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Summary

Update on MREL

What banks need is clarity. The bail-in tool is fully binding for European banks since 1 January 2016. However, doubts remain as to which instruments will count toward the minimum bail-in requirement, MREL, because it is not yet finalized and its definitive configuration is still uncertain. More clarity is needed for banks to start changing their balance sheet structures in order to comply with this new loss absorption requirement.

Call for evidence: the stance of the industry

A milestone for the regulatory framework. On 30 September 2015, the European Commission, with the Action Plan for a Capital Market Union, launched a call for evidence on the regulatory framework for financial services. It has been very well received by the industry and more than 300 responses have been sent in. Based on this input, the Commission will analyse whether changes are needed in the current framework.

Higher capital requirements for the trading book

New BCBS standards to come into effect in 2019. The BCBS published its finalized framework for market risk on January 2016, following a lengthy consultation. Even if the global regulators' stance softened during the consultation period, the final rules are far from being capital neutral. New rules encompassing the most significant risks taken by banks will follow, given the goal of undertaking a comprehensive review of the Basel III framework by end-2016.

A new settlement for the UK in the EU

The European Council reaches a deal. On 18-19 February the European Council reviewed two important issues: the refugee crisis and the proposal for "a new settlement for the UK within the EU" in order to prevent the Brexit. On the first issue, no major advances were made. On the second, the Council reached an agreement that provides for a reasonable balance between UK and EU interests. In this setting, the single rule book and the integrity of the single market remain as key elements of the EU.

MiFID II application delayed until 3 Jan 2018

EC's decision takes into account the technical implementation challenge. On 10 February, the European Commission (EC) delayed the application of the revised Markets in Financial Instruments Directive (MiFID II) for one year. Six days later, the European Parliament also proposed deferring its transposition into national legislation for one year, until 3 July 2017. This move followed concerns expressed by ESMA regarding the fact that neither the competent authorities, nor market participants, would have the necessary information technology (IT) systems ready in time for earlier implementation.

EBA report on NSFR

Good to go with some adjustments. The European Banking Authority (EBA) released a report in December recommending the implementation of a Net Stable Funding Ratio (NSFR) on European banks in accordance with the international standard. The NSFR ensures that banks have sufficient stable funding to cover their on- and off-balance sheet activities for a one-year horizon.

ECB publishes the SSM SREP Methodology Booklet

SSM improves transparency for its supervisory methodology. On 12 February 2016 the Governing Council approved the publication of the SSM SREP Methodology Booklet, which is a decisive step toward improving the transparency of the supervisory methodology. Although the SSM methodology follows, to some degree, the SREP EBA Guidelines, there are specific issues worth commenting on.

Regulatory sandboxing

A risk-based approach to promote innovation in digital financial services. Since stringent authorisation requirements and regulatory uncertainty hinder innovation in financial services, regulatory sandboxes could help both incumbents and new players to test innovative products and services with real customers without immediately incurring the entire regulatory burden.

1 Update on MREL

What banks need is clarity

The bail-in tool is fully binding for European banks since 1 January 2016. However, doubts remain on which instruments will count towards the minimum bail-in requirement, MREL, because it is not yet finalized and its definitive configuration is still uncertain. More clarity is needed for banks to start changing their balance sheet structures in order to comply with this new loss absorption requirement.

The bail-in tool is now fully binding and large Eurozone banks have a single resolution authority fully empowered since 1 January 2016: the SRB. During the third quarter of the year, this EU agency will communicate to the entities under its remit their first indicative MREL target. However, at this point, despite the tight schedule, a high level of uncertainty remains concerning the requirement's final characteristics.

The EBA's RTS on MREL published on 3 July 2015 is not binding yet because it has not been endorsed by the Commission. In fact, last month the EBA published its disagreement with the Commission's proposed amendments. These were related to, among others, the removal of direct references to the minimum loss absorption and recapitalisation contribution equal to at least 8% of total assets (before using the resolution fund)[1] and to the modification of the transitional period, which changed from 48 months to one that should be reached as soon as possible. Once the dispute is over and the Commission endorses the RTS, with a delegated regulation, the EU legislative process continues. The European Parliament and the Council will have a period of three months (with an extra three months if needed) to give their final approval. The regulation will become fully binding when this process is completed and twenty days after its publication in the Official Journal of the EU.

The final determination of the MREL should start to be clarified at the end of the year. The BRRD states that the EBA shall submit a **report on MREL to the Commission by 31 October 2016**. Among other topics, the EBA should review: how MREL has been implemented at the national level, the appropriate transitional period, whether changes to the calculation methodology are needed, whether it is appropriate to base MREL on RWAs rather than total liabilities and own funds, public disclosure of MREL, etc. Based on the results of this report, the Commission will most likely submit, **by 31 December 2016, a legislative proposal on the harmonised application of the MREL**. Furthermore, the Commission might take this opportunity to introduce the FSB's TLAC requirement into European law for G-SIBs.

