THE BANKING REGULATION REVIEW

NINTH EDITION

Editor
Jan Putnis

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PREFACE

Banking regulation is a never-ending quest to balance the three major policy objectives of financial stability, consumer protection and the needs of developed economies for reliable services involving the provision and intermediation of finance. It is safe to say that the relative importance of these factors to policymakers will never be constant. Driven by events – whether political, economic or financial – governments and regulators will move their centre of focus from one objective to another as circumstances require, while continuing to pay lip service to the need to balance all three. For their part, banks have to maintain the right quantity and quality of resources to react to policy shifts and, hopefully, to ensure that they can communicate their views clearly to the authorities before those shifts take place.

But what happens when there are developments that leave everyone – governments, regulators and banks alike – unsure of how to react, or even, in some cases, unsure of whether or not there are serious concerns to address? That is what we now face with the rise of technology in banking. Is technology simply an opportunity for banks to improve their service or does it present threats to customers and ultimately to financial stability? If there are threats, do these go beyond the much-publicised cyber risks?

Starting with the opportunity, the position is not quite what many new so-called fintech banks would have you believe. Their orthodox view of the world is that large, established banks will be supplanted by nimbler upstarts, particularly those new firms that are not actually banks and are relatively unburdened by regulation (or think they are). Particularly in the area of payments, those upstarts aim to appropriate banks' customer relationships, not by shutting banks out of payment transactions entirely, but by relegating them to mere infrastructure in payment clearing. I refer to this view as 'orthodox' because it ignores at least four important and fast-developing features of the way that technology is revolutionising many major, established banks:

a The ability of banks to fight back and the vast resources that large, established banks have to throw at this effort if they are minded to do so and have sufficient strategic focus to stick to the task.

b The capacity of technology to cut the costs and improve the efficiency of established banks.

c The strategy (and ability) of some banks to follow an inorganic approach to acquiring technology and new ideas; while cultural differences and other integration challenges often mean that banks do not realise the full benefits of acquiring newer technology-focused firms, if only a small proportion of these acquisitions succeed then much of the apparent hype around some start-up firms pursuing novel fintech strategies could evaporate as large, established banks become the principal means by which new ideas hatched by the founders of start-ups are put into practice.

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d Legal and regulatory changes in some parts of the world to open up banking, and payment services, to increased competition and therefore innovation – particularly PSD2 in the European Union – are pushing banks to adopt new technologies and are starting to foster a more creative and entrepreneurial culture in some banks.

Commentators frequently write that banks that fail properly to capitalise on the opportunities that technologies present will fail. This has become a truism as technologies once thought to be novel – contactless payments, for example – have become commonplace in many parts of the world. In other words, new technology has become such a pervasive feature of both wholesale and retail banking in most of the world that to say that banks have to use it effectively to survive has become little different from saying that banks will fail if they don't run their businesses effectively. That said, a proportion of banks will fail on this simple ground, and may therefore fail in business terms as others with a better understanding of the power of technology to improve and expand services and increase efficiency forge ahead. Many banks have also, so far, failed to create the right sort of creative environment in which genuinely new business ideas originate. There are a number of reasons for this that exist to varying degrees in all large banks, including complex and bureaucratic management structures, which can stifle innovation; a necessary preoccupation with legacy issues and structural reform; an understandably risk-averse approach to business development; and the opportunities that exist for talented and creative staff outside the banking sector. It would be entirely wrong, however, to assume that these issues simply cannot be overcome in any large, established banks.

So much for the opportunities; what about the threats? Cyber risk remains a very significant concern for regulators, perhaps the single most important area of bank regulatory concern worldwide at present. But there is another challenge that banks must face from technology, which is simply that more will be expected of them by regulators and customers alike once technology makes banking more transparent. So, from a front office perspective, technology does not just offer ways of providing better services to customers; it also raises their expectations, and banks will have to be ready to live up to those expectations, or they will simply lose customers. From a back-office perspective, technology is beginning to provide banks with innovative ways of understanding better the risks they have taken and their relationships with providers of funding, hedging services and other counterparties. For example, machine learning has now advanced to a level where it can provide real assistance to banks in understanding very quickly, in a very detailed way, the terms of the agreements to which they are party, how they interrelate with each other and how they would perform in a crisis. One of the lessons of the financial crisis was that recovery and resolution planning is a very resource-intensive exercise when done by means of a manual review of documents. Machine learning will eventually allow many of these review processes to be done in almost real time and for banks to verify the application of policies and procedures to documents and customer relationships as they develop, rather than retrospectively. Once these capabilities are developed to a usable level, which is likely to be in the next few years, it will not be surprising if regulators begin to expect banks to apply them. The fact that it might take a bank several months to review 100,000 documents manually will then no longer be a complete excuse for not having fairly immediate answers to regulators' straightforward questions about the nature of the risks on a bank's balance sheet; the bank should either know the answers or will be expected to have the means to find out quickly.

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Much of this would suggest that the adoption of new technology may ultimately have more profound effects on large banks than post-crisis structural reform. Apart from customer services, I would expect these effects to manifest themselves in reductions in staff numbers, particularly in front-office roles, risk management and compliance. It is apparent that even the most sophisticated and well-resourced banking regulators around the world are still behind the curve in realising the true impact of these developments: just as the banks have an enormous challenge in devising profitable and prudent ways of applying technology, regulators have an almost equal challenge in understanding the risks as well as the benefits.

Away from technology, the past year has failed to produce the destructive earthquake in international regulatory initiatives that some commentators predicted following the election of Donald Trump as President of the United States. Nevertheless, further and deeper international regulatory cooperation now looks significantly less likely than it did two years ago and regulators should be trying to work out what this will mean in a future banking crisis. For their part, the Basel Committee on Banking Supervision and other international organisations that promulgate bank regulatory reform will no doubt be wary of proposing ideas that do not receive widespread support from major banking jurisdictions.

In Europe, the preparations that banks are making for the UK's departure from the European Union in 2019 continue apace, even as the progress towards a political agreement and related transitional arrangements remains, at the time of writing, slow and fraught with difficulty. Almost whatever the nature of this agreement, the legal and regulatory barriers to cross-border banking and securities business that will be erected between the United Kingdom and the European Union when, as currently planned, the UK leaves the EU single market, are expected to make Europe as a whole a more expensive region for global banks. As a result, many of these banks are reconsidering their participation in certain less profitable business lines and some geographical markets in Europe. It remains to be seen whether smaller EU banks with a domestic or a regional focus can capitalise on these developments. Meanwhile, attempts to strengthen and deepen the eurozone's banking union continue, albeit very slowly. The move of some business from London to mainland Europe as a result of Brexit is unlikely to achieve the natural desire of many European politicians and central bankers for the eurozone to have its own, genuinely global financial centre.

In Asia it remains, as ever, as foolish as it is difficult to generalise about developments across such a diverse and fast developing region. However, the continuing growth of wealth management services is still of great interest to many banks in the region and beyond. It remains to be seen whether all the most important bank regulators in the region can keep up with understanding and monitoring the increased risks associated with this development, from investor protection to money laundering.

In the United States, we saw tangible proposals for regulatory reform during 2017, although at the time of writing it is not yet clear what the outcome will be.

This ninth edition of *The Banking Regulation Review* contains chapters provided by authors in 35 countries and territories in March and April 2018, as well as the usual chapters on International Initiatives and an overview of the European Union.

My thanks go once again to the authors, who thankfully find this subject sufficiently interesting and profitable both to continue to advise clients on it as well as to write about it in their spare time. However, I remain conscious of the fact that spare time has been in very short supply to many of the authors during the past year, and I am therefore very grateful for their dedication in contributing to this book.

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The team at Law Business Research have continued to tolerate the work schedules of the authors, and more particularly the editor, with their usual compassion, tolerance and sympathy, and to apply their usual high standard of professionalism to the production of this book. I would like to thank them for once again making this process look easy when it is anything but.

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Jan Putnis
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London
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Chapter 8

EUROPEAN UNION

Jan Putnis, Timothy Fosh and Emily Bradley[1]

I INTRODUCTION

This chapter provides an introduction to the most important EU legislation affecting the regulation of banks. It also analyses developments that have led to the concentration of certain regulatory powers in a series of EU supervisory authorities.

The development of this legislation since 2011 took place against the background of the eurozone crisis, which highlighted concerns about the prudential position of eurozone banks and related threats to financial stability in the eurozone and beyond.

The legislative response to the eurozone crisis can be characterised as consisting of two different approaches. First, an urgent and necessary fire-fighting operation was carried out to shore up embattled eurozone economies and banks. Second, a more fundamental restructuring of the foundations of financial supervision as a whole was considered necessary to prevent a recurrence of the crisis, with more European integration in many areas being seen as the long-term solution to problems arising from European monetary union. This second, more fundamental development is another step towards the fulfilment of the 'ever closer union' envisaged by EU Member States in the preamble to the Treaty on the Functioning of the European Union.

In Section IX, we have summarised the developments in relation to the second of these approaches, in particular the implementation of a single supervisory mechanism (SSM) for banking institutions in the eurozone, and common bank recovery and resolution arrangements.

It is important to note that much of the EU legislative activity in the area of banking regulation has traditionally been in the form of EU directives, which do not normally have legal effect in EU Member States until implemented by provisions of national laws. There have been some EU measures affecting the regulation of banks, however, which have taken the form of EU regulations that apply directly in all Member States. Following recent changes to the European supervisory architecture and the commitment of the European Commission (the Commission) to introduce an EU-wide 'single rule book' for financial services (both discussed in this chapter), the introduction of new EU rules relevant to banks is increasingly taking the form of directly applicable EU regulations.

Finally, it would be remiss to introduce this chapter without mention of the United Kingdom's decision to leave the European Union in the referendum of 23 June 2016. While this is addressed more fully in the United Kingdom chapter of this book, its particular impact on EU regulatory law must be noted. Without the UK – an historically influential voice in the financial services arena – sitting at the table, the course of EU banking regulation may

1 Jan Putnis is a partner and Timothy Fosh and Emily Bradley are associates at Slaughter and May.

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flow in a different direction. At the beginning of 2018, in the midst of negotiations between the European Union and the United Kingdom and uncertainty as to whether there will be a 'soft' or 'hard' Brexit, this direction is still far from clear. It can be said with some degree of certainty, however, that the loss of the UK from the conversation will have a significant effect on the shape of future EU banking legislation.

