Financial Regulation Outlook

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On the road of open initiatives and new challenges. On 30 December 2015, the Council of the EU published the work programme of the three countries that will take up the rotating presidency (Netherlands, Slovakia and Malta) in the next 18 months. The Netherlands is the first to do so. The European Deposit Insurance Scheme (EDIS) and Transatlantic Trade and Investment Partnership (TTIP) are key elements of its agenda.

SRB priorities for 2016

The Single Resolution Board becomes fully operational from 1 January 2016. The Single Resolution Mechanism, which includes the Single Resolution Board and the Single Resolution Fund, is fully empowered since the beginning of 2016. A total of 144 banks from the Eurozone are under the SRB's direct remit. During this year the Board will be in charge of designing banks' resolution plans, determining their MREL and managing the SRF, among other tasks.

SSM supervisory priorities for 2016

Five high-level priorities. The first year of the Single Supervisory Mechanism has revealed certain key risks on which the supervisory teams will prioritise their focus in the coming months. As a result, the SSM has identified five high-level priorities that will concentrate the majority of the supervisory effort in 2016.

MDA: the definitive explanation?

EBA's opinion on the Maximum Distributable Amount. At the end of last year, the EBA published an opinion on the interaction of Pillar 1, Pillar 2 and the combined buffer requirements and restrictions on earnings´ distribution. In this regard, the EBA clarifies how the limitation on payment of dividends, coupons of AT1 and/or variable remuneration will work. This refers to the MDA framework.

Capital Markets Union: the way forward for 2016

Where do we stand? On 30 September 2015, the European Commission presented the Action Plan on building a Capital Markets Union. This document contained a plethora of measures to be developed over both the short and long terms. Four months after the launching of the road-map and the first measures, we review the work programme scheduled for 2016.

Regulation to promote high-quality securitisation

Ongoing legislative process for securitisation and first steps for covered bonds. Securitisation instruments and covered bonds are important tools for the long-term financing of the economy. Whereas European securitisation markets plummeted during the financial crisis and have not yet recovered, covered bond markets have shown much more resilience. Restoring securitisation markets based on robust practices is a short-term priority of the CMU project.

A genuine EMU needs a European Deposit Insurance Scheme

Firm foundations for a stronger Eurozone architecture. Despite progress achieved, the EMU is still an unfinished building that needs firmer foundations to ensure that it can withstand the next economic earthquake. The focus now should be on stabilising the unfinished house, and prepare the ground for a complete architecture in the medium term. Setting up an EDIS to complete the banking union should be the immediate priority.

Revival of Europe's financial transactions tax

Third time lucky? The Finance Ministers of 10 European countries agreed on introducing a financial transactions tax (FTT) by June 2016 under an enhanced cooperation agreement. The FTT proposal has been on the table since 2011, was re-launched in 2013 and has recently gained momentum. It remains to be seen whether an agreement can be achieved, since it is unclear that the benefits would outweigh the costs.

Other Systemically Important Institutions in Europe

Preventing and mitigating systemic risk at a domestic level. Since 1 January 2016, credit entities have had to start complying with the capital buffers for global systemically important institutions (G-SIBs) and/or for other systemically important institutions (O-SIIs) at a domestic level, as the case may be.

AML regulation and identity verification

Further EU harmonisation is needed to facilitate digital cross-border activity. In the banking sector, the digital onboarding of new customers is conditioned by AML/CFT regulations. Despite the AML Directive, the valid methods for identity verification vary across the EU. This hampers the Single Market and creates an uneven playing field between banks located in different member states.

1 Council´s work programme for the next 18 months

On the road of open initiatives and new challenges

On 30 December 2015, the Council of the EU published the work programme of the three countries that will take up the rotating presidency (Netherlands, Slovakia and Malta) in the next 18 months. The Netherlands is the first to do so. The European Deposit Insurance Scheme (EDIS), the Transatlantic Trade and Investment Partnership (TTIP) and the development of the Digital Single Market Strategy are some of the key elements of its agenda.

Trio's presidential programme

The trio's presidential programme is based on the following five pillars which are on the same line plotted by the strategic agenda for the EU: i) jobs, growth and competitiveness; ii) protection for citizens; iii) energy union and climate policy; iv) freedom, security and justice, and v) the EU as a strong global actor. Following the Five Presidents Report presented in June 2015, the discussions to enhance the design of the European and Monetary Union (EMU) will be an important element during the next 18 months. The Council, as a co-legislator- considers that it is key to apply the principles of better regulation and that a reduction in regulatory burden will be an important driver for economic growth and competitiveness. In the next section, some priority areas regarding financial regulation included in the Netherlands' agenda will be pointed out.

Main features of the Netherlands' agenda

Following the same lines as the overall general work programme, the Dutch Presidency established its priorities between 1 January and 30 June 2016, with a focus on: i) a comprehensive approach to migration and international security; ii) Europe as an innovator and jobs creator; iii) sound, future-proof European finances and a robust Eurozone, and iv) a forward-looking policy on climate and energy. The agenda is closely coordinated with that presented by the European Commission for 2016, which was adopted on 27 October 2015. Down below, we highlight some measures and decisions to be developed in the various Council configurations.

The **General Affairs Council** will table the implementation of the measures agreed in the Inter-institutional Agreement (IIA) on Better Regulation concluded under the Dutch Presidency. The provisions of the IIA will need to be applied, both within the Council itself and in its work with the Commission and the European Parliament. The Dutch Presidency will also work to achieve greater and active transparency in European decision making.

One key element of the **Foreign Affairs Council** will be the negotiations on the EU´s bilateral free trade agreements (FTAs with Japan, Australia and New Zealand; modernize the existing one with Mexico), including with the US (Transatlantic Trade and Investment Partnership or TTIP) which is still on the table. The Dutch presidency will work hard and fast to make constructive progress, given the importance of this issue that could provide substantial benefits to the economy by generating jobs and raising the GDPs of both signatories.