However, the uncertainty will most likely be prolonged until 2017 because, in the best case scenario, the MREL would be finalized by December 2016. Also, **member states may decide to implement MREL with distinctive characteristics**. For example, the Bank of England recently published its intention to introduce MREL in the UK. The proposal is based on the unfinished EBA's RTS but includes unique features such as a requirement to structurally subordinate the eligible debt (large banks), an extended compliance calendar compared to that of the SRB's and different minimum levels of MREL depending on banks' size and preferred resolution strategies. But the most striking feature of this MREL proposal is the implementation of the FSB's TLAC requirements. It does not require G-SIBs to comply with an additional ratio but includes in their MREL similar characteristics to those of the TLAC.

Lastly, doubts still remain on the eligibility of MREL instruments. Indeed, member states have chosen different paths to achieve senior **debt subordination**. This is crucial in order to facilitate compliance with loss absorbing requirements such as MREL and TLAC. But a homogeneous solution at a European level is still far from being reached even though it is needed to reduce the level of uncertainty.

All in all, more clarity on MREL would be welcome, especially if banks have to start planning how to achieve their MREL target level, which will be communicated to them very soon (expected in third quarter of 2016).

1: Whatever the final wording, the 8% requisite for the use of the resolution fund is already present in the BRRD.

2 Call for evidence: industry's stance on EU regulation

A milestone for the EU regulatory framework

On 30 September 2015, the European Commission, with the Action Plan for a Capital Market Union, launched a consultation on the regulatory framework for financial services. It has been very well received by the industry and more than 300 responses have been sent in. Based on this input, the Commission will analyse whether changes are needed in the current framework.

Introduction

The Commission's consultation is seeking empirical evidence on specific aspects of the current regulatory framework. Its main objective is to understand the combined impact of the different pieces of legislation that have recently been implemented.

Figure 2.1
Structure of the consultation

Rules Affecting the ability of the economy to finance itself and grow	Unnecessary regulatory burdens	Interactions of individual rules, inconsistencies and gaps	Rules giving rise to possible other unintended consequences
• Unnecessary regulatory constraints on financing • Market Liquidity • Investor and consumer protection • Proportionality/ preserving diversity in the financial sector	• Excessive compliance costs and complexity • Reporting and disclosure obligations • Contractual documentations • Rules outdated due to technological change • Barriers to entry	• Links between individual rules and overall cumulative impact • Definitions • Overlaps, duplications and inconsistencies • Gaps	• Risks • Procyclicality

Source: BBVA Research based on the Call for evidence on the regulatory framework for financial services.

Industry's stance

This consultation has been very well received by the industry. As stated by Commissioner Hill, more than 300 responses have been received and are being analysed. Below, we summarise some of the main issues highlighted by the industry:

- **The impact of new regulations on market liquidity** has been one of the issues brought up by the industry. Recently adopted rules such as the CRD IV and CRR are found to cause a reduction in dealers' inventories. Also, some rules yet to be adopted (mainly Banking Structural Reform and the Fundamental Review of the Trading Book) are also likely to negatively affect trading activities and market making capacity, with the correspondent effects on market liquidity.
- Aimed at increasing transparency, the new regulatory framework has introduced new **reporting requirements that in some cases overlap.** This is the case of some requirements in regulations such as the BRRD or MIFID II and MIFIR and, as a consequence, the same information is being or will be required to be reported more than once, increasing complexity and operating burdens for entities.
- **The complexity in complying with some of the recently implemented requirements has also been highlighted**. Such is the case of **article 55 of the BRRD**, which requires the introduction of clauses on the recognition of the effects of bail-in in all contractual arrangements subject to third country law. This clause poses significant challenges for entities in the commercialization of financial products. The scope of this requirement is very wide and for some counterparties it is very unlikely that such a clause will be accepted.

The Commission will use the input from the responses that contain verifiable evidence in order to study regulatory or legislative changes.

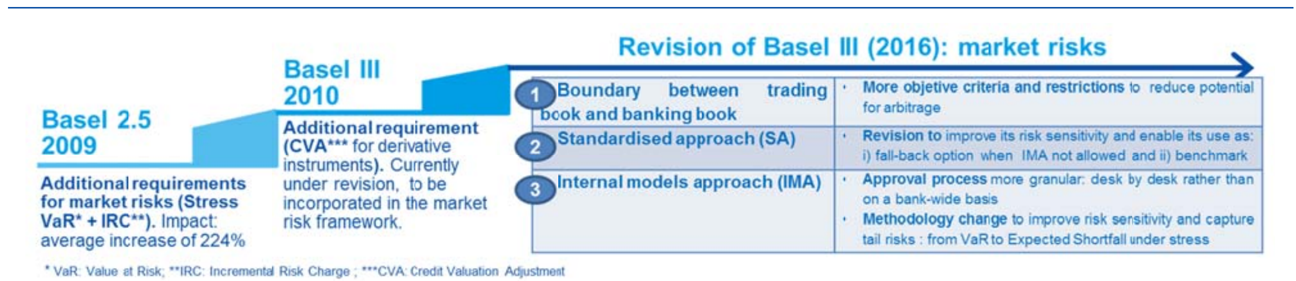
3 Higher capital requirements for the trading book