II EUROPEAN REGULATORY AND SUPERVISORY FRAMEWORK

i Key EU institutions

The Commission represents the interests of the European Union as a whole and has the sole right to propose new legislation. The Council of the European Union (the Council) represents the interests of the individual Member States. The European Parliament (the Parliament) represents the interests of EU citizens, and is directly elected by them.

ii Legislative procedure

The Commission, after consultation with interested stakeholders, will put forward a legislative proposal for joint adoption by the Council and the Parliament, which then usually goes through the 'ordinary legislative procedure' (previously known as the 'co-decision procedure'). In addition to its role in adopting legislation proposed by the Commission, the Parliament has limited power to request the Commission to submit appropriate proposals on matters on which it considers an EU legislative measure would be appropriate.

iii Lamfalussy approach to adoption of European financial services legislation

The Lamfalussy approach is a four-level procedure adopted by the EU for the development and application of financial services legislation that involves the following:

a a legislative act (Level 1): the framework legislation is proposed and adopted under the 'ordinary legislative procedure'. Individual articles in that legislation specify where power is delegated to the Commission to adopt Level 2 measures;

b implementing measures drafted and adopted by the Commission, following advice from the 'specialist committees' (Level 2);

c consultation and guidance by the European supervisory authorities (ESAs) (Level 3); and

d supervision and enforcement, principally by the regulators in each Member State (Level 4).

iv Reform of the EU supervisory framework

Until 2011, three 'Level 3 Committees' existed: the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR). These brought together regulators from each Member State to agree on the details of implementing measures and to help to coordinate the supervision of cross-border institutions. The failings in prudential regulation that were highlighted by the financial crisis led to criticism that these advisory committees did not have sufficient powers or influence to address the complex challenges of cross-border regulation.

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Following recommendations contained in the 2009 de Larosière Report,[2] the Commission proposed establishing a new European Systemic Risk Board (ESRB) to be responsible for macroprudential oversight and a European System of Financial Supervision (ESFS) to replace the Level 3 Committees, comprising three new pan-ESAs: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

The ESAs were established to oversee the European financial system at a microprudential level and to achieve convergence between Member States on technical rules and coordination between national supervisors. The ESAs' powers go beyond those of the Level 3 Committees and their role is no longer merely advisory. Indeed, the operations of the ESAs were subject to public consultation by the Commission in spring 2017, with a view to clarifying their role and to building a clearer overview of areas where their effectiveness and efficiency might be strengthened and improved. This resulted in the Commission publishing legislative proposals for reforming the ESAs, which it adopted on 20 September 2017. These supervisory structures, and the recent reforms, are discussed in further detail in Section XVII.

The Commission has committed itself to replacing separately implemented rules within Member States with a single set of harmonised prudential rules within the European Union, termed the 'single rule book'. The ESAs advance this project by developing draft technical standards, which will then be adopted by the Commission as EU law, and by issuing guidance and recommendations with which national supervisors and firms must make every effort to comply. In addition, the Commission's legislative proposals are increasingly taking the form of directly applicable EU regulations, or otherwise employ the 'maximum harmonisation' principle. This principle requires that national legislative implementation should not exceed the terms of the original EU legislation, and therefore prohibits the 'gold-plating' of EU legislation by individual Member States. The Commission's intention is that national options and discretions should be reduced, and that Member States should be permitted to apply stricter requirements only where these are justified by national circumstances, financial stability or a bank's specific risk profile.

The following is a brief description of some of the most important EU legislation affecting the regulation of banks, and several recent legislative initiatives that will affect banking activities in the European Union.

III CAPITAL REQUIREMENTS DIRECTIVE

Between 2006 and 1 January 2014, the principal EU legislation regarding the prudential regulation of banks was the Capital Requirements Directive (CRD I), which comprised two directives, commonly referred to as the Banking Consolidation Directive and the Capital Adequacy Directive. This legislation, which implemented many of the Basel II reforms, was amended in 2009 and 2011 by two further directives, CRD II and CRD III. CRD I was wider in scope than Basel II, as it applied not only to internationally active banks, but also to smaller banks, mutuals and investment firms. Changes to the prudential regime for banks were required as part of the Basel III international programme (discussed in the International

2 Report following The High Level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, Brussels, 25 February 2009.

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Initiatives chapter). A new package of legislation, in the form of the CRD IV Directive[3] and the Capital Requirements Regulation (CRR),[4] has now replaced CRD I, and has consolidated the changes introduced by CRD II and CRD III.

The CRD IV package continues to set out prudential rules for banks on a solo and on a consolidated basis, including solo and consolidated capital requirements. Consolidated supervision is, broadly, carried out in respect of groups or subgroups headed by parent undertakings incorporated in the EEA.[5] In addition, banks are required to include 'participations'[6] within the scope of consolidated supervision.

The CRD IV package continues to enshrine 'passport' rights for credit institutions, including banks, which broadly allow a bank authorised in one Member State of the EEA to provide a range of services for which it is so authorised in other Member States, or to establish a branch in other Member States, without having to obtain additional authorisation from the regulators in those Member States. The most important features of the CRD IV package are summarised below.

The Basel III-related reforms include the introduction of:

a new liquidity standards (a 30-day liquidity coverage ratio to promote short-term resilience to the risk that liquidity will cease to be available to a bank, and a net stable funding requirement to promote resilience to liquidity risks over longer periods) and a set of common monitoring metrics and application standards;

b measures to strengthen capital through the redefinition of capital into Common Equity Tier 1, Additional Tier 1 and Tier 2 (eliminating distinctions between different types of Tier 2 capital and abolishing Innovative Tier 1 capital and Tier 3 capital completely). The minimum ratios for Common Equity Tier 1 and total Tier 1 capital are set at 4.5 per cent and 6 per cent respectively (although the minimum capital ratio, ignoring capital buffers, remains at 8 per cent);

c new capital conservation and countercyclical capital buffers, which apply on top of the increased capital ratios and are intended to address the pro-cyclicality inherent in risk-based capital standards. The capital conservation buffer is set at 2.5 per cent of risk-weighted assets and must consist of common equity, with the bank's ability to make distributions limited if its capital ratio falls into the buffer. The countercyclical capital buffer is intended to supplement the capital conservation buffer, and is set by national regulators and used as a tool to require banks to build up capital during periods of excessive credit growth. This buffer also comprises common equity;

3 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

4 Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No. 648/2012.

5 The legislation provides that a lead regulator, agreed or determined from among the national regulators of members of the group in the EEA, carries out certain coordinating activities. In addition, the scope of consolidated supervision may, in principle, extend worldwide in certain circumstances, but in practice it is usually confined to an EEA-incorporated parent undertaking and its subsidiary undertakings and participations.

6 A 'participation' includes, broadly, a direct or indirect holding of 20 per cent or more of the voting rights or share capital in another undertaking. Participations are consolidated on a proportionate basis.

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d a leverage ratio acting as a cap on the ratio of banks' Tier 1 capital to total non-weighted assets and off-balance sheet exposures, intended to form a backstop to risk-based capital measures; and

e new rules on counterparty credit risk (increasing requirements in respect of exposures arising from derivatives, repurchase transactions (repos) and securities financing activities).

Measures in the CRD IV package not flowing directly from Basel III include:

a strengthened corporate governance arrangements and processes, including risk-management arrangements;

b strengthened sanctioning powers where banks breach CRD IV requirements, including the establishment of minimum administrative sanctions to be applied by national regulators;

c limited measures to reduce banks' reliance on external credit ratings, including requirements for banks to develop internal models to assess risk in portfolios and counterparty exposure;

d a bonus cap: the variable remuneration of certain individuals at banks is limited to 100 per cent of their fixed remuneration. This can be increased, subject to shareholder approval under certain circumstances, to 200 per cent of their fixed remuneration. This cap applies broadly to categories of staff such as senior management, risk-takers, staff engaged in control functions, and employees receiving total remuneration that takes them into the same remuneration bracket as senior management and risk-takers, whose professional activities have a material impact on a bank's risk profile; and

e further developments to the requirements in CRD III on remuneration to require the disclosure of the number of individuals within a bank receiving total remuneration of €1 million or more in each financial year (broken down into pay bands of €500,000).

CRD IV is intended to be a key instrument through which the Commission advances the development of a single rule book for financial services. The CRR is, by its nature, a maximum harmonisation measure that includes the majority of CRD IV's prudential requirements. As an EU regulation, the CRR is directly applicable in all Member States and divergences between national rules will thereby be minimised. On the other hand, provisions addressing, for example, the authorisation of credit institutions, cross-border passporting and the mechanics of prudential supervision (i.e., areas where there is more room for Member State discretion as well as a need to be more responsive to differences in national law) are contained in the CRD IV directive. As an EU directive, Member States have had some discretion as to how they choose to transpose the CRD IV directive into their national laws. An important illustration of this is that, while Member States have not generally been able to impose minimum capital requirements in excess of the CRD IV levels (these are provided for in the CRR), Member States do have a degree of flexibility in relation to the calibration of capital buffers (these are addressed in the CRD IV directive).

CRD IV entered into force on 1 January 2014. Full implementation of the capital and liquidity requirements in CRD IV remains subject to a staggered timeline, although national regulators are permitted to accelerate implementation ahead of the January 2019 deadline for full implementation of CRD IV (although national regulators retain limited discretion to use transitional provisions in relation to certain deductions from own funds until 2024). CRD IV is accompanied by a number of regulatory and implementing technical standards, the majority of which have been adopted.