The **Economic and Financial Affairs Council** will tackle another key issue currently under discussion, the proposal for a European Deposit Insurance Scheme (EDIS) aimed at completing the Banking Union. The two regulations on securitisation, included in the action plan on building a Capital Markets Union, could be completed during the first semester. With regard to the Commission's proposal on bank structural reform, trilogue negotiations will begin once the European Parliament has determined its position. Priority will be given to tackling tax evasion and tax avoidance, based on the package of measures agreed as part of the OECD´s Base Erosion and Profit Shifting project in October 2015. Last but not least is the question of a Financial Transaction Tax (FTT). Given the outcome of the Council meeting held on 8 December 2015, when this was part of the themes discussed, an agreement could be reached during the Dutch Presidency.

Regarding the **Competitiveness Council**, some concrete proposals are expected based on the Digital Single Market Strategy presented in May 2015 to enable citizens to benefit from advances in the digital sphere.

2 SRB priorities for 2016

The Single Resolution Board becomes fully operational from 1 January 2016

In Europe the Single Resolution Mechanism, which includes the Single Resolution Board (SRB) and the Single Resolution Fund (SRF), is fully empowered since the beginning of 2016. A total of 144 banks from the Eurozone are under the SRB's direct remit. During this year, the Board will be in charge of designing banks' resolution plans, determining their MREL and managing the SRF, among other tasks.

1 January 2016 marked the first anniversary of the establishing of the Single Resolution Board. On that day this EU agency became fully operational, with a complete set of resolution powers. 144 European banks are under its authority: 129 ECB-supervised entities and 15 other cross-border groups. In line with its achievements during 2015, the SRB's working plan for this year will revolve around four priorities that are further explained below:

i) **To be ready for and anticipate bank resolutions.** The main priority is to make bank resolutions feasible with minimal cost to taxpayers and to the real economy. Accordingly, the SRB will concentrate on: i) developing the resolution plans of the majority of the entities under its remit. These plans will highlight the obstacles to resolvability that will need to be removed and they will also outline access to liquidity and maintenance of critical services in resolution; ii) setting up the Internal Resolution Teams (IRTs), consisting of mixed personnel from the SRB as well as from National Resolution Authorities (NRAs); iii) finalising the resolution planning and crisis management manuals to be used by the SRB itself, the NRAs and financial entities, and iv) **determining, for the first time, the MREL,** on a case-by-case basis (the requirement comes into force this year, albeit with a transitional period), guaranteeing its consistent and harmonised application. It will also contribute to the EBA's revision of this new requirement for banks at the end of the year. Even if the TLAC standard has not yet been implemented into European law, the SRB will probably consider its core features when determining the MREL for G-SIBs.

ii) **To cooperate with other authorities inside and outside the EU**. Another crucial task for the SRB will be to foster cooperation with NRAs and other relevant stakeholders. Recently the Board signed an agreement with the European Parliament and a memorandum of understanding with the ECB, on accountability and information sharing respectively. One of the SRB's goals for this year is to conclude similar cooperation arrangements with, among others, NRAs from countries that do not belong to the Banking Union or to the EU. These will be useful when the time comes to establish resolution colleges, which are essential in order to manage cross-border resolutions for groups operating both inside and outside the Banking Union.

iii) **To manage the Single Resolution Fund.** Last November, the Intergovernmental Agreement (IGA) on the transfer of contributions from national resolution mechanisms to the SRF and their progressive mutualisation was ratified. Consequently, this allowed the full operationalisation of the SRF, whose capacity will be built up over a period of eight years (until 2024) with ex-ante contributions from the banking sector. Furthermore, the approval of the bridge financing mechanism last December, by which Member States temporarily provide sufficient funding in the form of credit lines during a transitional period (to be used as a last resort only), means that the SRF is ready to withstand eventual resolution processes as of today. Later this year, the SRB will approve its definitive investment strategy and, by 30 June, the first contributions will be collected from Eurozone banks. Other important tasks to be carried out by the SRB in relation to the SRF will be: to investigate further financing options, to develop procedures for ex-post contributions and to define a much needed backstop mechanism.

iv) **To complete its own capacity building**. Finally, the SRB will continue and finalise its internal recruitment process, it will complete the transfer to its new premises and it will decide which functions and tasks to externalise. In 2016 the SRB, in order to perform its duties, will manage a budget of around EUR60mn entirely funded by the banks under its authority.

3 SSM priorities for 2016

Five high-level priorities

The first year of the Single Supervisory Mechanism has revealed certain key risks where the supervisory teams will put a lot of focus in the coming months. As a result, the SSM has identified five high-level priorities that are likely to concentrate the majority of the supervisory efforts in 2016.

As a clear step towards enhancing transparency, the SSM has published the five high-level priorities that will guide its supervision for 2016 and several supervisory actions linked to them (see Figure 3.1 below), which are further explained below.

Figure 3.1
SSM priorities and corresponding supervisory actions

Priorities	Business model & profitability risk	Credit risk (focus on NPL & concentrations)	Capital adequacy	Risk governance & data quality	Liquidity
Supervisory Actions	Thematic review of banks' profitability drivers	• Task force on NPLs • Thematic review on IFRS 9	• Review of quality and consistency of banks' ICAAP • Review of banks' internal models	• Clarify supervisory expectations banks' boards • Review of compliance with BCBS principles	• Dialogue on ILAAP

Source: BBVA Research

i) **Business model and profitability risk.** Its importance for the SSM relies on the high level of asset impairments and excessively long period of low interest rates. In this regard, the SSM is launching a thematic review of banks´ profitability drivers, at firm level and across business models. The SSM will put a considerable focus on whether banks are achieving higher returns due to a weakening of credit standards, greater reliance on short-term funding or an increase in risk exposures not aligned with their risk appetite.

ii) **Credit risk.** The high levels of non-performing loans (NPL) in some countries have called the attention of supervisors. In fact, the SSM has detected a deterioration in the credit quality of loans, not only to households but also to corporates, especially in the countries hit hard by the crisis. For this year, a thematic review of IFRS 9 and a task force on NPLs are to be expected.

iii) **Capital adequacy.** This is not a novelty, as the SSM put a lot of emphasis on capital adequacy in 2015, focusing on the consistency of the ICAAP including banks´ internal stress-testing capacities (as part of SREP). For this year, supervisory stress-testing is also to be expected. In addition to this, the SSM will also focus attention on the capacity of banks to face new regulatory standards such as the TLAC and/or MREL.

iv) **Risk governance and data quality**. The recent financial crisis showed that banks´ management boards did not always have access to the appropriate information to take the correct decisions. As such, the SSM wants to implement the highest standards in corporate governance.

v) **Liquidity**. The 2015 SREP revealed several deficiencies in banks´ liquidity management. In this regard, the SSM will be more demanding of banks´ILAAPs, which are seen as a gap to be covered this year.