New BCBS standards to come into effect in 2019

The BCBS published its finalized framework for market risk on January 2016, following a lengthy consultation. Even if the global regulators' stance softened during the consultation period, the final rules are far from being capital neutral. New rules encompassing the most significant risks taken by banks will follow, given the goal of undertaking a comprehensive review of the Basel III framework by end-2016[2].

The severe market stresses that followed the outburst of the financial crisis and the high losses in the trading books of several banks raised global regulators' concerns and highlighted the urgency of revising the capital framework. A first step was taken in 2009 (Basel 2.5) and a fundamental review was left for a later stage.

Figure 3.1
Post-crisis revision of the trading book framework



Source: BBVA Research

The regulatory trading book refers to financial instruments, foreign exchange and commodities that are held with the intention to trade short-term and comply with several requirements (active risk management, defined policies and procedures, daily valuation and P&L recognition, etc.). Capital requirements differ significantly for trading book and banking book exposures, setting incentives to arbitrage the rule in order to benefit from lower requirements. To tackle this issue, the review reinforces the criteria for defining the trading book with additional objective rules and restrictions on moving instruments from/to the banking book.

The new methodologies for SA and IMA for market risk improve their risk sensitivity and are expected to reduce the gap between their outputs with the aim of improving comparability across entities. In the case of IMA, whose use is subject to supervisory approval at the desk level, the introduction of the Expected Shortfall[3] metric will lead to better capitalization of tail-risk events under stress scenarios, setting incentives to limit trading portfolios that could lead to outsized losses. The revised SA will be the fall-back to IMA, meaning that banks with internal models approval will be required to calculate and disclose both (Pillar III disclosure to be finalized). Besides, IMA is expected to be subject to a floor based on the SA in order to limit the potential for capital relief achievable by the use of internal models (rule on floors to be finalized), which could reduce incentives for the use of internal models for regulatory purposes given the additional operational costs involved.

Compared with the current market risk framework, the revised standard entails an overall increase in market risk related capital requirements (weighted average increase of 40% with wide dispersion across entities, according to BCBS' QIS). The impact is expected to differ significantly across banks depending on: i) the characteristics of the market risks they hold, ii) the use of IMA or SA and iii) the weight of market risks in the overall risks faced (higher for investment banks than for commercial banks). The increase in capital charges will likely question the viability of certain trading businesses and some industry members have also raised concerns around the negative impact on the banks' capital market activities, which could reduce market liquidity.

2: For an overview of changes expected in 2016, see the article "From Basel III to Basel IV", Financial Regulatory Outlook, January 2016.
3: It is a measure of the riskiness of a position during a period of significant market stress, considering both the size and the likelihood of losses above a certain threshold. It allows for the capture of tail risks that are not accounted for in the existing VaR models.

4 A new settlement for the UK in the EU

The European Council reaches a deal

On 18-19 February the European Council reviewed two important issues: the refugee crisis and the proposal for “a new settlement for the UK within the EU” in order to prevent the Brexit. On the first issue, no major advances were made. On the second, the Council reached an agreement that provides for a reasonable balance between UK and EU interests. In this setting, the single rule book and the integrity of the single market remain as key elements of the EU.[4]

The EU-UK agreement revolves around four major concerns: Economic Governance, Competitiveness, Sovereignty, and Social Benefits and Free Movement. It is worth mentioning that the deal contains a **“self-destruct” clause**, to prevent any strategic behaviour and renegotiation process.[5]

Economic Governance: The deal notes that **further integration is needed**, but this process is not compulsory for non-Eurozone Member States. Nevertheless, the proposal acknowledges that **if a Member State decides not to participate in the integration process, it should not interfere with the process** itself. In this vein, discrimination based on currency issues is completely prohibited. On the legislative front, **the single rulebook has to be applied to all financial institutions in order to ensure a level-playing field for the internal market**. However, some “specific provisions” should be added to the single rulebook, so that it is applied more uniformly by the ECB or SRB, as opposed to the application by national authorities from Member States that do not belong to the banking union. Finally, the deal states that the **banking union will not have a fiscal cost for non-participating Member States**.

Competitiveness: The deal seeks to strengthen the internal market (adapt it to a changing environment), **lowering administrative burdens** and compliance costs (especially for SMEs), while r**epealing unnecessary legislation**. These UK requests were easy to meet, given that they are common objectives across the Members.