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Building on this foundation, and taking further steps towards completion of the banking union (see Section IX), the Commission published a reform package on 23 November 2016, containing a proposed regulation amending the CRR (CRR II) and a proposed directive amending CRD IV (CRD V). The package includes amendments to the Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism Regulation (SRM Regulation) (see Sections IX and X). Through these legislative proposals, the Commission's stated aim was to tackle remaining weaknesses within the financial system and implement some outstanding elements that are essential to ensuring resilience, as recently finalised by global standard setters (i.e., the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB)).[7]

To this end, the reform package proffers wide-ranging regulatory reform that takes account of international standards set by the BCBS and FSB, while providing for – what the Commission terms – 'European specificities'. Measures in the reform package that take account of international standards include:

a a 3 per cent binding leverage ratio for all firms within the scope of CRD IV to prevent institutions from excessive leverage, for example to compensate for low profitability;

b a binding net stable funding ratio (NSFR), which will require credit institutions and systemic investment firms to finance their long-term activities (assets and off-balance sheet items) with stable sources of funding (liabilities) to address excessive reliance on short-term wholesale funding and to reduce long-term funding risk; and

c a requirement, known as total loss absorbing capacity (TLAC), for globally systemically important institutions to hold minimum levels of capital and other instruments that bear losses in resolution. TLAC will be integrated into the existing minimum requirement for own funds and eligible liabilities (MREL) system.

Operating in parallel, a keynote of the 'EU-specific' side of the package is increased proportionality, as a simplified approach for smaller and less complex institutions is introduced in respect of some of the current disclosure, reporting and complex book-related requirements. The other significant EU-specific change, which sparked considerable controversy, concerns the proposed requirement for certain non-EU banks headquartered in third countries to set up an intermediate holding company for their EU subsidiaries.

It is envisaged that the final legislative adoption of the package, including the amendments to the BRRD and SRM Regulation, will take place in early 2019; the Parliament and the Council are currently considering the package and are expected to reach political agreement by mid-2018. Entry into force and implementation vary according to the measure: for example, the NSFR proposal has a two-year implementation period. There are likely to be transitional provisions for implementation once the legislation is adopted.

In addition, the following related legislation was published in the Official Journal of the EU on 27 and 28 December 2017:

a a regulation amending the CRR regarding transitional arrangements for mitigating the impact of the introduction of International Financial Reporting Standard 9 (IFRS 9) on own funds and for the large exposures treatment of certain public sector exposures denominated in the domestic currency of any Member State (CRR IFRS 9 Regulation). This entered into force on 28 December 2017 and applied from 1 January 2018; and

7 COM(2016) 850.

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b a directive amending the BRRD as regards the ranking of unsecured debt instruments in the insolvency hierarchy (BRRD Insolvency Hierarchy Directive). This entered into force on 28 December 2017 and Member States are required to transpose it by 29 December 2018.

IV PAYMENT SERVICES DIRECTIVE

The Payment Services Directive (PSD)[8] is intended to harmonise conduct of business rules for all providers of electronic payment services across the EU, and to create a tiered prudential authorisation regime for non-bank payment service providers, known as 'payment institutions'. It affects banks, building societies, e-money issuers, money remitters, non-bank credit card issuers, non-bank merchant acquirers and their customers. The PSD focuses on electronic means of payment, including direct debits, debit cards, credit cards, standing orders, mobile or fixed phone payments and payments from other digital devices, as well as money remittance services. It does not apply to cash-only transactions or paper cheque-based payments.

The PSD was formally adopted on 13 November 2007. Member States were required to transpose the PSD into their national laws by 1 November 2009.

On 24 July 2013, the Commission adopted a legislative package seeking to amend the EU payments framework. The package proposed a revised and recast Payment Services Directive (PSD2)[9] and a Multilateral Interchange Fees Regulation (the MIF Regulation).[10]

PSD2 was formally adopted on 25 November 2015 and had an implementation deadline of 13 January 2018. It updates the existing framework for the regulation of the provision of payment services in the EU, covering payment services providers (PSPs) not previously regulated under the PSD, and introducing enhanced transparency and security requirements.

PSD2 increases the geographical scope of the PSD, applying transparency and information requirements to payment transactions in all currencies and to payment transactions where only one PSP is located in the EU (the PSD only applied where both PSPs were located in the EU). It also brings certain PSPs (such as those providing payment initiation services and account information services) within the scope of PSD2, and limits the exemptions that were available under the PSD. Throughout 2017, the EBA published technical standards and guidelines to accompany PSD2, in advance of its 13 January 2018 implementation date. Some of these technical standards and guidelines do not yet apply, most notably the regulatory technical standards relating to 'strong customer authentication', which are expected to apply from autumn 2019.

The MIF Regulation was formally adopted on 29 April 2015 and became fully effective on 9 June 2016. The Regulation imposes caps on interchange fees of 0.2 and 0.3 per cent of transaction value for consumer debit card and credit card transactions, respectively. These caps came into effect on 9 December 2015, although for a period of five years from that date, Member States can apply the cap of 0.2 per cent in respect of domestic debit card transactions to the annual weighted average transaction value of all such transactions within the card scheme. After expiry of this period, the cap must be set by reference to transaction value. The

8 Directive 2007/64/EC.

9 Directive (EU) 2015/2366.

10 Regulation (EU) 2015/751.

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Regulation also requires the organisational separation of payment schemes and transaction processing infrastructure, and prohibits territorial restrictions in licensing agreements or payment scheme rules.

V ACQUISITIONS DIRECTIVE

The Acquisitions Directive[11] was formally adopted on 5 September 2007. It was intended to harmonise the criteria that regulators apply in deciding whether to approve changes of control of financial institutions (specifically credit institutions, investment firms, insurers and reinsurers) and to harmonise some important aspects of the process by which they do so. Member States were required to implement the Acquisitions Directive into national law by 21 March 2009.

The Acquisitions Directive is a 'maximum harmonisation' directive in the sense that it prohibits Member States from imposing requirements for the notification to, and approval by, regulators of direct or indirect acquisitions of voting rights or share capital that are more stringent than those set out in the directive. The definition of 'control' (at or above which the person holding control requires regulatory approval) is set at 10 per cent of share capital or voting rights, which follows previously existing EU directives. The Acquisitions Directive also introduced a concept of aggregation of multiple parties' interests for the purpose of determining whether 'control' has been or would be attained where those parties are 'acting in concert'.

Between 8 December 2011 and 10 February 2012, the Commission consulted on the application of the Acquisitions Directive. In February 2013, the Commission published its report, concluding that, overall, the regime created by the Acquisitions Directive was working satisfactorily. The Commission did, however, ask the ESAs to clarify new Level 3 guidance on the directive in relation to a number of issues, including the definition of 'acting in concert'. These guidelines, which followed a consultation, were published by the ESAs on 20 December 2016, and applied from 1 October 2017.

The provisions which the Acquisitions Directive inserted into sectoral directives have now been repeated in the latest versions of those directives, namely MiFID II,[12] Solvency II[13] and CRD IV.[14]

VI FINANCIAL GROUPS DIRECTIVE

There is a separate EU regime for the consolidated supervision of mixed activity financial groups (financial conglomerates) established by the Financial Groups Directive,[15] also referred to as the Financial Conglomerates Directive or the FGD.

Financial conglomerates, within the meaning of the FGD, are groups that carry on financial services activities as a substantial portion of their business, and that have significant interests in each of the banking or investment services, and insurance sectors.

The FGD requires that a bank, investment firm or insurer that is authorised by an EEA regulator and that is a member (or parent) of a financial conglomerate group should be subject to supplementary supervision on a group-wide basis in addition to relevant sectoral

11 Directive 2007/44/EC.

12 Directive 2014/65/EU, see Section VII.

13 Directive 2009/138/EC.

14 See Section III.

15 Directive 2002/87/EC (as amended).

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(i.e., insurance or banking) consolidated supervision. The rules on how this supervision is effected may differ from those that apply to banking-only groups. The criteria for determining whether a group is a financial conglomerate for the purposes of the FGD depend on whether it is headed by a regulated entity. If a group is headed by a regulated entity, this entity must be the parent undertaking of, hold a participation in or be linked by a relationship based on unified management with, an entity in the banking, investment or insurance sector. Where the entity at the head of the group is not regulated, the gross assets attributable to all the financial business activities of the group (that is, all its banking or investment services, and insurance businesses) must account for at least 40 per cent of the group's total gross assets worldwide.

In both cases, groups must also meet the following criteria: at least one member of the group carries on business in each of the banking or investment services, and insurance sectors; and the group's business activities in each of the banking or investment services and insurance sectors are 'significant'.

Significance is measured by reference to the average of two tests: a balance sheet ratio test and a solvency requirements ratio test comparing the significance of each sector with the combined position of all financial sector entities in the group. The average ratio for each of the banking or investment firms and insurance businesses of the group must exceed 10 per cent for the group to be treated as a financial conglomerate. At the initiative of the 'lead' European regulator (to be identified or agreed among the national regulators that supervise members of the group in the EEA), national regulators that supervise members of the group in Member States may agree to substitute or supplement the significance test, or to exclude certain group members from its calculation, if they consider it appropriate to do so.

The significance test can also be satisfied if the gross assets of the smaller of the group's financial sector businesses (banking or investment services as against insurance) exceed €6 billion. If, however, the 10 per cent average ratio test is not satisfied, the relevant national regulators can agree that the group should not be regarded as a financial conglomerate.

Upon becoming a financial conglomerate, the relevant ratios are lowered for three years from that date unless the relevant national regulators agree otherwise. This minimises scenarios in which a group moves in and out of the FGD regime. The FGD also permits relevant regulators to treat a conglomerate as such for three years from the date on which it last satisfied the conglomerate test.[16]

The FGD was amended in December 2011, and those amendments were required to be implemented in full by Member States by 22 July 2013.

The amendments are intended to address certain deficiencies in the way the FGD interacts with CRD IV and equivalent sectoral rules for insurers that mean supplementary supervision cannot currently be carried out for certain groups or on a fully group-wide basis because of their legal structure. The amendments also introduce, *inter alia*, more discretion for supervisors in applying the 'significance test' and in deciding whether to identify 'small' groups (those with under €6 billion in total assets) as financial conglomerates.