Assessment

The SSM's initiative to announce its priorities for 2016 is welcome, as it enhances transparency related to the supervisory culture. As a consequence, financial institutions gain a clear understanding of the supervisory expectations for important issues such as liquidity, capital or risk governance. For the first two topics, the SSM has recently released a document explaining its expectations. In the same vein, for risk governance, the SSM launched a thematic review in 2015, which gave a clear picture of what the SSM's expectation is in this area. However, the same transparency should be recommendable for the business model analysis where, even if it is one of the main pillars of the SREP, banks still do not have a clear picture of the supervisor's expectations.

4 MDA: the definitive explanation?

EBA's opinion on the Maximum Distributable Amount

At the end of last year the EBA published an opinion on the interaction of Pillar 1, Pillar 2 and the combined buffer requirements and restrictions on earnings´ distribution. In this regard, the EBA clarifies how the limitation on payment of dividends, coupons of AT1 and/or variable remuneration will work. This refers to the MDA framework.

Capital requirements: a primer

European regulation defines the capital requirements that a financial institution must hold for prudential purposes. To be more precise, the CRR establishes (in Part Two) the own funds requirements that financial institutions must comply with (i.e. Pillar 1). In addition, competent authorities carry out their Supervisory Review and Evaluation Process (SREP) to assess the institution-specific level of own funds and therefore require additional capital above the Pillar 1 requirement (i.e. Pillar 2). Finally, and generally more based on macroprudential factors, financial institutions must comply with the combined buffer requirement (i.e. capital conservation buffer, systemic risk buffer, etc.). Normally, these capital requirements are defined in CET1 terms but in some cases they could include AT1 or Tier 2 requirements.

Origin of the debate: the problem

The CRD establishes that when a financial institution´s CET1 is not enough to cover the above-mentioned combined buffer, financial institutions must compute the MDA and, as a result, competent authorities will be able to impose restrictions on the distribution of earnings (i.e. dividends, AT1 coupons or variable remuneration). Even if this is clear, the problem is how to assess whether a financial institution has sufficient capital to avoid the computation of the MDA. In other words, how to compute the capital level that a financial institution must have in order to be able to make distributions. From a practical perspective, it is necessary to know exactly what the capital stack is, or how Pillar 1, Pillar 2 and the combined buffer interact with each other.

The EBA´s opinion: the solution?

The EBA recommends a stacking order, where Pillar 2 is located between Pillar 1 and the combined buffer. As such, financial institutions would have to take Pillar 2 into account in computing whether or not they would face restrictions on earnings´ distribution.

General assessment

The EBA tries to put some clarity into a very complex part of the European banking regulation. As such, it recommends competent authorities to take into account Pillar 1, Pillar 2 and the combined buffer in the computation of the MDA or, in other words, to discourage what is called the Danish approach (i.e. Pillar 2 was not included in this computation). Furthermore, in the same opinion, the EBA recommends competent authorities to ensure the funding continuity of financial institutions when revising capital plans due to the MDA computation. And finally, competent authorities should, at least, not prevent or dissuade any institution from disclosing Pillar 2 information. Moreover, the EBA's opinion includes some recommendations to the European Commission: first, to simplify the wording of the CRD article related to the computation of the MDA and therefore avoiding misinterpretations and, second, that the European Commission should revisit the prohibition on distribution when no profits are made, notably on AT1. In a nutshell, this opinion represents an important step towards increasing transparency, and it supported the decision taken by some European financial jurisdictions to encourage banks to disclose their SREP requirements.

5 Capital Markets Union: the way forward for 2016

Where do we stand?

On 30 September 2015, the European Commission presented the Action Plan on building a Capital Markets Union. This document contained a plethora of measures to be developed over both the short and long term. Four months after the launching of the road-map and the first measures, we review the work programme scheduled for 2016.

Road-map for 2016

For 2016, the work plan is very ambitious, with more than 10 measures to be accomplished through the year.

Figure 5.1
CMU's work plan for 2016

Work plan for2016

Q1:
- Report on crowd-funding

Q2:
- Pan-European venture capital fund-of-funds
- Strengthen feedback on declining SMEs credit applications
- Cross-boarding distribution of investment funds
- ESAs funding and governance

Q3:
- Revision of EuVECA and EuSEF legislation
- Strategy to support capitals market capacity

Q4:
- Loan origination by funds
- Debt-equity-bias
- Assessment of policy framework for European personal pensions
- Barriers for free movement of capital
- Business insolvency

Source: BBVA Research based on European Commission's Action Plan

Among all those initiatives, the following can be highlighted

- **Crowd-funding**: the Commission is analysing the rapid development of this kind of funding strategy, the regimes existing in Member States and best practices. A report is expected in the first quarter of 2016, following which the Commission will decide how to support and enable the future development of this funding source.
- **ESAs funding and governance**: the new regulatory framework has conferred on the ESAs a major role in developing the single rulebook through the issuance of level 2 legislation and ensuring supervisory convergence. In less than three years, the ESAs have managed to deliver on material demands with limited resources. Given the increasingly important role of these authorities, the Commission will publish a White Paper regarding both their budget and their governance.
- **SMEs' access to credit**: increasing funding options for SMEs is one of the main goals of the Capital Market Union. Within the wider strategy of overcoming information barriers for SMEs in their access to credit, in 2016 the Commission is planning to work with both banking federations and business organisations on: i) the feedback provided by banks when declining a credit application, and ii) alternative funding options.