Sovereignty: The agreement makes it clear that the **“ever closer union”** statement **does not apply to the UK**. The “ever closer” reference does not entail a legal basis for extending the interpretation of the abilities of the Union to enforce its decisions. Hence, this reference **is consistent with different degrees of integration** by different Member States. In the spirit of the subsidiarity principle, **if opinions on the non-compliance of a legislative draft with this principle rise to 55% of the votes allocated to national Parliaments**, the Presidency of the Council will have to re-open the discussions. Then Member States’ **representatives will discontinue the legislative draft unless amendments have been made**.

Social Benefits and Free Movement: This was one of the most sensitive areas of the deal. It acknowledges the right of Member States to define the fundamental principles of their social security systems. The deal provides that the **UK could apply an “emergency brake” on in-work benefits to newly arrived EU workers during a period of seven years, and an option to index child benefits** to the standard of living in the country where the child resides. For the former, the limits to non-contributory in-work benefits extends for a total period of four years from the beginning of the employment relationship but will be withdrawn progressively (against an initial UK request for complete exclusion). The cap on child benefits applies only to new claims made by EU workers in the host member state, but as from 1 January 2020 all member states may extend indexation to existing claims for child benefits.

4: See “The European Council: Brexit, refugees and beyond” – BBVA Research Watch.
5: “4. It is understood that, should the result of the referendum in the United Kingdom be for it to leave the European Union, the set of arrangements referred to in paragraph 2 above will cease to exist” [in reference to the new settlement for the United Kingdom and specific provisions for the effective management of the banking union and of the consequences of further integration of the euro area].

5 MiFID II application delayed until 3 Jan 2018

EC's decision takes into account the technical implementation challenges

On 10 February, the European Commission (EC) delayed for one year the application of the revised Markets in Financial Instruments Directive (MiFID II). Six days later, the European Parliament also proposed deferring its transposition into national legislation for one year, until 3 July 2017. This move followed concerns expressed by ESMA regarding the fact that neither the competent authorities, nor market participants, would have the necessary information technology (IT) systems ready in time for earlier implementation.

MiFID II aims, in global terms, at fostering investor protection, enhancing market transparency and competition and improving corporate governance and compliance all at the same time.

Chart 5.1
Main issues covered by MiFID II: Investor protection, financial markets and corporate issues

Investor protection	Financial markets	Corporate issues
✓ Investment advice, portfolio management & incentive structures	✓ Transparency	✓ Corporate governance
✓ Recordkeeping	✓ Reporting	✓ Compliance
✓ Product governance	✓ Microestructural issues	
✓ Protection of client assets	✓ Trading venues	
✓ Conflicts of interest & remuneration	✓ Commodity derivatives	
✓ Knowledge, skills & experience		
✓ Information for clients		
✓ Product clasification. Appropriateness or suitability		
✓ Best execution		
✓ Tied agents & outsourcing		

Source: BBVA Research based on EC and ESMA

MiFID II represents a major overhaul of the existing law, building on and extending the scope of the first MiFID, which originally came into force in November 2007. It will significantly change the functioning of secondary European markets, increasing their transparency, their efficiency and their safety[6]. To achieve those goals, the authorities and the industry will have to undertake a complex, in-depth reform of their systems and platforms in order to fulfil MiFID II requirements in terms of data collection and the availability of public information to be released. Indeed, this transformation in the systems has been the main reason for the delay in the application date.

Fostering investor protection is of the utmost importance as consumers and investors are the *raison d'être* of the global financial regulatory reform. In that vein, it should be noted that MiFID II extends it in many ways: **i)** Stricter requirements for product design, distribution and follow-up; **ii)** harsher conditions for the provision of independent services; **iii)** the prohibition of getting any remuneration, discount or non-monetary benefit, except when there is evidence of value-added due to the service provided (e.g. advisory and/or outcome of research activities) and provided that the requirements on conflicts of interest are not violated; and **iv)** the increase of cost disclosure.

Enhancing market transparency and competition for pre-trade and post-trade activities, including a comprehensive cost disclosure of them, will imply a transformation in the European financial market playing field. The application of MiFID II might contribute to improve the efficiency of the markets, and genuine competitive advantages are expected to play a prominent role in financial markets.

Corporate governance and compliance. MiFID II requirements are, from a broad perspective, focused respectively on the responsibilities of the management board in product governance issues and on the requirements and functions for regulatory compliance.

6: Steven Maijoor, ESMA Chair. ESMA readies MiFID II, MAR, and CSDR. Press release of 28 September 2015.

