The Banking Regulation Review

Thirteenth Edition

Editor
Jan Putnis

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Jan Putnis

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PREFACE

The past year in banking regulation has been dominated, in most parts of the world, by the severe economic effects of the coronavirus pandemic. Governments and regulators have taken unprecedented steps to support businesses and individuals through the crisis. In financial terms, much of this support has been channelled through banks, and banks have had to work hard to continue to lend and to serve their customers in this difficult period.

Despite the human suffering and long-term economic damage that the pandemic has caused, there has been no significant banking crisis in the past year and, in most countries, no real sign that banks are failing to weather the storm so far. While there are of course exceptions, this is in large part a consequence of the relatively strong capital and liquidity position that banks around the world were in before the pandemic struck, which was itself a position that would not have arisen in many countries without the comprehensive prudential regulatory reforms that followed the global financial crisis of 2007–2009. Indeed, some regulators have commented that the pandemic is proving to be the first real test of those reforms and that, at least so far, the rules and institutional frameworks for banking regulation that were created after the global financial crisis have proven their worth.

As in all ongoing crises, there are causes for both pessimism and optimism. A pessimistic assessment with which it is hard to argue in many parts of the world is that we are still at an early stage in the economic damage that the pandemic has caused. The gradual withdrawal of government support programmes for businesses and the consequent further increases in non-performing loans with which banks have to deal will pose a further severe test for the banking systems of many countries at a time when governments will be relying on banks to support economic recovery. In some countries the strong links between bank viability and the ability of governments to issue sovereign debt at sustainable interest rates may re-emerge as a significant problem.

The optimistic assessment is necessarily a longer-term one given the challenges that the pandemic continues to present. The pandemic has undoubtedly provided the banking sector with an opportunity to show that it can be a force for financial stability and economic renewal at a time of crisis, in marked contrast to the blow to confidence that the sector suffered following the global financial crisis. This opportunity is closely linked to moves by many banks to consider their corporate purpose, the sustainability of their activities in environmental and social terms, and the quality, and in many cases the diversity, of their governance. This somewhat disparate collection of objectives, referred to as ESG (for environmental, social and governance) in many parts of the world, is increasingly dominating discourse between banks and their regulators and investors. Whether this would have happened in quite the way it has without the pandemic is impossible to know, but it does not seem much of an exaggeration to suggest that in many countries the banking sector that will emerge from the pandemic will have a series of cultural and business objectives that are quite different from those that existed before.

Regulators have become more assertive on these matters, particularly with regard to environmental objectives, and we will increasingly see a harder edge to the expectations that they are forming of banks' adherence to policies designed to address climate change. The repricing of many risks that is expected to take place as opinion settles on the pace at which transition to a low-carbon economy should take place will have a profound effect on the balance sheets of many banks. Shareholder pressure will force change in some banks, and banks with significant exposure to the petroleum economy will have to consider radical changes to their business models.

On social matters, financial inclusion and fair treatment of vulnerable customers are motivating legal and regulatory reform in many countries. There is a strong link between financial inclusion and the adoption of new technologies and business models, particularly in payment services. Many of the businesses that are contributing to the adoption of these technologies are not banks but rely on banks (or payment systems that are owned or controlled by banks) in order to operate. Allied to this are the increasingly serious and well-resourced attempts by firms using distributed ledger technologies to develop new means of payment, including stablecoins.

Regulators struggle to keep pace with these developments, but they hold back at their peril on addressing the implications for banks. The concept that the same or similar services and activities should be regulated in the same way is proving to be difficult to apply in practice, not least because there is a fundamental difference in financial stability terms between institutions that take deposits and those that do not. But the challenge of how to establish a level playing field on which to supervise banks and non-bank payment firms and lenders is one that must surely be addressed, and addressed soon, by regulators in a coordinated way around the world. The time for regulators to congratulate themselves on the effectiveness of financial sector reform following the global financial crisis has come to an end. It is now time to think hard about where risks lie and how risks will develop in the emerging tech-enabled financial system, and the possible causes of the next financial crisis.

It is perhaps surprising, given all the disruption caused by covid-19, that some countries have managed to push through significant legal and regulatory reforms in banking in the past year. These measures have included significant overhauls of the whole bank regulatory regime in some countries and, in other countries, further moves to implement Basel III standards. We have already seen some important changes of policy and emphasis in the United States under the new Biden administration. Legal and regulatory reform has continued in the European Union, although many initiatives have been delayed by the pandemic. The final departure of the United Kingdom from the European Union single market on 31 December 2020 and the resulting decoupling of London as a major banking centre from the European Union legal framework will continue to have reverberations and structural implications for banks operating in Europe. The long-term implications of Brexit for banks remain hard to predict; in particular, whether it will be a prelude to further fragmentation in banking regulation around the world.