Assessment

The schedule for 2016 is very ambitious but will be positive if it is achieved. The development of alternative funding sources is welcome, but appropriate supervision should be established for the sake of consumer protection and financial stability. The review of the ESAs' governance and funding will also be key in order to ensure a consistent implementation of the single rulebook and to grant these authorities with the necessary economic resources to develop their increasing tasks.

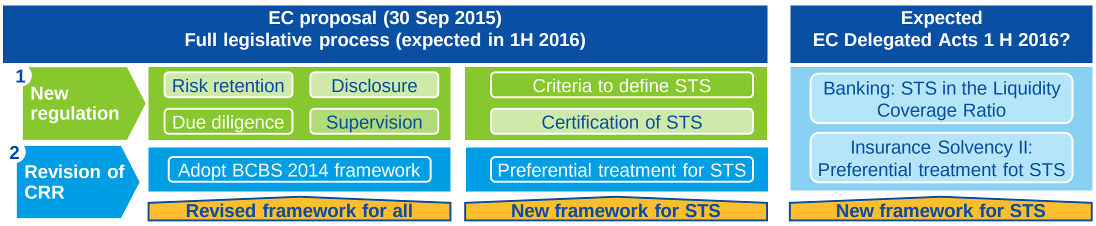
6 Regulation to promote high-quality securitisation

Ongoing legislative process for securitisation and first steps for covered bonds

Securitisation instruments and covered bonds are important tools for the long-term financing of the economy. Whereas European securitisation markets plummeted during the financial crisis and have not yet recovered, covered bond markets have shown much more resilience. In line with that, restoring securitisation markets based on robust practices is a short-term priority of the CMU project.

Last September, the European Commission (EC) put forward its legislative proposal to relaunch securitisation, after a process that took more than one year and in which the EBA played a key role in the design of the new framework for "simple, transparent and standardised" (STS) instruments. On 8 December, the Council agreed on the EC's proposal (compromise texts). Following that, the European Parliament needs to agree its position to allow for a final agreement between the two co-legislators.

Figure 2.1
EU Regulatory initiatives on securitisation



Source: BBVA Research

The EC proposal includes 2 regulations: i) a Securitisation Regulation that, on the one hand, includes a set of common rules applicable to all securitisations to promote consistency in the regulations across banks, insurance companies and investment funds. On the other hand, it sets out a new framework for STS, including the definition and supervision of transactions that are simple and transparent; facilitating risk assessment by investors, and ii) a proposal to amend the Capital Requirements Regulation (CRR) to make the capital treatment of securitisations for banks more risk-sensitive and able to reflect properly the lower structural risks of STS transactions. Additionally, the EC intends to make further adjustments (at a later date) to the capital requirements for insurance companies investing in STS and to the prudential treatment of STS for liquidity purposes, which will require changes in Level 2 texts (EC Delegated Acts). The new rules will be directly applicable throughout the EU, enabling the new framework to be operational in the current year.

Europe is moving ahead of global regulatory initiatives at this respect, but the same general approach (to differentiate high-quality securitisation and adjust its prudential treatment) is being following. The BCBS is currently consulting on the capital treatment for high-quality securitisation (until 5 February) showing a more conservative stance. Given the urgency to relaunch securitisation in the EU, a partial departure from global standards could be considered to be a lesser evil.

Starting discussion on regulatory action to further harmonise EU covered bonds

A topic currently being discussed, as part of the CMU project, is the convenience of moving towards increased integration in EU covered bond markets, the degree of desired/achievable integration and how to implement it. These instruments are currently important for the long-term financing of real estate and the public sector, and extending the scope to prime SMEs is being considered. The EC finalised a consultation[1] on these issues on 6 January 2016, and following that will decide on further regulatory action.

1: FRO December 2015: "A European framework for covered bonds? EC consultation on whether and how to build it"

7 A genuine EMU needs a European Deposit Insurance Scheme

Firm foundations for a stronger Eurozone architecture

Despite the substantial progress achieved since the financial crisis (in particular the establishment of the banking union), the EMU is still an unfinished building that requires firmer foundations to ensure that it can withstand the next economic earthquake. The EU authorities and Member States should now focus on stabilising the project in the short term and preparing the ground for a completed structure in the medium term. Setting up a European Deposit Insurance Scheme (EDIS) to complete the banking union should be the immediate priority.

Enhancing the Eurozone institutional architecture

In the second half of 2015, the Commission brought forward an initial set of measures included in the **first phase** of the plan outlined in the Five Presidents Report towards full financial, fiscal, economic and political union. During 2016, the Commission should continue working on the follow-up to this report by launching the Capital Markets Union, designing a common public backstop for the Single Resolution Fund (SRF) and increasing cooperation between the European and national parliaments. Furthermore, by mid-2016 the Commission will establish an Expert Group to prepare for the more far-reaching measures outlined in the Report for the **second phase**. The Commission will also engage in consultations with the public, and all this will serve to prepare a White Paper to be presented in the first half of 2017.

The European Deposit Insurance Scheme

In late 2015, the European Commission presented a long-awaited proposal to finally complete the banking union with a centralised system for deposit protection. Starting in 2017 with a system of reinsurance at European level for national systems, the Commission's intention is to progressively increase the mutualisation of deposit protection until full mutualisation is achieved in 2024. In practice, no significant progress in risk-sharing will be achieved until 2020 (when the co-insurance phase is launched).

Despite this extended calendar, in 2016 the Eurozone is surely going to witness an intense political debate on EDIS, given the strong opposition from several Member States (especially Germany). In fact, the topic has been scheduled in several ECOFIN meetings under the Dutch Presidency (1H2016). One of the main issues that has been raised is the need to further reduce the remaining risks in the banking sector, together with increased levels of risk sharing. However, the Commission's proposal is consistent with the need to ensure full implementation of key rules (i.e. BRRD and DGSD) prior to achieving the full mutualisation of deposit insurance. Therefore, the timing of the proposal is appropriate. The longer the delay in creating a common deposit insurance scheme, the longer the Eurozone will remain vulnerable to financial shocks that might come at a higher cost in the future.