6 EBA report on NSFR

Good to go with some adjustments for Europe

On 18 December, 2015, the European Banking Authority (EBA) released a full report on the suitability of implementing the Net Stable Funding Ratio (NSFR) on European banks as suggested by the Basel Committee on Banking Supervision (BCBS). The NSFR aims to ensure that banks have sufficient stable funding to cover their on- and off-balance sheet activities for a one-year horizon. The EBA report recommends the introduction of the NSFR in the European Union in line with the global standard but with some minor adjustments.

Five general recommendations can be derived from the report. Firstly, that a NSFR should be introduced in credit institutions in the European Union. Secondly, that the NSFR should apply both on a consolidated and individual basis, while taking into consideration waivers and intragroup preferential treatment. Thirdly, **the BCBS' definition and calibration of the ratio is well suited to the EU system, while taking into consideration some specificities for trade finance, pass-through models, central counterparty clearing houses (CCPs), centralized regulatory savings and residential guaranteed loans.** Fourthly, small banks should be equally subject to the same NSFR as larger banks. And fifthly, the NSFR should be set at a minimum of 100% on an ongoing basis. The EBA has essentially concluded that the NSFR as proposed by the BCBS is a prudential measure well suited to ensuring adequate funding for credit institutions in Europe and therefore limiting liquidity risks that might arise under the normal operation of banking activities.

The report is comprehensive and has both quantitative and qualitative elements. For the former, the most significant results are that by the end of December 2014 most banks (70%) in the representative sample studied were NSFR-compliant (above 100%), while 14% had an NSFR below 90%.[7] For non-compliant banks, the shortfall is low as it represents only 3% of total available funding to banks. Only four business models had greater shortfalls: banks specialising in auto and consumer loans, securities trading houses, pass-through banks and diversified institutions without deposits. Finally, since December 2012 (first data point) until December 2014, 93 banks improved their NSFR, 80 stayed at the same level and 24 had their NSFR deteriorate. All in all, **the EBA report concludes that the European banking system can implement an NSFR as proposed by BCBS with a limited negative impact on a bank's ability to lend and without significant distortions of market activity.**

Assessment

There are several concerns from the banking industry regarding the EBA's report. First of all, the final recommendations are drawn in part from the quantitative analysis of the report, which had the objective of estimating the impact of an NSFR on banks and was based on few data points: five for the dynamic analysis of estimating the NSFR and one for the simulation exercise where non-compliant banks are forced to abide by the NSFR. Secondly, banking activities such as trade finance and covered bond structures are penalised too harshly by the NSFR and do not take into consideration the full nuance of these products, especially given the limited funding risk they exhibited during the most recent financial crisis. Thirdly, the NSFR has been defined as a ratio to be estimated under a business-as-usual scenario; however, many high quality liquid assets are treated as if under a stress scenario and unnecessary haircuts are applied. Lastly, the industry has suggested some better alignment with the LCR and expressed their concern with the tight implementation schedule once the European Commission assesses the appropriateness of submitting a legislative proposal to the European Parliament by the end of the year. Full compliance is expected by January 2018 and twelve months seem few for a slowly adjusting ratio like the NSFR.

7: The representative sample is made up of 279 banks and covers 13 different business models.

7 ECB publishes the SSM SREP Methodology Booklet

SSM improves transparency for its supervisory methodology

On 12 February 2016 the Governing Council approved the publication of the SSM SREP Methodology Booklet, which is a decisive step toward improving the transparency of the supervisory methodology. Although the SSM methodology follows, in some degree, the SREP EBA Guidelines, there are specific issues worth commenting on.

Building block approach in line with EBA Guidelines

Like the EBA Guidelines, the SSM SREP Methodology is based on four elements: i) business model analysis, which tries to assess the viability and sustainability of the financial institution; ii) governance and risk management that evaluates the adequacy of the corporate governance of the bank; iii) assessment of risk to capital and iv) assessment of risk to liquidity. The supervision approach is holistic, meaning that the SSM would have a broader perspective of the financial institution and try to avoid a silo view.

Supervisory judgment and forward looking perspective

The four elements of the SREP are subject to a three-phase supervisory road: Phase 1: data gathering; Phase 2: automated anchoring score and finally Phase 3: supervisory judgment. The methodology tries to strike a balance between the automatic process and the supervisory judgment taking into account the specificities and complexity of each supervised institution. Constrained judgment goes in both directions as it can improve and worsen the rating obtained in Phase 2. One of the main novelties of the new methodology is the need to avoid a static view of the financial institution and try to go further. In this regard, **the forward looking approach gains extraordinary importance, more specifically when assessing the risk to capital and risk to liquidity**. In these two blocks, not only supervisory stress testing but also internal stress tests will play a major role. This approach will try to assess the resiliency of the capital and liquidity position of the bank under the worst circumstances. In fact, this year, the supervisory stress tests (i.e., EBA and SSM stress tests) will be part of the SREP process.

