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Banking Law Update

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REGULATORY DEVELOPMENTS

Financial Conduct Authority (FCA)

Advisory Firm Charges

An FCA review has confirmed that a number of advisory firms were still not providing sufficient information to their customers on charges and services. A review of financial advisors revealed that 73% of firms had failed to provide required information on the cost of advice. Firms were not sufficiently clear on how much advice cost, the type of services provided and any relevant restrictions and subsequent on-going services. The review was carried out as part of the second stage of a three cycle assessment of how firms had implemented the disclosure requirements within the Retail Distribution Review (RDR) which came into effect at the beginning of 2013. This introduced a number of new disclosure obligations to improve transparency to allow consumers to make informed decisions. The first review in July 2013 confirmed that progress had been made and that firms were generally willing to adapt to the new rules. A number of tools had been made available by the FCA to firms in 2013 including examples of good and poor practice and a fact sheet. Two specific firms would be referred to the FCA's Enforcement and Financial Crime Division for possible action.

FCA, 7.4.2014

Bond Trader Fine

Mark Stevenson, a former bond trader at Credit Suisse Securities (Europe) Ltd (CSSEL) has been banned from the financial services industry and fined £662,700 for market abuse and market manipulation. Stevenson had attempted to sell £1.2 billion in UK government gilts to the Bank of England at an artificially high price as part of its Quantitative Easing purchases on 10 October 2011 with Stevenson's unusual trading being reported within 40 minutes and the Bank deciding not to purchase the gilts. Stevenson had increased his holding of the specific gilt between July and October 2011 and purchased additional gilts on the morning of 10 October 2011 after the Bank announced the reintroduction of QE on 6 October 2011. Stevenson's trading accounted for 92% of the gilt's turnover with other traders in the market reporting the activity to the Bank which appeared to be a deliberate attempt to push the price higher to benefit from the QE purchase. Stevenson stopped purchasing at 14:30 pm during QE with the Bank announcing that it would not purchase the gilts at 14:56 pm with the price of the gilt collapsing. Stevenson would have accounted for 70% of the £1.7 billion QE allocation for that day. The conduct was considered to be deliberate and ′particularly egregious′.

FCA, 20.3.2014

Broker Fine

The Upper Tribunal has upheld the decision of the Financial Conduct Authority (FCA) to fine Amir Khan, director of Sovereign Worldwide Ltd,

for dishonestly submitting false income details to a mortgage lender in a personal mortgage application. Khan had dishonestly submitted inflated income figures using false payslips having earlier submitted false income details in a mortgage application. Khan later deliberately disposed of assets to reduce his ability to pay a financial penalty which was concealed during an FCA investigation.

FCA, 14.4.2014

Business Plan

The FCA has published its *Business Plan 2014/15* (March 2014) which sets out its activities for the following year to protect consumers, enhance market integrity and promote competition. The FCA has to respond to continuing challenges and enhance processes to authorise new firms, supervise firm conduct, enforce rules and ensure good outcomes for consumers in the most effective and efficient way. The Business Plan sets out how the FCA will achieve its objectives, protect consumers, enhance market integrity, build competitive markets, regulate consumer credit, deal with seven future areas of risk identified in its *Risk Outlook 2014* and how the FCA will operate with its proposed budget for 2014/15. New activities include integrating consumer credit within its other supervisory responsibilities, working with the PRA on implementation of the Financial Services (Banking Reform) Act 2013 requirements, in particular, on Senior Managers and Certified Persons Regimes and preparing for the establishment of the new authority to oversee UK payment systems. Other continuing areas of activity include competition, risk-based supervision, lowering barriers to bank entry and bank expansion, the prudential supervision of personal investment firms, EU implementation, payment protection insurance (PPI), Retail Distribution Review (RDR), Mortgage Market Review (MMR), listing revisions, enforcement, benchmarks and anti-money laundering (AML) as well as ensuring clear, consistent and constructive communication, investing in people and reducing any expectations gap with consumers.

FCA, 31.3.2014

Changing Market Structure

David Lawton, FCA Director of Markets, has given an address on 'Regulatory Developments and the Changing Market Structure' before the American Bar Association Capital Markets Conference, Law Society, London. A number of steps had been taken to achieve the G20 Leaders Pittsburgh objectives of raising standards together with national authorities implementing global standards consistently in a way that ensures a level playing field and avoids the fragmentation of markets, protectionism and regulatory arbitrage. A number of initiatives had been undertaken to increase transparency and improve risk management with transactions being carried on organised trading venues and cleared through CCPs with capital, liquidity and collateral measures being tightened and data transparency improved. National authorities had worked more closely together such as with the CFTC/EU Commission 'Path Forward' agreement in summer 2013 with

CFTC conditional no-action relief being given to EU multilateral trading facilities to allow US persons to comply with their Dodd-Frank obligations on EU venues. A number of significant EU measures were being brought forward especially with implementation of the European Markets and Infrastructure Regulation (EMIR) and the Markets in Financial Instruments Directive (MFID). At the domestic level, the FCA had carried out important work in the area of benchmarks dealing commissions, client asset protection and listing revisions. Regulators had to consider international developments with global and EU markets experiencing increased transparency, reporting and higher standards of risk management while domestic reforms also remained important.

FCA, 12.3.2014

Competition and Behavioural Economics

FCA CE, Martin Wheatley, has given an address on ′Making competition king: the rise of behavioural economics at the FCA′ for the Australian Securities and Investments Commission (ASIC). Martin Wheatley referred to the Australian Wallis Inquiry regulatory division between prudential and conduct regulations although new initiatives were being undertaken especially in such areas as ethics, crisis prevention and consumer protection. Behavioural economics were specifically being used to support increased competition in financial services. Earlier 1970s and 1980s de-regulatory responses to monopolistic behaviour were being replaced by more balanced and sophisticated approaches although competition remained ′sticky′. More British people were likely to seek a divorce than move current account with 60% of annuities being purchased from the company that people insured with. It was traditionally assumed that prices respond efficiently to new information and that decision taking is rational although consumers still undertook wrong or sub-optimal decisions in selecting financial products. PPI produced £45 billion in premia which represented a 490% return on equity although it was both too expensive and ineffective to succeed. This had to be understood in terms of consumers being unable to take rational decisions against a ′black box′ of finance and Michael Lewis's ′hidden gears′ within the industry. Behavioural economics explained this in terms of ′bounded willpower′, and an inability to follow through on rational plans, and ′bounded rationality′ with decision taking not being able to fully process complex information and moving parts. Firms were able to take advantage of these consumer biases and profit from human mistakes partly through inertia, information limitations and lack of confidence or over confidence with firms being able to benefit from increased complexity. The FCA launched its use of behavioural economics in an occasional paper *Applying behavioural economics at the Financial Conduct Authority* (April 2013). This has been embedded into traditional regulatory analysis with the FCA also examining new potential areas of interest including complexity, consumer inertia, marketing and communications. The use of behavioural economics would be extended from consumer responses and corporate behaviour to include individual behaviour within organisations and regulatory responses. The FCA would use behavioural economics ′illusion of understanding′ for

self-examination purposes as well. Behavioural economics was most recently used as part of the FCA competition market study of the £1 billion add-on general insurance industry which was published in March 2014 (FCA, *How does selling insurance as an add-on affect consumer decisions? A practical application of behavioural experiments in financial regulation* (March 2014 Occasional Paper No 3).

FCA, 25.3.2014

Consumer Complaints

Data published by the FCA confirmed that consumer complaints had fallen by 15% between July and December 2013. Complaints had fallen from 2,911,154 to 2,479,029. The banks receiving the most complaints were Barclays, Lloyds, MBNA, Bank of Scotland and National Westminster Bank. The principal matters complained of concerned payment protection insurance (PPI), other general insurance products, current accounts, credit cards and savings.

FCA, 10.4.2014

Consumer Credit

The FCA has written to firms holding Office of Fair Trading (OFT) licences advising that their licence has since expired unless they had registered for interim permission by 31 March 2014. The FCA assumed responsibility for the regulation of consumer credit from the OFT on 1 April 2014. Firms that had not applied for interim permission cannot continue to carry on consumer credit activities without applying for new authorisation. Firms exiting the market should have advised the FCA that they had stopped providing consumer credit services.

FCA, 10.4.2014

Consumer Credit Rules

The FCA published its final rules on consumer credit in a policy statement in February 2014 (FCA, *Detailed rules for the FCA regime for consumer credit* (February 2014) PS14/3). This follows an earlier consultation document in October 2013 to which 300 responses were received. Responsibility for the regulation of 50,000 consumer credit firms was transferred from the OFT to the FCA on 1 April 2014. The policy statement contains detailed provisions on authorisation, supervision and regulatory reporting, conduct rules for general consumer credit activities, high-cost short-term credit (including payday loans) and debt advice providers (and peer-to-peer lending platforms), prudential standards for debt management firms and not-for-profit advice bodies, debt management firms holding clients' assets, second charge loans, complaints and enforcement. The *Made rules* (*legal instrument*)*: Consumer Credit Sourcebook* (CONC) and *Made rules* (*legal instrument*)*: Consequential and Supplementary Amendment* are attached as appendices 1 and 2.).

FCA, 28.2.2014

Consumer Premium Calls

The FCA is to consult with the financial services industry, consumer organisations and consumers on high rate charges for premium calls to financial services firms. The FCA is specifically concerned that it is not fair that consumers have to pay higher rates to call firms for assistance or to make complaints. Consumer groups have called for helplines to operate only at basic rates. The FCA will consult on standardisation of the rules governing charges for consumer assistance and complaints with lines being capped at the cost of a basic rate call. Equivalent provisions were to be included within the EU Consumer Rights Directive which could be applied in the financial services area.

FCA, 15.4.2014

Credit Cards Review

The FCA has confirmed that it will undertake a competition review of the UK credit card market end 2014. The UK credit card market was worth £150 billion with £57 billion being outstanding and with 30 million people using, at least, one credit card. 70% of all European credit cards are issued in the UK. The review would specifically consider the position of the nine million people in serious debt using multiple credit cards to transfer balances. The Charity StepChange confirmed that 10% of people seeking advice with an average £27,000 of total debt had five or more credit cards. The review followed the FCA's assumption for consumer credit in April 2014. The FCA had conducted separate research into consumers with unmanageable debt which distinguished between survival borrowers, lifestyle borrowers and reluctant borrowers with the resultant financial detriment and effects on health and wellbeing. 1.8 million of the 9 million people in serious debt were in denial. [The credit card market was worth £150 billion with £2.3 billion of purchases being made each year. There were over 30 million current accounts with overdraft facilities with £8 billion being owed. The 26.4 million UK households owed £6,000 of consumer credit debt on average. The UK consumer credit market was worth £200 billion in 2013 with £158 billion currently being owed. 50,000 businesses provided consumer credit in addition to the 27,000 financial firms already supervised by the FCA. There were 500 payday loan firms in operation in the UK. A number of changes would be introduced specifically on payday lenders and debt management companies. These included limiting the number of loan roll-overs to two, restricting to two the number of times a firm can seek repayment using a continuous payment authority (CPA), providing information to consumers on free debt advice with debt management companies being required to pass more money onto creditors at the beginning of a debt management plan and to protect client money.