Given the divergence of opinions across Europe, during the negotiations it is essential to avoid losing sight of the final aim of the banking union, which is to break the bank-sovereign link. Thus, it is essential that the path proposed by the Commission is followed all the way, that is until a single European DGS is achieved. Other intermediate alternatives are not sufficient to break the vicious circle and to ensure complete depositor confidence in the European banking sector. The latter is essential to guarantee that banks can perform their role of financing the economy during a phase of economic recovery.

Apart from the political debate, 2016 will probably involve high doses of technical willingness to finalise key open issues. These include developing the methodology for calculating banks' risk-based contributions and working to ensure that introducing an EDIS does not impose an unnecessary burden by creating a system of double contributions. Furthermore, the Commission should start outlining the design of a common public backstop for EDIS, in line with the project to design a backstop for the SRF.

8 Revival of Europe's financial transactions tax

Third time lucky?

The Finance Ministers of 10 European countries agreed on introducing a financial transactions tax (FTT) by June 2016 under an enhanced cooperation agreement. The FTT proposal has been on the table since 2011, was re-launched in 2013 and has recently gained momentum. It remains to be seen if an agreement can be achieved, since it is unclear that the benefits would outweigh the costs.

In December the introduction of a financial transactions tax (FTT) was brought to the forefront again by Europe's Finance Ministers when ten countries agreed on several aspects of the harmonised tax[2]. The objective of the tax remains the same as that of the original proposal of 2011, which is to recover some of the public money spent during the financial crisis on rescuing banks, to curb speculative trading across the EU and to synchronise the levies already charged in several countries. Current Member States have announced that a final agreement should be met by June of this year, and it looks slightly more likely to be achieved than in previous years, as it continues to have support from the major European economies (except the United Kingdom) and is no longer opposed by the EU presidency.

The proposal is the same as that disclosed in 2011 by the European Commission, which included all states. The current 10 FTT Member States have agreed that the tax will be levied on shares, debt and derivatives trades for both organised markets and over-the-counter transactions. It is to be levied on both the buyer and the seller of shares and debt with a rate of 0.1% of the value traded (0.01% for derivatives). It will not include primary issuances in order not to discourage initial placements. Transactions with Member States' central banks and the ECB are excluded, as are transactions with international organisations or restructuring operations. Central counterparties (CCPs) and central securities depositories (CSD) are also exempted when exercising their specific activities, as will Member States when exercising their function of managing public debt. The possibility of introducing a narrow market-making exemption for share trading has been agreed upon.

According to December's Economic and Financial Affairs Council (EcoFin) statement, all transactions, including intra-day trades, will be taxed, and this is one of the reasons why Estonia no longer supports the motion. More recently Belgium has expressed strong opposition to the current draft of the tax, albeit has not withdrawn. The tax is expected to collect EUR31bn or 0.4% of GDP of Member States in revenues on an annual basis, which could be an important source of funds for the EU. However, the costs for the Member States will be significant. First of all, the FTT will reduce the value of securities and raise the cost of capital for issuers. Second, it will reduce trading volumes, which limits price discovery and reduces market liquidity. Third, reducing trading volume does not reduce market volatility. Fourth, it will make financial risk management more expensive. Finally, it is a distortionary tax with an impact on economic activity and pension schemes[3].

Assessment

The objectives of the tax seem to be politically motivated, as stated by one of its main objectives: "financial institutions do not make a fair and substantial contribution to covering the cost of the recent crisis"[4]. However, given that not all 28 EU members will take part in the proposed FTT, a clear incentive will exist for trading activity to move towards countries with a more favourable fiscal treatment. Furthermore, establishing differential financial regulation within the European Union is against its recent priority of developing a Capital Markets Union. Finally, in order to achieve an agreement among member states without breaching the EU mandate, various exemptions have been included and probably more remain, making the FTT more complex than initially conceived and therefore less effective than anticipated.

2: Current Member States are: Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia, and Spain.
3: Thornton Matheson *Taxing Financial Transactions: Issues and Evidence*, IMF Working Paper, Washington, DC.
4: European Commission, *Proposal for a Council Directive: implementing enhanced cooperation in the area of financial transaction tax*, 14 February 2013, Brussels.

9 Other Systemically Important Institutions in Europe

Preventing and mitigating systemic risk at a domestic level

Since 1 January 2016, credit entities have had to start to comply with their capital buffers for global systemically important institutions (G-SIBs) and/or for other systemically important institutions (O-SIIs) at a domestic level, as the case may be.

The EBA released its final framework for O-SIIs on 16 December 2014. It is broadly an adaptation of the G-SIB methodology of the BCBS - with some differences - and broadly consistent with it. It is composed of four equally-weighted indicators (size, importance of the entity for the domestic economy, complexity including cross-border activity and interconnectedness) that provide a score for each entity. If a bank exceeds the 350bp threshold (the range is from 275bp to 425bp), it is automatically designated as an O-SII.

On the one hand, national authorities use their supervisory judgement to include also banks that are below the cut-off score as O-SIIs and to set, in any case, the O-SIIs capital buffer from 0% to 2% at the highest consolidated level. **On the other hand, they have national discretion** to set a 0% buffer for entities that exceed the quantitative limit. As a consequence of that, two banks with exactly the same systemic score that operate in two different EU markets might be subject to different capital surcharges.

The O-SII buffer might or might not be added to the G-SII buffer and to the systemic risk buffer (SRB)[5], and the ECB is empowered[6] to raise (but not to lower) the O-SII buffer for the banks of the Member States supervised by the Single Supervisory Mechanism - and of the non-Member States that would like to adhere to it.

In Europe, there is some heterogeneity in establishing the O-SIIs' buffer, as shown in Table 1. Fifteen countries have identified eighty-five O-SIIs in 2015-16. Twelve of the fifteen countries have also established the O-SIIs' buffers for 2016 and six of the twelve have combined the O-SII buffer with the SRB buffer. Two issues should be noted: i) there is national discretion to apply 0% buffers to entities that exceed the quantitative threshold (two Spanish and three Italian banks) and supervisory judgment to designate O-SIIs that do not exceed it (Czech Republic and Belgium) have been applied, and ii) the German and French authorities have not yet completed the identification of their O-SIIs and their respective capital buffers for 2016.