Overall SREP decision

The overall SREP assessment provides a synthetic overview of an institution´s risk profile based on the assessment of the four elements mentioned above, with all four being given equal weight. In addition, in order to make this assessment, the SSM takes into account peer comparisons and the macro environment under which the institution operates. As a result of this process, the SSM will make an SREP decision that could cover, apart from quantitative capital and liquidity measures, other supervisory remedial actions, such as limits to variable remuneration, additional reporting requirements or even a change in board members.

General assessment

Apart from the positive sign of enhancing the transparency of the SSM supervisory methodology, there are major practical messages from the SSM SREP booklet worth commenting on. Firstly, regarding the SSM interpretation of the MDA computation, the SSM is disregarding the impact of any shortfall in AT1 or T2 on the distance to the MDA, which is not totally aligned with EBA opinion. Secondly, it seems that the SSM assumes that SREP capital requirements will remain constant if the risk profiles of financial institution do not vary (increases in the capital conservation buffer where subject to a phase-in calendar will be compensated by decreases in the Pillar II add-on). As such, the message is clear and further increases in the supervisory capital requirements going forward are “ceteris paribus” not expected. Thirdly, on average, the SREP capital requirements have been 9.9% (ex-systemic risk buffers), 30 bp above last year. Lastly, in 2015 there was an increase in the correlation between the financial institutions’ scores and capital requirements. Undoubtedly, the assessment of institutions under the SSM remit has gained in consistency in 2015 and the SREP methodology will be refined and improved in certain aspects going forward, as the ECB has already announced.

8 Regulatory sandboxing

A risk-based approach to promote innovation in digital financial services

Since stringent authorisation requirements and regulatory uncertainty hinder innovation in financial services, regulatory sandboxes could help both incumbents and new players to test innovative products and services with real customers without immediately incurring the entire regulatory burden.

Testing new solutions or business models with real customers allows innovative firms to quickly learn, improve their value propositions, get more access to funding or, conversely, give up on non-viable ideas at an early stage. Real market testing is a common practice in innovation ecosystems across industries, but it is particularly hindered in financial services due to the greater regulatory burden in terms of prudential requirements, consumer protection and financial integrity. Having to comply from the beginning with stringent requirements increases the time and cost to market and prevents some innovations from even being tested in the market. Moreover, as new services and business models sometimes challenge the existing regulatory framework, innovative businesses face regulatory uncertainty, which increases the investment risk and makes it harder to raise funds.

Regulatory sandboxes could help both incumbents and new players to overcome these obstacles to innovation. In the computing world, sandboxes are isolated environments in which a program or file can be executed without affecting the application on which it runs. They are used to test new programming code or untrusted programs. In its regulatory version, sandboxes would be 'safe spaces' in which businesses could test innovative products, services, business models and delivery mechanisms without immediately incurring all of the normal regulatory burden of engaging in the activity in question. This definition is provided by the UK's Financial Conduct Authority (FCA) in the report in which they set out their plans for implementing a regulatory sandbox.

Innovative firms face different regulatory challenges depending on whether they have been authorised or not and what kind of products they want to test. To address these challenges within the sandbox, the FCA has identified a number of options. Firstly, unauthorised firms could benefit from a "tailored authorisation process" with requirements that are proportionate to the testing activities. However, meeting these requirements still involves one-off costs that may be too burdensome for some start-ups. Therefore, the British authority suggests that the industry set up a not-for-profit company that would act as a "sandbox umbrella" that allows unauthorised innovators to offer their services as appointed representatives under its shelter. The regulatory sandbox could also provide legal certainty for authorised firms to test new products or services through the following options:

- 'No-action letters' by which the FCA commits not to take enforcement action during the testing as long as the firm follows the conditions agreed. Nevertheless, the FCA would reserve the right to close down the trial.
- Individual guidance on the interpretation of applicable rules in regard to the testing activities of a firm.
- Waivers to particular rules as long as the rule and the exception fall within the FCA's waiver powers.

The degree of regulatory flexibility that the sandbox may offer is constrained by EU and UK legislation. Therefore, the FCA argues that an effective implementation of the sandbox may require certain regulatory changes, such as introducing a new regulated activity of 'sandboxing' and amending the FCA's waiver powers.

In addition, since real market testing involves risks of consumer detriment, appropriate safeguards are needed. The FCA intends to agree on a case-by-case basis to the disclosure, protection and compensation appropriate to each testing activity. Nonetheless, the scale of testing has to be limited to avoid risks to the financial system.

If appropriately implemented, with clear criteria for entering the sandbox, transparency and control during the testing and safeguards for consumers, sandboxes have the potential to foster innovation in financial services and benefit both providers and consumers through increased efficiency and competition. Furthermore, regulators would better understand the benefits and risks of new services before they amend the regulatory framework.

