarter of 2018. This aims to:

• Reduces the instability experienced in production by focusing all resources and effort on stabilisation of the core assets already in production for a period of time; and

• Mitigates against future production instability by placing renewed focus and rigour on testing through a re-designed testing approach, which will run until completed by end of July 2018.

The key focus was therefore to achieve a stable environment where all the functionality as per the full AC design has been developed, productionalised and operationalised to enable the industry to, with confidence, take on the User community (Ramp-Up) and Migrate the remaining Authenticated Early Debit Order and Non-Authenticated Early Debit Order books to Authenticated Collections afterwards. This is seen as the most prudent approach with the highest chance of de-risking the programme and achieving the critical dates contained in the Reserve Bank Directive.

*Debit Order Abuse Project*

On 23 June 2017, the SARB issued a Directive for Conduct within the National Payment System in respect of the Collection of Payment Instructions for Authenticated Collections. The Directive regulates the conduct of participants involved in the collection of payment instructions in the early Debit Order environment.

In addition to providing for the collection of early debit orders through Authenticated Collections in the early processing window by 31 October 2019, the Directive requires PASA to continue to improve the safety and efficiency of Debit Orders, including the introduction of measures to address risk emanating from Debit Order Abuse. In response the Debit Order Abuse project was established to explore and implement measures to curb the risk of debit order abuse in the existing debit order payment system.

The project aims to introduce revised measures to protect the rights of both consumers & users, and at the same time curtails the abuse of the debit order system currently present. The strategic objectives for this project are noted as:

- Enhance PASA's gatekeeping role;
- Enhance analytics and reporting on debit order abuse;
- Enhance the investigation and prosecution process;
- Understand and manage consumer behaviour; and
- Enhance market perception and confidence around debit orders.

*Common Monetary Area (**CMA**) Low value Cross Border Payments*

The National Payment System Department issued a letter and a Directive for Regularisation of Clearing and Settlement of Cross Border Low Value Credit Electronic Funds Transfer Transactions within the Common Monetary Area.

The objective of this Directive is to regularise involvement in the current inappropriate practices of Clearing and Settlement of the CMA cross border low value credit EFT transactions. These are currently processed as domestic transactions.

PASA agreed to manage the execution of a project on behalf of the industry and work was initiated in August 2017. Progress on the project is slower than anticipated with a number of key regulatory, governance and legal matters that are being addressed.

## SPAIN

After two general elections and months of talks aimed at building governing coalitions during the past years, 2017 has been the year when all four major parties have weighed their respective forces at the parliamentary level trying to reach agreements.

The following are the main legislative changes from 2017 and the first months of 2018:

- Act 7/2017, of 4 November, on consumer alternative dispute resolution systems for consumer disputes which implements EU Directive 2013/11. The main purpose of the Act is to ensure access for Spanish and European consumers to independent, impartial, transparent and effective alternative dispute resolution mechanisms.

- Act 4/2018 of 11 June, which modifies the General Law for the protection of consumers and users and other complementary laws approved by Royal Legislative Decree 1/2007.

- Act 5/2018 of 11 June which partially modifies Law 1/2000 on civil procedure, in relation to illegal occupation of houses.

- Royal Decree-law 18/2017, of November 24, which modifies the Commercial Code, the revised text of the Capital Companies Act approved by Royal Decree Legislative 1/2010, of July 2, and Law 22/2015, of July 20, on Audit of Accounts, regarding non-financial information and diversity. By virtue of the amendment introduced, the affected texts

require the inclusion in the management report of public limited companies, limited liability companies and limited partnerships for actions that, simultaneously, have the status of "public interest" entities whose number average of workers employed during the year exceeds 500 and, additionally, are considered large companies, in the terms defined by Directive 2013/34, of non-financial information of a social and environmental nature.

- Royal Decree-law 19/2017 of 24 November on basic payment accounts, account switching and comparability of payment account fees, which transposes Directive 2014/92/EU of the European Parliament and of the Council of 23 July 2014 on the comparability of fees related to payment accounts, payment account switching and access to basic payment accounts. The main updates introduced by the RD are: (a) Credit institutions must offer basic payments accounts to potential clients who meet certain requirements; (b) Payment service providers (PSP) must enable their clients to switch effectively and nimbly their payment accounts to other PSP in Spain and (c) PSP shall provide their clients with a fee information document and a statement of fees and the Bank of Spain's website shall offer access to comparative analyses of the fees charged by several PSP.

- Royal Decree-Law 21/2017, of 29 December, on urgent measures for the adaptation of Spanish law in accordance with European Union regulations in relation to the securities market. Its purpose is to establish and govern certain aspects of the legal regime of Spanish trading venues for financial instruments so as to ensure full compliance with and certification thereof, pursuant to the European standards provided for in Directive 2014/65/EU, of the European Parliament and of the Council, of 15 May 2014, on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

- Royal Decree 1070/2017, of 29 December 2017 amending the General Regulations on tax management and audit work and procedures and implementing the common rules on procedures for applying taxes, approved by Royal Decree 1065/2007, of 27 July 2007, and Royal Decree 1676/2009, of 13 November 2009, on the Council for the Defence of the Taxpayer. The main objective of most of the changes is to increase the tax authorities efficiency´s to enhance the fight against tax fraud.

- Royal Decree 1071/2017, of 29 December 2017 amending the General Collection Regulations, approved by Royal Decree 939/2005, of 29 July 2005. The most relevant changes are those related to criminal offences.

- Royal Decree 1072/2017, of 29 December 2017, amending the General Regulations on the tax penalty regime, approved by Royal Decree 2063/2004, of 15 October 2005. The most notable change is the implementing provisions on penalties associated with the "Immediate Supply of Information System" in relation to VAT.

- Royal Decree 1073/2017, of 29 December 2017, amending the General Implementing Regulations for General Taxation Law 58/2003, of 17 December 2003, regarding administrative review, approved by Royal Decree 520/2005, of 13 May 2005. The main changes are those related to mutual agreement procedures under international conventions and tax treaties, as well as the specific rules established to assess the quantum of economic-administrative claims.

- Royal Decree 1074/2017, of December 29, 2017, amending the main direct income Tax regulations (i.e. the Personal Income Tax Regulations, approved by Royal Decree 439/2007, of March 30, 2007, the Corporate Income Tax Regulations, approved by Royal Decree 634/2015, of July 10, 2015, and the Inheritance and Gift Tax Regulations, approved by Royal Decree 1629/1991, of November 8, 1991). Among the most important changes in Corporate Income Tax are those related to rules governing the country-by country reporting, as well as the new exception to the obligation to withhold tax on amounts paid to pension funds by open pensions funds.

- Royal Decree 1075/2017, of December 29, 2017, amending other tax regulations (being the most relevant the Value Added Tax Regulations, approved by Royal Decree 1624/1992, of December 29, 1992, the Transfer and Stamp Tax Regulations, approved by Royal Decree 828/1995, of May 29, 1995, the Regulations on invoicing obligations, approved by Royal Decree 1619/2012, of November 30, 2012). One of the most significant changes is the change related to the system of monitoring taxable persons subject to the Special VAT Group Scheme to adapt it to the new regulations contained in the General Taxation Law.

