Looking back
Financial Markets
Regulatory Outlook 2017
Scorecard

CENTRE *for*
REGULATORY STRATEGY
EMEA

2017 Scorecard

Theme	What were our predictions?	What happened?	Score out of 10
BREXIT: PROLONGED UNCERTAINTY IS HERE TO STAY	• Even if Article 50 is triggered by March 2017, exit negotiations are likely to be influenced by the newly elected leaders in France and Germany. • The UK's status on leaving the EU and the existence of any transitional period will only become clear towards the end of negotiations. • Persisting uncertainty on EU market access will pressure some firms to start implementing their contingency plans in the course of 2017. • Supervisors around the world will continue to monitor closely the Brexit contingency plans of the firms for which they are responsible.	• Brexit negotiations were slower and less productive than anticipated, and elections had a lesser impact than expected. • The UK's post-Brexit status remains unclear, and there appears to be little prospect of it becoming clearer in the immediate near-term. • Some firms have begun implementing relocation plans, and most have otherwise made significant progress in the planning phase, ready to make decisions and take action in early 2018. • Supervisors outside the UK, most clearly the ECB and NCAs in other EU countries (such as BaFin), have demonstrated a clear interest in firms' contingency plans and are planning to carry out the relevant authorisation work.	**7**
BUSINESS MODEL SUSTAINABILITY: ACCELERATING STRATEGIC CHANGE	• Business model sustainability will come to the fore as a key consideration in managing (regulatory) costs and restoring returns. • There will be more scrutiny in supervisory and resolution authority discussions, in particular for banks, of the coherence of the business strategy and the integration between strategic planning, stress testing and recovery planning.	• EU bank returns continued to languish and supervisors (particularly the ECB) has indicated that business model sustainability is a significant supervisory priority through numerous speeches. • The practical implications of supervisory concern have remained less clear, particularly with the ECB having made less progress in development of its supervisory business model analysis work.	**8**
RESOLVABILITY: EUROPE TEST-DRIVES BANK RESOLVABILITY	• The EU's BSR proposal will remain stuck and regulators will instead focus on resilience and resolvability. • The SRB will start to press Eurozone banks to become more resolvable and meet interim MREL targets. • Banks will have to show they can overcome practical obstacles to resolvability. • CCP resolution will come into focus with EU and FSB level rule development. • Insurance resolvability will continue to lag significantly behind that of banks and CCPs.	• The BSR was formally withdrawn by the European Commission. • The SRB resolved its first bank in what was generally deemed a successful use of the BRRD. • However, in the case of a number of Italian banks, State Aid was used over the BRRD, leading some to question whether the BRRD is fit for purpose. • Tangible public progress in terms of resolvability remains scant. • EIOPA became a strong advocate of an EU-wide insurance resolution framework, although there remains no evidence of legislative appetite for introducing such a framework. • The EU's CCP resolution framework, having been published in late 2016, remained in negotiation throughout 2017.	**7**

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

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FINANCIAL RESILIENCE: SIGNIFICANT IMPLEMENTATION CHALLENGES AHEAD	• The BCBS will finish most of its work on measuring risk weighted assets. • The EU will consider carefully its adoption of the BCBS standards as it takes into account its own economic priorities. • Uncertainty over the final shape of EU capital rules will make it harder for institutions to model their impact. • Adoption of TLAC, MREL and IFRS 9 will require greatly enhanced balance sheet management capabilities. • In the EU, comparability of internal credit risk models and enhancement of the Pillar II framework will remain high on the agenda.	• The BCBS finalised the outstanding components of its agenda, including a capital output floor, and major revisions to the credit risk and operational risk frameworks. • The EU's negotiators made relatively little progress on their CRD V/CRR II package, and look set to miss their self-imposed aggressive schedule for its agreement. • Little happened to make the medium-term impact of capital requirements clearer for firms in the EU (or internationally). • The ECB's TRIM exercise entered into full swing, although findings will not be known for some time.	**8**
CONDUCT AND CULTURE: FIRMS HAVE YET TO PUT MISCONDUCT TRULY BEHIND THEM	• Firms will need to articulate clearly their conduct risk appetite and embed this into their culture and processes. • Firms will need to improve systems and controls for managing conduct risk, despite practical challenges. • Prudential regulators will increasingly hold senior management accountable for ensuring the right culture and controls are in place in respect of conduct risk.	• Misconduct issues continued to surface over the course of 2017. • The FCA has handed out three multi-million pound fines in 2017, for AML failures, reporting failures, and disclosure failures. • The PRA fined a bank for failing to be open and cooperative in the course of an investigation. • Investigations continue into other misconduct issues. • Although the FCA fined a number of individuals, there have been no enforcement cases under the SMR as yet.	**8**
REGULATION OF NEW TECHNOLOGIES: THE TRICKY BUSINESS OF KEEPING UP WITH THE TIMES	• National regulators in Europe will take a much more active and engaged role to understand emerging inherent risks and regulate as necessary. • Industry standards of communication for third party access will be crucial for both FinTech firms and banks if they are to succeed in exploiting the opportunities presented by PSD2. • As firms harness AI and data analytics to offer tailored customer experiences, supervisors will focus on the unintended consequences these may bring.	• We have seen relatively little supervisory proactivity across Europe to understand the roles of new technology as such technologies remain niche in their deployment. • The EBA finalised its SREP guidelines on the assessment of ICT risk. • The EU's technical standards on secure communication under PSD II remain unpublished by the European Commission, although they have been finalised by the EBA. • PSD II remained a largely operational implementation challenge throughout 2017. • The FSB took the lead on the implications of AI for financial stability with a report published in November.	**7**