FCA, 3.4.2014

Crowd Funding

The FCA has issued a policy statement on *The FCA's regulatory approach to crowd funding* (*and similar activities*) (October 2013) CP13/13. Crowd funding

allows individuals, organisations and businesses to raise money through online portals or platforms to finance or re-finance activities and enterprises. Crowd funding may either be exempt or subject to FCA authorisation such as for arranging deals in investments or financial promotions. Crowd funding falls within the FCA's new responsibility for consumer credit. The paper provides an overview of the market, relevant regulatory considerations, loan based crowd funding and investment based crowd funding. The FCA has identified 25 loan based crowd funding platforms that allow consumers to invest in loan agreements and 10 firms and 11 appointed representatives involved with investment based crowd funding which allow the purchase of investments in unlisted equity or debt securities or units in unregulated collective investment schemes. The FCA currently regulates investment although not loan based crowd funding platforms including the marketing of unlisted equities and debt security. Loan based schemes are considered to be of lower risk than investment based platforms. A number of proposed amendments were set out in the FCA CP13/13. The FCA set out its feedback to the consultation with published rules in *The FCA's regulatory approach to crowd funding over the internet and the promotion of non-readily realisable securities by other media* (March 2014) PS14/4.

FCA, 6.3.2014

Ethics and Economics

FCA CE, Martin Wheatley, has given an address on 'Ethics and Economics' before the Worshipful Company of International Bankers, London. Authorities had to consider how to continue to focus on culture during the next phase of the UK financial cycle and economic recovery. Authorities had to be careful to avoid a proliferation of new high risk products and forms of 'enchanted wealth' as referred to by Thomas Carlyle after the industrial revolution. Growth and profitability had to be based on productivity, high quality standards and high quality client service. The new challenge was to restore the long term link between ethics and growth that dominated financial services for most of their history. This specifically required creating effective, future proofed regulation and effective self-regulation. The FCA had specifically to anticipate better and be more forward looking and to re-assess the regulatory balance between ethics and rules. Roger Steare had called for a more sophisticated interpretation of integrity in business in his book on *Ethicability: How to Decide What's Right and Find the Courage to Do it?* (2006). Good self-regulation within firms was also dependent on proper incentives. 53% of financial services executives reported that career progression was dependent on ethical 'flexibility' which rose to 71% within investment banking. Franklin Roosevelt noted in his inaugural presidential address in 1937 that, 'We've always known heedless self-interest was bad morals, we know now that it is bad economics'.

FCA, 4.3.2014

FCA Fees and Levies

The FCA has issued consultation paper on Regulated Fees and Levies: Rates proposals 2014/15 (March 2014) CP14/6. The consultation covers fees and

levies for the FCA, the Financial Ombudsman Service general levy and the Money Advise Service (MAS). The paper also includes feedback on consumer credit fees and levies following earlier consultation. The FCA Annual Funding Requirement (AFR) has increased by £14.3 million (3.3%) to £446.4 million. The increase relates to the FCA's new competition objectives (£6.3 million), scope change recovery cost (£1.1 million), underspends returned (£9.5 million) with a reduction in regulatory reform cost (£2.6 million). Total fees collected will nevertheless only rise by £8.9 million (2.3%) allowing for financial penalty rebates. The FOS has asked that the FCA raise £23.3 million in general levy with the total funding requirement for the MAS being £81.1 million including £43 million for delivering money advice and £38.1 million in the coordination and provision of debt advice.

FCA, 31.3.2014

Household and Travel Insurance Claims

The FCA is to discuss the initial findings of its thematic review on household and travel insurance claims handling with firms and other interested parties. The review attempted to assess the extent to which insurers had considered consumers making claims as part of their core business. 65% of household insurance customers were satisfied with their claims and 64% of travel insurance claimants. The FCA has identified a number of areas for further improvement to increase customer satisfaction including on the handling of in-bound claims, ownership of claims and client communication, supply chain management, medical conditions, delegation and product documentation clarity.

FCA, 9.4.2014

Independent Financial Advice

The FCA has published the results of its thematic review into delivering independent financial advice following the implementation of the Retail Distribution Review (RDR) which came into effect in 2013. The objective was to improve outcomes for consumers by enhancing standards of professionalism, removing key biases and ensuring that the cost of advice was clear. Financial advisors had either to operate as restricted or independent service providers with the review considering the extent to which firms had properly used the independent status. The FCA also sought to clarify standards that firms should adhere to where they held themselves out as being independent. These specifically related to providing advice on retail investment products, use of product panels and platforms, model portfolios and referrals to discretionary investment services. The FCA published the results of its thematic review *Supervising Retail Investment Advice: Delivering Independent Advice* (March 2014) TR14/5.

FCA, 20.3.2014

Joint regulatory Guide

The Pensions Regulator and the FCA have published a joint *Guide to the regulation of workplace defined contribution pensions* (March 2014). This

outlines the approaches adopted by each authority and how they will work together to ensure consistency and avoid duplication. Specific definitions of trust and contract-based arrangements are provided. The Pensions Regulator is responsible for work-based pension schemes in the UK and is required to protect members' benefits, reduce the risk of calls on the Pension Protection Fund (PPF), promote and improve understanding and the good administration of work-based schemes and to maximise employer compliance with automatic enrolment duties.

FCA, 21.3.2014

Leadership and Conduct

FCA Chief Executive, Martin Wheatley, has given an address on 'Leadership and Conduct' at City Week 2014: International Financial Services in the Post-Reform World: Opportunities and Challenges. Martin Wheatley noted that 71% of financial professionals benefited from London's financial reputation without acknowledging their responsibility to protect. 71% of investment bankers accepted that they had to demonstrate ethical flexibility as part of their career progression with 91% of executives believing that ethical conduct was as important as financial success. A number of key wholesale themes were identified within market integrity. These included the principle of acting as a good agent, clean pricing, management of conflicts of interest in the use of information including how information is received, held and shared, financial crime and the quality of market infrastructure including with regard to financial innovation such as high frequency trading and cyber threats. The FCA had announced the commencement of a number of major thematic reviews in 2013 especially with regard to the use of dealing commissions and their execution. Other wholesale related reviews had been referred to in the FCA Business Plan including with regard to information use and benchmarks. Annual UK revenue for wholesale banks and investment firms was around £70 billion a year. The FCA would specifically examine the complex operations of firms with institutions operating in multiple roles and with multiple capacities. The FCA would separately review the control and governance practices within firms of traders in connection with benchmark rate setting.

FCA, 31.3.2014

Life Insurance Announcement Investigation

The FCA has confirmed that Simon Davis, a senior Commercial Litigation Partner at Clifford Chance, has been appointed to conduct the independent inquiry into the FCA's handing of its announcement of proposed supervisory work on the fair treatment of long standing customers by life insurance firms. The inquiry has been commissioned by the FCA Non-Executive Directors and covers the events leading up to and following the publication on 28 March 2014 of the FCA's intention to review certain long-term life assurance products during 2014. The review had been referred to in the FCA's Business Plan published on 31 March 2014. The results of the investigation will be published subject to any relevant legal considerations. The inquiry will

specifically examine the circumstances surrounding the FCA's Business Plan, subsequent press briefing, the handling of price-sensitive information, the events of Friday 28 March 2014 and future lessons.

FCA, 8.4.2014

Listing Rules

The new UK listing regime is proposed to come into effect on 16 May 2014. This includes a series of changes to the listing rules proposed in November 2013 in CP13/15. The revision specifically concerned the governance of premium listed companies with a controlling shareholder and the need to protect the interests of minority shareholders with separate options being provided on the rules on the cancellation of listing. Premium listed companies applying for a cancellation would have to have a majority of, at least, 75% of votes attached to the shares voting on the resolution and approval by a majority of the votes attaching to the shares of independent shareholders. Equivalent measures using acceptances will apply in takeover situations unless the offeror acquires or agrees to acquire more than 80% of the voting rights with the need for independent shareholder approval or acceptance being unnecessary.

FCA, 17.4.2014

Market Infrastructure

The FCA and the Bank of England have agreed a Memorandum of Understanding for supervision of markets and market infrastructure. The FCA and PRA are responsible for the supervision of financial market infrastructure (FMI) participants with the FCA also being responsible for trading venues dealing with FMIs. The MOU entered into has to be reviewed annually under the Financial Service Act 2012 with the FCA and Bank undertaking to include industry feedback. The FCA and Bank believe that the MOU arrangements had worked well over the first 11 months and had operated in a coordinated manner without material duplication. Strong working level relationships would be maintained between staff that had previously worked together within the Financial Services Industry (FSA) with the FCA and Bank continuing to refine their working relations.

FCA, 17.3.2014

Mortgage Lending

The FCA's new mortgage lending rules were to come into effect on 26 April 2014. These would specifically require that borrowers can only obtain a mortgage where they can prove that they can afford the repayments immediately and in the future. The FCA has produced a *Guide: Getting a mortgage* (April 2014) which outlines the new affordability requirements and obligations of mortgage advisors. Evidence of income must be provided in the form of payslips or accounts or tax returns by self-employed people. The UK mortgage market was worth $1.3 trillion in 2013 with $1.06 trillion of owner

occupants and the balance buy-to-let (BTL). 9.6 million mortgages were in place with average first time loans of £137,000 and £144,500 on remortgage.

FCA, 14.4.2014

Overdraft Charges

The FCA has published the results of its consumer credit insight report on overdraft charges which confirms that a large number of consumers were paying too much for overdrafts. The FCA had conducted research into the $8 billion overdraft market following its assumption of responsibility for 50,000 consumer credit firms. The FCA had investigated arranged and unarranged overdraft charges. The research confirms that many customers did not realise how much overdrafts cost and were confused by unarranged overdraft charges. Consumers did not consider arranged overdrafts as borrowing and used them as an extension of income as available funds. Firms raised additional revenue by increasing limits which consumers considered as a form of trust and reward. The FCA did not accept that overdraft charges subsidise free current accounts with current accounts being used to sell other more profitable products. The FCA would examine cash savings in a separate market study and how credit providers set and monitor limits. The FCA would work with the Competition and Markets Authority as part of its review of the current account market.

FCA, 14.4.2014

Payments Systems Regulator

The FCA has issued an approach document on *Payments Systems Regulation – Call for Inputs* (5 March 2014) in anticipation of the creation of a new UK payment systems regulator by April 2015. Seven billion payment transactions are carried out each year worth over $75 trillion. The three objectives of the new regulator will be to promote competition and innovation and ensure that payment systems operate in the interests of users. The PSR will be set up as a subsidiary of the FCA with its own managing director and board. HM Treasury is to designate firms subject to regulation by the PSR which were expected to include CHAPS, BACS, FPS, LINK, Cheque and Credit and the principal three and four party card schemes referred to in HM Treasury, *Opening up UK payments* (March 2013). The FCA document contains 27 questions on which responses are sought. These include coverage, competition, functions, ownership structures, governance, access, sponsoring, access rules and conditions, infrastructure, messaging, incentives, innovation, benefit and risks.

FCA, 5.3.2014

Pension Reform

The FCA has issued Guidance on the pension reforms announced as part of the 2014 Budget (FG14/3). This covers the interim period between 27 March 2014, when some of the changes announced came into effect, and April 2015 when the rest apply. The guidance is directed at pension providers including

insurers and SIPP operators, annuity providers, income drawdown providers, financial advisors providing retirement income advice and intermediaries selling annuities and income drawdown products on a non-advised basis. The guidance is intended to ensure that customers are provided with necessary information to allow them to make informed decisions to avoid being disadvantaged. Firms had already begun to amend their processes and procedures to provide necessary information with some having asked the FCA for clarification of its expectations during the interim period.

FCA, 9.4.2014

Risk Outlook

The FCA has published its *Risk Outlook 2014* (March 2014). The *Risk Outlook* examines how risks arise including underlying drivers of risk and its objectives and changes in environmental conditions. Underlying drivers include inherent factors (information asymmetries, biases, rules of thumb and metal shortcuts and the growing importance of financial capability), structures and business conduct (market structures, culture and incentives and conflicts of interest) and conduct factors (policy and regulatory, technological and economic and market). The evolving risk landscape is considered in terms of cross-market pressures (including pressure on business model sustainability and strategies, pressure to balance profitability, shareholder returns, cost base and financial soundness with good consumer outcomes and misalignment of expectations and underlying fundamentals) and related risks and forward-looking areas of focus. Severn specific areas of forward-looking focus are identified in terms of technological developments outstripping investment, consumer capability and regulatory response, poor culture and controls continuing to threaten market integrity, large back-books leaving firms to act against their existing customers' best interest, retirement income products and distribution delivering poor consumer outcomes, continued growth in consumer credit leading to unaffordable debt, excessively complex terms and conditions and conduct issues arising from substantial and rapid house price growth.