As well as:

- National Securities and Exchange Commission Circular 1/2018 of 12 March on financial instrument warnings which will apply to those entities that provide investment services but not discretionary investment management services for retail clients in Spain; namely, investment firms, credit institutions and collective investment scheme management companies, these same European entities operating in Spain through a branch or an agent and these foreign non-EU entities that operate through a branch or on a freedom-to-provide-services basis (each of them, the "Entity" and together, the "Entities").

  The purpose of Circular 1/2018 is to increase retail investor protection when contracting certain sophisticated financial instruments and at the same time to increase transparency in their distribution.

- Circular 4/2017, of November 27, from the Bank of Spain to credit institutions, on rules of public and reserved financial information, and financial statement models. The Circular regulates accounting standards of credit institutions, highlighting the following matters: content of the annual accounts; recognition and valuation criteria, where the rules on impairment of values / provisions stand out; business combination and consolidation and finally, content of the financial statements. In addition, it regulates certain aspects of the reserved financial information (corresponding to the information to be sent for supervisory purposes) as well as the internal accounting development and the presentation of information to the Bank of Spain. This Circular adapts the Spanish regulations to the International Financial Reporting Standards (IFRS), specifically to IFRS 9, on financial instruments and IFRS 15, on ordinary income.

# SWEDEN

## The banks' results and key figures

The description focuses on the four major commercial banks in Sweden. They jointly represent about 70 per cent of the market. These major banks have considerable activities in markets outside Sweden. The text is mainly based on reports from the National Institute of Economic Research (NIER), Finansinspektionen (the Swedish FSA) and the Swedish Central Bank' (The Riksbank).

## Market developments

Sweden's GDP increased by 2.4 percent in 2017 according to Statistics Sweden. The household consumption contributed with 1.1 percent units to the total GDP growth and public consumption contributed with 0.1 percent units. Gross fixed capital formation increased by 6.0 per cent and added to the GDP growth with 1.5 percent units. The high level of residential construction is an important factor behind the increasing gross fixed capital formation. Changes in inventories added to the GDP growth by 0.1 percent units. Import increased more than export and therefore net exports held back GDP growth with 0.3 percent units. GDP continued growing in the first quarter by 2.8 percent on an annual basis.

Market production of goods and services increased by 2.9 percent in 2017. Production of goods rose by 3.8 percent and service-producing industries rose by 2.4 percent. The number of employed in the economy increased by 2.3 percent. The employment, measured as the total number of hours worked, increased by 1.2 percent. The unemployment rate fell to 6.7 per cent in 2017 from 6.9 per cent in 2016. In the first quarter 2018 the unemployment has fallen slightly further to 6.6 percent.

Even though the unemployment is falling due to robust growth, the unemployment is higher now than the previous cyclical peak, writes the NIER (National Institute of Economic Research). One reason for this is that the share of people with a weak attachment to the labour market has risen markedly over the past decade, due partly to political measures to increase labour force participation and partly to high levels of immigration in recent years.

The inflation has increased slightly during 2017 and was 1.7 per cent in the end of the year. The same development has been observed for the core inflation which was 1.9 percent in the end of 2017. During 2018 the inflation has been relatively stable and in April 2018 amounted to the same figures respectively.

Government debt as a percentage of GDP was 29 percent in 2017, down from 31 percent in 2016, according to the Swedish National Debt Office. The Swedish central government showed a budget surplus of SEK 61.8 billion in 2017, compared with a surplus of SEK 85.3 billion in 2016. Among other things, rising employment and high housing investment contributed to the development according to the Debt Office.

## Household and corporate borrowing

The strong economy continues to strengthen household finances writes Finansinspektionen in their Stability Report. Household disposable income has increased as a result of falling unemployment and real wage increases. At the same time, low interest rates have meant that the portion of disposable income that households spend on interest rate expenses is historically low. Taken together, this creates a large capacity for consumption and savings.

High savings and rising asset prices have led to an increase in household assets. Over the past ten years, households' total assets have more than doubled in value. The sharp increase in house prices has meant that residential properties' share of households' total assets now constitutes more than 60 per cent, writes Finansinspektionen.

Household debt is high from both an international and a historical perspective, writes Finansinspektionen. The rate at which household debt is increasing has stabilised at a high level, approximately 7 per cent on an annual basis. Household mortgages are currently increasing around 7 per cent a year. Loans collateralised by tenant-owned apartments are increasing the fastest. Consumption loans have also increased sharply since the autumn of 2016, approximately 7 per cent a year.

The banks' lending to non-financial firms increased by 6 per cent in Q1 2018 compared to the same period the previous quarter according to Finansinspektionen. However, it is not only traditional bank loans that are increasing. Non-financial firms' debt through interest-bearing securities rose on average by approximately 15 per cent at an annual rate in 2017 and continued to grow at the same tact during the start of 2018. This form of financing has grown rapidly and now constitutes approximately one third of non-financial firms' total borrowings, writes Finansinspektionen in their Stability Report.

## The Swedish mortgage market

The house prices started to cool off in the autumn 2017 and have continued in 2018 with falling prices. One factor which has influenced the market is that amortisation rules have been introduced to curb interest-only loans. Another factor is that construction has reached relatively high levels and has created a larger supply of housing in certain segments.

Residential mortgage lending grew by 7.1% in 2017, which is only marginally slower than in 2016. The growth rate of residential loans has been levelling off the last two years, however on a relatively high level.

Several factors, which have been similar for several years, explain the increasing residential lending. The Swedish population is growing in record numbers due to high immigration and relatively high birth rates. The internal migration in Sweden towards the south and larger cities has driven the housing markets in expanding areas. This in combination with a long period of comparably low residential housing construction has created a severe lack of housing and housing imbalances. Another factor is the dysfunctional rental markets in the growth regions due to a general rent control, which results in many years of queuing to get a rental apartment on the first-hand market. If you move to a city in a growth region in Sweden, you normally have to buy an

apartment or rent a second-hand apartment to a cost usually far higher than rents on the first-hand market. An additional factor is historically low mortgage interest rates. Also, the high construction figures of the last years of tenant-owned apartments has created a demand to finance all the new apartments with mortgage loans.

The authorities have tried to restrain the development of increasing household debt with different measures. An LTV-roof of 85% on new mortgage lending has been imposed and risk weights on mortgage lending have been increased. For several years, interest-only loans have been curbed by the banks. In June 2016, an amortisation law has been imposed which means that all new mortgage loans above 50 per cent LTV must amortise. Finansinspektionen (the Swedish Financial Supervisory Authority) added new amortisation rules in March 2018 when additional amortisations for LTI above 450 percent (gross income) entered into force.

Mortgage interest rates have been relatively stable the last three years. The variable (3-month) mortgage interest rate has varied between 1.5 and 1.6 percent during 2017, which is about the same level as in 2015 and 2016. The initial fixed mortgage interest rates, 1-5 years, have varied between 1.6 and 1.7 percent in 2017, which is also the same level as previous years. Initial fixed mortgage interest rates over 5 years were record low in 2017 and reached levels below 2 per cent in the second half of 2017. The low interest rates have persisted in the first half of 2018.