In February 2012, the Commission launched a review of the FGD and published the results on 9 January 2013. The report identified future issues that would be addressed in further revisions to the FGD. These included the criteria for the identification of a conglomerate, the identification of the parent entity responsible for meeting group requirements and the

16 Not all national regulators have exercised this discretion.

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strengthening of enforcement in relation to group entities. Recital (80) to the CRR stated that a review of the FGD was expected in 2015, and in June 2016 the Commission published a consultation paper seeking views on a number of issues, including:

a the scope of the FGD, including asking whether supervisors are able to capture the right groups (and entities within those groups) as well as the right activities under the FGD;

b how the FGD requirements address group risk management, looking at areas such as capital adequacy, corporate governance and intra-group transactions; and

c the FGD's framework for supervisory cooperation.

Following this consultation, the Council published a Commission staff working document (SWD), with a summary, in July 2017. While stating that this did not represent a full evaluation of the FGD (owing to a lack of sufficient evidence to support a full evaluation) the Commission concluded that the FGD has, in general, functioned well, and that, overall, it remains a useful supervisory tool.

VII MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID)

The Markets in Financial Instruments Directive (MiFID)[17] replaced the Investment Services Directive (ISD),[18] which had constituted one of the foundations upon which the single European market in financial services was developed. The ISD introduced a system of 'passports' under which an investment firm authorised as such in one Member State could carry out certain regulated activities for which it was so authorised in other Member States, or establish a branch in other Member States, without having to obtain additional authorisation from the regulators in those other Member States. MiFID retained and expanded this passporting framework.

MiFID is very important to the very large number of EU banks that provide investment services as well as carrying on deposit-taking and lending activities.

Although the effect in each Member State has varied, MiFID has had some important consequences for the investment services market in the EEA as a whole:

a the scope of regulation of the investment services sector required by EU law has expanded, with the addition of important new regulated investment services and products;

b as a result, the investment services passport now enables firms to provide a wider range of investment services on a cross-border basis, or from branches within the EEA;

c national-level barriers to investment services within the EU single market have been reduced;

d important core business standards for investment services are now prescribed in detail at EU level; and

e the rules applying to different securities trading venues have been harmonised to a significant degree, resulting in a wider range of regulated trading venues, such as multilateral trading facilities (MTFs).

The deadline for the implementation of MiFID into the national law of each Member State was 1 November 2007.

17 Directive 2004/39/EC (as amended). This directive was supplemented by implementing measures in the form of an EU regulation (1287/2006/EC) and a further directive (2006/73/EC).

18 Directive 93/22/EEC.

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In October 2011, the Commission published a legislative proposal to amend MiFID (MiFID II). MiFID II comprises a directive and a regulation (the latter also amended the European Market Infrastructure Regulation, which is discussed below). The provisions of the MiFID II Directive and Markets in Financial Instruments Regulation (MiFIR) came into force on 2 July 2014. A legislative package postponing the application of MiFID II and MiFIR came into force on 1 July 2016, which meant that Member States had until 3 July 2017 to transpose the majority of measures contained in the MiFID II Directive into their national laws, and have had to apply those provisions, and MiFIR, since 3 January 2018. This legislative package delayed the application of MiFID II and MiFIR by one year. The delay reflects the difficulties faced by the ESMA and the Commission in delivering the necessary technical standards and delegated acts, and the difficulties in developing the infrastructure required for the collection of financial instrument reference data that trading venues and other entities are required to provide under the new regime.

MiFID II covers a range of issues, some of which are self-evidently matters of regulatory policy playing catch-up with market developments, for example in relation to new trading methods such as high-frequency and algorithmic trading strategies. Other measures, however, demonstrate a prescriptive and rigid response to perceived or suspected potential for investor detriment. In some cases, indeed, the measures seem to cross the line between the regulation of firms' conduct and the imposition of specific conduct requirements, even to the extent of banning certain products or activities. Key elements of MiFID II include the following:

a a new type of trading venue, the organised trading facility (OTF), is within the scope of MiFID II. OTFs are subject to the same core requirements for a trading venue's operation as existing platforms and are defined broadly to capture all forms of organised trading not matching existing categories;

b all trading of derivatives, which are eligible for clearing and are sufficiently liquid, move either to regulated markets, MTFs or to the new OTFs;

c improved transparency of trading activities in equity markets, including 'dark pools', and a new trade transparency regime for non-equity markets;

d new safeguards for algorithmic and high-frequency trading activities;

e in coordination with the ESMA or the EBA and under defined circumstances, supervisors are able to ban specific products, services or practices in the case of threats to investor protection, financial stability or the orderly functioning of markets;

f new powers for regulators to monitor and intervene in commodity derivatives trading, including the imposition of position limits;

g stricter requirements for portfolio management, investment advice and the offer of complex financial products, such as structured deposits; and

h a ban on third-party inducements in the case of portfolio management and for firms providing independent advice.

MiFID II is accompanied by a number of regulatory technical standards and implementing technical standards, the majority of which have now been finalised.

VIII EUROPEAN MARKET INFRASTRUCTURE REGULATION

At the September 2009 summit in Pittsburgh, G20 leaders agreed that all standardised over-the-counter (OTC) derivative contracts should be cleared through central counterparties (CCPs) by the end of 2012 at the latest, and that OTC derivative contracts should be reported to trade repositories. The EU's response to this commitment is the Regulation on

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OTC derivatives, central counterparties and trade repositories (commonly referred to as the European Market Infrastructure Regulation or EMIR). The EMIR entered into force on 16 August 2012, although where requirements rely on the publication and implementation of Level 2 measures, those requirements will come into force when the relevant Level 2 measures are implemented. In particular, the first clearing obligations came into effect on 21 June 2016 in respect of certain interest rate derivatives.

The requirements of the EMIR, which extend to all derivative contracts and not just to standardised OTC derivative contracts, include:

a a reporting obligation in respect of derivatives entered into by EU financial and non-financial counterparties, requiring detailed information to be reported to trade repositories and made accessible to supervisory authorities (this obligation came into force on 12 February 2014);

b a clearing obligation for derivatives that meet certain eligibility criteria set by the ESMA;

c measures to reduce counterparty credit risk and operational risk for uncleared OTC derivatives, including risk mitigation standards (such as exchanges of collateral);

d prudential requirements for CCPs and trade repositories, including requirements for authorisation, capital, the provision of margin, the establishment of a default fund, organisational rules and conduct of business standards. These include an obligation on trade repositories to publish aggregate positions by classes of derivatives accessible to all market participants; and

e rules on the interoperability of CCPs.

The majority of the regulatory technical standards and implementing technical standards have been finalised, including those relating to measures to reduce counterparty credit risk for uncleared OTC derivatives.

In November 2016, the Commission published a report under Article 85(1) EMIR to review the EMIR. While noting that certain core requirements provided for under the EMIR were yet to be implemented or completed, the report concluded that no fundamental change should be made to the nature of the core requirements of the EMIR. Nonetheless, a number of areas were highlighted where the EMIR requirements could be adjusted, including:

a introducing a mechanism to suspend the clearing obligation. The Commission has proposed such a mechanism as part of its legislative proposal on CCP recovery and resolution (see Section XVIII);

b facilitating the predictability of margin requirements through better information sharing;

c streamlining trade reporting through an assessment of the current rules, and considering alternative methods for providing access to third country authorities of trade repositories' data; and

d reducing disproportionate costs and burdens through a review of the scope of transactions and entities.

The Commission published two proposed regulations in 2017, which seek to amend the EMIR. The first, following the November 2016 consultation and published in May 2017, tackles several areas, including the streamlining of reporting requirements, the asset classes required to be cleared by non-financial counterparties, the introduction of a clearing threshold for small financial counterparties, and a new three-year temporary exemption for pension funds

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from clearing (and is referred to as the EMIR REFIT proposal). The second, published in June 2017, concerns the procedures and authorities involved for the authorisation of CCPs and requirements for the recognition of third country CCPs (which would be subject to a 'two-tier' classification system). In both cases, the Parliament has published (in January and February 2018, respectively) a draft report on the proposed regulation, suggesting amendments.

IX THE BANKING UNION, SSM AND SINGLE RESOLUTION MECHANISM

Herman van Rompuy, former president of the European Council, published a report on 26 June 2012 entitled 'Towards a Genuine Economic and Monetary Union', in which he set out his vision for the future of EU economic and monetary union. This was based on four elements: an integrated financial framework, an integrated budgetary framework, an integrated economic policy framework, and democratic legitimacy and accountability.

The proposals for an integrated financial framework (otherwise known as a 'banking union') comprise:

a a new role for the European Central Bank (ECB), giving it responsibility for the prudential regulation of all 'credit institutions' (meaning all banks, mutuals and other deposit-taking entities) established in the eurozone, resulting in an SSM for banking supervision;

b a single prudential rule book applicable across the European Union, the core elements of which are already contained in CRD IV;

c a harmonised recovery and resolution framework for credit institutions and other systemic firms in the eurozone on the basis of the Commission's current proposals in this area; and

d a common deposit guarantee scheme (DGS) for the European Union.

i The SSM

The legislation establishing the SSM includes two regulations: one conferring supervisory tasks on the ECB (the SSM Regulation) and the other modifying the regulation establishing the EBA (the EBA Amending Regulation). These are supplemented by the SSM Framework Regulation, which sets out detailed procedures for the SSM. The SSM Regulation entered into force on 3 November 2013 and the EBA Amending Regulation entered into force on 30 October 2013. In accordance with the SSM Regulation, the ECB assumed its supervisory role on 4 November 2014.