Main regulatory actions around the world over the last month

	Recent issues	Upcoming issues
GLOBAL	**On 04 Feb BCBS** revised its guide to account opening and promotes its implementation to protect consumers against fraud and identity theft and prevent risks of money laundering **On 05 Feb CPMI-IOSCO** published a statement on clearing deliverable FX instruments **On 22 Feb IOSCO** published discussions on recent market developments and the challenges and opportunities posed by fintech **On 23 Feb FSB** published a report on possible measures of non-cash collateral re-use	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 26 Jan EC** adopted a Delegated Regulation with regard to regulatory technical standards specifying the derogations referred to in Article 419(2) of the CRR concerning currencies with constraints on the availability of liquid assets **On 26 Jan EC** published a report to the EU Council and the EP on its review of the appropriateness of the definition of eligible capital pursuant to Article 517 of the CRR **On 28 Jan EC** presented its Anti-Tax Avoidance Package as part of its campaign for the reduction of corporate tax avoidance in the European Union **On 28 Jan ESMA** published a consultation on draft Guidelines on the Market Abuse Regulation (MAR) **On 28 Jan EC** presented new measures to deal with corporate tax avoidance **On 02 Feb EC** presented its action plan to combat the financing of terrorism **On 02 Feb EC** adopted delegated regulations on circumstances for deferring contributions ex post to resolution funds and criteria for the determination of critical functions and business lines under the BRRD **On 03 Feb ECON** published a report on the proposal for a directive on the supervision of institutions for occupational retirement provision **On 04 Feb EC** published a delegated regulation on exclusions from the bail-in **On 04 Feb ECON** published a draft report on access to finance for SMEs **On 04 Feb EBA** published a roadmap for the implementation of the regulatory review of internal models **On 05 Feb ESMA** published its work programme for 2016 and annual report for 2015 and work programme for 2016 in relation to the supervision of credit rating agencies and trade repositories **On 05 Feb EC** adopted an implementing regulation on the risk-free rate under the Solvency II Directive **On 09 Feb EBA** published an opinion expressing its dissent over EC proposed amendments to the MREL technical standards **On 10 Feb EC** proposed a one year extension to the application of the revised Markets in Financial Instruments Directive (MiFID II) **On 10 Feb EC and CFTC** announced a common approach to transatlantic CCPs **On 11 Feb ECON** published a report on a proposed regulation amending the CRR as regards exemptions for commodity dealers **On 15 Feb EIOPA** published the retail risk indicators methodology report **On 15 Feb ESMA** published a consultation on the application of the benchmarks regulation **On 15 Feb EBA** published ITS on the correspondence between credit ratings and the various credit quality steps **On 15 Feb EBA** published guidelines on cooperation agreements between DGSs **On 16 Feb ECON** has published two draft reports on the EU Commission's legislative proposals to amend MiFID II and MiFIR as regards certain dates, which were published by the Commission on 10 February 2016 **On 16 Feb EIOPA** published its annual work programme for 2016 **On 16 Feb ESMA** published a peer review of guidelines on money market funds	In **Oct 2016 EBA** will publish reports on the 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 striking a final deal on FTT by **June 2016**
MEXICO	**On 09 Feb the National Banking and Securities Commission (CNBV)** updated its Conduct of Sales rules, improving investment advisors'' transparency along with clarifications on conflict of interest prevention, among other changes	**The CNBV's** proposal for banks' countercyclical capital buffer, which has been recently submitted to public review