Finansinspektionen, writes an annual report on the mortgage lending market. The report is an important part of the Finansinspektionen's analysis of the mortgage market and the debt situation of the Swedish households. Finansinspektionen writes in the latest report that the amortisation on new mortgage loans has increased continuously since 2011. The share of households amortising and the average size of the amortisations increased markedly in 2016 as the new amortisation rules entered into force. The share of households with new loans that amortise was 79% in 2017, which is slightly higher than in 2016. The average LTV for new mortgage loans is 63% in 2017, which is lower than in 2016.

The credit losses on mortgage loans have been very low in Sweden for many years. The credit loss ratio has been very close to zero for several years, including 2017.

**Profitability in the Swedish banking sector**

On average, the Swedish banking sector has good profitability, writes Finansinspektionen in their Stability Report. This also applies to the major banks whose net interest income has continued to increase over the past six months. Net commission income has also increased as a result of high activity on the capital markets. The favourable economy contributed to the low level of credit losses. As a whole, this has resulted in continued high levels for the major banks' profits. The major Swedish banks are relatively cost-effective and in general have lower costs in relation to income than other major banks in the EU.

Lending to households and corporates constitutes just over half of the four major banks' total assets at the consolidated level. Almost 90 per cent of lending to households consists of mortgages. At the same time, approximately 35 per cent of lending to corporates is for commercial real estate in some form, including tenant-owner associations. The developments on the real estate market therefore have a major impact on the banks' financial position.

## Bank capital

The major Swedish banks meet the risk-based capital requirements by a good margin according to Finansinspektionen. The banks average total capital ratio is 28 per cent. Even the narrower CET 1 ratio is higher from a European perspective. Overall, the Swedish banking system's capital levels and the assessment of profitability leads to the conclusion that resilience to stressed scenarios is satisfactory, writes Finansinspektionen. The vulnerability indicator for the equity/assets ratio in the banking sector has also demonstrated low vulnerability for a long time.

# SWITZERLAND

## Introduction

The banks in Switzerland are an important sector for the Swiss economy, one that accounts for approximately 4.6% of the country's total economic output. Being a highly internationally interconnected market, legal, capital and liquidity requirements such as those established by the Financial Action Task Force (FATF) and the Basel Committee on Banking Supervision are rigorously complied with. In 2017 and 2018, the supervising authorities continued to enforce Basel III standards such as unweighted capital adequacy requirements for non-systemically important banks. Equally binding for all banks is the automatic exchange of information for financial accounts (AEOI). Switzerland will exchange tax relevant data for the first time in 2018, and Swiss banks are fully committed to implementing the AEOI. Another important issue is digitalisation, which is viewed on the one hand as an opportunity for the financial sector, while on the other, it gives rise to specific needs in terms of regulation. As a result, the Swiss Financial Market Supervisory Authority (FINMA), for example, published a guideline on initial coin offerings (ICOs) in February 2018, and was one of the first supervisory authorities worldwide to do so.

## Capital and liquidity requirements

In autumn 2017, the Federal Council adopted a revision of the Capital Adequacy Ordinance. The revision concerns both the introduction of a leverage ratio and new risk diversification provisions, thus introducing two supplements to the international standards of the Basel Committee on Banking Supervision (Basel III). As part of this, FINMA revised its relevant circulars (FINMA circular 2015/3, 2017/7 and 2019/1).

Since 1 January 2018, all non-systemically important banks must now also fulfil an unweighted capital adequacy requirement, with a minimum core capital to total exposure ratio of 3%. Systemically important banks continue to be subject to more stringent requirements.

For the new risk diversification provisions, risk concentrations will be measured only according to core capital. Moreover, banks will be permitted only a very restricted use of models for determining their risk concentrations. Further changes include overruns of the upper limits, the weighting of certain assets, as well as the adjustment of some special rules for systemically important banks. In accordance with the Basel Committee's schedule, the new provisions are to enter into force on 1 January 2019.

Further to this, FINMA is revising several circulars in accordance with changes to Basel III rules and international financial reporting standards. For example, the latest Basel standards on interest rate risks in the banking book require a complete revision of the corresponding circular, whereby risk management provisions are to be given additional granularity and the rules regarding the measurement and disclosure tightened. The majority of the revised provisions are due to come into effect on 1 January 2019.

The Federal Department of Finance also held a consultation on amendments to the Capital Adequacy Ordinance. With the revision, gone-concern capital requirements should also be introduced for the three systemically important Swiss banks which do not operate internationally.

**Anti-money laundering**

In spring 2016, the FATF held an onsite visit to verify whether Switzerland had properly implemented the FATF recommendations revised in 2012. The mutual evaluation report of Switzerland was published in December 2016. In the report FATF acknowledged the generally good quality of the Swiss system for combating money laundering and terrorist financing. Despite being considered largely compliant, the FATF identified weaknesses in Switzerland's anti-money laundering and terrorist financing provisions. In order to further improve its AML system, Switzerland is currently undergoing an enhanced follow-up review.

To finalise this enhanced follow-up audit process, various adjustments are necessary to the Federal Act on Combating Money Laundering and Terrorist Financing (AMLA), to FINMA's Anti-Money Laundering Ordinance (AMLO-FINMA) and to the self-regulation of the Swiss Bankers Association, the Agreement on the Swiss banks' code of conduct with regard to the exercise of due diligence (CDB). This concerns, among others, the following points:

- The mandatory verification of information on beneficial owners by financial intermediaries.
- The introduction of an obligation to regularly update customer information for all business relationships.
- A reduction of the threshold value for cash transactions with regular clients from CHF 25,000 to the FATF level of CHF 15,000.

The AMLO-FINMA and CDB were revised on this basis and published in July 2018. They will enter into force on 1 January 2020. The revised AMLA is expected to enter into force in 2020.

**Financial market legislation**

Over the last few years, Switzerland has been updating its financial market architecture. As part of this large-scale legislative effort, almost all of the elements relating to modern financial market legislation are being revised or drafted from scratch. The project began in 2007 with the revision of the existing Financial Market Supervision Act (FINMASA) and continued with the enacting of the new Financial Market Infrastructure Act (FMIA), which has been in force since 2016. The final building block was the introduction of the new Financial Services Act (FinSA) and the new Financial Institutions Act (FinIA). Under FinIA, independent wealth managers will come under the remit of newly created supervisory organisations, which will in turn report to FINMA.

FinSA introduces standardised rules of conduct and distribution rules for all financial services providers, and establishes a general securities prospectus requirement. With FinSA and FinIA, solid, modern and practicable investor protection has been established. Customers' rights are now clearly consolidated in one place only, which increases transparency for customers. Particularly important was also that independent asset managers be subject to appropriate supervision. In turn, under the new laws, financial services providers have greater legal and planning certainty.

## Access to foreign markets

Swiss banks are strongly committed to maintaining their leading position in wealth management for private clients. In this context, access to foreign markets is of strategic importance for ensuring the Swiss financial centre's ability to remain competitive and to act in the best interests of customers. In order to preserve, and where clients' interests call for it, to improve market access, political agreement must also be reached with the various partner states, also to ensure free movement of capital. A financial services agreement with the European Union remains a strategic option for the industry. Furthermore, the industry expects equivalence decisions that have not yet been reached to be tackled swiftly by the EU. In this context, a draft report by the EU parliament stated that the EU's process for granting equivalence lacks certainty and sufficient transparency, and requires a structured and practical framework outlining clear procedures. The Swiss banking industry is also pursuing bilateral discussions on market access with several individual European states.