The SSM Regulation is the key piece of legislation establishing the SSM elements of the banking union. The key elements of the SSM Regulation include:

a direct supervisory responsibility for the ECB over significant credit institutions (generally, those with assets of more than €30 billion, representing more than one-fifth of a Member State's national output (where those total assets exceed €5 billion), or with a ratio of cross-border assets or liabilities to total assets or liabilities (respectively) that exceeds 20 per cent). Other banks largely remain under the supervision of the national competent authorities in the participating Member States. However, the ECB does have the supervisory role for licensing and authorising credit institutions, and for assessing the qualifying holdings for all credit institutions;

b the ECB should issue regulations, guidelines or general instructions to national supervisors for the performance of their supervisory responsibilities; and

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c investigatory and enforcement powers for the ECB. It may impose fines of up to twice the amount of the profits gained or losses avoided as a result of a breach (where these can be determined), or up to 10 per cent of the total annual turnover of a legal person in the preceding business year. It does not, however, have the power to impose sanctions on individuals.

The EBA Amending Regulation revises the EBA Regulation in relation to voting procedures in respect of the EBA. It includes revised decision-making arrangements in respect of the EBA, which require a majority of non-SSM countries to approve EBA decisions (to prevent the EBA from being dominated by the ECB, representing the SSM Member States).

On 11 October 2017, as required by the SSM Regulation, the Commission published a report that provides an assessment of the setting up and functioning of the SSM, to determine its effectiveness as the first pillar of the banking union. The report covers five themes:

a the governance of the SSM;
b supervisory tools developed by the ECB;
c the performance of supervisory tasks by the ECB;
d the interaction with relevant EU and international bodies; and
e the cost-effectiveness of the SSM.

In its report, the Commission came to an overall positive assessment of the SSM and the first two years of the ECB acting in its supervisory capacity. While stating that there is scope for further improvement, the Commission does not consider it necessary to propose any amendments to the SSM Regulation.

Although non-eurozone Member States do not participate in the SSM, the SSM Regulation allows those countries to enter into close supervisory cooperation with the ECB. To date, none of the nine non-eurozone Member States have opted to do so, although in October 2017, the Commission published a communication stating that Denmark, Sweden and Bulgaria were considering joining the banking union.

ii The Single Resolution Mechanism

The SRM Regulation, certain provisions of which have applied since August 2014 and which has been fully effective since 1 January 2016, established the single resolution mechanism (SRM). Its key elements include:

a the establishment of a single resolution board (SRB). The SRB's main role is to assess whether an individual bank needs to be placed under resolution, and to determine the application of the resolution tools and use of the single bank resolution fund (SBRF);
b the establishment of the SBRF, which is funded through contributions made by all banks established in participating Member States. The level of contributions payable by banks reflects their respective size and business model; and
c the establishment of a resolution mechanism that is intended to reflect the mechanism used by national authorities under the BRRD, discussed below. The framework includes preparatory and preventive measures, early intervention measures and resolution tools, including bail-in.

As discussed in Section III, the Commission published a legislative package in November 2016, which included proposed amendments to the SRM (under the SRM II Regulation). These amendments are intended to mirror those made under BRRD II (see Section X) and

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relate to the implementation of the TLAC requirements and revisions to MREL. As with the broader legislative package, it is now for the Parliament and the Council to consider the proposed amendments.

X RECOVERY AND RESOLUTION PLANS

Both the G20 and the FSB have advocated the development of recovery and resolution plans – 'living wills' – for financial institutions. The numerous high-profile banking failures in the European Union during the financial crisis (e.g., Fortis and Anglo Irish Bank) revealed shortcomings in the existing arrangements for organising an orderly wind-down of ailing banks and financial institutions, which left Member States with no choice but to bail out their banking sectors.

In response to this, the Commission proposed an EU framework for crisis management in the financial sector with common and effective tools and powers to deal with failing banks at an early stage, and to minimise costs for taxpayers. The overriding objective of the proposal was to ensure that failing banks could be resolved in ways that minimise the risks of contagion and ensure continuity of essential financial services, including continuous access to deposits for insured depositors.

The BRRD is the framework legislation passed as a result of the Commission's proposal to deal with future bank failures. It came into force on 2 July 2014 and establishes new tools and powers for national regulators to deal with crises, including (1) rules requiring banks to prepare recovery plans and requiring resolution authorities to prepare resolution plans based on consultation with the institution concerned; (2) new powers of supervisory intervention at an early stage and during a crisis, such as the ability to require a bank to implement its recovery plan; and (3) powers giving regulators new tools to deal with the failure of a firm, including a sale-of-business tool, a bridge institution tool, an asset-separation tool and a 'bail-in' tool.

The BRRD also establishes new mechanisms for cross-border cooperation for handling banking crises, including a much greater role for the EBA.

The deadline by which Member States had to transpose the BRRD into national law was 31 December 2014, and all the provisions of the directive (except for the bail-in tool for use by national regulators) should have come into force by 1 January 2015. The provisions relating to the use of the bail-in tool came into force on 1 January 2016, although some Member States (including the United Kingdom) chose to bring these provisions into force sooner.

As discussed in Section III, the Commission adopted a broad reform package in November 2016, which contained reforms to the BRRD (BRRD II). These reforms, which form part of the Commission's efforts to implement the TLAC standard, included the revision of the existing MREL provisions to align them with the TLAC standard, and targeted amendments to the BRRD related to the insolvency ranking of holders of debt instruments issued by EU banks for the purposes of complying with the BRRD and TLAC requirements concerning loss absorption and recapitalisation capacity of banks.

As with the broader legislative package, it is now for the Parliament and the Council to consider BRRD II. In addition, as flagged in Section III, the BRRD Insolvency Hierarchy Directive entered into force on 28 December 2017 and Member States are required to transpose it by 29 December 2018.

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XI SHORT SELLING REGULATION

In distressed markets, short selling can amplify price falls and may lead to disorderly markets giving rise to systemic risk. In 2008, fears of such risks led to various Member States suspending short selling, although there was no coordinated approach across the European Union. To address the perceived risks in a coordinated manner, a regulation on short selling and certain aspects of credit default swaps (the Short Selling Regulation (SSR)) was agreed upon and came into force on 1 November 2012. It includes provisions that:

a increase transparency on short positions in certain situations relating to EU shares and EU sovereign debt, and to persons with significant credit default swap positions relating to EU sovereign debt issuers;

b require that those who enter into short sales of European sovereign debt instruments or shares admitted to trading on an EU-regulated market, or an MTF, must have borrowed, entered into an agreement to borrow, or made other arrangements that ensure that the relevant instruments are available for borrowing. This effectively bans 'naked' short selling;

c oblige disclosure of a short position in shares of an EU company to the relevant regulator once the short position reaches 0.2 per cent, and to the market once it reaches 0.5 per cent (and each 0.1 per cent above this), of the target's share capital. Only 'significant' short positions in credit default swaps or EU sovereign bonds will need to be disclosed to the regulator (and not the market);

d require trading venues to ensure that there are default arrangements and penalties in place if a short settlement fails;

e require that all short orders should be flagged as such;

f empower national competent authorities to impose restrictions on short selling and related derivative transactions for up to three months where there is a serious threat to financial stability or market confidence in a Member State or the European Union more generally, and very short-term restrictions where there is a significant fall in the price of a financial instrument; and

g provide that the ESMA will coordinate cross-border measures and intervene in situations where national authorities have not taken sufficient action to address a threat.

On 7 July 2017, the ESMA published a consultation paper seeking the views of market participants on three aspects of its future technical advice to the European Commission regarding the SSR: (1) the scope and functioning of the exemption for market making activities; (2) the procedure for imposing a short-term ban on short selling in the event of a significant fall in price of a financial instrument; and (3) the transparency of net short positions, and the related reporting and disclosure requirements.

Following this consultation, the ESMA published its final report containing its technical advice on 21 December 2017, which included a number of proposals centring around the three elements set out in the consultation. These proposals include transforming the current bans on short selling into a ban on entering into or increasing net short positions, and building a centralised notification and publication system across the European Union for transparency purposes. This report is expected to feed into the follow-up actions the Commission announced in its call for evidence as regards the EU regulatory framework for financial services dated 23 November 2016.

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XII CONSUMER PROTECTION DIRECTIVES RELEVANT TO THE BANKING SECTOR

A number of other EU directives of importance to banks have been enacted, broadly with the aim of achieving harmonised consumer protection measures in the areas to which they relate. They include those summarised below.

i Deposit Guarantee Schemes Directive

This Directive[19] established minimum levels of protection that Member States are required to provide to depositors of banks that their national regulators supervise. In February 2009, the Council adopted an amending directive[20] that raised the minimum deposit coverage level to €50,000 as from 30 June 2009 (from €20,000) and set the coverage level at €100,000 as from 31 December 2010; and reduced the maximum payout delay to 25 working days (a period of five working days to establish that a credit institution has failed to repay deposits that are due and payable, followed by a period of 20 working days), subject to extension by 10 working days.

On 2 July 2014, a recast version of the Deposit Guarantee Schemes Directive[21] (DGSD) came into force, and the overwhelming majority of its provisions had to be implemented by 3 July 2015. Among its key provisions are:

- *a* reducing the time permitted for payout to seven working days by 2024 and, to facilitate this more rapid timetable, requiring managers of schemes to inform authorities of likely bank failures, and requiring banks to be able to provide a breakdown of the aggregated deposits of a depositor at any time;
- *b* requiring the provision of standard information to depositors about the scheme that applies to them;
- *c* requiring funds of schemes to reach 0.8 per cent of covered deposits within 10 years of the directive coming into force. The Commission may permit a Member State to set a lower level (although not less than 0.5 per cent) where that Member State has a concentrated banking sector; and
- *d* introducing a principle of risk-based contributions, whereby riskier banks are required to make greater contributions to the relevant DGS.

The DGSD requires the Commission to submit two reports by 3 July 2019:

- *a* one setting out how deposit guarantee schemes operating in the EU may cooperate through a European scheme to prevent risks arising from cross-border activities and protect deposits from such risks (and, if appropriate, to submit a legislative proposal); and
- *b* one, with the support of the EBA, on the progress towards the implementation of the DGSD, having regard to a number of topics, such as the adequacy of the current coverage level for depositors and the impact on the diversity of banking models.