Continued on next page

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

	Recent issues	Upcoming issues
LATAM	**On 01 Feb in Argentina** the maximum position in foreign currency banks are allowed to hold was raised to 15% of net worth for spot positions and 7.5% for NDF's **On 01 Feb the Central Reserve Bank of Peru** included FX options that replicate FX forwards under the limit it has set for the latter. Any excess on that limit is penalised with additional reserve requirements. The goal of this measure is to discourage the use of such instruments to bet against the local currency **On 15 Feb the Peruvian Banking Association**, in order to promote financial inclusion, has launched the mobile wallet, which is based on commercial transactions via cell phone **On 19 Feb the Central Bank of Colombia** modified the threshold at which the auctions of FX intervention options will be made	**On 01 Mar in Argentina** the foreign currency ceiling will be raised to 20% of net worth for spot positions and 10% for NDF's **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 **The Government of Colombia** will present a decree that modified the mandatory pension fund investment regime, modifying the limits for alternative investments
USA	**On 21 Jan FDIC** consulted on deposit guarantees of small banks **On 28 Jan Fed** released supervisory scenarios for CCAR and Dodd-Frank Act stress test exercises, along with instructions addressed to firms participating in 2016 exercise **On 03 Feb Fed** extended period for commentaries on the framework for setting up the CCB **On 09 Feb FDIC** published economic scenarios for 2016 stress testing **On 10 Feb SEC** adopted cross-border security-based swap rules to increase transparency and reduce competitive differences and fragmentation **On 17 Feb SEC and FDIC** proposed rules for the orderly liquidation of brokers and dealers **On 17 Feb FDIC** approved a proposal on record-keeping to facilitate access to deposits that applies to institutions with more than two million deposit accounts	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	**The China Securities Regulatory Commission (CSRC)** implemented new IPO policies effective from January 1. According to the new rules, investors will not pay extra for new share subscription and there will be more information disclosure requirements	**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	**FSB**	Financial Stability Board
AMC	Company for the Management of Assets proceeding from Restructuring of the Banking System (Bad bank)	**FTT**	Financial Transactions Tax
AQR	Asset Quality Review	**G-SIB**	Global Systemically Important Bank
BCBS	Basel Committee on Banking Supervision	**G-SIFI**	Global Systemically Important Financial Institution
BIS	Bank for International Settlements	**IAIS**	International Association of Insurance Supervisors
BoE	Bank of England	**IASB**	International Accounting Standards Board
BoS	Bank of Spain	**IHC**	Intermediate Holding Company
BRRD	Bank Recovery and Resolution Directive	**IIF**	Institute of International Finance
CCAR	Comprehensive Capital Analysis and Review	**IMF**	International Monetary Fund
CCB	Counter Cyclical Buffer	**IOSCO**	International Organization of Securities Commissions
CCP	Central Counterparty	**ISDA**	International Swaps and Derivatives Association
CET1	Common Equity Tier 1	**ITS**	Implementing Technical Standard
CFTC	Commodity Futures Trading Commission	**Joint Forum**	International group bringing together IOSCO, BCBS and IAIS
CNMV	Comisión Nacional de Mercados de Valores (Spanish Securities and Exchange Commission)	**LCR**	Liquidity Coverage Ratio
COREPER	Committee of Permanent Representatives to the Council of the European Union	**LEI**	Legal Entity Identifier
CPSS	Committee on Payment and Settlement Systems	**MAD**	Market Abuse Directive
CRA	Credit Rating Agency	**MiFID**	Markets in Financial Instruments Directive
CRD IV	Capital Requirements Directive IV	**MiFIR**	Markets in Financial Instruments Regulation
CRR	Capital Requirements Regulation	**MMFs**	Money Market Funds
CSD	Central Securities Depository	**MoU**	Memorandum of Understanding
DFA	The Dodd–Frank Wall Street Reform and Consumer Protection Act	**MPE**	Multiple Point of Entry
DGSD	Deposit Guarantee Schemes Directive	**MREL**	Minimum Requirement on Eligible Liabilities and own Funds
EBA	European Bank Authority	**MS**	Member States
EC	European Commission	**NRAs**	National Resolution Authorities
ECB	European Central Bank	**NSAs**	National Supervision Authorities
ECOFIN	Economic and Financial Affairs Council	**NSFR**	Net Stable Funding Ratio
ECON	Economic and Monetary Affairs Committee of the European Parliament	**OJEU**	Official Journal of the European Union
EDIS	European Deposit Insurance Scheme	**OTC**	Over-The-Counter (Derivatives)
EIOPA	European Insurance and Occupational Pensions Authority	**PRA**	Prudential Regulation Authority
EMIR	European Market Infrastructure Regulation	**QIS**	Quantitative Impact Study
EP	European Parliament	**RRPs**	Recovery and Resolution Plans
ESA	European Supervisory Authority	**RTS**	Regulatory Technical Standards
ESFS	European System of Financial Supervisors	**SCAP**	Supervisory Capital Assessment Program
ESM	European Stability Mechanism	**SEC**	Securities and Exchange Commission
ESMA	European Securities and Markets Authority	**SIB (G-SIB, D-SIB)**	Global-Systemically Important Bank, Domestic-Systemically Important Bank
ESRB	European Systemic Risk Board	**SIFI (G-SIFI, D-SIFI)**	Global-Systemically Important Financial Institution, Domestic-Systemically Financial Institution
EU	European Union	**SII (G-SII, D-SII)**	Systemically Important Insurance
EZ	Eurozone	**SPE**	Single Point of Entry
FASB	Financial Accounting Standards Board	**SRB**	Single Resolution Board
FBO	Foreign Bank Organisations	**SREP**	Supervisory Review and Evaluation Process
FCA	Financial Conduct Authority	**SRF**	Single Resolution Fund
FDIC	Federal Deposit Insurance Corporation	**SRM**	Single Resolution Mechanism
Fed	Federal Reserve	**SSM**	Single Supervisory Mechanism
FPC	Financial Policy Committee	**TLAC**	Total Loss Absorbing Capacity
FROB	Spanish Fund for Orderly Bank Restructuring	**UCITS**	Undertakings for Collective Investment in Transferrable Securities Directive
FSAP	Financial Sector Assessment Program		

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