## Tax matters

### *Domestic tax reforms*

Switzerland is one of the most attractive locations for multinational companies, including banks and other financial services providers. Swiss Parliament is currently working on a corporate tax reform (Tax proposal 17) in order to further strengthen the competitiveness of the tax regime. Ordinary cantonal corporate tax rates will be lowered to an average of 14%, down from the current 19%.

In addition, the domestic withholding tax (WHT) on interest is expected be changed from a levy at source to a paying agent system. This will allow companies and financial services providers to issue bonds, investment funds or structured products in Switzerland free from WHT at source. For dividends, the WHT rate is expected to be lowered from 35% to 15%. In the future, Swiss bonds, shares, investment funds and structured products will be very attractive to foreign investors, as there will be no more WHT on interest earnings, and WHT on dividends will be lowered directly to the treaty rate. A more ambitious project is the abolishment of stamp duties on the issuance of shares and trading in securities. The Swiss Federal Council will issue proposals for the WHT reform and the abolishment of stamp duties later in 2018 or in early 2019.

### *International automatic exchange of information on financial accounts (AEOI)*

The international AEOI standard governs how tax authorities in participating countries exchange data relating to taxpayers' bank accounts. Its primary objective is to prevent

cross-border tax evasion. Members of the G20, the OECD as well as a significant number of other countries totalling over 100 jurisdictions, have committed to implementing the AEOI.

Compared to other jurisdictions, Switzerland was prompt to establish the legal framework required for collecting and exchanging data within the scope of the AEOI. In addition, with a current AEOI network consisting of more than 80 partner jurisdictions that is still being expanded, Switzerland is internationally well positioned in this respect.

In line with Swiss legislation, Swiss banks began to implement the AEOI in 2017. This means that Switzerland's first exchange of information will take place in 2018 for information gathered in 2017.

Swiss banks are fully committed to implementing the AEOI. As almost one-quarter of the world's cross-border private wealth is managed in Switzerland, the country is particularly concerned about the proper implementation of the AEOI. In this context, the issue of data protection and data security during the effective exchange of information, as well as in the respective recipient states, is of major importance for Swiss banks.

## Framework conditions for digitalisation

Digitalisation is driving the structural realignment in the banking sector. As an important factor for the competitiveness of the Swiss financial centre, Switzerland requires innovation-friendly framework conditions: regulation should not present any unjustified barriers to market entry for the development of new technologies. FINMA regularly examines the regulations in this area and is designing them to be technology-neutral.

### *ICOs and blockchain*

One of the key issues in Switzerland over the past year was the rapid increase in the number of initial coin offerings (ICOs) as a new method for raising capital. ICO organisers issue digital tokens based on blockchain technology in return for crypto currencies such as bitcoin and sometimes also Fiat currencies. However, the legal qualifications and consequences of ICOs in terms of existing market legislation remain unclear. In order to clarify the matter, FINMA published a guideline on the subject in February 2018. It was one of the first supervisory authorities worldwide to do so.

The new guidelines set out how the authorities intend to apply existing financial market legislation, especially anti-money laundering and securities regulations. Money laundering risks are especially high in a decentralised blockchain-based system in which assets can be transferred anonymously and without any regulated intermediaries. Securities regulation, on the other hand, is intended to ensure that market participants can base their decisions about investments on a reliable minimum amount of information. The guidelines also define the information FINMA requires to deal with such enquiries and the principles upon which it will base its responses, creating clarity for market participants.

Accordingly, the guidelines categorise tokens into three categories: payment tokens, asset tokens and utility tokens. Whereas payment tokens require compliance with anti-money

laundering regulations, they will not be treated as securities. Asset tokens, on the other hand, are treated as securities and must comply with securities law requirements for trading in such tokens, as well as civil law requirements under the Swiss Code of Obligations (e.g. prospectus requirements). Finally, utility tokens are only treated as securities if they function solely or partially as an investment in economic terms.

*Sandbox and settlement accounts*

In July 2017, the Federal Council issued a new fintech regulation that has established an authorisation-exempt area (regulatory sandbox) and has extended the timeframe for settlement accounts to 60 days. The regulation thereby aims to reduce unnecessary regulatory obstacles for innovative business models. In connection with this new regulation, FINMA set these points out in its amended circular and adopted the new timeframe for settlement accounts in September 2017.

The new sandbox concept defined in the revised Banking Ordinance allows for public deposits to be accepted without a license up to a limit of CHF 1 million, provided they are not invested and do not bear interest, even if such deposits come from more than 20 depositors. Depositors must be informed in advance that the sandbox is not subject to FINMA supervision and that the deposits are not covered by the deposit protection scheme. Deposits may be invested and interest-bearing if they are intended to fund a main commercial or industrial activity. The Federal Council has additionally set the maximum period for which deposits may be held in settlement accounts at 60 days. Prior to this, FINMA applied a timeframe of seven working days in accordance with the old legal provisions.

## UNITED KINGDOM

*Stress Testing*

The 2017 stress test was the fourth concurrent stress test of the UK banking system and covered seven major banks and building societies. The 2017 annual cyclical scenario (ACS) was more severe than the financial crisis, assuming a smaller fall in GDP growth but higher unemployment and bigger falls in UK residential property prices. Unlike during the financial crisis, the scenario included an increase in Bank Rate to 4%, as the Monetary Policy Committee traded off growth with building inflation.

The results of the stress test reduced the aggregate Core Equity Tier 1 (CET1) ratio by 6% to a low point of 8.3%. However, for the first time since the stress tests started in 2014, no bank needed to strengthen its capital position – which shows that the UK banking system is resilient to deep simultaneous recessions in the UK and global economies, large falls in asset prices and a separate stress of misconduct costs.

Alongside the ACS banks were subject to an additional biennial exploratory scenario (BES). This asked banks to consider how the UK banking system would evolve over a seven year period in an environment of weak global growth, persistently low interest rates, stagnant world trade and cross-border banking activity, as well as increased competitive pressure on large banks from smaller banks and FinTech and a continuation of costs related to misconduct. The results

identified three risks to banks' projections. Firstly that competitive pressures from FinTech may cause greater disruption to banks' business models than they expect. Secondly, banks expectations about large reductions in costs needed to meet Return on Equity targets may be compromised given that the cost of maintaining and acquiring customers may be higher in the BES. And thirdly, in an environment of low growth and low interest rates the equity risk premium may be higher than banks currently expect.

As a result of its experience in running stress test and examining banks' modelling of the evolution of their balances sheets as the cyclical stress plays out the PRA released a set of expectations about model management, focussing on four principles that banks should have:

- an established definition of a model and maintaining a model inventory;
- an effective governance framework, policies, procedures and controls to manage their model risk;
- a robust model development and implementation process, and ensure appropriate use of models, and:
- undertaken an appropriate model validation and independent review activities to ensure sound model performance and greater understanding of model uncertainties.

