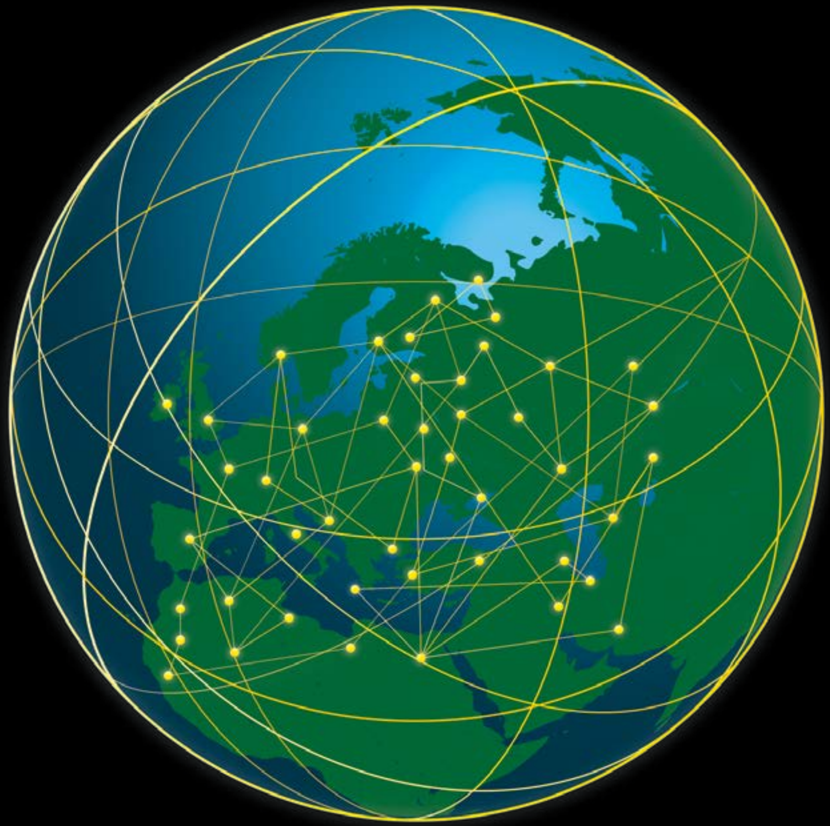

Looking back
Financial Markets
Regulatory Outlook 2018
Scorecard

CENTRE *for*
REGULATORY STRATEGY
EMEA

2018 Scorecard

Theme	What were our predictions?	What happened?	Score out of 10
MEETING MULTIPLE REGULATORY DEADLINES	• Some implementation work will overrun regulatory deadlines, with firms having to adopt tactical approaches to compliance due to resource pressures. • Firms should not assume that regulators and supervisors will refrain from early use of enforcement powers across all regulations that go live in 2018, notwithstanding indications from a small number of regulators that they will adopt a pragmatic approach to early post implementation supervision of MiFID II. • Firms will have to make ongoing changes to implementation plans in 2018 to ensure that they are working towards strategic solutions that will deliver optimal operating models. • Firms will not have been able to exploit synergies to the full, will have diverted resources from other strategic priorities and will likely have to undertake significant remediation work post-deadline to make compliance efficient and effective.	• In January MiFID II, PRIIPs, and BMR went live. However, some Member States failed to transpose MiFID II into national law on time, leaving their firms without final rules to implement. On PRIIPs, some funds were taken off platforms because their KIDs had not been produced on time. Many firms' implementation programmes for MiFID II, PRIIPs and BMR have run well into 2018 as firms continue to improve their business processes to ensure compliance and increase business efficiency. • GDPR went live in May, and whilst we are yet to see any enforcement action in this area, the increasing prominence of data protection and privacy issues will mean any serious breaches of GDPR will be met with a strong response. • Many EU supervisors have started supervisory work on the new regulations that came into force in 2018. Some of this has already resulted in remediation work for firms – for example the FCA has found errors in some firms' PRIIPs calculations. In most cases, supervisory work is still underway and enforcement actions have not yet been taken. • Some firms are now moving their focus towards implementing more strategic solutions and improving business efficiency. For example, some firms are starting to explore how they can use newly available data, such as MiFID II trade data and target market data, to benefit their business.	**9.5**
PREPARING FOR BREXIT	• Firms and supervisors will continue preparing for Brexit in a world of uncertainty. • It remains unclear whether a transitional period will be agreed; even if one is, we expect firms to press ahead with aspects of their plans, including new authorisations and model approvals. • We expect legislative (or equivalent) solutions to the issue of cross-border derivative and insurance contracts in order to maintain financial stability and consumer protection. • In the UK, we expect the PRA and FCA to clarify their approach to the treatment of branches of EEA firms in the UK post-Brexit.	• Firms and supervisors have continued to prepare in an uncertain environment, characterised by a lack of legal certainty on a transition period and the future relationship on FS. • While political agreement on a transition period was reached early in 2018, the Withdrawal Agreement will need to be ratified by the UK and EU to provide legal certainty on transition. Firms are pressing ahead with executing their contingency plans. • The UK authorities announced the TPR and TRR to ensure EU firms, including CCPs, can continue their regulated activities in the UK, including servicing contracts for a period of up to three years after exit day. The EU has proposed a time-limited equivalence decision and temporary recognition by ESMA of UK CCPs, but has not proposed any legislative solutions for uncleared derivatives or insurance contracts. • The PRA and FCA announced their approaches to the treatment of branches of EEA firms. The PRA approach allows some EEA firms to operate in the UK as branches following Brexit. However, firms posing a greater threat to the PRA's objectives may in certain circumstances have to establish subsidiaries.	**8.5**