This edition of *The Banking Regulation Review* covers 33 countries and territories in addition to the usual chapters on International Initiatives and the European Union. My thanks go to the authors for continuing to prepare informative chapters in the difficult and uncertain conditions in which many of them have been working over the past year. They continue to make this book the useful overview and guide to banking regulation around the world that it is.

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Jan Putnis
Slaughter and May
London
April 2022

Chapter 9

EUROPEAN UNION

Jan Putnis, Ben Goldstein and David Kasal[1]

I INTRODUCTION

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

i Financial crises

The development of EU banking legislation since 2011 took place against the background of the global financial crisis of 2007–2009 and the subsequent eurozone crisis, which highlighted concerns about the prudential position of eurozone banks and related threats to financial stability in the eurozone and beyond.

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

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

It is important to note that much EU legislative activity in the area of banking regulation historically took the form of directives, which do not normally have legal effect in EU Member States until implemented by provisions of national laws. In the past 10 years, however, there has been a marked change of approach. Following changes to the European supervisory architecture and the commitment of the European Commission (the Commission) to introduce an EU-wide single rule book for financial services (both discussed in this chapter), the introduction of new EU rules relevant to banks is increasingly taking the form of EU regulations that apply directly in all Member States.

1 Jan Putnis is a partner and Ben Goldstein and David Kasal are associates at Slaughter and May.

ii Brexit

It would be remiss to introduce this chapter without mention of the UK's departure from the EU on 31 January 2020. Since then, the UK has not participated in the EU's decision-making processes or been represented in EU institutions, agencies or other bodies. The post-Brexit transition period (the Transition Period), during which the UK remained (broadly speaking) subject to EU law, ended on 31 December 2020.

The Trade Cooperation Agreement (TCA), which establishes the economic relationship between the UK and the EU beyond the Transition Period, was agreed on 24 December 2020. The TCA was incorporated into UK law on 30 December 2021[2] and has applied as a matter of EU law since the end of the Transition Period.[3]

The TCA contains only certain limited provisions relating to financial services (concerning, for instance, basic rights to commercial establishment and cross-border contracting). The TCA contains no regulatory equivalence regime and explicitly excludes financial services from the most-favoured nation clause with respect to any future trade deals with third countries. The UK and the EU have agreed in principle a limited memorandum of understanding (MOU) on financial regulatory cooperation, which will establish the Joint UK–EU Financial Regulatory Forum to facilitate dialogue on financial services issues. However, at the time of writing, the MOU has not been finalised or published.

While the detailed effects of Brexit are addressed more fully in the United Kingdom chapter of this book, the particular impact of Brexit on EU regulatory law must be noted. Without the UK – a historically influential voice in the financial services arena – sitting at the table, the course of EU banking regulation may flow in a different direction.

iii Covid-19

The European Central Bank (ECB), the European Banking Authority (EBA) and relevant national regulators in Member States have been forced to coordinate efforts to alleviate the short-term operational burden caused by the pandemic for banks and have introduced a series of supervisory measures and proposals. By way of example:

a in the early days of the pandemic, the ECB announced a number of crisis measures, including allowing banks to operate temporarily below the level of capital ordinarily required;

b the EBA postponed its 2020 EU-wide stress test exercise, which was instead undertaken in the first half of 2021; and

c throughout 2020, the ECB issued a number of recommendations that banks refrain from or limit the payment of dividends.

These measures demonstrate the flexible approach to the pandemic adopted by EU regulators. Some of these measures have since been unwound. For instance, the recommendation against the payment of dividends was repealed with effect from 30 September 2021. The long-term effects of the covid-19 crisis on the EU banking sector remain unclear.

2 The European Union (Future Relationship) Act 2020.

3 Council Decision (EU) 2020/2252 of 29 December 2020 applied the TCA provisionally in the EU until 28 April 2021. The ratification of the TCA was completed by Council Decision (EU) 2021/689 of 29 April 2021.

II EUROPEAN REGULATORY AND SUPERVISORY FRAMEWORK

i Key EU institutions

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

ii Legislative procedure

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

iii Lamfalussy approach to adoption of European financial services legislation

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

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

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

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

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

iv Reform of the EU supervisory framework

Following recommendations contained in the 2009 de Larosière Report,[4] the Commission established a new European Systemic Risk Board (ESRB) to be responsible for macroprudential oversight and a European System of Financial Supervision (ESFS) to replace the then-existing 'Level 3 Committees' (the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR)), which only enjoyed limited advisory responsibilities. This new supervisory framework, now well established, comprises three pan-European ESAs: the EBA, the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).