*Ring Fencing*

With the completion by mid-2017 of the statutory and legislative framework for the ring-fencing of the core retail and commercial banking and payments services from other activities in global and wholesale banking markets, the five largest UK banking groups set about putting into action their ring-fencing plans. The precise nature of the re-organisation depended upon how business structure, strategy and mix lined up in comparison to the new legislative provisions. Implementation involved firms having to submit their detailed plans for independent expert and regulatory review before seeking Court approval for the transfer of business between different legal entities within their group structure. This has been a multi-year, multi £ billion infrastructure project on the part of the UK's largest banks and, with projects largely complete, has been delivered substantially within the 1 January 2019 statutory timeline.

*Operational Resilience*

The UK regulators released a joint discussion paper on 'Building the UK financial sector's operational resilience'. The view of UK supervisory authorities is that operational resilience of the financial sector is no less important than financial resilience.

Operational resilience is defined as the ability of the financial system as a whole to prevent, adapt and respond to, as well as recover and learn from, operational disruption.

The challenge of making sure businesses are resilient has become more complex and intense in recent years, due to technological change and an increasingly hostile cyber environment. Additional complexities arise where firms have a global footprint or outsource significantly.

Operational disruptions have the potential to cause harm to consumers and market participants, threaten the viability of firms and Financial Market Infrastructures, and cause

instability in the financial system. Potential examples of include outdated technology, communication breakdowns, employee errors, cybercrime, and fraud.

The starting point of the discussion paper is that an operational disruption is inevitable. However hard financial institutions try to mitigate operational disruption, they need to think forensically about how their systems would be affected, how long an outage could last before contaminating critical business services and how quickly those services could be restored.

Central to this is the concept of impact tolerance to disruption, with the impact tolerance appetite calibrated by the maximum tolerable period of disruption, number of customers affected or the volume of disruption.

*Pillar 2A*

In September 2017 the PRA finalised its refinements to the Pillar 2A framework which are designed to smooth out the perceived unlevel playing field between banks using the Internal Ratings Based (IRB) approach to calculating credit risk weighted assets (RWAs) and those, typically smaller specialist and challenger banks, that use the Standardised Approach (SA). The SA produces higher capital requirements for some types of lending, such as low loan-to-value residential mortgages. This makes it harder for SA banks to match the pricing (which is partly determined by capital requirements) offered by larger banks using the IRB approach, reducing choice for consumers. Addressing this competition aspect of the capital regime is a key driver behind the PRA's changes to the Pillar 2 A.

Banks will be able to adjust SA requirements through offsetting some of the Pillar 1 excess by adjusting Pillar 2A. Correcting this over-prudence is achieved by allowing SA banks to refer to the range of risk weightings that IRB banks use in calculating their capital requirements, which will be regularly published and updated by the PRA.

At the same time the PRA announced plans to allow banks currently on the SA to transition to an IRB approach. It clarified that a bank can apply for IRB before it has had a fully compliant rating system in place for at least three years, (the previous requirement) as long as the framework has been reviewed in one full annual cycle after its board gave internal approval for the use of internal rating systems for credit decisions, and lending and risk appetite policies.

Many banks seeking to move from an SA may not have statistically adequate internal data on either Probability of Default or Loss Given Default, which are key inputs into IRB modelling. This lack of default data is exacerbated in the current low interest rate environment in which there will be fewer stressed mortgage borrowers and thus lower rates of default. So the PRA is proposing that UK-based external data may be used to supplement internal data the bank already has.

Both the approach to Pillar 2A offsetting and the refined approach to IRB transition are compliant with existing EU Capital Requirements Regulations about the use of modelling approaches.

*Liquidity*

In February 2018 the PRA updated its guidance on liquidity management, requiring banks to consider Cashflow Mismatch Scenarios (CFMR) on both a consolidated and single currency basis and to assess the speed and scale with which they expect to be able to monetise different types on non-cash High Quality Liquid Assets during a liquidity stress.

The guidance also addresses the franchise viability risks to liquidity adequacy of early termination of non-margined derivatives, possible debt buyback, securities financing margin and prime brokerage and matched book liquidity risk.

In addition, from next year, PRA is introducing a new liquidity reporting requirement to monitor cash flow mismatches, on a daily basis over a 92 day time horizon.

*Branch Authorisation*

Early in 2018 the PRA published a Supervisory Statement outlining its updated approach to international banking supervision and clarifies how the PRA will authorise and supervise internationally headquartered banking groups that branch into the UK, with a specific focus on EEA passported branches undertaking wholesale banking activities in the UK post BREXIT.

The PRA's view is that the ability of financial services firms to branch into other countries is, if done safely, an important component of an open world economy, which in turn benefits the UK economy. This acknowledges that, for wholesale activities, branches provide a valuable means of providing services to customers, without the full cost, complexity and duplication of establishing full subsidiaries. However, this is predicated on appropriate supervisory cooperation with the branch's home state regulator.

There are 77 branches of EEA banks operating in the UK and it is expected that 66 of these will be applying to convert to third-country status post BREXIT, with the remaining subsidiarising as they are predominantly retail-focused, reflecting the PRA's view that retail activity is more appropriately conducted through a separate legal entity and aligns to the ring-fencing rules.

*Vulnerability*

Vulnerability is a wide, high profile policy agenda, of increasing regulatory, political and media attention in the UK, tackling questions around consumer and firm responsibility, access and exclusion; social inequality and individual capability.

The Financial Conduct Authority is increasingly entrenching vulnerability as a conduct obligation – with increased expectations around the proactive identification and support of vulnerable customers, and equally expectations around redress where firms have failed to do so.

In its 2018 Mission Statement consultation, the FCA introduced proposals requiring firms to account for behavioural economics in systems and processes, and a regulatory decision-making framework openly acknowledging '*predictably irrational*' consumer behaviours as baseline criteria for firms' product modelling and risk assessments.

The potential for rapid change in the regulatory expectation that such concepts introduce, has led industry to question what constitutes *sustainable change*; something that it will review in conjunction with the FCA's conclusions, following its strategic review of retail banking business models.

In its 2018 final document *Our Approach to Consumers* the FCA reverted to its 2015 broad definition of vulnerability: "*A vulnerable consumer is someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care.*" It added to this four drivers (risk factors) of vulnerability:

- Health
- Financial resilience
- Financial capability
- Life events

The same drivers were used for the FCA 2017 Financial Lives Survey which indicates that 50% of the UK's population - or the equivalent of a firm's customer base - is potentially vulnerable.

This marked shift in the regulator's thinking and approach raises opportunities but also a range of challenges for industry.

Banks also recognise that consumer vulnerability is a dynamic state, which is affected by various factors including firm conduct and ability to leverage technology, innovation, data and cross-sector learnings towards a holistic view of a consumer's situation - or 'financial life'.

The highly individual nature of vulnerable circumstances, however, does not naturally conclude in the same product, service or system adjustments, as the risk of harm to consumers will also be particular, rather than generic.

Therefore, a pragmatic approach to implementation is needed with targeted use. Industry needs a fair, clear and balanced framework of regulatory expectations of the sector towards consumers. This is not without significant challenges.

*Interest-only Mortgages*

In January 2018 the FCA published the results of its thematic review into the fair treatment of existing interest-only mortgage customers, which represent 17.6% of all outstanding mortgages in the UK with 70% of all interest-only and part capital repayment mortgages held by customers aged over 45. It found that, although mortgage lenders are writing to customers prior to their mortgage maturing, their engagement rates with firms are low. The review was a follow up to one carried out in 2013 and the FCA said that "good progress has been made in reducing the number of people with interest-only mortgages". However, they remain concerned that a significant number of interest-only customers may not be able to repay the capital at the end of the mortgage and will be at risk of losing their homes so encouraged borrowers to engage with their lender.