FCA, 31.3.2014

Sales Incentives

The FCA has published the results of its thematic review of *Risks to consumers from financial incentives – an update* (March 2014) TR14/4. Significant improvements were revealed although the number of areas of concern remained. All of the major retail banks had replaced or introduced substantial changes to financial incentive schemes which had resulted in earlier mis-selling scandals. Better management of incentive schemes was required. Firms had specifically to monitor for spikes or trends in individual sales patterns, monitor poor behaviour in face-to-face sales conversations, manage risks in discretionary incentive schemes and balanced scorecards, monitor non-advice sales to ensure that staff do not provide personal recommendations, improve oversight of appointed representatives and manage the additional risks created through the use of 100% variable sales based

pay schemes with the associated increased risk of mis-selling. One in ten firms with sales teams had higher risk incentive schemes which were not managed properly.

FCA, 4.3.2014

Santander Fine

Santander UK has been fined £12,377,800 for widespread investment advice failings. Santander had failed to make sure that advisors were taking into account customers' personal circumstances before making recommendations, failing to ensure that investors were given clear and not misleading information, carry out regular ongoing checks in connection with Premium Investments, inadequate training and improper monitoring.

FCA, 26.3.2014

SME Banking Market Study

The FCA has been working with the OFT on the *SME Banking Market Study* with the FCA also to work with the Competition and Markets Authority (CMA) which will assume responsibility for the study from April 2014. A number of meetings, roundtables and focus groups have been held as part of the survey work. Concerns remained with regard to business current account (BCA) and SME lending concentration levels, significant barriers to entry and expansion, the limited scale of new market entrants, SME switching, inertia and low levels of engagement and low awareness of alternative funding providers. Further concerns arose with regard to security waivers and failure by banks to comply with undertakings given following the Competition Commission's inquiry into SME banking in 2002.

FCA, 11.3.2014

Sustainable Conduct

Clive Adamson, FCA Director of Supervision, has given an address on 'A sustainable conduct environment' before the Association of Professional Compliance Consultants' annual conference. Authorities had adopted a greater focus on conduct regulation and supervision to attempt to restore consumer, investor and market participant trust. Firms had shifted from recognition to the new environment, to panic about how to respond, to expanding control frameworks, to realising the culture in front-line businesses required radical overhaul and finally to accepting that business models required significant change as well. Investors had accepted lower returns and unpredictable costs as a part of doing business. Authorities had still to attempt to ensure that a more sustainable environment was developed within which the number and severity of incidents of poor behaviour was reduced on a permanent basis to restore longer term trust. Normal market solutions did not work in the financial services area with complex products, limited consumer understanding, their long-term nature, substantial inertia, insufficient differentiation within providers and markets not being sufficiently competitive. It was for this reason that authorities had to intervene on behalf

of consumers and investors to overcome natural market incentives in fair of shareholders and employees and to redress the balance in fair of consumers and investors. The FCA was attempting ensure that retail customers achieved fair outcomes and that wholesale markets operated with integrity within its outcome focused philosophy. The fair treatment of customers should not be treated simply as a risk to be managed within a tick box compliance approach. Conduct was a business model and cultural challenge. Firms had to evolve current business models into models that were demonstrably safer and consistently able to deliver products and services of good value that met customer needs over their lifecycle with firms being trusted and maintaining resilient delivery infrastructures. Firm were only at a relatively early stage of constructing these new sustainable business models. Incentives had to be adjusted to rebalance the interests of consumers and shareholders with the FCA acting in the interest of consumers but also in a constructive and trusted manner in dealing with the financial services industry.

FCA, 20.3.2014

Prudential Regulation Authority (PRA)

Annual Funding Requirement

The Bank of England has issued a consultation paper on the *Prudential Regulation Authority Regulated fees and levies: rates proposals 2014/15* (April 2014) cp8/14. The fees and levies are to support the costs incurred by the PRA in securing its strategic priorities and business aims for 2014/15. The Annual Funding Requirement (AFR) for 2014/15 is estimated to be £227.2 million which is 4% lower than the AFR in 2013/14 of £235.5 million with a £19.6 million surplus being refunded. The AFR covers ongoing regulatory costs, transition costs and a surplus refund in respect of the IMAP Solvency II Special Project Fee. The budget reflects any additional regulatory work undertaken or work carried out within a short time limit such as with the implementation of the Financial Services (Banking Reform) Act 2013 which came into effect on 1 March 2014. Additional costs include stress testing UK banks to determine capital adequacy under Financial Policy Committee recommendations, implementing the structural (ring fencing and loss absorbing) reforms and Parliamentary Commission on Banking Standards Requirements and promoting competition for services provided by PRA firms as a secondary objective. The Bank of England incurred £73.9 million in costs in setting up the PRA which will be recovered between 2013/14 – 2017/18 with £14.8 million being added to the PRA AFR between 2015/16 – 2017/18.

PRA, 2.4.2014

Mortgage Lenders and Administrators Statistics

The Bank of England and Financial Conduct Authority (FCA) have published the latest Mortgage Lenders and Administrators Statistics for the UK for the fourth quarter (Q4) of 2013. The data is collected through the Mortgage Lenders and Administrators Return (MLAR) which covers residential mortgage lending and certain non-regulated business such as buy-to-let and second charge mortgages. Gross advances were at their highest level

since 2008 with first-time buyer mortgages rising to their highest level since Q4 2007. Interest rates on new lending, arrears and possession cases remaining unsold were at their lowest level since 2007. Total residential loans rose to £1,238 billion which was up 0.4% on the previous quarter. Gross advances were 31% higher at £51.5 billion with new commitments rising to £50.3 billion. Loans advanced to first-time buyers grew by 41% to £3.1 billion with buy-to-let increasing from £4.3 billion to £6.6 billion. Only 2.1% of advances were over 90% loan to value (LTV) arrears increased by 2.2% to £32 million with new cases in possession falling by 21% to £6,137 million.

PRA, 11.3.2014

Occasional Consultation Paper

The PRA has issued an Occasional Consultation Paper (March 2014) CPR/14. This contains a series of proposed miscellaneous and minor amendments to its rules, guidance and supervisory statements especially with regard to financial conglomerates capital adequacy, Shari'ah compliant liquid assets, the risk management of asset encumbrance and proposed amendment to Supervisory Statement on the Internal Capital Adequacy Assessment Process (ICAAP) and the Supervisory Review and Evaluation Process (SREP) (ss5/13). The conglomerate provisions remove an inconsistency in group compliance with amendments to the definitions of ultimate insurance parent undertaking and ultimate EEA insurance parent undertaking. Eligibility criteria had to be amended to allow a wider range of assets to be included as liquid asset buffers for Shari'ah compliant firms in addition to Sukuk issued by the Islamic Development Bank. The European Systemic Risk Board (ESRB) had recommended that credit institutions maintain risk management systems and controls for asset encumbrance following the increased use of secured funding and additional exposures that may arise. The ss5/13 amendments deal with the specific risk in foreign currency lending to unhedged borrowers.

PRA, 4.3.2014

PRA Administration Instruments

The PRA has issued its third Handbook administration instrument to update and correct its rules (PRA, *Handbook Administration Instrument* (*no 3*) *2014* (PRA 2014/1)). Corrections are made to Handbook provisions to ensure that they are clearing presented and are up-to-date. Administration instruments cannot be used to make major policy changes although they may still result in rule amendments. The PRA consults with the FCA on administration instrument consultations (FSMA 2000, s 138j(1)) with the corrections being consistent with its regulatory principles (FSMA 2000, s 2h).

PRA, 1.4.2014

Remuneration Clawback

The Bank of England has issued a consultation paper on *Clawback* (March 2014) cp6/14 on amending the Remuneration Code (in The Senior Management Arrangements, Systems and Controls (SYSC) 19a sourcebook) to

require PRA authorised firms to amend employment contracts to allow them to clawback vested variable remuneration on a group wide-basis. Firms can be required to hold payments of unvested bonuses or malus. The PRA issued a supervisory statement on malus in Principle 12(h) of the Remuneration Code SYSC 19A on 20 October 2013 (ss 2/13). Up to 100% of total variable remuneration is to be subject to malus or clawback under the EU Capital Requirements Directive IV and the Parliamentary Commission on Banking Standards (PCBS) final report. Under the new measures, vested remuneration would be recovered where there is reasonable evidence of employee misbehaviour or material error, the firm or business unit has suffered a material downturn in financial performance or suffered a material failure of risk management. Clawback is not limited to employees directly culpable of malfeasance and would apply to those reasonably expected to be aware of the failure or misconduct or deemed indirectly responsible or accountable due to their role or seniority. The provisions will come into effect on 1 January 2015. The PRA will consult further on implementation of the PCBS recommendations.

PRA, 13.3.2014

Bank for International Settlements (BIS)

Basel III Monitoring Results

The Basel Committee has published its *Basel III – Monitoring Report* (March 2014) which provides a six monthly update on the implications of Basel III implementation. 225 banks participated in the study including 102 large internationally active Group 1 banks (with over €3 billion in Tier 1 capital) and 125 Group 2 banks. Predicted capital shortfalls had continued to fall with Common Equity Tier 1 (CET1) 7% target capital shortfall for Group 1 banks falling from €115 billion end December 2012 to €57.5 billion March 2014. CET1 capital against a 4.5% minimum level had increased by €1.1 billion to €3.3 billion. After-tax profits for Group 1 banks for the year to June 2013 were €456 billion. The shortfall for Group 2 banks had increased to €27.7 billion at a 7% target level and €12.4 billion at 4.5% with after-tax profits being €26 billion. After CET1 capital ratios for Group 1 banks were 9.5% and 9.1% for Group 2 banks. Separate data is provided on liquidity LCR and NSFR figures.

BIS, 6.3.2014

Capital Adjustment Channels

The BIS has published a working paper on ′Banks and capital requirements: channels of adjustment′ (March 2014) no 443 by Benjamin Cohen and Michela Scatigna. The paper examines the increase in bank capital ratios since the financial crisis with 94 large banks from advanced and emerging economies having adjusted their capital ratios through earnings account retention rather than reductions in risk weights. Banks continue to expand their lending although lending growth was lower with European banks. Banks had used retained earnings to increase capital principally through

lower dividend payments and the imposition of wider lending spreads in advanced economies. Banks were able to expand lending further where they had higher capital ratios and stronger profitability following the crisis.

BIS, 11.3.2014

Capital Progress

The Basel Committee has issues a *Progress report on implementation of the Basel regulatory framework* (April 2014). This covers domestic implementation of Basel II, Basel 2.5 and Basel III at end March 2014. The paper sets out the scope of coverage and methodology with the data being set out in an extending overview table for each member country covered. Implementation is graded in terms of being complete (green), in process (yellow) and no progress (red). EU figures are tied to overall EU progress. Basel II had been produced in 2004 and was to be implemented by end 2006 with its three pillars covering minimum capital requirements, supervisory review and market discipline. Basel 2.5 was agreed in July 2009 and was to be implemented by end 2011 with specific revised provisions on securitisation and trading book exposures. Basel III was produced in December 2010 and was to be implemented between January 2013 and January 2019. The assessment methodology on global systemic importance and additional loss absorbency for G-SIBs was produced in November 2011 with relevant requirements to be issued in January 2016 and implemented by the beginning of January 2019. The revised Liquidity Coverage Ratio (LCR) was issued in January 2013 and will come into effect on 1 January 2015 subject to transitional arrangements to January 2019. The leverage ratio framework and disclosure requirements were produced in January 2014 with banks already reporting ratios to national supervisors with public disclosure to commence on 1 January 2015. The revised Net Stable Funding Ratio (NSFR) was produced in January 2014 and will be implemented by 1 January 2018 under the liquidity timeline originally produced in 2010.