19 Directive 94/19/EC.
20 Directive 2009/14/EC.
21 Directive 2014/49/EU.

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ii Unfair Terms in Consumer Contracts Directive and Consumer Rights Directive

The Unfair Terms in Consumer Contracts Directive (the Unfair Terms Directive)[22] requires Member States, *inter alia*, to enact provisions in their national laws rendering unenforceable certain 'unfair' terms in consumer contracts. These are defined as contracts between a 'seller or supplier' (meaning 'any natural or legal person' who, in contracts covered by the directive, is 'acting for purposes relating to his trade, business or profession') and a 'consumer' (meaning 'any natural person' who, in contracts covered by the directive, is 'acting for purposes which are outside his trade, business or profession'). In particular, a term of such a contract that has not been individually negotiated is 'unfair' (and therefore unenforceable) if, 'contrary to the requirement of good faith', it causes a 'significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer'. An annex to the directive contains an indicative and non-exhaustive list of terms that may be regarded as 'unfair'.

The directive also introduced a requirement that Member States implement measures ensuring that contracts to which the directive relates be drafted in plain, intelligible language.

In October 2008, the Commission published a communication proposing the repeal and replacement of this directive with a single EU directive on consumer rights that would also repeal and replace certain other consumer protection directives. The Consumer Rights Directive,[23] which came into force on 12 December 2011, made only minor amendments to the Unfair Terms Directive, rather than repealing it. Among its key provisions are an extension of consumer withdrawal rights on distance purchases to 14 days across the European Union; a cap on fees for use of means of payment equal to the cost borne by the trader for the use of such means; and the provision of mandatory information by the trader to the consumer on distance and off-premises contracts. Member States were required to implement the measures contained in the Consumer Rights Directive by 13 June 2013, and to apply those measures from 13 June 2014.

On 12 May 2016, the Commission launched a consultation as part of its 'fitness check' of EU consumer and marketing law, which included an evaluation of the Unfair Terms Directive. The Consumer Rights Directive underwent a separate evaluation in parallel. The Commission found, overall, the current EU consumer law *acquis* to still be fit for purpose, and not in need of a major overhaul. Nevertheless, the Commission launched a public consultation to seek stakeholder views on some possible targeted legislative changes, which closed on 8 October 2017. The possible legislative changes included consideration of:

- *a* providing more transparency regarding whom consumers conclude contracts with when buying on online platforms and whether EU consumer rights are applicable to such contracts;
- *b* extension of some consumer rights to contracts for online services where consumers provide data instead of paying with money;
- *c* individual redress or remedies for consumers harmed by unfair commercial practices; for example, misleading green claims;
- *d* more proportionate, effective and deterrent financial penalties to tackle breaches of consumer laws; and
- *e* simplification of some rules and requirements.

22 Directive 93/13/EEC.

23 Directive 2011/83/EEC.

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Following this consultation, the Commission will prepare an impact assessment and, if necessary, present legislative proposals.

iii Anti-money laundering legislation

There are also extensive provisions of EU law setting out anti-money laundering requirements, but these are beyond the scope of this chapter.

XIII THE SFT REGULATION

In its September 2013 Communication on shadow banking, the Commission identified increasing the transparency of securities financing transactions (SFTs) as a priority area. This prompted it to publish a proposal for a regulation on the reporting and transparency of SFTs in January 2014. The final text of the SFT Regulation[24] was formally adopted on 25 November 2015 and came into force on 12 January 2016; the ESMA published a final report on its proposed regulatory and implementing technical standards in March 2017. The Commission is now to decide whether to endorse these draft technical standards.

The SFT Regulation imposes the following requirements on counterparties to SFTs:

a counterparties must report details of SFTs to a registered or recognised trade repository no later than the working day following the conclusion of the transaction;

b fund managers must provide detailed information on any recourse they have to SFTs and other financing structures in pre-contractual documents and at regular reporting intervals: this measure is aimed at enabling investors to become aware of the risks associated with the use of SFTs and other financing structures; and

c a counterparty that wishes to rehypothecate clients' financial instruments that it holds as collateral can do so only after receiving the express consent of the providing counterparty, disclosing the potential risks and having the financial instruments transferred to its own account.

The SFT Regulation covers repos, securities and commodities lending and borrowing transactions, buy-sell back and sell-buy back transactions, and margin lending transactions, and applies to all counterparties in SFT transactions that are domiciled in the European Union or acting through an EU branch, certain fund managers and counterparties engaging in rehypothecation.

XIV THE MARKET ABUSE REGULATION

In October 2011, the Commission published legislative proposals for a regulation and directive to replace the Market Abuse Directive (MAD)[25] and to strengthen and update the existing EU market abuse regime. Following consideration by the Council and the Parliament, the final texts of the Market Abuse Regulation[26] (MAR) and the Directive on Criminal Sanctions for Market Abuse (CSMAD)[27] (referred to collectively as MAD II) were published on 12 June 2014 and came into force on 2 July 2014.

24 Regulation (EU) 2015/2365.
25 Directive 2003/6/EC.
26 Regulation (EU) No. 596/2014.
27 Directive 2014/57/EU.

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The MAR is intended to expand and develop the market abuse regime under the MAD by establishing a common regulatory framework on market abuse. This regulation is intended to complement the MiFID II legislative package, and the two regimes were updated together to ensure that they are coherent and support each other's objectives and principles.

The framework established by the MAR prohibits insider dealing, the unlawful disclosure of inside information and market manipulation. Key changes made to the existing EU market abuse regime by the MAR include:

a an expansion of scope to cover market abuse relating to financial instruments traded on an OTF or MTF, certain OTC activities and, in some cases, spot commodity contracts;
b extraterritorial reach, covering behaviour both within and, where such behaviour relates to instruments traded on an EU trading venue, outside the European Union;
c the introduction of a prohibition on attempted market manipulation;
d the extension of the market manipulation prohibition under the MAD to cover the manipulation of benchmarks; and
e the introduction of a new 'market soundings' safe harbour to the offence of unlawfully disclosing inside information.

The majority of the MAR's provisions applied from 3 July 2016.

The CSMAD is intended to complement the MAR by requiring Member States to implement minimum rules for criminal sanctions in the most serious instances of market abuse. Under the CSMAD, 'serious' instances of market abuse are broadly those that cause a great impact on the integrity of the market, or under which the profit gained or loss avoided, the level of damage caused to the market or the overall value of the financial instruments concerned is high.

Member States were required to transpose CSMAD provisions into domestic law by 3 July 2016 but, as the CSMAD is a minimum harmonisation directive, are free to impose more stringent requirements. Two Member States, Denmark and the United Kingdom, have opted out of the CSMAD. The Commission is required to report to the European Parliament and to the Council by 4 July 2018 on the functioning of the CSMAD and, if necessary, on the need to amend it.

XV THE MORTGAGE CREDIT DIRECTIVE

In March 2011, the Commission published a proposal for a directive on credit agreements relating to residential immoveable property for consumers. The Mortgage Credit Directive (MCD) was published in the Official Journal on 28 February 2014 and had to be transposed and implemented by Member States by 21 March 2016.

The MCD introduces requirements in the European Union for residential mortgage lending, and places obligations on credit intermediaries and creditors. The MCD imposes requirements in relation to, *inter alia*, advertising and marketing, standard pre-contractual information, calculation of the annual percentage rate of charge, creditworthiness and suitability assessments and advice, and introduces a right of the borrower to make early repayment.

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XVI BENCHMARKS REGULATION

Following global investigations into the conduct of a number of banks in relation to attempts to manipulate two key financial market benchmarks – the London interbank offered rate (LIBOR) and the Euro interbank offered rate (EURIBOR) – the Commission published a consultation document on the regulation of indices in September 2012.

Further to the consultation, the Commission adopted a proposal for a regulation on indices used as benchmarks in financial instruments and financial contracts (the Benchmarks Regulation). Adopted by the European Parliament in April 2016, the majority of the provisions of the Benchmarks Regulation applied from 1 January 2018.

The key elements of the Regulation are as follows:

a the activity of the provision of benchmarks is subject to prior authorisation and continuing supervision at national and EU level. Different governance and control requirements apply to administrators depending on whether they administer 'critical', 'significant' or 'non-significant' benchmarks. For 'critical' benchmarks (a class likely to include LIBOR and EURIBOR), colleges of supervisors should be formed to enhance the exchange of information and ensure uniform authorisation and supervision;

b provisions to improve the quality of input data are provided. Input data used to produce a benchmark should be sufficient and accurate to reflect actual market or economic reality, the data should be obtained from a reliable and representative panel of submitting institutions, and the benchmark administrator should use robust and reliable methodology for determining the benchmark;

c the benchmark administrator is required to draw up a code of conduct for contributors that clearly specifies their obligations and responsibilities when they provide input data for the determination of the benchmark;

d annexes to the Benchmarks Regulation are provided in relation to commodity benchmarks and interest rate benchmarks to take account of the 'risks and specificities' of these benchmarks in a proportionate manner. Additional requirements are imposed on critical benchmarks, including the power for the relevant competent authority to mandate submission data from contributors and mandate administration; and

e transparency provisions require administrators to provide a statement setting out the relevant benchmark measures and its vulnerabilities, to allow users to choose the most appropriate and suitable benchmark.

XVII SECURITISATION REGULATION

In September 2015, the Commission published a legislative proposal for a regulation establishing a European framework for simple, transparent and standardised (STS) securitisations (the Securitisation Regulation), one of the building blocks of the Capital Markets Union action plan adopted by the Commission. In parallel, it published a proposal for a regulation amending the CRR on prudential requirements for credit institutions and investment firms (the CRR Amendment Regulation). Political agreement between the Parliament and the Council on these two regulations was achieved in May 2017.

The Securitisation Regulation introduces certain requirements in relation to securitisations, requiring defined institutional investors to conduct due diligence before investing in securitisation instruments and imposing risk retention, reporting and transparency requirements on originators, sponsors and original lenders. The Securitisation Regulation

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also sets out what constitutes an STS securitisation, and establishes a more risk-sensitive prudential framework in respect of such securitisations. The CRR Amendment Regulation amends the CRR in order to give STS securitisations more favourable capital treatment.