The ESAs were established to oversee the European financial system at a microprudential level and to achieve convergence between Member States on technical rules and coordination between national supervisors. A legislative reform package to strengthen the operations of the ESAs entered into force on 30 December 2019 and is discussed further in Section XXI.

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

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

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

III CAPITAL REQUIREMENTS DIRECTIVE

i CRD IV

The Basel III international programme was a central element of the Basel Committee's attempt to address the shortcomings of the pre-crisis regulatory framework. As a result of Basel III, a new package of EU legislation, in the form of the CRD IV Directive[5] and the Capital Requirements Regulation (CRR)[6] (together, CRD IV), was introduced and now forms the basis of the EU capital requirements regime (as amended by the Risk Reduction Measures reform package outlined below).

CRD IV sets out prudential rules for banks on a solo and on a consolidated basis, including solo and consolidated capital and liquidity requirements. Consolidated supervision is, broadly, carried out in respect of groups or subgroups headed by parent undertakings incorporated in the European Economic Area (EEA).[7] In addition, banks are required to include participations[8] within the scope of consolidated supervision.

Importantly, CRD IV also enshrines passport rights for credit institutions, including banks, which broadly allow a bank authorised in one Member State of the EEA to provide a range of services for which it is so authorised in other Member States, or to establish a

5 Directive 2013/36/EU, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

6 Regulation (EU) No. 575/2013, amending Regulation (EU) No. 648/2012.

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

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

branch in other Member States to provide such services, without having to obtain additional authorisation from the regulators in those Member States. The most important features of CRD IV are summarised below.

The Basel III-related reforms included the introduction of:

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

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

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

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

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

Measures in CRD IV not flowing directly from Basel III included:

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

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

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

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

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

Full implementation of the CRD IV capital and liquidity requirements was mandated by 1 January 2019 (although national regulators retain limited discretion to use transitional provisions in relation to certain deductions from own funds until 2024).

ii CRD V

Building on CRD IV and taking further steps towards completion of the banking union (see Section IX), the CRR II[9] and the CRD V Directive[10] (together, CRD V) were introduced to make significant amendments to the CRR and the CRD IV Directive, respectively. CRD V was initially proposed as part of the Risk Reduction Measures package published by the Commission on 23 November 2016, which also included amendments to the Single Resolution Mechanism Regulation (the SRM Regulation) and the Bank Recovery and Resolution Directive (BRRD) (see Sections IX and X). Through these legislative proposals, the Commission's stated aim was to tackle the remaining weaknesses within the financial system and implement some outstanding provisions essential to ensuring resilience, as recently finalised by global standard setters (i.e., the Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB)).[11]

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

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

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

9 Regulation (EU) No. 2019/876, amending Regulation (EU) No 575/2013 and Regulation (EU) No. 648/2012.

10 Directive (EU) 2019/878, amending Directive 2013/36/EU.

11 COM(2016) 850.

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

d various measures relating, broadly, to market risk, counterparty credit risk, equity investments in funds and large exposures.

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

The Risk Reduction Measures package (including CRD V) entered into force on 27 June 2019. The majority of the provisions in CRR II have applied since 28 June 2021. EU Member States were required to adopt and publish the measures necessary to comply with the CRD V Directive by 28 December 2020, and to apply those measures from 29 December 2020, subject to specified exceptions.

iii CRD VI

A further reform package,[12] consisting of the CRR III and the CRD VI Directive (together, CRD VI), was adopted by the Commission in October 2021. CRD VI will implement the remaining Basel III reforms, including in relation to credit risk, market risk and operational risk frameworks, by amending the CRR and the CRD IV Directive (as amended by CRD V). CRD VI will also contain EU-specific reforms not linked to the recommendations of the BCBS, including: a new regulatory framework for third-country branches; a harmonised 'fit and proper' regime for key function holders in banks; and measures to ensure credit institutions incorporate environmental, social and governance (ESG) risks into their risk management systems. CRD VI is currently being considered by and negotiated between the Council and the Parliament. The proposed date of application for the majority of the CRD VI provisions is 1 January 2025.

IV PAYMENT SERVICES DIRECTIVE

The revised Payment Services Directive (PSD2)[13] harmonises conduct of business rules for all providers of electronic payment services across the EU and creates a tiered prudential authorisation regime for non-bank payment service providers, known as payment institutions. It affects banks, building societies, e-money issuers, money remitters, non-bank credit card issuers, non-bank merchant acquirers and their customers. PSD2 focuses on electronic means of payment, including direct debits, debit cards, credit cards, standing orders, mobile or fixed phone payments and payments from other digital devices, as well as money remittance services. It does not apply to physical cash-only transactions or paper cheque-based payments.

12 2021/0342(COD) and 2021/0341(COD).