Table 1
Empirical evidence: Identification of European O-SIIs and capital buffers notified

<table>
<tr><th>Country</th><th>O-SIIs</th><th>O-SII buffer</th><th>Plus SRB</th><th>Observations</th><th>Phase-in</th><th>Implementation</th></tr>
<tr><td>Austria</td><td>12</td><td rowspan="12">Yes</td><td rowspan="6">Yes</td><td>SRB* [0%; 3%] = SVB** [0%; 1%] + O-SIIs [0%; 2%]</td><td rowspan="4">Yes</td><td rowspan="8">1 Jan 2016</td></tr>
<tr><td>Netherlands</td><td>5</td><td>O-SIIs [1%; 2%] & SRB [until 3%]. The highest applies in 2019</td></tr>
<tr><td>Slovakia</td><td>5</td><td>O-SIIs [1.5%; 2%] + SRB [0%; 1%] in 2019</td></tr>
<tr><td>Denmark</td><td>6</td><td>Same level of application than SRB. SRB [1%; 3%] in 2019</td></tr>
<tr><td>Italy</td><td>3</td><td>O-SIIs buffer= 0%. Entities must maintain a 1% SRB</td><td>N/A</td></tr>
<tr><td>Sweden</td><td>4</td><td>O-SIIs (2%) & SRB (3%) SRB. Only SRB applies</td><td>No</td></tr>
<tr><td>Spain</td><td>6</td><td rowspan="9">No</td><td>BdE applied its national discretion. O-SIIs [0%; 1%] in 2019</td><td rowspan="3">Yes</td></tr>
<tr><td>Belgium</td><td>8</td><td>O-SIIs [0.75%; 1.50%] in 2019. 1 entity by superv. judgement</td></tr>
<tr><td>Norway</td><td>3</td><td>2 % from 1 July 2016</td><td>1 Jul 2016</td></tr>
<tr><td>Portugal</td><td>6</td><td>1 of the 7 O-SIIs excluded due to the resolution measure</td><td rowspan="3">No</td><td>1 Jan 2017</td></tr>
<tr><td>Finland</td><td>4</td><td>O-SIIs [0.5%; 2%] in 2019</td><td>7 Jan 2016</td></tr>
<tr><td>Slovenia</td><td>8</td><td>Advocates for a longer phase-in period. O-SIIs [0.25%; 1%]</td><td>1 Jan 2019</td></tr>
<tr><td>Czech Rep</td><td>7</td><td rowspan="3">Not Yet</td><td>1 of the 7 designated by domestic supervisory judgement</td><td rowspan="3">N/A</td><td rowspan="3">1 Jan 2016</td></tr>
<tr><td>Latvia</td><td>6</td><td>Threshold in 425 bps as allowed by the EBA</td></tr>
<tr><td>Estonia</td><td>2</td><td>O-SII buffer will be fixed in 1H2016</td></tr>
<tr><td>15</td><td>85</td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Source: BBVA Research based on ESRB and national authorities. Data as of 25 January 2016. **SVB: Systemic Vulnerability Buffer

5: Accumulation capital buffer rules: i) at consolidated level: max (G-SII buffer, O-SII buffer); ii) a banking group can be subject to G-SII and O-SII buffers: G-SII buffer (consolidated level) + O-SII buffer (sub-consolidated or subsidiary); iii) if G-SII buffer, O-SII buffer and SRB apply at the same level: iii.a) SRB covers domestic and cross-border exposures: max (G-SII buffer, O-SII, SRB); iii.b) SRB covers only domestic exposures: SRB + max (G-SII, O-SII). The SRB is a discretionary buffer that applies to portfolios or sectors.
6: OJEU. COUNCIL REGULATION (EU) No 1024/2013 of 15 October 2013.

10 AML regulation and identity verification

Further EU harmonisation is needed to facilitate digital cross-border activity

In the banking sector, the digital onboarding of new customers is conditioned by AML/CFT regulations. Despite the AML Directive, the valid methods for identity verification vary across the EU. This hampers the Single Market and creates an uneven playing field between banks located in different member states.

Customers are nowadays accustomed to signing up easily to digital services (such as social networks or on-demand streaming) from their computers or mobile devices in just a few seconds. After providing some personal information, accounts become fully operational and customers can immediately start enjoying the services. However, in the case of banking services, digital onboarding – the process of turning a non-customer into a new one through digital channels – is far from being so straightforward. This is because regulations on **Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)** require financial institutions to verify the identity of their customers and know their occupation and/or economic activity. Verifying the identity of new customers by remote means is the main challenge to digital onboarding from both the regulatory and the technical perspective.

Although the Financial Action Task Force (FATF) sets global standards for AML/CFT, specific customer due diligence requirements are set at the national level. Even in the EU, where the AML Directive rules, national transpositions and supervisory criteria lead to significant differences across countries in the authorised methods for remote verification of the identity of new customers. In Germany, for example, in November 2014 the Federal Financial Supervisory Authority (BaFin) approved the use of a video call as a valid method. This has enabled German banks to implement fully-digital customer onboarding processes that take just a few minutes.

In contrast, banks operating in other EU countries with more restrictive regulations have to rely on identity verification methods that are not real-time, such as requiring new customers to make a first transfer of funds from a bank account that they hold at another financial institution. In the particular case of Spain, the AML/CFT supervisory authority (Sepblac) approved a new method in May 2015 in which the bank asks the customer to provide the number of an account that he holds at another institution and then the bank checks the customer's identity with that institution. Although this mechanism removes the need to transfer funds, it still excludes unbanked individuals and delays the account opening process by between five and seven working days. The only real-time identity verification method that is allowed in Spain – the national electronic identity (eID) card – is in practice difficult to use, due to hardware and software requirements. The non-harmonisation of valid identity verification methods in the EU creates an uneven playing field between banks located in different member states offering digital financial services across the Union. For instance, making use of the "single passport" mechanism, a German bank may acquire customers in Spain under an identity verification method (video call) that financial institutions established in Spain are not allowed to use. This uneven playing field introduces incentives for regulatory arbitrage.