BIS, 4.4.2014

Central Counterparty Exposures

The Basel Committee has issued a final standard on *Capital requirements for bank exposures to central counterparties* (April 2014) which will come into effect in January 2017 replacing the interim requirements published in July 2012. The final measures were produced following collaborative work with the Committee on Payment and Settlement Systems (CPSS) and the International Organisation of Securities Commissions (IOSCO). The final measures have been simplified and adjusted to reflect the CPSS-IOSCO *Principles for Financial market infrastructures* (April 2012). The final measures include a single approach for calculating capital on the bank's contributions to the mutualised default fund of a qualifying CCP (QCCP). The standardised approach (rather than Current Exposure Method) is used to measure the hypothetical capital requirement of a CCP. An explicit limit is placed on

QCCP exposure charges. Additional provision is also included on the treatment of multi-level client structures clearing trades through CCP linked intermediaries.

BIS, 10.4.2014

Chinese Renminbi

The BIS has published a working paper on 'One Currency, Two Markets: the renminbi's growing influence in Asia-Pacific' (April 24) no 446 by Chang Shu, Dong He and Xiaoqiang Cheng. The paper examines the growing influence of the renminbi especially through the offshore renminbi foreign exchange market in Hong Kong SAR (the CNH) which has separate effects on Asian currencies apart from the onshore renminbi market (CNY). Both markets impact Asian currency rates against the US dollar with the CNH market exerting more influence over time. Future effects will depend on China's progress in liberalising its capital account. The paper also confirms that China's regional influence is increasingly transmitted through financial channels.

BIS, 11.4.2014

Counterparty Credit Risk Exposures

The Basel Committee has produced a final standard on *The standardised approach for measuring counterparty credit risk exposures* (March 2014). This sets out a comprehensive, non-modelled approach for measuring counterparty credit risk associated with OTC derivatives, exchange-traded derivatives and long settlement transactions with the new standardised approach (SA-CCR) replacing the Current Exposure Method (CEM) and the Standardised Method (SM) within the Committee's capital adequacy framework with the separate IMM shortcut being replaced by the SA-CCR. The new standard is to come into effect on 1 January 2017. The objective is to produce a risk sensitive methodology that distinguishes between margined and unmargined trades with more effective recognition of the value of netting. The new framework limits discretion, minimises the use of internal estimates and avoids undue complexity. The SA-CCR is based on the replacement cost and potential future exposure with an alpha factor being applied to the sum of these to produce the exposure at default (EAD) which is multiplied by the counterparty risk weight under either the standardised or internal ratings based (IRB) approaches. This follows an earlier consultation document in June 2013 and joint quantitative impact study (JQIS) to assess the effect of the methodology, weight and technical calibration.

BIS, 31.3.2014

European Stability Mechanism

The Basel Committee has agreed to allow supervisors to apply a zero percent risk weight to claims on the European Stability Mechanism (ESM) and the European Financial Stability Facility (EFSF) under the list of permitted entities under Basel II. Claims against the ESM and EFSF will also be

included as level 1 High Quality Liquid Assets (HQLA) under the Basel III LCR and liquidity risk monitoring tools.

BIS, 18.3.2014

External Bank Audits

The Basel Committee has issued *Guidance on external audits of banks* (March 2014). This replaces the Committee's earlier guidance on the relationship between banking supervisors and external auditors in 2002 and external audit quality and banking supervision in 2008. The new guidance sets out supervisory expectations on audit quality and the work of the external auditor and audit committee within a bank. The papers covers supervisory expectations on how audit committees can contribute to audit quality in the oversight of the external audit function, the effective discharge of external auditor responsibilities, the relationship between the external auditor and supervisors to support mutual understanding and regular communication and the maintenance of regular and effective dialogue between the supervisory authorities and relevant audit oversight bodies. The Committee has published a separate 'Letter to the International Auditing and Assurance Standards Board (IAASB)' (21 March 2013) supporting the IAASB's strategy and work programme on supporting global financial stability with specific areas where International Standards and Auditing could be enhanced.

BIS, 31.3.2014

Foreign Exchange and Money Markets

Peter Zollner, Head of the BIS Banking Department, has given an address on 'Recent trends in the foreign exchange and money markets' before the 53rd ACI Financial Markets World Congress, Berlin, 29 March 2014. Foreign exchange trading had increased by 35% between 2010 and 2013 to $5.3 trillion following a 20% rise between 2007–2010. Reasons for the increase included the increased trading of yen pairs following the Bank of Japan's monetary policy changes given affect to in April 2013, growth of investment in international assets, greater participation by non-dealer financial institutions which increased by 48% to $2.8 trillion and associated technological advances including the emergence of liquidity aggregators and algorithmic trading techniques. Trading peaked in April 2013 and subsequently fell by $300 billion to $5 trillion per day in October 2013 following a drop in euro and yen trades against the US dollar. Non-dealer financial counterparties specifically included lower-tier banks and institutional investors and hedge funds. Greater interconnectivity and a greater dispersion of risk sharing arose through technological improvements with liquidity aggregation and algorithmic trading. This allows liquidity pools to be linked through algorithms which directs trades to the lowest trading venue and to allow participants to select preferred counterparties to provide price quotes. This compensated for the loss of liquidity previously provided through the inter-dealer market. New trading technologies have also increased non-dealer market participation especially through electronic trading and retail-oriented trading platforms. The US dollar remained the dominant traded currency with 87%

increasing from 84.9% in 2010 while the euro decreased from 39% to 33%. While trading in Chinese renminbi still on represented 2% of global currency trading, the amount of trade being settled in renminbi had grown from 1% to 17% between 2009–2014. The renminbi had become more volatile and would grow in trade volumes following the Chinese government's announcement in November 2013 that China would transition to market oriented exchange rate regime with increased capital account convertibility.

BIS, 31.3.2014

Globalisation and Asian Monetary Policy

The BIS has published the research papers following the final conference on ′Globalisation and Inflation Dynamics in Asia and the Pacific′ with the People's Bank of China (PBOC) on 23–24 September 2013 in Beijing. The BIS Asian Office had undertaken a two year research programme on globalisation and inflation beginning in February 2012. The papers produced covered the dynamics of inflation forecast, measurement of economic slack, supply chains and inflation spillovers, financial globalisation and the role of exchange rates in monetary policy, global commodity price cycles and their monetary policy implications and the role of inflation in China's monetary policy rule.

BIS, 2.4.2014

Global Economic and Financial Challenges

Jaime Caruana, General Manager of the BID, has given an address on ′Global economic and financial challenges: a tale of two views′ before the Harvard Kennedy School Cambridge, Massachusetts, 9 April 2014. Caruana distinguishes the two explanations of the slow and uneven recovery since the global financial crisis in 2008/9 based either on a persistent shortfall of demand or balance sheet specificities of the financial cycle induced recession. Seven stylised propositions are developed to explain each diagnosis covering the origin of the recession, implications of deleveraging, weak credit growth causes, the role of asymmetries in the international monetary system, the nature of hysteresis (historical dependence), negative equilibrium real interest rates interpretation and risk of deflation. The evidence supporting each view and relevant policy prescriptions are examined. The paper concludes that the balance sheet approach provides a more acceptable overall explanation with too much emphasis since the crisis on stimulating demand and not enough on balance sheet repair and structural reform to promote productivity. Policy frameworks had to ensure that policies were more symmetrical over the financial cycle to avoid the risks of entrenching instability and exhausting policy ammunition.

BIS, 9.4.2014

Global Liquidity

Jaime Caruana, BIS General Manager, has given an address on ′Global liquidity: where it stands, and why it matters′ at the Goethe University,

Frankfurt, 5 March 2014. The speech examines global liquidity and the financial cycle over the past decade. Financial risk taking, asset prices and credit expansion had moved together across countries even where they were at different stages of the macroeconomic business cycle. Following an increase in market activity in the early 2000s and collapse in 2007–9, the international financial system had entered a new phase of global liquidity with potential new risks. While global liquidity conditions remained accommodative, conditions would return to normal over time. Policymakers and the private sector had had to prepare for this adjustment and, in particular, monitor vulnerabilities that may have built up during their previous period with action also being required to build up resilience in the financial system.

BIS, 5.3.2014

International Monetary System

The BIS has issued a working paper on ′Reforming the international monetary system in the 1970s and 2000s: would an SDR substitution account have worked?′ (March 2014) no 444 by Robert N McCauley and Catherine R Schenk. The paper examines the use of a substitution account in the 1970s to allow central banks to use IMF Special Drawing Rights (SDRs) in place of US dollars. The SDR was calculated against a group of countries consisting of the US dollar, deutschemark and French franc (replaced by the euro), Japanese yen and sterling. Parties were unable to agree use of the account in 1980 with difficulties in the distribution of the cost of covering any shortfall which may arise if the dollar's depreciation exceeded the value of any cumulative interest rate premium on the dollar. The substitution account would not have remained solvent if the US dollar return had been based on Treasury bill yields even if a substantial amount of IMF gold had been used to cover the shortfall. The paper confirms that the account would have remained solvent without backing if the US dollar rate had been based on Treasury bond yields.

BIS, 12.3.2014

Large Exposures

The Basel Committee on Banking Supervision has issued revised standards on large exposures with its *Standards-Supervisory framework for measuring and controlling large exposures* (April 2014). These replace its earlier January 1991 standards. A general limit of 25% of Tier 1 capital is imposed on all exposures to a single counterparty and groups of connected counterparties with a 15% limit applying to global systemically important banks (G-SIBs). Large exposures are defined and reporting thresholds set at 10% of eligible capital base (up from 5% under the original proposal). The treatment of credit default swaps (CDSs) has been adjusted to reflect the risk based capital framework with the granularity threshold on securitisation vehicles being replaced with a materiality threshold set at 0.25% of the bank's capital base. Additional provision has been included on covered bonds. The current exemption in respect of exposures to qualifying central counterparties

(QCCPs) is to be reviewed before 2016. The paper contains specific provisions on the objectives of the large exposures framework and types of concentration risk, overall design, exposure values, specific exposure treatments (including sovereign, interbank, covered bonds, collective investment undertakings, securitisation vehicles and other structures and central counterparty exposures), G-SIB limits and implementation and transitional arrangements.

BIS, 15.4.2014

Quarterly Review

The BIS has issued its latest *Quarterly Review* for March 2014. Interbank landing had fallen from $22.7 trillion end March 2008 to $17 trillion end September 2013 with two thirds of the contraction in the euro area. Cross-border interbank lending had fallen in Q3 2013, in particular, in the Eurozone area and Switzerland. Emerging market central banks had been able to defend the exchange rates despite political uncertainty. Total debt securities had increased to $100 trillion by mid 2013 following increased post-crisis issuance by governments and non-financial corporations with a temporary decrease in the amount of securities held by foreign investors and a de-globalisation of portfolios which represented a 30% increase on the $70 trillion outstanding in 2007. Public debt securities issued by central, state and local governments had increased by 80% to $43 trillion by June 2013. The issuance of forward guidance by major central banks had lowered the volatility of expected future policy rates. Non-residents held around 25% of debt stock down from 29% in 2007. The BIS also issued its *Locational Banking Statistics* for Q3 2013 in March 2014. Total exchange traded futures had increased to $25.933 trillion by December 2013 with options falling from $46.361 trillion to $38.694 trillion between September and December 2013. The BIS has separately constructed a long series on credit data to the private non-financial sector for 40 economies in advanced and emerging countries.