UK Finance figures found in May that the number of outstanding interest-only mortgages has fallen significantly in recent times – at 1.7 million, it is a little over half the level it was six years ago.

*Mortgage Market Study*

In May 2018 the FCA published its interim report into the Mortgage Market which took a holistic look at competition in a market, assessing how consumers and firms behave and interact. The report said that generally the mortgage market is working well with high levels of consumer engagement, but identified a range of potential ways to make the market work better. These include:

- making it easier for consumers, at an early stage, to identify for which mortgage products they qualify, to assess and compare those products and, ultimately, to take out a mortgage;
- removing barriers to innovation in the sale of mortgages, including those due to aspects of FCA advice rules and guidance;
- making it easier for consumers to assess the strengths of different mortgage brokers. The FCA intends to work with the broker sector to develop metrics to help consumers compare brokers;
- The regulator also wants to help longstanding borrowers who are currently unable to switch to a better deal, often referred to as 'mortgage prisoners'.

In response, on 31 July 2018, UK Finance, alongside the Building Societies Association (BSA) and Intermediary Mortgage Lenders Association (IMLA) announced a voluntary cross-industry agreement by authorised lenders of common standards to help existing borrowers on reversion rates who are up-to-date with repayments but, because of stricter affordability criteria, are currently ineligible to move to an alternative product provided by their lender.

The FCA is continuing to consult on its interim findings and proposed remedies. It intends to publish a final report around the end of the year and will consult on any specific changes required to its rules.

*Open Banking*

The Retail Banking Market Investigation conducted by the Competition and Markets Authority (CMA) (concluding in 2016) requires the nine largest UK retail financial institutions to:

- develop and implement APIs for open banking to provide third party access to account information
- initiate payments for Personal Current Accounts and SME Business Current Accounts
- set up an entity the Open Banking Implementation Entity (OBIE) to develop the standards and other deliverables. The CMA Order also requires the publication of reference data including current account product information.

The API standards were implemented in January 2018, and following a managed rollout, are now live in the market and can be used by authorised Third Party Providers (TPPs) including Account Information Service Providers and Payment Initiation Service Providers. In November

2017, the CMA published an extension to the agreed arrangements (known as the Open Banking Road Map) which extended the role of the OBIE to develop API standards and other items for compliance with Payment Service Directive 2 (PSD2).

These API specifications – for PSD2 – are in draft form and will be published in final form in September.

It is expected that the OBIE standards will be widely used in the UK market, although some financial institutions may choose to use other API standards or adapt the customer interface to allow TPPs access to account.

## UNITED STATES

On May 24, 2018, President Donald Trump signed regulatory reform legislation, the *Economic Growth, Regulatory Relief and Consumer Protection Act* (EGRRCPA), that, among other things, amended Section 165 of the Dodd-Frank Act by recalibrating the SIFI threshold that triggers the application of enhanced prudential standards to banking organizations. In contrast to the bipartisan Congressional support for the Dodd-Frank reform bill, a sweeping overhaul of the U.S. tax code, signed by President Trump on December 22, 2017, had no Democratic support in either the House or the Senate. At the heart of the controversial tax bill was a sharp reduction in the U.S. corporate tax rate from 35 percent to 21 percent. Also included in the bill was the so-called BEAT provision, intended to prevent U.S. taxpayers, including U.S. branches of foreign banks, from stripping taxable income out of the United States. In another major development during the period under review, President Trump on May 8, 2018 announced that the U.S. was pulling out of the Iran nuclear deal and re-imposing sanctions on Iran.

Following is a review of key developments that are of particular importance to foreign banking organizations operating in the United States.

### Regulatory Reform Legislation

Title IV of the Dodd-Frank reform bill (S.2155), which passed the Senate on March 14th and the House of Representatives on May 22nd, amended Section 165 of the Dodd-Frank Act by raising the asset threshold that triggers the application of enhanced prudential standards to $250 billion from $50 billion. Bank holding companies with total consolidated assets between $50 billion and $100 billion are exempt from enhanced prudential standards immediately, and bank holding companies with total consolidated assets between $100 billion and $250 billion will be exempt 18 months after the date of enactment. However, the Federal Reserve Board retains authority to apply enhanced prudential standards to banks in the $100-$250 billion category if the Fed deems appropriate. In addition, the Fed will still be required to conduct periodic supervisory stress tests of such banks. When applying enhanced prudential standards to any domestic or foreign banks, regardless of size, the Fed is directed to take a tailored approach, taking into consideration their capital structures, riskiness, complexity and other risk-related factors.

On July 6th, the Federal Reserve Board issued a statement describing how the Board will no longer subject primarily smaller, less complex banking organizations to certain Board regulations,

including those relating to stress testing and liquidity. Because EGRRCPA raised the threshold for Dodd-Frank enhanced prudential standards, certain Board regulations are inconsistent with the new law. As described in the Board's statement, the Board will not take action to enforce certain regulations and reporting requirements for firms with less than $100 billion in total consolidated assets, such as rules implementing enhanced prudential standards and the liquidity coverage ratio requirements. The Board will take the positions described in the statement in the interim until the Board incorporates EGRRCPA's changes into its regulations. Separately, the Fed, FDIC and OCC issued a statement on July 6th detailing rules and associated reporting requirements that are immediately affected by the enactment of EGRRCPA. The changes affect company-run stress testing, resolution plans, the Volcker rule, high volatility commercial real estate exposures, examination cycles, municipal obligations as high-quality liquid assets, and other provisions.

In a July 18th speech, Randal Quarles, the Fed's Vice Chairman for Supervision, set a "near-term priority" for the Fed to issue a proposed rule that would tailor enhanced prudential standards for large banks with over $100 billion in assets. EGRRCPA set an 18 month deadline for further tailoring, "but we can and will move much more rapidly than this," Vice Chairman Quarles said. He said the Fed could consider a number of changes for less complex and less interconnected firms related to their capital requirements. For example, even firms with more than $250 billion in assets could have less frequent company-run stress tests, he said. For firms below $250 billion, "the statute requires supervisory stress tests to be conducted 'periodically', which suggests the legislature wanted us to at least consider a rhythm other than annually," he said. Less complex and less interconnected firms could be exempted from requirements to calculate risk-weighted assets under the models-based advanced approaches to capital, he added. With respect to liquidity requirements for less complex and interconnected firms with assets above $100 billion, "there may be opportunities to modify aspects of the standardized liquidity requirements as well as expectations around internal liquidity stress tests and liquidity risk management," he said. "Similarly, banks with more than $250 billion in assets that are not G-SIBs currently face largely the same liquidity regulation as G-SIBs. As I've said previously, I believe it would make sense to calibrate the liquidity requirements differently for these firms relative to their G-SIB counterparts," he said. Turning to living wills, he said most firms with total assets between $100 billion and $250 billion do not pose a high degree of resolvability risk, especially if they are less complex and less interconnected. "Therefore, we should consider scaling back or removing entirely resolution planning requirements for most of the firms in that asset range."