The Green Paper on retail financial services that was recently launched by the European Commission (EC) aims to identify and mitigate the barriers to cross-border activity that hamper the EU Single Market. One of these barriers is the difficulty in complying with heterogeneous AML/CFT requirements when acquiring cross-border customers through digital channels. Verifying their identity is particularly troublesome, not only due to the restrictions in the authorised real-time methods, but also because of the absence of a clear framework for the private sector to use national eID systems. The Electronic Identification and Trust Services Regulation (eIDAS Regulation) creates an interoperability framework for the national eID systems to be recognised by public bodies across the EU. However, it leaves it up to Member States to define the terms of access for the private sector.

Digital channels offer a great opportunity to overcome the existing EU market fragmentation. Therefore, facilitating the digital onboarding of cross-border customers should be among the top priorities of the EC's Green Paper.

Main regulatory actions around the world over the last month

	Recent issues	Upcoming issues
GLOBAL	On **21 Dec BCBS** published a consultation on guidance for the regulation and supervision of institutions relevant to financial inclusion On **21 Dec IOSCO** published a statement and responses to a survey on crowdfunding On **22 Dec IOSCO** published reports on sound supervisory practices regarding market intermediaries and business continuity plans for trading venues On **11 Jan BCBS** approved the market risk framework (to come into effect in 2019) and the 2016 work programme On **21 Jan FSB** announced membership of Task Force on Climate-related Financial Disclosures On **21 Jan IOSCO** published on emerging capital markets, highlighting divergence in monetary policies and priorities such as to improve cyber resiliency and to promote financial innovation	In **Sep** 2016 China will host the **G20** Leaders' **Summit** in Hangzhou In **2016 BCBS** will finalise its review of internal models and calibration of leverage ratio applicable in Jan 2018
EUROPE	On **17 Dec the EC** adopted a draft Commission Delegated Regulation supplementing the Market Abuse Regulation (MAR) On **22 Dec ESMA** published its final guidelines on cross-selling practices under MiFID II On **23 Dec OJEU** published the recast Payment Services Directive (PSD 2) and the regulation on transparency of securities financing transactions and of reuse (SFTR) On **23 Dec the SRB and the ECB** signed a memorandum of understanding (MoU) relating to cooperation and the exchange of information On **30 Dec OJEU** published an ECB recommendation on banks' dividend distribution policies within the SSM On **30 Dec the Council of the EU** published its work programme for the next 18 months On **4 Jan ESRB** published a risk dashboard for 4Q2015, indicating that financial market conditions generally continue to remain favourable On **5 Jan ESMA** published a review on how national competent authorities apply the exemption for market makers regarding short-selling regulation On **6 Jan ECB** published the priorities of **Single Supervisory Mechanism (SSM)** for supervision in 2016 On **6 Jan the EC** published a report to the Parliament and the Council on the effect of the revised International Accounting Standard (IAS) 19 on the volatility of own funds of credit institutions and investment firms On **8 Jan ECB** communicated to significant institutions its supervisory expectations regarding ICAAP and ILAAP for 2016, and the process of harmonised information collection On **8 Jan SRB** published the list of banks under its remit On **13 Jan the EBA** published revised final draft technical standards and guidelines on methodology and disclosure for global systemically important institutions (G-SIIs) On **15 Jan the EC** published a consultation on how large public interest entities, such as listed companies and banks, could disclose social and environmental information On **18 Jan the ESRB** submitted a report to the EC on the systemic risk implications of central counterparty (CCP) interoperability arrangements under EMIR On **18 Jan EIOPA** published its strategic approach to risk-based and preventative conduct of business supervision On **19 Jan the EP** adopted a non-legislative resolution on stocktaking and challenges of the EU financial services regulation On **20 Jan EBA** published a consultation on securitisation regarding the restrictions to the implicit support established by the CRR	In **Oct 2016 EBA** will published reports on implementation of the MREL In **2016 the EC** will present concrete legislative proposals on the Digital Single Market In **2016 EU institutions** will start working on the design of a common fiscal backstop for the SRF In **2016 the EC** will bring forward a legislative proposal on TLAC **Member States** are committed to strike a final deal on FTT by **June 2016**
MEXICO	On **31 Dec the National Banking and Securities Commission (CNBV) and Banco de México** revised their joint rules on bank liquidity, delaying by one year the requirement for daily reporting of the Liquidity Coverage Ratio On **31 Dec the CNBV** modified its bank prudential rulebook with the implementation of the D-SIB regime: banks' systemic importance will be subject to supplementary capital requirements (five buckets, from 0.6% to 2.25%, additional to the capital conservation buffer) On **31 Dec the CNBV** issued a new prudential rulebook for derivative market participants to strengthen, bring transparency and reduce risks in this market	

Continued on next page

Main regulatory actions around the world over the last month (cont.)