Adopted towards the end of 2017, both regulations entered into force on 17 January 2018 and will apply from 1 January 2019.

XVIII FUTURE LEGISLATIVE DEVELOPMENTS

A number of measures of importance to banking activities have recently been proposed by the Commission, including those briefly summarised below.

i Investment Firms Regulation and Investment Firms Directive

The proposals for the Investment Firms Regulation (IFR) and the Investment Firms Directive (IFD), adopted by the Commission on 20 December 2017, seek to establish a new prudential framework for investment firms that are authorised under MiFID II and are subject to prudential requirements deriving from CRD IV and the CRR. This is intended to foster a more effective prudential and supervisory framework for investment firms, calibrated to the size and nature of investment firms, in order to boost competition and improve investors' access to new opportunities and better ways of managing their risks. This update to the regulatory architecture is highlighted by the Commission as being particularly important in light of the pivotal role played by UK investment firms in this area to date, and the UK's decision to withdraw from the European Union.

Key features include:

a new and simpler prudential rules for the large majority of investment firms that are not systemic, without compromising financial stability; and

b amended rules to ensure that large, systemic investment firms that carry out bank-like activities and pose similar risks as banks are regulated and supervised like banks. As a consequence, the ECB, in its supervisory capacity (the SSM) would supervise such systemic investment firms in the banking union. This is intended to ensure a level playing field between large and systemic financial institutions.

The European Parliament and the Council must now consider these legislative proposals.

ii The European deposit insurance scheme

In November 2015, the Commission adopted a legislative proposal for a regulation establishing a European deposit insurance scheme (EDIS). The proposal reflects the Commission's concern that national DGSs established under the Deposit Guarantee Schemes Directive (see Section XII) may be vulnerable to large local events and form one of the key components of the proposals for a European banking union. The Commission's proposals would only apply in Member States that are participants in the SSM. The Parliament and the Council are currently considering the legislative proposal.

Under the legislative proposals, EDIS would provide insurance to participating DGSs from 2024, funding a participating DGS where it is required to contribute to a resolution or make a payout under the Deposit Guarantee Schemes Directive. This would be funded by risk-based contributions paid by banks to a deposit insurance fund, which the Commission envisages would be equivalent to 0.8 per cent of the covered deposits of all banks within the banking union by 2024.

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On 11 October 2017, the Commission – noting that it had been two years since the presentation of the EDIS proposal, which remains on the table unchanged – proposed revisions to the operation of the EDIS regulation, with a view to ensuring agreement by the end of 2018. These revisions included introducing the EDIS in a more gradual manner, starting with a more limited reinsurance phase and moving gradually to co-insurance.

iii CCP resolution framework

In October 2012, the Commission published a consultation paper on the establishment of a recovery and resolution framework for CCPs. Following this consultation paper, the Commission published its legislative proposal for a proposed regulation establishing the CCP recovery and resolution framework on 28 November 2016. The proposed rules aim to ensure that the critical functions of CCPs are preserved, while maintaining financial stability and helping to avoid the costs associated with the restructuring and resolution of failing CCPs from falling on taxpayers. Setting out provisions comparable to those in the BBRD (see Section X), while using CCP-specific tools, key elements of the proposed rules are as follows:

a a requirement for CCPs to draw up recovery plans, which would include measures to overcome any form of financial distress that would exceed their default management resources and other requirements under the EMIR;

b a requirement for resolution authorities to prepare resolution plans for how CCPs would be restructured, and their critical functions maintained, in the event of their failure;

c specific powers that are to be granted to CCP supervisors to intervene in the operations of CCPs where their viability is at risk, but before they reach the point of failure or where their actions may be detrimental to overall financial stability;

d a requirement to place a CCP in resolution when it is failing or likely to fail, when no private sector alternative can avert failure and when its failure would jeopardise the public interest; and

e the establishment of 'resolution colleges' for each CCP containing all the relevant authorities, including the ESMA and the EBA.

The draft regulation has been submitted to the Parliament and the Council for their approval and adoption.

iv Non-performing loans

In a communication dated 11 October 2017 regarding the proposed completion of the banking union by 2019, the Commission highlighted the need to continue reducing the high level of non-performing loans (NPLs) in parts of the banking sector. As a result, it announced that by spring 2018 it would adopt a comprehensive package of measures to address NPLs. The package consists of the following measures:

a a blueprint for how national Asset Management Companies (AMCs) can be set up within existing banking and State aid rules by building on best practices learned from past experiences in Member States.;

b measures to further develop secondary markets for NPLs, especially with the aim of removing undue impediments to loan servicing by third parties and the transfer of loans;

c measures to enhance the protection of secured creditors by allowing them more efficient methods of value recovery from secured loans;

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d the introduction of statutory prudential backstops to prevent the risk of under-provisioning of NPLs. Such backstops, on newly originated loans that later turn non-performing, would amount to minimum levels of provisions and deductions from own funds that banks would be required to make to cover incurred and expected losses. In this context, the Commission will also consider introducing a common definition of non-performing exposures (or NPEs), in accordance with the one already used for supervisory reporting purposes; and

e a way forward to foster transparency on NPLs in Europe by improving the availability and comparability of data as regards NPLs, and potentially supporting the development by market participants of NPL information platforms or credit registers.

In addition to this package, the Commission presented a proposal in November 2016 for a directive on restructuring, 'second chance' and efficiency of insolvency. The key features of this proposal – in particular the availability of restructuring procedures enabling viable companies in financial difficulties to avoid insolvency, and measures to enhance the effectiveness of restructuring and insolvency proceedings – would contribute to reducing NPLs and preventing their accumulation in the future. In its January 2018 progress report, the Commission called on the European Parliament and the Council to progress swiftly on this proposal.

XIX EU REGULATORY BODIES

In response to the de Larosière Report, the Commission announced in May 2009 a new financial services supervisory framework for the European Union. In November 2010, the Council and the Parliament adopted legislation creating, from 1 January 2011, two structures around which new European financial supervisory arrangements were established: the ESRB, which is concerned with macroprudential supervision, and the ESFS, which is focused on microprudential supervision.

This change in European regulatory architecture was made in the context of widespread dissatisfaction among politicians and regulators with the way in which the previous EU regulatory system, with its network of national regulators and the division of responsibilities for cross-border institutions between 'home' and 'host' authorities, failed to cope during the financial crisis.

Targeted powers, including powers to overrule national regulators and, in limited cases, to intervene directly in the supervision of individual firms, have been allocated to the new EU authorities.

In the case of macroprudential supervision, the changes were not so much a matter of making the previous arrangements work better as addressing the significant gap in those arrangements that arose from the fact that systemic supervision at an EU level was not within the remit of national regulators.

i The ESFS

Three ESAs were established, which are independent EU bodies with full legal personality: the EBA, the ESMA and the EIOPA. The former committees (CEBS, CESR and CEIOPS) were replaced, and effectively merged into the ESAs. The ESA of most importance to the banking sector is the EBA.

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The regulations that created the ESAs[28] are supported by the Omnibus I Directive,[29] which amended financial services legislation (other than Solvency II).[30] Together, these pieces of legislation give the ESAs significant powers, including the power to make decisions that bind national regulators and, in certain circumstances (particularly in an emergency), even circumvent national regulators in the supervision of significant financial institutions. The ESMA also has direct responsibility for the regulation of credit rating agencies.

The powers of the ESAs may be summarised as follows:

a to develop binding 'technical standards' in connection with specific areas of existing directives;

b to ensure the consistent application of EU rules by national regulators, including requesting the Commission to make 'decisions' binding on national regulators;

c in cases designated by the Council as 'emergency situations', to make 'decisions' that bind national regulators, or to intervene directly in the supervision of financial institutions in limited cases. In these circumstances, the ESAs also have the power to require competent national regulators to take necessary action in accordance with EU law where developments threaten the orderly functioning and integrity of financial markets or the stability of the whole, or part, of the financial system of the European Union;

d to arbitrate disagreements between national regulators, including making decisions that bind regulators to end disagreements, and to address decisions to financial institutions if a national regulator does not comply with a decision made by the ESMA in respect of requirements directly applicable to the institutions (i.e., under EU regulations); and

e the EBA may temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the whole, or part, of the financial system in cases specified, and under the conditions laid down, in EU legislation or, if so required, in emergency situations as provided for in the regulations.

The last two powers are subject to the important proviso that no decision adopted in their exercise should 'impinge in any way on the fiscal responsibilities of Member States'.

Technical standards

The ESAs' powers to set technical standards are intentionally limited. Only those issues identified in the relevant EU legislation may be subject to technical standards. Selection of the issues to which technical standards may relate is based on the following high-level principles:

a the issues must be genuinely technical, where the development of standards is best left to supervisory experts. They are not areas that involve strategic or policy decisions, although distinguishing between technical and policy matters may be difficult;

28 The EBA was created by Regulation No. 1093/2010, the ESMA by Regulation No. 1095/2010 and the EIOPA by Regulation No. 1094/2010.

29 Directive 2010/78/EU.

30 Solvency II has been amended by the Omnibus II Directive, which came into force on 23 May 2014. The Solvency II regime came into force on 1 January 2016.

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b issues where a common approach or predictability would be of benefit to all concerned are candidates for technical standards; and

c the areas selected should be ones where detailed technical rules promote financial stability, consumer protection, and market efficiency and integrity.

The ESAs do not themselves have the power to set binding technical standards; the Commission must enact the standards, usually in the form of a decision or a directly applicable EU regulation, for them to be binding. It is open to the Commission not to endorse technical standards submitted by an ESA, or to endorse them only in part. In addition, both the Council and the Parliament have the right to object to technical standards, in which case those standards will not enter into force or will only enter into force with amendments.

Before proposing technical standards to the Commission, an EBA is generally required to hold a public consultation and to obtain the opinion of the Banking Stakeholder Group. This is a group of 30 members, representing credit and investment institutions operating in the European Union, their employees' representatives, as well as consumers, users of banking services, top-ranking academics, and representatives of small and medium-sized enterprises.