BIS, 9.3.2014

Restoring Confidence in Banks

Stefan Ingves, Chairman of the Basel Committee and Governor of the Sveriges Riksbank, has given an address on ′Restoring confidence in banks′ before the 15th Annual Convention of the Global Association of Risk Professionals, New York, 4 March 2014. Banking is a business built on confidence with modern highly leveraged banks and the fractional reserve banking system only being successful for so long as lenders have confidence that banks have sufficient financial strength to cover their obligations as and when they fall due. The financial crisis represented a collapse in confidence in essence which stress tested regulation and banks which were both lacking. The crisis of confidence which underlies a liquidity contraction reflected uncertainty. Specific risk management and regulatory failures included allowing equity capital to be run down to as low as 2% of risk-weighted assets with investors considering mark-to-market losses on securities which had been filtered out and ignored and with bank provisioning standards being

backward-looking. The key regulatory metric of the capital ratio had accordingly been increasingly discounted due to its overstatement of banks' true loss absorbing capacity. Basel III would attempt to correct these shortcomings. The Basel Committee was also working to correct variability in standards implementation with two studies having been published on trading book and another on banking book risk weighted differences. Differences in individual bank practice and 'scatter' showed that ratios could vary by up to 4% on identical assets. A series of policy, supervisory and implementation and disclosure initiatives were designed to correct these differences and restore confidence. Simplifications and safeguards were introduced within the framework to help limit variability but secure appropriate risk sensitivity. The studies referred to would assist supervisors assess national banks against international peer groups with appropriate action being taken with regard to outliers. Pillar 3 disclosure requirements were also being reviewed to ensure more effective market disclosure.

BIS, 4.3.2014

Financial Stability Board (FSB)

G20 Chairman's Letter

Chairman of the Financial Stability Board (FSB), Mark Carney, has issued a Chair's Letter to the G20 Ministers and Governors on Financial Reforms and Update on Progress. The G20 Leaders agreed on priorities to achieve the programme of fundamental reform of the global financial system at the St Petersburg meeting in February which would be achieved during the Australian Presidency and the Brisbane Summit. Carney confirmed that decisions remained in three particular areas with regard to ending too-big-to-fail, transforming shadow banking to transparent and resilient market based financing and making derivatives markets safer. Carney also recommended the development of an approach to financial regulation beyond the Brisbane Summit based on commitments to peer reviews and impact assessments, outcomes based approaches to resolving cross-border issues and enhanced cooperation to avoid domestic measures that fragment the global financial system. The FSB is undertaking a review of jurisdictional representation to build mutual confidence and trust. Too-big-to-fail will be dealt with through strengthening 'gone-concern loss-absorbing capacity' (GLAC) of global systemically important financial institutions (GSIFIs), cross-border resolution actions, strengthening supervisory intensity and effectiveness, higher loss absorbency for global systemically important insurers (GSIIs) and a review of domestic structural banking reforms including ring-fencing in specific jurisdictions. Shadow banking was being considered with the adoption of an information sharing process to support implementation of the policy framework on the oversight and regulation of shadow activities, specific policy to deal with securities financing transactions and revise large exposure requirements. The OTC Derivatives Regulators Group (ODRG) has produced a report on cross-border implementation issues for OTC derivatives reforms with the Basel Committee publishing capital standards for the treatment of exposures to central counterparties (CCPs) clearing OTC derivatives. The

FSB Plenary had confirmed that members considered the current membership of 70 to be an upper limit and rejected constituency based membership or specific exit rules for individual members or extending national representation beyond financial ministries, central banks and supervisory and regulatory agencies. Objective criteria of economic and financial size would continue to be used to determine membership and seat allocation. The FSB procedures provided sufficient flexibility to allow other authorities to be involved in the development of policy work especially through standing committees and working groups.

FSB, 11.4.2014

Germany Peer Review

The FSB has published its peer review of Germany which specifically examined the macroprudential policy framework and microprudential supervision. This included implementation work following the recommendations made by the International Monetary Fund (IMF) in its 2011 Financial Sector Assessment Program (FSAP). The FSB confirmed that the German authorities had made good overall progress in dealing with the FSAP recommendations although some specific areas of reform continued. Macroprudential was generally dealt with under the institutional revisions adopted under the Financial Stability Act in October 2012 which established the Financial Stability Committee (FSC) which would be supported by the Bundesbank with cooperation and information exchange arrangements being set up between the Bundesbank and the Federal Financial Supervisory Authority (BaFin). Separate progress had been made in strengthening macroprudential supervision especially with regard to stress testing, regulatory reporting and the intensity of on-site supervision. It was further expected that responsibility for the supervision of around 24 German banks would be transferred to the European Central Bank (ECB) on 4 November 2014 under the EU Single Supervisory Mechanism (SSM) with national authorities continuing to assist in individual firm supervision. The peer review report recommended that efforts continued to enhance the analysis of business models and risk culture, ensure prompt notification of major acquisitions by supervised banks, increasing credit risk expertise, incorporating liquidity risk scenarios within the stress testing, increasing on-site inspections for insurance companies and expanding the use of a ladder of supervisory actions in the event that deficiencies are identified.

FSB, 9.4.2014

London Plenary Meeting

The FSB held a Plenary meeting in London in March 2014. The meeting discussed vulnerabilities affecting the global financial system with the various work plans in place to complete core financial reforms being reviewed. These included too-big-to-fail, shadow banking, OTC derivatives, benchmark reforms, data gaps, implementation monitoring and the work of the regional consultative groups and FSB's review of its governance arrangements.

FSB, 31.3.2014

Middle East and North Africa RCG

The fifth meeting of the FSB Regional Consultative Group (RCG) for the Middle East and North Africa (RCG-MENA) was held in Rabat, Morocco in March 2014. The meeting considered the FSB's policy priorities and work plan and vulnerabilities including the implications for the region of the normalisation of monetary policy in advanced economies and changes in bank funding patterns. The impact on G-SIFI and D-SIB frameworks on the region were also reviewed. The development of Islamic finance within the region was also considered.

FSB, 20.3.2014

OTC Derivatives Reforms

The FSB has published its seventh semi-annual progress reports on OTC derivatives implementation market reforms. The reform agenda was agreed by the G20 Leaders in 2009 which would specifically improve transparency, mitigate systemic risk and protect against market abuse. OTC derivatives would be reported to trade repositories (TRs), all standardised contracts would be traded on exchanges or electronic trading platforms and cleared through central counterparties (CCPs) with non-centrally cleared contracts being subject to higher capital requirements and minimum margining conditions. Substantial progress had been made in achieving each of these. Over three quarters of FSB members had TR reporting arrangements in place with key international policy standards having already been agreed in the areas of CCPs as well as the capitalisation of CCP exposures, recovery and resolution of financial market infrastructures and risk mitigation for non-centrally cleared contracts. The OTC Derivatives Regulators Group had also agreed understandings to improve the cross-border implementation of OTC derivatives reform.

FSB, 9.4.2014

Risk Culture

The FSB has published a framework for assessing risk culture following an earlier consultation document on 18 November 2013 with a progress report on enhanced supervision outlining the changes in supervisory practices adopted since the financial crisis with areas for further work being identified. These measures are adopted as part of the FSB's efforts to reduce the moral hazard created by GSIFIs. The framework for assessing risk culture is set out in FSB, *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture* (17 April 2014). This follows the recommendations set out in the November 2012 progress report requiring supervisors to consider ways to assess risk culture (FSB, *Intensity and Effectiveness of SIFI Supervision – Progress Report to the G20 Ministers and Governors* (November 2012)). The FSB Supervisory Intensity and Effectiveness (SIE) group have held a round table on risk culture with board members, risk committee chairs and chief risk officers of banks and insurers as well as with the G30, KPMG and

McKinsey & Company, and Tapestry. The G20 had published its report on, *A New Paradigm: Financial Institutions Boards and Supervisors* (2013) with a separate International Institute of Finance (IIF) Symposium on Supervision examining risk culture in July 2013. The IIF had produced a report in 2009 on *Reform in the financial services industry: Strengthening Practices for a More Stable System* (2009). The FSB report recommends that supervisors attempt to understand an institution's culture and how this affects its safety and soundness. The IIF defined risk culture as the norms of behaviour for individuals and groups within an organisation that determined the collective ability to identify and understand, openly discuss and act on the organisation's current and future risk. (See also M Power, S Ashby and T Palermo, *Risk culture in financial organisations* London School of Economics and Political Science (2013). Weaknesses in risk culture were considered a significant cause of the global financial crisis with a sound risk culture being of value in consistently supporting appropriate risk awareness, behaviour and judgement on risk taking within a strong risk governance framework. This supported effective risk management, promoted sound risk taking and ensured that emerging risks or risk taking activities beyond the institution's risk appetite were recognised, assessed, escalated and dealt with in a timely manner. A sound risk culture should ensure that: (a) an appropriate risk reward balance is achieved in taking on new risks consistent with the firm's risk appetite; (b) an effective system of controls is put in place that properly reflects the scale and complexity of the institution's activities; (c) the quality of risk models, data accuracy, tool capability to measure risks and justifications for risk taking can be challenged; and (d) all limit breaches, deviations from established policies and operational incidents are properly followed up with proportionate disciplinary action being taken as necessary. It was accepted that risk culture evolves over time as with corporate culture including following mergers and acquisitions or to reflect the external environment within which the firm operated. Sub-cultures may also develop with every effort having to be taken to ensure that they reflected the high level values imposed by the firm. All employees had to conduct business in a legal and ethical manner with integrity being promoted throughout the firm which specifically focused on achieving fair outcomes for customers. The FSB paper sets out certain foundational elements to promote sound risk culture including on risk governance, risk appetite and compensation (section 1), identifies practices, behaviours and attitudes that may influence risk culture (section 2) with additional guidance being provided to assess the soundness and effectiveness of risk culture within individual firms without setting out any target culture (section 3).

FSB, 7.4.2014

International Organisation of Securities Commissions (IOSCO)

Affiliate Members

The Affiliate Member Consultative Committee (AMCC) of IOSCO met in Tokyo in April 2014 to examine emerging risks, investment funds data, cyber

threats and other initiatives. The IMCC is made up of affiliate members including self-regulatory organisations (SROs), securities exchanges, financial market infrastructures, investor protection funds and other securities markets regulatory organisations. A new strategic direction had been adopted in 2013 to strengthen its role as a consultative committee to support the work of the securities regulators making up the principal membership of IOSCO. The AMCC had previously referred to as the SRO Consultative Committee.

IOSCO, 11.4.2014

Corporate Bond Markets

The Research Department of the International Organisation of Securities Commissions has published a Staff Working Paper on *Corporate Bond Markets: A Global Perspective* (April 2014). This sets out the results of a study on the development and functioning of corporate bond markets globally in emerging and developed markets and the value of corporate bond markets in promoting economic growth, financial stability and recovery. The report reviews the size and importance of the market. Corporate bond issuances had continually increased to $3.2 trillion in 2013 as against $0.9 trillion in 2000 with 27 new economies recording corporate bond issuances and 30% of issuance volume being undertaken in emerging markets. High yield issuances had increased from $72 billion in 2000 to $550 billion in 2013. The report also notes that the corporate bond markets were being used to provide alternative funding to bank and long-term/infrastructure financing and potential to support small medium enterprises (SMEs). Changes in the market were partly driven by a search for yield with changes in interest rates altering risks and raising potential investor protection issues. Secondary markets had developed to support the new economic and regulatory environment following earlier difficulties with illiquidity in the secondary markets. Pre-crisis markets including large amounts of ′phantom liquidity′ provided through potentially systemically risky practices such as with the bundling of illiquid bonds through structured debt products and collateralised debt obligations (CDOs). Phantom liquidity had decreased through increased transparency with dealer banks reducing their market making function and new regulatory and internal control requirements. This increased liquidity risk for investors which may lead to higher yields and borrowing costs. It was expected that changes in secondary markets may alter primary market practices including through the increased use of standardised issuances to support electronic trading or to issue tailored bonds for specific financing needs with a segmented market possible emerging.