In another legislative development, the House of Representatives on July 17th passed by a vote of 406-4 the *JOBS and Investor Confidence Act of 2018*, comprised of 32 individual pieces of legislation that previously passed the Financial Services Committee or the full House with broad bipartisan support. The package of bills is mainly aimed at helping small businesses, entrepreneurs and investors with capital market reforms. Included in the package is the *Financial Institution Living Will Improvement Act of 2017*, which reforms the "living will" process under Dodd-Frank by requiring bank holding companies to submit their resolution plans every two years. The bill also requires the Federal Reserve and FDIC to provide feedback regarding a resolution plan within six months after a bank holding company submission, and requires the Federal Reserve and FDIC to publicly disclose the assessment framework used to review the adequacy of resolution plans. It passed the House on January 30, 2018 with unanimous support, 414-0.

## Volcker Rule

The Federal Reserve Board on May 30th released for public comment proposed revisions to the Volcker Rule developed jointly with the four other Volcker agencies - the OCC, FDIC, SEC and CFTC. In a memo to the Board, Fed Vice Chair Quarles said the intent of the proposed revisions is to i) tailor the requirements to focus on entities with large trading operations, and ii) streamline and simplify regulatory requirements by eliminating or adjusting them and focus on "quantitative, bright-line rules where possible to provide clarity regarding prohibited and permissible activities." Specifically, the proposed changes would:

- Tailor the rule's compliance requirements based on the size of a firm's trading assets and liabilities, with the most stringent requirements applied to firms with the most trading activity;
- Provide more clarity by revising the definition of "trading account" in the rule, in part by relying on commonly used accounting definitions;
- Clarify that firms that trade within appropriately developed internal risk limits are engaged in permissible market making or underwriting activity;
- Streamline the criteria that apply when a banking entity seeks to rely on the hedging exemption from the proprietary trading prohibition;
- Limit the impact of the Volcker rule on the foreign activity of foreign banks; and
- Simplify the trading activity information that banking entities are required to provide to the agencies.

The proposal would create three categories of banking entities based on trading activity. Those with consolidated gross U.S. trading assets and liabilities of $10 billion or more would be subject to comprehensive compliance requirements. Firms with less than $1 billion in global trading assets and liabilities would have a rebuttable presumption of compliance with the Volcker Rule. All other firms would be subject to reduced compliance requirements that would be tailored to reflect their relatively smaller, less complex trading activities.

Importantly, with respect to permitted trading activities of foreign banking entities, the proposed revisions seek to reduce the impact of the 2013 final Volcker Rule on FBOs' operations outside the U.S. by focusing on where the principal risk and actions of the purchases or sale take place. The proposal would also seek comment on issues surrounding foreign excluded funds and extend the no-action period for another year to July 21, 2019.

## Single Counterparty Credit Limit Rule

The Federal Reserve Board on June 14, 2018 voted to approve a final rule establishing single counterparty credit limits for large U.S. bank holding companies and foreign banking organizations. Under the final rule, a bank holding company with $250 billion or more in total consolidated assets would be restricted to a credit exposure of no more than 25 percent of its tier 1 capital to a counterparty. Foreign banks operating in the U.S. with $250 billion or more in total global consolidated assets, and their intermediate holding companies (IHCs) with $50 billion or more in total U.S. consolidated assets, would be subject to similar limits. A global systemically important bank holding company (GSIB) would be limited to a credit exposure of no more than 15 percent of the GSIB's tier 1 capital to another systemically important financial firm. Consistent

with EGRRCPA, the Fed said it will consider the extent to which additional standards, including credit exposure limits, should apply to holding companies with total consolidated assets between $100 billion and $250 billion at a later date. Fed staff also plans to conduct further analysis regarding the scope of application of the SCCL framework and other enhanced prudential standards to U.S. IHCs as part of its broader implementation of EGRRCPA.

In response to comments, the final rule reduces regulatory burden by using common accounting definitions to simplify application of the exposure limits. In addition, a foreign bank's combined U.S. operations, though not its U.S. IHC, will be considered in compliance with the final rule if a comparable rule is in effect in the foreign bank's home country. GSIBs will be required to comply by January 1, 2020, and all other firms are required to comply by July 1, 2020. The Board also issued for public comment a proposal to implement a new information collection and associated notice requirements in connection with the final SCCL rule.

**Internal TLAC**

In a May 16th speech at a Harvard Law School symposium on ring-fencing in the global banking system, Fed Vice Chairman Quarles said the Fed should consider whether the internal Total Loss-Absorbing Capacity (TLAC) requirement for the U.S. intermediate holding companies of large foreign banks should be recalibrated to reflect the practices of regulators in other jurisdictions. "The current calibration is at the top end of the scale set forth by the FSB, and willingness by the United States to reconsider its calibration may prompt other jurisdictions to do the same, which could better the prospects of successful resolution for both foreign G-SIBs operating in the United States, and for U.S. G-SIBs operating abroad," he said. Vice Chairman Quarles suggested as an alternative that the Fed could streamline the elements of the resolution loss absorbency regime, which include both TLAC and long-term debt requirements.

**Global Market Shock**

The Federal Reserve Board on December 15, 2017 published in the Federal Register a notice of its final action on its proposal to modify the scope of the Global Market Shock (GMS) component of its CCAR/DFAST programs in a manner that for the first time would apply the GMS to intermediate holding company (IHC) subsidiaries of FBOs which satisfy the prescribed criteria. The Fed retained the core of its proposal while responding favorably to recommendations by the Institute of International Bankers (IIB) to delay the implementation of the GMS and its related reporting requirements. No changes were made to the qualifying criteria, which apply the GMS to any IHC which (1) has aggregate trading assets and liabilities of $50 billion or more, or aggregate trading assets and liabilities equal to 10 percent or more of total consolidated assets; and (2) is not a large and noncomplex firm under the Fed's capital plan rule. Implementation of the GMS to the six newly-covered IHCs is delayed to the 2019 CCAR/DFAST exercises, and a phase-in period is provided for the related reporting requirements.

**Swap Dealer *de Minimis* Threshold**

The Commodity Futures Trading Commission on June 4, 2018 approved a proposed rule that would maintain the *de minimis* exception for swaps registration at $8 billion. The threshold is currently scheduled to drop to $3 billion at the end of 2019. In an August 10th comment letter, the

IIB expressed support for the Commission's proposal to fix the *de minimis* exception's aggregate gross notional amount (AGNA) threshold at $8 billion. The IIB also expressed support for the Commission's efforts to promote loan origination and hedging activity through the proposal's exclusions, but argued that additional steps are needed. Specifically, the IIB said the Commission should expand the ability of foreign banks to participate in the U.S. swap markets by (i) providing hedges to their lending customers, (ii) hedging their own risk, and (iii) providing liquidity to U.S. dealers, who may otherwise need to redirect swap transactions through their foreign branches.

**Cross-Border Swaps Regulation**

On October 1, 2018, J. Christopher Giancarlo, Chairman of the Commodity Futures Exchange Commission released a white paper titled "Cross-Border Swaps Regulation Version 2.0: A Risk-Based Approach with Deference to Comparable Non-U.S. Regulation." Based on the principles set forth in the white paper, Chairman Giancarlo said he plans to direct the CFTC staff to issue new rule proposals to address a range of cross-border issues in swaps reform.