Consistent application of rules

This power enables an ESA to investigate breaches or non-application of EU law and, in certain limited circumstances, to direct decisions to financial institutions. Use of this power, and in particular the ability to make binding decisions, is triggered if:

> *[A] competent authority has not applied the [provisions of the relevant EU legislation], or has applied them in a way which appears to be a breach of Union law, including the regulatory technical standards and implementing technical standards [. . .], in particular by failing to ensure that a [financial institution or financial market participant] satisfies the requirements laid down in those acts*[31]

This is clearly aimed at a national regulator's failures in the prudential supervision of a financial institution.

The power would be exercised as follows:

a an ESA may investigate the alleged incorrect application of EU law. This investigation may be undertaken at the ESA's own initiative or at the request of the Commission, the Council, the relevant stakeholder group (which in the case of the EBA is the Banking Stakeholder Group), or one or more national regulators;

b within two months of commencing an investigation, the ESA may give the national regulator a formal recommendation as to how it should comply with EU law. The national regulator then has only 10 working days to respond with assurances as to the steps that it has taken or intends to take;

c if the national regulator has not complied with EU law within one month of the recommendation, the ESA will inform the Commission of this fact. The Commission may then issue a formal opinion, requiring it to take the necessary action to comply with EU law; and

d the national regulator then has 10 working days to inform the Commission and the relevant ESA of the steps it has taken or intends to take to comply with that opinion.

31 Regulation No. 1093/2010, Regulation No. 1094/2010 and Regulation No. 1095/2010.

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As is the case with the development of new technical standards, the Commission has the final say. The Commission must issue its opinion no later than three months after the adoption of an ESA's recommendation, with an option for the Commission to extend this period by one month. The Commission's power to issue an opinion may be exercised on its own initiative or at the request of an ESA.

There are circumstances in which an ESA may take its own action without the involvement of the Commission. If the relevant requirement of EU legislation that is the subject of a Commission formal opinion is 'directly applicable' to financial institutions (i.e., it is contained in an EU regulation), then the ESA may adopt an individual decision addressed to a particular financial institution requiring it to take the necessary action to comply with EU law, but only where the national regulator has not complied with the formal opinion within the time specified. This power is exercisable where, in the ESA's opinion, it is necessary to remedy non-compliance in a timely manner to maintain or restore neutral conditions of competition in the market or to ensure the orderly functioning and integrity of the financial system.

Action in emergency situations

The ESAs' powers here are triggered by the Council adopting a decision determining the existence of an 'emergency situation'. The Council is required to consult the Commission and the ESRB and, where appropriate, the ESAs. An 'emergency situation' is defined as one where there are 'adverse developments which may seriously jeopardise the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system in the Union'.

Where the Council has adopted such a decision, the ESA may, where coordinated action is necessary, adopt individual decisions requiring competent authorities to take action in accordance with EU law that are needed to address adverse developments in the markets or the stability of the wider financial system by ensuring that financial institutions and competent authorities satisfy the requirements laid down in that legislation. The ESA can enforce a decision if the competent authority does not comply where urgent action is required.

In these circumstances, an ESA may temporarily prohibit or restrict certain financial activities if those financial activities threaten the orderly functioning and integrity of financial markets, or the financial stability of the whole or part of the financial system in the European Union. An ESA must review these decisions at least every three months, and the decision automatically expires after three months if it is not renewed. The ESA must also reconsider its decision if requested to do so by a Member State. Where the ESA considers that a permanent restriction or prohibition on a particular financial activity is required, it can inform the Commission, which will consider facilitating the action. An ESA is not permitted to take such actions where it would impinge in any way on the fiscal responsibilities of Member States (e.g., by requiring the financial rescue of an institution).

Settlement of disagreements

These powers arise where a national regulator is in disagreement with another regulator concerning the application of EU legislation. Following a request by one or more of the national regulators concerned, an ESA may attempt to assist the national regulators to reach an agreement. In addition, where disagreement between the national regulators can be determined on the basis of objective criteria the ESA may, on its own initiative, assist national regulators to reach agreement.

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In that case:

a where, despite such assistance, no agreement is reached, the ESA may make a binding decision requiring one or more of the national regulators to take action to comply with EU law; and

b where a national regulator fails to comply with an ESA's decision and thereby fails to ensure that a financial institution complies with directly applicable requirements of EU law, the ESA may make a further decision addressed to the financial institution concerned requiring it to take any necessary action to comply.

These powers are also subject to the safeguard that no decision may impinge on the fiscal responsibilities of any Member State.

ii The ESRB

The establishment of the ESRB addressed an obvious gap exposed by the financial crisis that, at an EU level, responsibility for macroprudential analysis was fragmented, and conducted by various authorities at different levels with no mechanism to ensure that macroprudential risks were adequately identified, and that warnings and recommendations were issued clearly, followed up and translated into action.

Unlike the ESAs, the ESRB is a pan-sectoral body, covering not just the banking or investment services sector but also the insurance sector.

The responsibility of the ESRB is to provide macroprudential oversight of the financial system within the European Union to prevent or mitigate systemic risks within the financial system. The ESRB's main functions are the collection and exchange of information, the identification and prioritisation of systemic risks, and the issuance of warnings and recommendations.

Information

The information function is directed primarily at the provision by the ESRB of information on systemic risks to the relevant ESAs. In return, the ESAs, with the national central banks and Member States themselves, are required to cooperate with the ESRB and provide it with information necessary for the fulfilment of its systemic monitoring objective.

Where deemed systemically relevant, the ESRB may address a 'reasoned request' to an ESA to provide data about particular institutions.

Warnings and recommendations

If the ESRB identifies significant systemic risks, it must issue a warning and, if appropriate, issue recommendations. Warnings or recommendations may be either general or specific, and may be addressed to the Union as a whole, one or more Member States, one or more of the ESAs, one or more national regulators, or (in respect of relevant EU legislation) the Commission. Different levels of risk are differentiated by a colour-coded system to enable correct prioritisation. A Member State, an ESA or a national regulator in receipt of a recommendation from the ESRB must respond by setting out either the actions undertaken to implement the recommendation or the reasons for not following the recommendation.

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The only tool available to the ESRB to deal with a refusal by the recipient of a recommendation to act on it is to inform the Council or, where relevant, the ESA or ESAs concerned. Those bodies may then take action. It will be at the discretion of the ESRB whether to make a warning or recommendation public. If it decides to do so, it must inform the Council and the addressee in advance.

iii Reform

On 20 September 2017, the Commission published a communication and adopted a package of measures to strengthen the European system of financial supervision, comprising the ERSB and the ESAs. These proposals followed a consultation on the future of the ESAs inaugurated in March 2017, as well as reflecting the Commission's August 2014 review of the ESFS. The Commission is proposing:

a stronger coordination of supervision across the European Union, whereby the ESAs will set EU-wide supervisory priorities. They will also monitor authorities' practices in allowing banks, fund managers and investment firms to delegate and outsource business functions to non-EU countries. The EIOPA will have a stronger role in promoting convergence in the validation of the internal models that some large insurance companies use to calculate solvency capital requirements. The functioning of the ESRB will also be made more efficient;

b the extension of direct supervision by the ESMA to selected capital market sectors. The Commission is proposing that the ESMA would have direct supervisory powers over critical benchmarks and data reporting services, and a greater coordinating role over market abuse regulation. It would also supervise certain prospectuses and be responsible for direct supervision of European Venture Capital Funds (EuVECA), European Social Entrepreneurship Funds (EuSEF) and European Long-Term Investment Funds (ELTIF). The proposals would also extend its product intervention powers to fund managers. The Commission is not proposing to change the responsibilities of national authorities to supervise other areas, such as central depositories, money market funds, trading venues, Undertakings for Collective Investment in Transferable Securities (UCITS) and alternative investment funds;

c improved governance and funding of the ESAs. New executive boards will prepare the ESAs' work programmes and have decision-making powers. There will also be a new funding system to ensure that the resources of the ESAs are commensurate with their tasks, with a greater contribution by industry and market participants; and

d the promotion of sustainable finance and fintech by ESAs.

The Commission has invited the Parliament and the Council to discuss and agree these proposals as a matter of priority, to ensure their entry into force before the end of the current legislative term in 2019.

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Jan Putnis has been a partner at Slaughter and May in London since 2003. His practice focuses on financial regulation, with particular emphasis on international corporate and commercial transactions. Mr Putnis acts for a broad range of financial institutions, including banks, insurance groups and asset managers, on strategic regulatory matters and investigations, cross-border and domestic mergers and acquisitions, and outsourcings. His work involves extensive advice on regulatory capital and on capital structures of new businesses, as well as capital structures to facilitate acquisitions and group reorganisations.

Mr Putnis qualified as a solicitor in 1996. In a previous life, he graduated with a degree in physics from Oxford University in 1992.

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Timothy Fosh is an associate in the financial regulation group at Slaughter and May in London. His practice incorporates transactional and non-transactional work for a wide variety of financial and non-financial institutions. His practice has recently involved providing advice on many elements of UK banking regulation (including the ring-fencing regime, capital requirements and the UK implementation of the Bank Recovery and Resolution Directive), as well as advising on the regulation applicable to derivatives trading and activities relating to financial instruments more generally. He has also recently advised a number of banks and fund managers on M&A, restructuring and material outsourcing issues, including as part of those entities' response to Brexit. He graduated with a degree in classics from Durham University in 2007, and qualified as a solicitor in England and Wales in 2012.

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Emily Bradley is an associate in the financial regulation group at Slaughter and May in London. Her practice incorporates advisory, transactional and contentious work for a broad range of financial institutions. During her time at Slaughter and May, she has advised on the supervision and regulation of investment firms, banks, insurance companies and lenders. She has recently been on secondment to the Financial Markets Law Committee, focusing in particular on conflict of laws issues arising in the context of distributed ledger technology systems. Emily graduated with a degree in history from the University of Oxford in 2012, and qualified as a solicitor in England and Wales in 2016.

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