Note: Scores are derived from a qualitative assessment by partners and staff of the EMEA Centre for Regulatory Strategy.

2018 Scorecard

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SUPERVISORY SPOTLIGHT ON BUSINESS MODELS	• Supervisors will expect the board and senior management team to demonstrate tangible improvement in the quality of debate and discussion on business strategy and its risk implications, and the quality of data supporting that debate. • Business strategy will become an important lens through which supervisors will view the competence and effectiveness of the board and senior management.	• Scrutiny of business models has intensified as predicted, although limited tangible new requirements have been placed on firms. • The ECB's thematic review of profitability and business models concluded that banks should focus on improving their "strategic steering" capabilities. The ECB's guides to the ICAAP and ILAAP, published in November, also emphasised the expectation that banks improve how decisions on business strategy are made. • The EBA reported in July on its work on the implications of FinTech for bank business models and has continued to raise the issue in speeches. The BoE's project "2030: the future of finance", due to report by the end of 2018, is examining similar themes. • The FCA published new rules for asset managers requiring them to assess value for money and appoint independent directors. ESMA have been doing work on closet tracking in order to identify funds that are ostensibly active (and charge accordingly) but behave more like passive funds. • MiFID II has forced a business model change, where asset managers can only pay for research through their own P&L or via an explicit client charge (most have opted for the former due to competitive pressures and because it is operationally easier). Scrutinising firms' implementation of these reforms has also been a focus of EU supervisors. • The UK FCA has undertaken several pieces of business model focused work over the course of the year, including its strategic review of retail banking business models, and its work on general insurance.	**8**

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DATA PROTECTION, INNOVATION AND GOOD CUSTOMER OUTCOMES	• GDPR will serve as a catalyst for regulators to increase scrutiny of wholesale automated processing of customers' personal data. • GDPR will require a gear shift in relationships with data protection authorities, both at a firm and industry level. • The risks associated with large-scale processing of consumer data will also be on the radar of FS policy makers and supervisors. • Data protection issues are blurring the lines between financial services regulation and other policy domains.	• FS and data protection regulators both in the EU and UK have confirmed that the wholesale automated processing of customers' data is an area of focus which will only continue to grow for the foreseeable future. Particular attention is being paid to the use of data in the context of AI, internet of things, and tracking devices. • In the UK, the ICO has identified Big Data technologies as a priority area and has consulted on the creation of a data protection regulatory sandbox. The FCA is conducting a feasibility study for a new cross-sector UK sandbox open to developments arising from the IoT and Big Data. • While firms have remained mostly focussed on optimising their GDPR compliance programmes, some have started to think more strategically about how they can establish a more effective and fruitful relationship with the ICO, both individually and as a sector. • Nevertheless, FS-focused GDPR supervisory programmes have developed more slowly than we anticipated, as DPAs are still building their capabilities and resources. • Formal and informal collaborations between DPAs and their FS counterparts are also still absent or embryonic in many EU member states, although there are notable exceptions such as in the UK.	**7.5**
CUSTOMER VULNERABILITY – BROADENING THE PERSPECTIVE	• Regulatory understanding of customer vulnerability is broadening to recognise that vulnerability is dynamic and a function of many variables. • Firms need to adapt to this broader definition of vulnerability and factor it into their governance and interactions with customers. • Strong board and senior executive engagement will be needed. Robust discussion on how vulnerability is identified and addressed will be expected. • Vulnerability will feature with increasing prominence in supervisory dialogue with boards and senior management, with an emphasis on how firms' strategies are being reviewed and adjusted in response to changes in customers' behaviour and needs.	• Regulators and supervisors have looked at vulnerability from a variety of angles. Firms' treatment of aging consumers continues to attract attention, with ESMA's MIFID II guidance explicitly calling out "older clients" as a group of potentially vulnerable consumers. The potential for vulnerable consumers to face exclusion as a result of digitalisation and new technologies is being explored in EIOPA and FCA reviews. The FCA also published work on access to insurance for those with long-term health conditions, highlighting another aspect of vulnerability. • Firms' approaches to vulnerability are most well developed in larger UK banks and insurers, many of which have put in place measures to detect and monitor vulnerable consumers. Outside the UK, firms have not faced the same supervisory focus on vulnerability, and consequently have less well developed approaches. • The FCA's approach to consumers and approach to supervision documents confirm that vulnerability will be a core part of its supervisory dialogue with firms and boards. More generally, vulnerability is now built into supervisory approaches across the UK and Ireland, with both the FCA and CBI having incorporated it in their consumer protection frameworks. However, other EU countries do not have the same day-to-day supervisory approach to vulnerability.	**8.5**