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CYBER AND IT RESILIENCE: MORE SPECIFIC AND MORE DEMANDING	• The focus of supervisors on cyber resilience will continue to increase. • Supervisors will begin to articulate more detailed expectations of firms. • Testing, war-gaming and red-team exercises will be used to show whether resilience plans work. • Real-time cross-industry information-sharing on cyber threats will become more important. • Large-scale improvements in IT infrastructure remain costly and will make little progress in 2017.	• There has been an uptick in interest into cyber security issues, with the FSB having carried out a stock-taking exercise, and a number of supervisors looking to integrate cyber security issues into their ongoing supervisory practices. • Regulators did not publish more detailed expectations of firms on cyber resilience. • The EBA finalised guidelines on ICT risk assessment under the SREP. • The ECB launched its cyber incident reporting framework to all “significant” institutions.	**6**
OPENING UP MARKETS: VULNERABLE INCUMBENTS	• Banks will need to choose their strategic positioning following increased competition in the payments market. • Firms across the financial services industry will need to be more transparent about the nature and costs of their products and services. • In the UK, life insurers will continue to face strong competition from investment managers in the retirement market following the introduction of pension freedoms.	• It remained too early in 2017 for banks to take significant strategic decisions about their role in the payments market, with the evolution of open banking and related initiatives still in their infancy. • There are signs of a push towards greater transparency in costs, such as pre-emptive action by banks to clarify their overdraft fees, and major regulatory work in the UK into the investment management sector. • A number of big fund management groups have continued to enter the SIPP provision and drawdown markets.	**7**
EVOLUTION OF THE TRADING LANDSCAPE: DECISION TIME FOR TRADING STRATEGIES	• Authorisations and registrations for new MTFs, OTFs and SIs and decisions on trading strategies will need to be taken ahead of January 2018. • More OTC derivatives will move to central clearing, not only as part of the mandatory clearing obligation but also on a voluntary basis. • The entry into force of the clearing and margining requirements in the EU will add pressure on market participants to restructure their product offerings, such as moving from non-standardised to standardised derivative products.	• ESMA’s SI register showed a significant increase in MTF and SI registrations in 2017. Most firms that registered as SIs did so for equities rather than non-equities. • Evidence on OTF registrations remains scant. • Central clearing continued to make inroads in OTC derivatives markets, particularly for CDS, for which over half of the market is now cleared. Clearing in interest rate derivatives markets was little changed in the first half of 2017, although over three quarters of the market is now centrally cleared. • The FCA’s analysis of the impact of EMIR variation margin requirements shows they do not appear to have had a significant market impact so far, either in terms of overall activity or the number of different counterparties trading in the market.	**5**

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CONTROLS EFFICIENCY: THE RISE OF REGTECH	• The imperative to reduce compliance costs will make it essential for firms to turn to new technologies to achieve efficient controls and value for money. • New RegTech solutions will proliferate, although their adoption will be gradual as firms seek comprehensive solutions that add value beyond compliance. • The largest banks will struggle to reap the full benefits of RegTech due to their current IT infrastructure. Smaller banks are well positioned to be RegTech pioneers.	• A number of banks made significant investments in technological solutions, most notably in front line surveillance tools. • Adoption of RegTech remains niche, however, with many firms distracted by large scale regulatory implementation projects, remediation work, and significantly constrained budgets.	**7**
GOVERNANCE STRATEGY: TOO BIG TO MANAGE?	• Supervisors will increasingly look at the functioning of intra-group relationships. • Subsidiaries will have to demonstrate their ability to operate independently of their parent company. • Governance inadequacies will come under heightened scrutiny in business-as-usual times, including through supervisory stress-testing and resolvability assessments. • Firms will have reduced flexibility to deploy capital and liquidity around their group.	• The EBA published its revised guidelines on internal governance which place additional emphasis on board understanding and oversight of legal and operational structures. • Brexit planning introduced additional complexities into EU group structures.	**7**

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