	Recent issues	Upcoming issues
LATAM	On **17 Dec 2015**, the **National Monetary Council of Brazil** adopted another step to guarantee the convergence of local accountancy rules towards international standards (IFRS) On **28 Dec the Colombian Financial Regulator (Superfinanciera)** published the final decree on the stress test that should be presented by banks this year. Starting in 2017, banks that are subject to consolidation will have to do the stress test on a consolidated basis	**Colombia's Ministry of Finance** is working on two studies that evaluate the implementation of Basel III's capital buffers in Colombia and the composition of regulatory capital and solvency requirement for pension funds, stockbrokers, fiduciary and insurance companies. Publication expected during 4Q15 **Colombian Congress** is studying a legislative reform that forbids charges for ATM withdrawals for accounts with average monthly transactions lower than three minimum monthly wages
USA	On **21 Dec Fed** published a consultation on the framework for implementation of Countercyclical Capital Buffer (CCB) and confirms that the CCB will remain at 0% On **21 Dec Fed** issued guidance to its examiners and banking institutions that consolidates the capital planning expectations for all large financial institutions On **28 Dec** SEC published its annual staff report on the credit rating agencies, highlighting that operational improvements have been made to controls and governance processes On **5 Jan** Financial Industry Regulatory Authority (FINRA) published its 2016 regulatory and examination priorities letter with a focus on supervision and liquidity On **14 Jan** the Fed published USD figures for the calculation of capital surcharges for G-SIBs in 2015 On **19 Jan** the Treasury published a consultation on the structure of the public debt market	Regulators are working to **complete some of the pending reforms outlined by the Dodd-Frank Act** before the next administration takes office (2017) The **Consumer Financial Protection Bureau** expects to issue final rules on **consumer protection for prepaid cards** in the spring of 2016 and on mortgage servicing by mid-2016 The **SEC** will publish a notice of proposed rule-making for **fiduciary standards** in October 2016
TURKEY	In **Dec the CBRT** raised the remuneration rate of the USD-denominated required reserves, reserve options and free reserves held at the Bank from 0.24% to 0.49%	**The Central Bank of Turkey** stated that the Financial Stability Committee will study regulations on CAR so as to prevent the negative impacts on banks of the new regulation and to conserve FX liquidity reserves
ASIA	On **27 Dec, China's National People's Congress** passed the "registration-based" IPO reform, a move aimed at reducing government intervention and easing the burden on the country's cash-strapped enterprises On **8 Jan, China's CSRC** abolished the stock market "circuit breaker" mechanism, which was implemented on 1 Jan 2016 as a means to curb volatility On **11 Jan, the Reserve Bank of India** allowed domestic banks to extend non-fund based credit to customers who do not make use of any fund-based facility from any bank in India On **18 Jan, the People's Bank of China (PBoC)** announced that it will start implementing a reserve requirement ratio (RRR) on offshore banks' domestic deposits	**China** may be considering the establishment of a new cabinet office to co-ordinate financial and economic policy. The new cabinet would fall under the State Council

Source: BBVA Research

Abbreviations

AIFMD	Alternative Investment Fund Managers Directive	**G-SIB**	Global Systemically Important Bank
AQR	Asset Quality Review	**G-SIFI**	Global Systemically Important Financial Institution
BCBS	Basel Committee on Banking Supervision	**IAIS**	International Association of Insurance Supervisors
BIS	Bank for International Settlements	**IASB**	International Accounting Standards Board
BoE	Bank of England	**IHC**	Intermediate Holding Company
BoS	Bank of Spain	**IIF**	Institute of International Finance
BRRD	Bank Recovery and Resolution Directive	**IMF**	International Monetary Fund
CCAR	Comprehensive Capital Analysis and Review	**IOSCO**	International Organization of Securities Commissions
CCP	Central Counterparty	**ISDA**	International Swaps and Derivatives Association
CET	Common Equity Tier	**ITS**	Implementing Technical Standard
CFTC	Commodity Futures Trading Commission	**Joint Forum**	International group bringing together IOSCO, BCBS and IAIS
AMC	Company for the Management of Assets proceeding from Restructuring of the Banking System (Bad bank)	**LCR**	Liquidity Coverage Ratio
CNMV	Comisión Nacional de Mercados de Valores (Spanish Securities and Exchange Commission)	**LEI**	Legal Entity Identifier
COREPER	Committee of Permanent Representatives to the Council of the European Union	**MAD**	Market Abuse Directive
CPSS	Committee on Payment and Settlement Systems	**MiFID**	Markets in Financial Instruments Directive
CRA	Credit Rating Agency	**MiFIR**	Markets in Financial Instruments Regulation
CRD IV	Capital Requirements Directive IV	**MMFs**	Money Market Funds
CRR	Capital Requirements Regulation	**MoU**	Memorandum of Understanding
CSD	Central Securities Depository	**MPE**	Multiple Point of Entry
DGSD	Deposit Guarantee Schemes Directive	**MREL**	Minimum Requirement on Eligible Liabilities and own Funds
DFA	The Dodd–Frank Wall Street Reform and Consumer Protection Act	**MS**	Member States
EBA	European Bank Authority	**NRAs**	National Resolution Authorities
EC	European Commission	**NSAs**	National Supervision Authorities
ECB	European Central Bank	**NSFR**	Net Stable Funding Ratio
ECOFIN	Economic and Financial Affairs Council	**OJEU**	Official Journal of the European Union
ECON	Economic and Monetary Affairs Committee of the European Parliament	**OTC**	Over-The-Counter (Derivatives)
EDIS	European Deposit Insurance Scheme	**PRA**	Prudential Regulation Authority
EIOPA	European Insurance and Occupational Pensions Authority	**QIS**	Quantitative Impact Study
EMIR	European Market Infrastructure Regulation	**RRPs**	Recovery and Resolution Plans
EP	European Parliament	**RTS**	Regulatory Technical Standards
ESA	European Supervisory Authority	**SCAP**	Supervisory Capital Assessment Program
ESFS	European System of Financial Supervisors	**SEC**	Securities and Exchange Commission
ESM	European Stability Mechanism	**SIB (G-SIB, D-SIB)**	Global-Systemically Important Bank, Domestic-Systemically Important Bank
ESMA	European Securities and Markets Authority	**SIFI (G-SIFI, D-SIFI)**	Global-Systemically Important Financial Institution, Domestic-Systemically Financial Institution
ESRB	European Systemic Risk Board	**SII (G-SII, D-SII)**	Systemically Important Insurance
EU	European Union	**SPE**	Single Point of Entry
EZ	Eurozone	**SRB**	Single Resolution Board
FASB	Financial Accounting Standards Board	**SREP**	Supervisory Review and Evaluation Process
FBO	Foreign Bank Organisations	**SRF**	Single Resolution Fund
FCA	Financial Conduct Authority	**SRM**	Single Resolution Mechanism
FDIC	Federal Deposit Insurance Corporation	**SSM**	Single Supervisory Mechanism
Fed	Federal Reserve	**TLAC**	Total Loss Absorbing Capacity
FPC	Financial Policy Committee	**UCITS**	Undertakings for Collective Investment in Transferrable Securities Directive
FROB	Spanish Fund for Orderly Bank Restructuring		
FSAP	Financial Sector Assessment Program		
FSB	Financial Stability Board		
FTT	Financial Transactions Tax		

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