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CYBER RISK AND RESILIENCE	• 2018 will see regulators, most notably the BoE and ECB, issue a range of new standards on cyber security in financial services, building on earlier pilot programmes around resilience testing, and expanding into newer areas such as threat intelligence sharing. • European banking supervisors will increasingly make firm-specific interventions where deficiencies in cyber risk identification or management are found; fines and even capital charges will be part of a growing supervisory toolkit. • Insurance supervisors will be alert to the potential risks arising from cyber insurance underwriting practices.	• European regulators made substantial progress in developing cyber resilience standards. The ECB issued its CROE for EU FMIs, and UK supervisors published a discussion paper on an "impact tolerance" framework for UK firms and FMIs. • The ECB also published its TIBER-EU framework to be adopted by national authorities. UK supervisors proceeded with the second round of their CBEST cyber penetration testing programme. • The EU Network Information Security Directive came into force in 2018, providing a legal basis for authorities to fine firms operating essential services for cybersecurity deficiencies. • Separately, in the UK, the FCA fined a bank £16.4m for deficiencies identified in its handling of a 2016 cyber-attack. • In 2018, EIOPA conducted a survey and engaged with the insurance industry to understand better its exposure to cyber risk underwriting, later publishing a paper calling for supervisors to develop a better understanding of this risk and to carry out further work.	**9**
MANAGING RISK FROM INTERNAL MODELS	• Supervisors will increasingly expect boards and executive management to demonstrate understanding of the uses, limitations and potential adverse incentives of models. • Fieldwork for the ECB's TRIM will be largely complete by the end of the year, and some banks may have to undertake remediation work. • The use of hard floors or "guard rails" on model results is likely to be considered for the insurance sector, and EIOPA will also develop quantitative benchmarking and limits to help identify outlying model results. • Firms should expect a high bar for approval of model changes. Supervisors will give serious consideration to whether overall model re-approvals are needed where multiple non-material changes have been made.	• Supervisors have been emphasising and prioritising the understanding of models and their effect on business models, particularly in relation to firms seeking approval to use models for capital calculation purposes for the first time. Supervisors also have been demonstrating high expectations of the board's and executive's understanding of the limitations of models and their use, both in a base scenario and under stress testing. • The ECB issued an updated TRIM guide in 2018. The TRIM programme continues into 2019, using the updated guide. Most banks that have been through the TRIM process have had to undertake remediation work. There will be a new wave of remediated models being submitted for approval. • In 2018, EIOPA released the first of what it expects to be annual reports on market and credit risk modelling by insurers. While EIOPA has not at this stage recommended hard floors or guard rails for model results, it indicates in its report that some insurers have updated their models following participation in the study. • The EBA issued guidelines for the probability of default (PD) and the loss given default (LGD) estimation and the treatment of defaulted exposures in 2018. The new RTS raised the bar and provide a benchmark of good practice which regulators are starting to use to drive local policy and expectations.	**8**

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