IOSCO, 15.4.2014

Securities Prudential Standards

IOSCO has issued a consultation report on *A Comparison and Analysis of Prudential Standards in the Securities Sector* (March 2014). This provides a high level comparative analysis of principal prudential and capital frameworks for securities firms including relevant similarities, differences and gaps. This updates IOSCO's earlier *Capital Adequacy Standards for Securities*

Firms report in 1989. The paper examines the US Net Capital Rule (NCR) and EU Capital Requirements Directive (CRD) approaches which provide the basis for the two principal prudential frameworks. The Joint Forum had expressed concerns with regard to the lack of a uniform global standard for capital adequacy in the securities area which may create regulatory arbitrage, competitive inequalities across jurisdictions and a constrained ability to supervise cross-border groups in *Review of the Differentiated Nature and Scope of Financial Regulation* (January 2010). The key themes relate to regulatory scope, risk capture, capital components, prudential comparisons, internal model use, group entity risk and supervision. The report specifically examines relevant high level objectives and approaches, regulatory scope of the different capital frameworks, prudential frameworks and group entity risks, capital constituents, capital requirements and regulatory developments. The 1989 Capital Standards Report had specifically to be updated to identify opportunities for regulatory capital arbitrage materialising from differences in prudential regulations and to allow for the increased use of internal models and necessary infrastructure, systems and controls requirements necessary to ensure that firms are not undercapitalised having regard to their risk positions and activities.

IOSCO, 10.3.2014

Swap Execution Facilities

The Asia Pacific Regional Committee (APRC) of IOSCO has written to the US Commodity Futures Trading Commission (CFTC) to express its concerns with regard to the impact of the Core Principles and other requirements for Swap Execution Facilities (SEF Rule) especially with regard to the extra territorial effect of footnote 88 of the SEF Rule. Footnote 88 appeared to require that any entity providing a platform which facilitated the execution or trading of swaps by a US person on a multiple-to-multiple basis had to register and operate as a SEF even if the platform only dealt in swaps not subject to the trade execution mandate. Specific difficulties had arisen in determining which clients were US or non-US persons with liquidity becoming fragmented. IOSCO specifically recommended that a mutual recognition exemption was provided where non-US platforms were subject to comparable, comprehensive regulation and supervision.

IOSCO, 9.4.2014

International Swap Derivatives Association (ISDA)

Robert Pickel is to retire as Chief Executive Office (CEO) of the International Swaps and Derivatives Association (ISDA) after 17 years as ISDA. Pickel had specifically supported the role of privately traded credit derivatives during the credit crisis in 2007–2009 and had appeared on ′60 Minutes′ in 2008 to defend the value of credit default swaps (CDSs) with difficulties only having arisen as investors had failed to account for the risks in the subprime mortgage contracts underlying the derivatives. ISDA published its 2014 Margin Survey at its 29th Annual General Meeting in Munich in April 2014 which confirmed that 90% of non-cleared OTC derivatives trades were

subject to collateral agreements at the end of 2013 with 87% of the 133,155 active collateral agreements being based on ISDA documentation. The total amount of collateral in circulation had decreased by 14% from $3.7 trillion to $3.17 trillion end 2013 due to mandatory central clearing. Twelve directors were appointed at the 29th AGM with four new directors and eight re-elections. Two papers were published at the AGM on *The Value of OTC Derivatives: Case Study Analyses of Hedges by Publically Traded Non-Financial Firms* (2014) by Ivilina Popva and Betty J Simkins and an ISDA study on *Size and Uses of Non-Cleared Derivatives Market* (2014) which specifically examined the interest rate derivatives (IRD) market. The first paper confirmed that suitable exchange traded derivatives to replace OTC hedges may not always be available, OTC hedges can be more efficient and effective as against exchange traded options, OTC hedges can reduce earnings volatility as compared to exchange traded alternatives, mark-to-market and potential margin requirements can impact the liquidity of non-financial firms and increase operational costs and exchange traded derivatives can lead to increased ineffectiveness and may not qualify for Financial Accounting Standard (FAS) 133 hedge accounting. ISDA published a separate research note on the effects of the US CFTC ′Made-Available-to-Trade′ (MAT) regulation and potential increased market fragmentation following ISDA's earlier survey on *Cross-Border Fragmentation of Global OTC Derivatives: An Empirical Analysis* (21 January 2014). A separate survey was published of derivatives end-users on issues and trends in the OTC derivatives market. 57% of respondents confirmed that the financial system was safer today than before the financial crisis principally due to tighter credit risk management (87%) as well as reduced leverage (76%) and higher capital requirements (79%) as well as central clearing mandates (32%), trade execution requirements (34%) and transaction reporting requirements (30%). 74% of respondents considered that the new electronic trade execution requirements for OTC derivatives in the US and EU would be increased transparency although concerns remained with regard to price, liquidity and ease of use. 68% considered that the new financial requirements were increasing costs on hedging with 81% seeing increased administrative burdens. 47% believe that regulatory changes were resulting in geographic market fragmentation with 61% considered this detrimental to their ability to manage risk and 83% believing that this increased OTC derivatives costs.

The Swedish clearing house, NASDAQ OMX, was the first central counterparty (CCP) to be authorised under the EU Market Infrastructure Regulation (EMIR) on 18 March 2014 with applications for authorisation having to be submitted by 15 September 2013. Difficulties nevertheless arose with regard to the ′front loading′ requirement under the EMIR which requires that certain contracts are back-loaded to a CCP entered into between the date of notification of clearing authorisation to the European Securities and Markets Authority (ESMA) and the subsequent commencement of clearing in those products following ESMA and European Commission approval. Regulatory authorities had noted a decrease in the participation of banks in commodity markets including commodity derivatives markets as a result of various regulatory changes imposed under the US Dodd Frank Act and

Volcker Rule, the EU EMIR, revised Markets in Financial Instruments Directive (MIFID) and Market Abuse Regulation (MAR) and Basel III capital and liquidity rules. The UK FCA had referred to a report on *Commodity Markets Update* (February 2014) which highlighted the fundamental changes taking place in the commodity derivatives markets.

ISDA, March/April 2014

EUROPEAN DEVELOPMENTS

Commission adopts Regulatory Technical standards

On 13 March 2014 the European Commission adopted a package of Regulatory Technical Standards (RTS) needed to implement important provisions of the Capital Requirements Regulation and Directive.

The nine RTS adopted by the Commission are:

1. Commission Delegated Regulation determining proxy spread and limited smaller portfolios for credit valuation adjustment risk.
2. Commission Delegated Regulation specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk.
3. Commission Delegated Regulation specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration.
4. Commission Delegated Regulation assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach.
5. Commission Delegated Regulation specifying the information that competent authorities of home and host Member States supply to one another.
6. Commission Delegated Regulation for the definition of ‘market’.
7. Commission Delegated Regulation defining non-delta risk of options in the standardised.
8. Commission Delegated Regulation further defining material exposures and thresholds for internal approaches to specific risk in the trading book.
9. Commission Delegated Regulation determining what constitutes the close correspondence between the value of an institution’s covered bonds and the value of the institution’s assets.

The texts can be accessed through:
http://ec.europa.eu/internal_market/bank/regcapital/acts_en.htm#rts

EBA publishes final draft technical standards

On 28 March 2014 the EBA published a number of final draft technical standards that will form part of the EU Single Rulebook in banking. These comprised the final draft technical standards on:

1. The requirements related to prudent valuation adjustments of fair valued positions.
2. Liquidity requirements, including in particular: (i) final draft ITS on currencies for which the justified demand for liquid assets exceeds their availability; (ii) final draft RTS on derogations for eligible currencies; and (iii) final draft ITS listing the currencies with an extremely narrow definition of central bank eligibility.
3. Additional collateral outflows.
4. Own funds (Part IV).

EBA publishes Guidelines on the applicable notional discount rate for variable remuneration

On 27 March the EBA published its final Guidelines for the calculation of the discount rate for variable remuneration and clarifying how it should be applied. These Guidelines seek to support EU Member States in the calculation of the ratio between the variable and fixed component of total remuneration and refer to services or performances provided from 2014 onwards.

The Guidelines can be viewed at: http://goo.gl/0hXhl1

MiFID II and MiFIR

Following the agreement of compromise texts between the European Parliament and the Council in February 2014, on 15 April 2014 the European Parliament formally approved the agreed texts of MiFID II and MiFIR. It now falls to the Council to adopt them. Once this has happened, the texts will be published in the Official Journal, which the Commission anticipates will take place before July 2014.

Following this approval, on 24 April 2014 the Commission formally sent a mandate to ESMA to develop the numerous technical standards required to accompany the requirements in MiFID II and MiFIR.

A review of the provisions in MiFID II and MiFIR is beyond the scope of this update, but the Commission has published a number of detailed explanations which can be accessed, along with the mandate to ESMA, at: http://ec.europa.eu/internal_market/securities/isd/mifid/index_en.htm

Payment Accounts Directive

On 20 March 2014 agreement was reached between the European Council and European Parliament on the Directive on the transparency and comparability of payment account fees, payment account switching and access to a basic payment account (the Payment Accounts Directive).

As reported in previous updates, the draft directive sets rules and conditions guaranteeing the provision of payment accounts with basic features to any consumer residing legally in a member state of the EU. Consumers may be required to show a genuine interest in opening an account, though the requirement must not be too burdensome. A fee information document must be provided, using a clear and standardised format, and member states must ensure access, free of charge, to at least one website comparing fees charged by service providers. The draft directive also establishes rules on the switching of accounts within a member state and facilitating the opening of an account in another member state.

On 15 April 2014, in accordance with that agreement, the European Parliament adopted the text. The Council should soon adopt the text without further discussion. Under the agreed text, member states will have two years to transpose the directive into national law from the date of publication in the Official Journal.

Further information can be found through: http://ec.europa.eu/internal_market/finservices-retail/inclusion/index_en.htm

Single Resolution Mechanism Regulation, Bank Recovery and Resolution Directive, and Deposit Guarantee Schemes Directive

There have been important developments on the related Single Resolution Mechanism regime, the Bank Recovery and Resolution Directive, and the Deposit Guarantee Schemes Directive.

On 4 March 2014, further to agreement with the European Parliament, the European Council adopted the draft text of the Deposit Guarantee Schemes Directive.

On 20 March 2014 The European Parliament and the Council reached a provisional agreement on the proposed Single Resolution Mechanism for the Banking Union, which comprises the SRM regulation itself (covering the main aspects of the mechanism) and an intergovernmental agreement related to some specific aspects of the Single Resolution Fund.

On 15 April 2014 the European Parliament adopted the SRM Regulation, Bank Recovery and Resolution Directive and Deposit Guarantee Scheme Directive.

The SRM would enter into force on 1 January 2015, and the bail-in and resolution functions under the Bank Recovery and Resolution Directive will apply from 1 January 2016.

More information can be obtained through: http://ec.europa.eu/internal_market/finances/banking-union/

ISLAMIC FINANCE DEVELOPMENTS

The Islamic Financial Services Board Council Adopts IFSB-16 for the Islamic Financial Services Industry

The Council of the Islamic Financial Services Board (IFSB) has resolved on 27 March 2014 to approve the adoption of a new Standard in its 24th Meeting in Bandar Seri Begawan, Brunei Darussalam. The document is Revised Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes), or IFSB-16.