Among other things, the White Paper recommended the following changes to the CFTC's cross-border approach:

- Non-U.S. CCPs - Expand the use of the CFTC's exemptive authority for non-U.S. CCPs that are subject to comparable regulation in their home country and do not pose substantial risk to the U.S. financial system, permitting them to provide clearing services to U.S. customers indirectly through non-U.S. clearing members that are not registered with the CFTC.
- Non-U.S. Trading Venues - End the current bifurcation of the global swaps markets into separate U.S. person and non-U.S. person marketplaces by exempting non-U.S. trading venues in regulatory jurisdictions that have adopted comparable G20 swaps reforms from having to register with the CFTC as swap execution facilities, thereby permitting such jurisdictions to each function as a unified marketplace, under one set of comparable trading rules and under one competent regulator.
- Non-U.S. Swap Dealers - Require registration of non-U.S. swap dealers whose swap dealing activity poses a "direct and significant" risk to the U.S. financial system; take into account situations where the risk to the U.S. financial system is otherwise addressed, such as swap transactions with registered swap dealers that are conducted outside the United States; and show appropriate deference to non-U.S. regulatory regimes that have comparable requirements for entities engaged in swap dealing activity.
- Clearing and Trade Execution Requirements - Adopt an approach that permits non-U.S. persons to rely on substituted compliance with respect to the swap clearing and trade execution requirements in Comparable Jurisdictions, and that applies those requirements in Non-Comparable Jurisdictions if they have a "direct and significant" effect on the United States.
- ANE Transactions - Take a territorial approach to U.S. swaps trading activity, including trades that are "arranged, negotiated, or executed" within the United States by personnel or agents of such non-U.S. persons. Nonincidental swaps trading activity in the United States should be subject to U.S. swaps trading rules. Such an approach addresses the current fragmentation of U.S. swaps markets, with some activity subject to CFTC rules and some activity not subject to CFTC rules. This approach is consistent with the principle - one

unified marketplace, under one set of comparable trading rules and under one competent regulator.

The resulting rulemakings would replace the cross-border guidance issued by the CFTC in 2013 and the cross-border rules proposed by the CFTC in 2016, as well as address certain positions taken in CFTC staff advisories and no-action letters.

**Customer Due Diligence**

The Financial Crimes Enforcement Network's customer due diligence rule went into effect on May 11, 2018. The CDD rule has four core requirements. It requires covered financial institutions to establish and maintain written policies and procedures that are reasonably designed to (1) identify and verify the identity of customers; (2) identify and verify the identity of the beneficial owners of companies opening accounts; (3) understand the nature and purpose of customer relationships to develop customer risk profiles; and (4) conduct ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information. With respect to the new requirement to obtain beneficial ownership information, financial institutions will have to identify and verify the identity of any individual who owns 25 percent or more of a legal entity, and an individual who controls the legal entity. The Federal Financial Institutions Examination Council on May 11th released an updated version of its exam manual explaining examination procedures with respect to the CDD/beneficial ownership rule. FinCEN subsequently issued a ruling on May 16th to provide limited exceptive relief to covered financial institutions from the obligations of the beneficial ownership requirements for Legal Entity Customers with respect to certain financial products and services that automatically rollover or renew (i.e., certificate of deposit or loan accounts) and were established before the rule's May 11th effective date. The exception began retroactively, on May 11th.

On September 7th, FinCEN granted exceptive relief to covered financial institutions from the obligations of the Beneficial Ownership Requirements for Legal Entity Customers (Beneficial Ownership Rule) and its requirement to identify and verify the identity of the beneficial owner(s) when a legal entity customer opens a new account as a result of the following: 1) a rollover of a certificate of deposit; 2) a renewal, modification, or extension of a loan (e.g., setting a later payoff date) that does not require underwriting review and approval; 3) a renewal, modification, or extension of a commercial line of credit or credit card account (e.g., a later payoff date is set) that does not require underwriting review; and 4) a renewal of a safe deposit box rental. The exception only applies to the rollover, renewal, modification or extension of any of the types of accounts listed above occurring on or after May 11, 2018, and does not apply to the initial opening of such accounts.

**Iran Sanctions**

The U.S. re-imposed sanctions on Iran following President Trump's May 8th announcement that he was pulling the U.S. out of the Iran nuclear deal negotiated by the Obama Administration with Britain, France, Germany, the EU, Russia and China. In a statement following the announcement, the Treasury Department said the Office of Foreign Assets Control (OFAC) is "taking immediate action to implement the President's decision." Treasury said sanctions would be re-imposed subject to certain 90 day and 180 day wind-down periods, after

which the applicable sanctions will come back into full effect. OFAC posted to its website frequently asked questions (FAQs) that provide guidance on the sanctions that are to be re-imposed and the relevant wind-down periods.

**Cybersecurity**

Effective September 4, 2018, banks, insurance companies, and other financial services institutions regulated by New York's Department of Financial Services were required to have come into compliance with several additional provisions of the Department's Part 500 cybersecurity regulation. Regulated financial institutions were required to have commenced mandatory annual reporting to the board by the Chief Information Security Officer concerning critical aspects of the cybersecurity program, have an audit trail designed to reconstruct material financial transactions sufficient to support normal operations in the event of a breach, and have policies and procedures in place to ensure the use of secure development practices for IT personnel that develop applications for the Covered Entity. Companies also must implement encryption to protect nonpublic information held or transmitted by the company. Entities are also required to have developed policies and procedures to ensure secure disposal of information that is no longer necessary for the business operations, and must have implemented a monitoring system that includes risk based monitoring of all persons who access or use any of the company's information systems or who access or use the company's nonpublic information. Under DFS's regulation, if companies use third-party service providers, they must evaluate the risk that any such providers pose to the security of those systems and data and ensure those systems and data are protected by March 1, 2019.

**Tax Reform**

Congressional Republicans gave final approval to their sweeping overhaul of the tax code (H.R. 1) on December 20, 2017, sending the $1.5 trillion tax cut to the White House for President Trump's signature. He signed it two days later. At the heart of the measure is a sharp reduction in the corporate tax rate to 21 percent from 35 percent. Included in the final bill was the Senate version of the Base Erosion and Anti-Abuse Tax (BEAT) provision. The BEAT is intended to prevent U.S. taxpayers (including U.S. branches of foreign banks) from stripping taxable income out of the United States by making deductible payments to foreign affiliates.

Prior to final passage of the bill, the IIB submitted a letter to the House-Senate Conference Committee on tax reform legislation, expressing concern with the Senate version of the BEAT provision, which was ultimately included in the final version of the tax bill signed by President Trump. The BEAT potentially applies to payments by U.S. subsidiaries of: (i) interest on internal LTD TLAC and other interest paid to a foreign affiliate; (ii) interest on securities loan cash collateral, and repurchase premium on repos, paid to foreign affiliates; (iii) interest and other deductible amounts paid by U.S. subsidiaries to the U.S. branch of the bank; (iv) service fees paid to a non-U.S. services company; (v) commissions and similar transaction-based payments paid to foreign affiliates; and (vi) payments for allocated home office expenses. (There is an exception for payments on derivatives.)