The 24th meeting of the IFSB Council, hosted by Autoriti Monetari Brunei Darussalam (AMBD), at the Empire Hotel and Country Club in Brunei Darussalam. It was chaired by the Managing Director, AMBD, H.E. Dato Mohd Rosli Sabtu and attended by 10 central bank governors and heads of regulatory and supervisory authorities, as well as 12 senior representatives from among the Council and Full members of the IFSB, representing 17 countries. The meeting was also attended by the President of the Islamic Development Bank.

IFSB-16: Revised Guidance on Key Elements in the Supervisory Review Process of Institutions Offering Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Collective Investment Schemes).

The overall aim of the revised Standard is to update the earlier standard on this subject (IFSB-5), in setting forth guidance on key elements in the supervisory review process for authorities supervising institutions offering Islamic financial services (IIFS), taking into consideration the specificities of the IIFS, the lessons learnt from the global financial crisis, and, at the same time, to complement the existing international guidance on the supervisory review process issued by the Basel Committee on Banking Supervision (BCBS).

IFSB-16, which is broadly analogous to Pillar 2 of the Basel Accords, is about the supervisory process and how regulatory and supervisory authorities should supervise some specific areas pertinent to the IIFS. It ensures that the supervisory review process covering IIFS is consistent with those for conventional institutions and relevant to the current state of the industry, while catering for the specificities of Shariah-compliant financial transactions and promoting the financial soundness of the IIFS. In this respect, it intends to foster convergence towards best practice among authorities supervising IIFS by establishing a minimum standard, enabling such supervisory authorities to meet their requirements when carrying out the roles expected of them in the light of IFSB Standards.

The Islamic Financial Services Board 27.03.14

http://www.ifsb.org/preess_full.php?id=254&submit=more

Bank of England May Broaden Islamic Liquidity Tools

The Bank of England is studying ways to increase the number of sharia-compliant assets that Islamic financial institutions can use in their liquidity buffers, a step towards reducing concentration risks in the sector. The move comes as part of a broader push to promote London as a top centre for Islamic finance, in the face of growing competition from other centres such as Dubai and Kuala Lumpur.

Currently, sukuk (Islamic bonds) issued by the AAA-rated Islamic Development Bank ISDBA.ULare the only assets that meet the central bank's criteria for use in the liquidity buffers of the 22 Islamic financial institutions operating in Britain.

These include six full-fledged Islamic banks such as the European Islamic Investment BankEIIB.L, Bank of London and the Middle East BLME.DI and Gatehouse Bank.

In addition to reducing risks, expanding the eligible list could improve growth prospects for the industry and remove a potential entry barrier to the sector, a consultation paper released by the central bank said.

'Recognising only one asset also potentially limits the growth of existing sharia-compliant firms and creates barriers to entry for new sharia-compliant firms due to the difficulties that can be experienced obtaining the asset.'

Islamic finance follows religious principles such as bans on interest and pure monetary speculation; this limits the types of financial tools that banks can use to manage their short-term funding needs.

The Bank of England's proposal is in line with the approach of Basel III global banking regulations, which allow sukuk issued by high-rated sovereigns to be included in the liquid assets buffer without a haircut.

This would allow Britain's proposed 200 million pound ($330 million) sovereign sukuk issue to be used, as well as other high-investment grade instruments such as sukuk issued by the Malaysia-based International Islamic Liquidity Management Corp.

Sukuk issued by sovereigns with lower credit ratings and other non-financial issuers could also be eligible, subject to haircuts and caps, the consultation paper said. The consultation will end on April 15 but no date was given for the proposed reform.

Britain first announced plans for a sovereign sukuk issue six years ago but that issue never materialised as the country's Debt Management Office decided the structure was too expensive.

The new proposal is less than a fifth of the size of the original, and is designed to boost London's status rather than to diversify Britain's investor base to a significant degree.

(By Bernardo Vizcaino, Editing by Andrew Torchia)

Reuters 26.03.14

http://www.reuters.com/article/2014/03/26/islamic-finance-britain-idUSL5N0MN38O20140326

The Central Bank of Malaysia Announces its Transition Policy under Islamic Financial Services Act 2013

The Islamic Financial Services Act 2013 (IFSA) has introduced two major classifications of products for the acceptance of money from customers by the Islamic banking institutions, namely:

- Islamic deposits; and
- investment accounts.

The differentiation will allow the Islamic banking institutions to develop a wider range of products for both classifications to meet the diverse needs of the customers. Consequently, customers will be able to better appreciate the product offerings by the Islamic banking institutions and make an informed decision in respect of the choices of Islamic banking products.

Two year transition period

Under the repealed Islamic Banking Act 1983 (IBA), all monies accepted from customers are classified as Islamic deposits, which comprise both deposit and investment products.

In this regard, Islamic banking institutions are required to reclassify their Islamic deposits under the IBA into Islamic deposits and investment accounts under the IFSA. In ensuring a seamless and effective process of reclassification, a two-year transition period until 30 June 2015 has been accorded to the Islamic banking institutions.

The Islamic banking institutions will engage with their customers in providing information and clarification on the differences between the Islamic deposit and investment account products as well as the options available to them to either retain their placements in Islamic deposit or migrate to investment accounts. The Islamic banking institutions will allow sufficient time for the customers to inform them of their decision.

During the transition period, all Islamic deposits (accepted under IBA) will continue to be protected by Perbadanan Insurans Deposit Malaysia. The Islamic banking institutions will also ensure that the customers' rights are protected.

Islamic banking institutions will be making available hotlines, call centres and the front line staff of their headquarters and branches to attend to further queries by their customers.

Members of the public can also contact the Association of Islamic Banks in Malaysia (AIBIM) and Bank Negara Malaysia in this regard.

Central Bank of Malaysia 19.03.14

http://www.bnm.gov.my/index.php?ch=en_press&pg=en_press_all&ac=2974&lang=en

Islamic Development Bank (IDB) Celebrates Listing of Six Sukuk Totaling US$ 5.4 Billion on NASDAQ Dubai

Dr. Abdul Aziz AlHinai, Vice President (Finance) of the Islamic Development Bank (IDB), rang 12 March 2014 the market opening bell to celebrate the listing of six Sukuk totalling US$ 5.4 billion (AED 19.8 billion) on NASDAQ Dubai, the Middle East's international stock exchange. NASDAQ Dubai is the international financial exchange serving the region between Western Europe and East Asia. It welcomes regional as well as global issuers that seek regional and international investment. The exchange currently lists shares, derivatives, Sukuk (Islamic bonds) and conventional bonds. The majority shareholder of NASDAQ Dubai is Dubai Financial Market with a two-thirds stake. Borse Dubai owns one third of the shares. The regulator of NASDAQ Dubai is the Dubai Financial Services Authority (DFSA). NASDAQ Dubai is located in the Dubai International Financial Centre (DIFC).

The listings make the IDB the largest Sukuk issuer on NASDAQ Dubai by value and add significant momentum to Dubai's expansion as the capital of the Islamic Economy globally, in line with the vision of His Highness Sheikh Mohammed Bin Rashid Al Maktoum, UAE Vice President, Prime Minister and Ruler of Dubai.

The bell-ringing ceremony at Dubai Financial Market (DFM) took place in the presence of His Excellency Mohammed Abdulla Al Gergawi, Chairman of The Executive Office of His Highness Sheikh Mohammed Bin Rashid Al Maktoum and Chairman of the Board, Dubai Islamic Economy Development Centre; His Excellency Essa Kazim, Chairman of DFM and Secretary General of the Dubai Islamic Economy Development Centre; Abdul Wahed Al Fahim, Chairman of NASDAQ Dubai; and Hamed Ali, Chief Executive of NASDAQ Dubai.

His Excellency Mohammed Abdulla Al Gergawi, Chairman of the Board, Dubai Islamic Economy Development Center said:

> "The IDB's international importance and the substantial size of its Sukuk make the listings a landmark in the growth of Dubai as the capital of the Islamic economy globally, in line with the vision of His Highness Sheikh Mohammed Bin Rashid Al Maktoum, UAE Vice President, Prime Minister and Ruler of Dubai, to position Dubai as the global capital of the Islamic Economy, under the direction of His Highness Sheikh Hamdan Bin Mohammed Bin Rashid Al Maktoum, Crown Prince of Dubai and Chairman of the Executive Council. Dubai's strategic relationship with the IDB will strengthen the growth of Islamic finance regionally and internationally, bringing widespread social and economic benefits."

Dr. Abdul Aziz AlHinai, Vice President (Finance) of the Islamic Development Bank (IDB) said:

> "By operating a sophisticated listing venue regulated to international standards in which investors can have full confidence, Dubai is providing important support for the positive work carried out by the IDB

> across scores of countries. The Bank looks forward to listing further Sukuk valued at billions of dollars on NASDAQ Dubai, when these are issued in due course to provide funding for furtherdevelopment projects and activities."

The six listed Sukuk were issued under a US$ 10 billion program created by the IDB, which provides project financing for 56 member countries. The program has been approved by NASDAQ Dubai and its regulator, the Dubai Financial Services Authority (DFSA).

His Excellency Essa Kazim, Chairman of Dubai Financial Market (DFM) and Secretary General of Dubai Islamic Economy Development Centre, said:

> "The IDB's Sukuk listings reflect Dubai's commitment to further expanding its Islamic finance sector, which will include attracting more issuances of Sukuk and other asset classes from both the public and private sectors, as well as offering new services to issuers and investors. In 2014 and beyond, Dubai will prove an increasingly attractive capital markets base for Islamic companies and organizations that are active internationally as well as in the region."

Sukuk with a value of US$ 12.55 billion have been listed on Dubai's exchanges since the beginning of 2013. The total value of Sukuk currently listed in Dubai is US$ 18.98 billion, making it the third largest venue in the world for Sukuk listings.

Abdul Wahed Al Fahim, Chairman of NASDAQ Dubai, said:

> "NASDAQ Dubai welcomes the opportunity to host the Sukuk issued by the IDB as the bank expands its important development activities and we look forward to deepening and broadening our relationship. The exchange aims to develop the world's most competitive Sukuk admissions framework and infrastructure in order to further strengthen its position in the marketplace."

Five of the IDB's Sukuk were issued between 2009 and 2013 and listed on NASDAQ Dubai in February 2014. The sixth Sukuk listed on the exchange after being issued earlier this month.

The Islamic Development Bank 18.03.14

http://www.isdb.org/irj/portal/anonymous/idb_news_en

INTERNATIONAL DEVELOPMENTS

The International Monetary Fund-World Bank Publish Revised Guidelines for Public Debt Management

The International Monetary Fund (IMF) and World Bank staffs have prepared and issued to the Executive Boards of both institutions the Revised Guidelines for Public Debt Management for information on April 1, 2014. Application of these guidelines should strengthen the international financial

architecture, promote policies and practices that contribute to financial stability and transparency, and reduce member countries' external vulnerabilities.

The revision of the original 2001 Guidelines and their 2003 Amendments was requested by the G-20 Finance Ministers and Central Bank Governors at their meeting in Moscow on February 15–16, 2013. The request was triggered by structural changes in many countries' debt portfolios— in terms of both size and composition—over the last decade, as a result of financial sector and macroeconomic policy developments, especially in response to the recent financial crisis.

The 2014 revision of the Guidelines was carried out by the IMF and World Bank staffs, supported by a working group of debt management offices and central bank authorities from Argentina, Bangladesh, Belgium, Brazil, the Comoros, Denmark, the Gambia, Germany, India, Italy, Jamaica, Korea, the People's Republic of China, Russia, Sierra Leone, Spain, Sudan, Sweden, Turkey, the United States, Uruguay, and Vietnam. Lars Hörngren, Chief Economist at the Swedish National Debt Office, chaired this working group. The OECD provided inputs during the review process.

The revisions to the Guidelines mainly concentrate on:

(i) management objectives and coordination, including clarifying the roles and accountabilities of fiscal authorities and debt managers to the debt sustainability analysis process;

(ii) transparency and accountability by enhancing communication with investors, especially during periods of crisis;

(iii) institutional framework with the use of collective action clauses (CACs) in bond contracts as necessary for the efficient resolution of sovereign debt restructuring;

(iv) debt management strategy, including debt portfolio risk mitigation strategies and contingency plans;

(v) risk management framework, with emphasis on stress testing of the public debt portfolio and the use of derivatives in managing portfolio risk; and

(vi) development and maintenance of efficient markets for government securities, as an integral part of developing a robust debt management strategy.

The revised Guidelines will be used by the IMF and World Bank staffs to provide a framework for technical assistance and will serve as background for discussions in the context of IMF surveillance. It may also be used as reference material by third party consultants and experts dealing with public debt management issues.

The International Monetary Fund 25.04.14

http://www.imf.org/external/np/sec/pr/2014/pr14181.htm

Final Paper on Point Of Sale Disclosure in the Insurance, Banking and Securities Sectors Released By the Joint Forum

The Joint Forum released its final report on Point of sale disclosure in the insurance, banking and securities sectors. The Joint Forum was established in 1996 under the aegis of the Basel Committee on Banking Supervision (BCBS), the International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS) to deal with issues common to the banking, securities and insurance sectors, including the regulation of financial conglomerates.

The report identifies and assesses differences and gaps in regulatory approaches to point of sale (POS) disclosure for investment and savings products across the insurance, banking and securities sectors, and considers whether the approaches need to be further aligned across sectors. It sets out eight recommendations, for use mainly by policymakers and supervisors to assist them in considering, developing or modifying their POS disclosure regulations:

1. Jurisdictions should consider implementing a concise written or electronic POS disclosure document for the product sample identified in this report, taking into account the jurisdiction's regulatory regime.
2. The POS disclosure document should be provided to consumers free of charge, before the time of purchase.
3. A jurisdiction considering POS disclosure should consider requiring that a POS disclosure document disclose key characteristics including costs, risks and financial benefits or other features of a given product and any underlying or referenced assets, investments or indices, irrespective of the financial sector from which the products are derived.
4. The POS disclosure document should be clear, fair, not misleading and written in a plain language designed to be understandable by the consumer.
5. The POS disclosures should include the same type of information to facilitate comparison of competing products.
6. The POS disclosure document should be concise, set out key information about a product and may include, as appropriate, links or refer to other information. It should make clear that it does not provide exhaustive information.
7. Allocation of responsibility for preparing, making available and/or delivering the POS disclosure document should be clearly established, and the POS disclosure document should identify which entity is responsible for its content.
8. A jurisdiction considering POS disclosure should consider how to use its capabilities and powers to implement these POS recommendations, taking into account the jurisdiction's regulatory regime.

International Organisation of Securities Commissions 30.04.14

http://www.iosco.org/news/pdf/IOSCONEWS328.pdf

New approach for measuring counterparty credit risk exposures finalised by the Basel Committee

The Basel Committee has published a final standard on the treatment of derivatives-related transactions in its capital adequacy framework.

'*The standardised approach for measuring counterparty credit risk exposures*' improves on existing non-modelled methodologies for assessing the counterparty credit risk associated with derivative transactions. The standardised approach therefore replaces both the Current Exposure Method and the Standardised Method in the Basel capital framework. It also simplifies the framework by narrowing the range of methodologies available to banks in measuring their counterparty credit risk exposures.

The Committee's aim was to develop a risk-sensitive methodology that appropriately differentiates between margined and unmargined trades, and provides a more meaningful recognition of netting benefits than either of the existing non-modelled approaches.

The new approach reduces the need for discretion by national authorities, limits the use of banks' internal estimates, and avoids undue complexity by drawing upon prudential approaches already available in the capital framework. It is calibrated to reflect the volatilities observed over the recent stress period, while also taking account of incentives for centralised clearing of derivative transactions.

The new approach gives regard to the feedback received from respondents to the Basel Committee's consultative paper '*The non-internal model method for capitalising counterparty credit risk exposures*', and the results of a related quantitative impact study. In the light of this information, a number of adjustments were made to the methodology outlined in the consultative paper, which include:

- increased specificity on the application of the approach to complex instruments;
- the introduction of a supervisory measure of duration for interest rate and credit derivative exposures;
- removal of the one-year trade maturity floor for unmargined trades and the addition of a formula to scale down the maturity factor for any such trades with remaining maturities of less than one year; and
- adjustments to the calibration of the approach with respect to foreign exchange, credit and some commodity derivatives.

The standardised approach for counterparty credit risk will take effect from **1 January 2017**. Given the approach's enhanced risk sensitivity, the Basel Committee has also agreed to eliminate the use of the ′Internal Model

Method (IMM) shortcut method′ for measuring counterparty exposures once the new standardised approach takes effect.

Bank for International Settlement 31.03.14

https://www.bis.org/press/p140331.htm

Dubai Financial Services Authority Consults on Major Regulatory Changes

Consultation Paper No. 94 proposes changes to the Financial Market Tribunal (FTM) Jurisdiction, to Dubai Financial Serves Authority's (DFSA) supervisory powers and to Dubai Financial Serves Authority's (DFSA) approach to decision making.

This Consultation Paper (CP) includes the results of public consultation on CP90, proposed changes arising from that consultation and further proposals resulting from the DFSA's review of its supervisory powers. The DFSA undertook the review to assess whether the current supervisory powers are adequate and effective to enable the DFSA to achieve its regulatory objectives, in line with the standards set by relevant international standard setters, and also in light of the DFSA's own supervisory experience in the past decade. This CP also includes further proposals on the DFSA's approach to decision making.

This CP contains two sets of proposals on which we seek public comments:

(a) the first set is the position adopted by the DFSA relating to CP90 proposals to enhance the administrative review of DFSA decisions by the Financial Markets Tribunal (FMT) – with further refinements to the original proposals in light of public comments received and through our own initiative. Where CP90 only set out proposed changes at the level of laws, this CP also proposes changes at the level of Rulebook Modules; and

(b) the second set is detailed proposals to enhance the DFSA's supervisory powers resulting from the comprehensive review of the DFSA's current powers, as indicated in CP90.

The DFSA intends (subject to the outcome of this further consultation) to move forward with the overall set of proposals consulted on in CP90, namely to:

(a) expand the jurisdiction of the FMT to include matters currently falling within the jurisdiction of the Regulatory Appeals Committee (RAC);

(b) abolish the RAC; and

(c) adapt its own approach and processes:

  (i) to decision making ; and

  (ii) to setting the level of fines, which was discussed in detail in CP90.

From the review of its supervisory powers, the DFSA proposes:

(a) some minor changes to powers to make sure that the DFSA's regime is sufficiently in line with international standards for financial services regulation;

(b) a number of changes to powers that our supervisory experience suggests are necessary; and

(c) amendments to ensure a more consistent and coherent approach to the due process requirements that apply when the DFSA exercises its supervisory powers.

Dubai Financial Services Authority 21.04.14

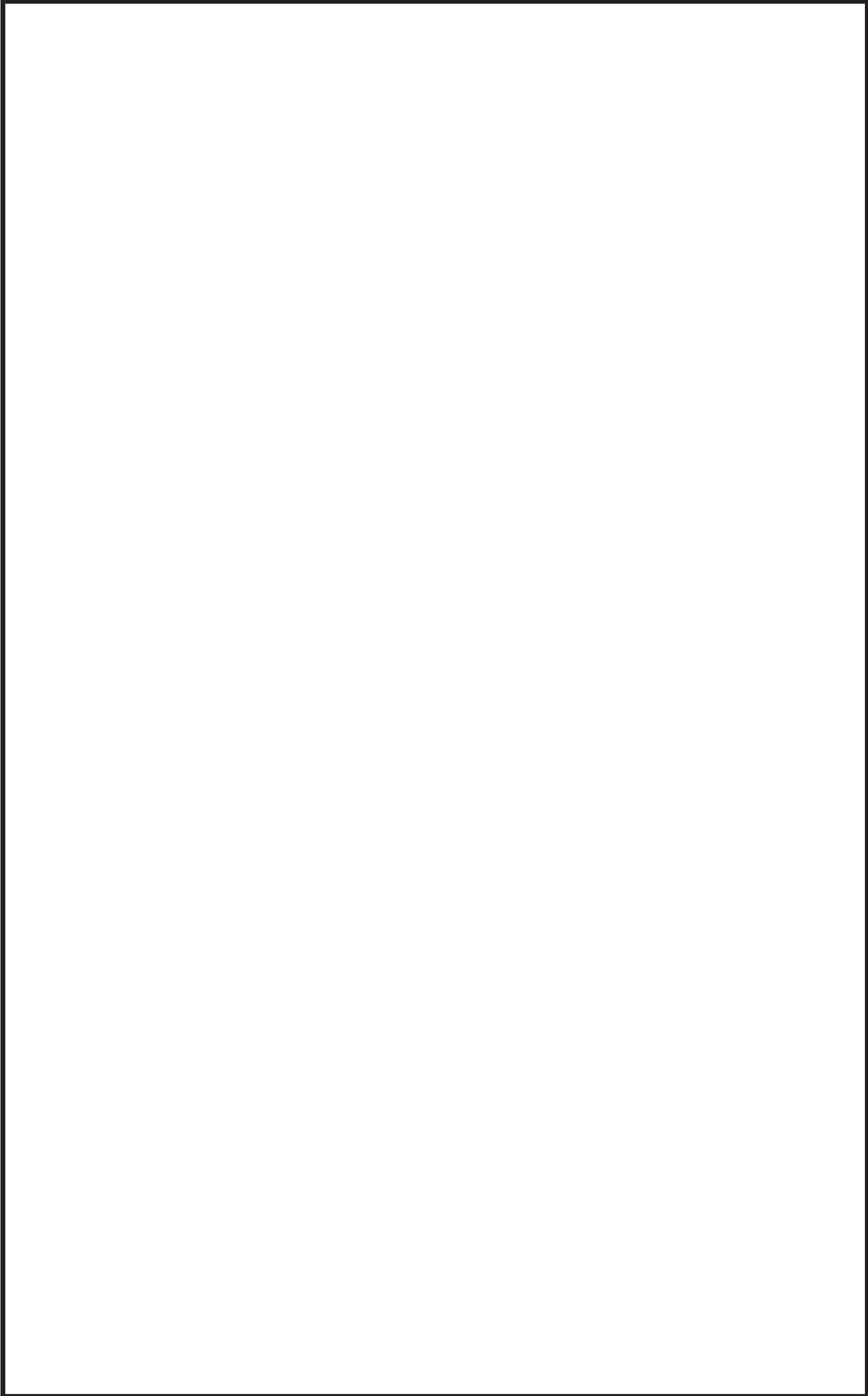
http://www.dfsa.ae/WhatsNew/DispForm.aspx?ID=286

People's Bank of China Established a Centralized Clearing Mechanism for OTC Financial Derivative and Launching Centralized Clearing of RMB Interest Rate Swap

In order to promote the sound development of OTC financial derivative market and establish a centralized clearing mechanism for OTC trading of financial derivatives, the trading of RMB interest rate swap and other OTC financial derivatives among the national inter-bank bond market participants (market participants) should go through a centralized clearing arrangement in accordance with the requirements and the Shanghai Clearing House shall provide the centralized clearing services.

People's Bank of China 08.04.14

http://www.pbc.gov.cn/publish/english/955/2014/20140408162107938969555/20140408162107938969555_.html



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