13 Directive (EU) 2015/2366.

PSD2 was formally adopted on 25 November 2015 and had an implementation deadline of 13 January 2018. It updated the existing framework for the regulation of the provision of payment services in the EU and introduced enhanced transparency and security requirements. For example, it applied certain requirements to payment transactions where only one payment service provider is located in the EU.

In October 2021, the Commission published a call for advice to the EBA, asking for, among other things, evidence of the benefits and challenges created by PSD2 and an identification of any appropriate amendments. The EBA has until 30 June 2022 to deliver its findings.

The Multilateral Interchange Fees Regulation (the MIF Regulation)[14] was formally adopted on 29 April 2015 and became fully effective on 9 June 2016. The MIF Regulation imposes caps on interchange fees of 0.2 per cent and 0.3 per cent of transaction value for consumer debit card and credit card transactions, respectively. The Regulation also requires the organisational separation of payment schemes and transaction processing infrastructure, and prohibits territorial restrictions in licensing agreements or payment scheme rules. The Commission continues to monitor the effects of the MIF Regulation.

On 19 August 2021, the new Cross-Border Payments Regulation came into effect.[15] This Regulation contains provisions on (among other things) currency conversion charges and charges for cross-border payments.

V ACQUISITIONS DIRECTIVE

The Acquisitions Directive,[16] which Member States were required to implement into national law by 21 March 2009, was intended to harmonise the criteria for, and process of, granting change of control approval in relation to financial institutions. This is often known as the qualifying holdings regime.

The definition of control (at or above which the person holding control requires regulatory approval) was set at 10 per cent of share capital or voting rights, which followed previous EU directives. The Acquisitions Directive also introduced a concept of aggregation of multiple parties' interests for the purpose of determining whether control has been or would be attained where those parties are acting in concert. The ESAs published guidance on the definition of 'acting in concert', which applied from 1 October 2017.

The Acquisitions Directive was repealed and replaced (in part) by the following sectoral directives: the Markets in Financial Instruments Directive II (the MiFID II Directive);[17] the Solvency II Directive;[18] and the CRD IV Directive (each as amended).[19] The most important aspect of the Acquisitions Directive regime, namely the qualifying holdings regime, is therefore now contained in these sectoral directives. Broadly, the qualifying holdings regime imposes notification requirements on:

a regulated firms within the scope of the sectoral directives;

14 Regulation (EU) No. 2015/751.
15 Regulation (EU) No. 2021/1230.
16 Directive 2007/44/EC.
17 Directive 2014/65/EU; see Section VII.
18 Directive 2009/138/EC.
19 See Section III.

b persons that have acquired, or are contemplating acquiring, certain levels of qualifying holdings in such regulated firms; and
c persons that are contemplating disposing of their qualifying holdings in such regulated firms (either entirely or so that their holdings fall below certain thresholds).

The sectoral directives also require firms applying for regulatory authorisation to disclose qualifying holdings as part of the authorisation process. The qualifying holding regime contained in the sectoral directives is a maximum harmonisation regime: Member States are prohibited from imposing notification requirements that are more stringent than those set out in the sectoral directives.

VI FINANCIAL GROUPS DIRECTIVE

There is a separate EU regime for the consolidated supervision of mixed activity financial groups (financial conglomerates) established by the Financial Groups Directive[20] (FGD), which Members States were obliged to transfer into domestic law by 11 August 2004.

The FGD requires that a bank, investment firm or insurer that is authorised by an EEA regulator and that is a member (or parent) of a financial conglomerate group should be subject to supplementary supervision on a group-wide basis in addition to relevant sectoral (i.e., insurance or banking) consolidated supervision. The rules on how this supervision is effected may differ from those that apply to banking-only groups.

The test for determining whether a group is a financial conglomerate for the purposes of the FGD is quantitative and complex, but in essence the group must carry out financial services activities as a substantial portion of their business and have 'significant' business activities in each of the banking or investment services and insurance sectors.

Upon becoming a financial conglomerate, the relevant ratios for determining 'significance' are generally lowered for three years to minimise scenarios in which a group moves in and out of the FGD regime. The FGD also permits relevant regulators to treat a conglomerate as such for three years from the date on which it last satisfied the conglomerate test.[21]

The FGD was amended in December 2011 to address certain deficiencies in the way the FGD interacts with CRD IV and equivalent sectoral rules for insurers that mean supplementary supervision cannot currently be carried out for certain groups on a fully group-wide basis because of their legal structure. The amendments also introduced, inter alia, more discretion for supervisors in applying the significance test and in deciding whether to identify small groups (those with under €6 billion in total assets) as financial conglomerates.

20 Directive 2002/87/EC (as amended).
21 Not all national regulators have exercised this discretion.

VII MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE

The Markets in Financial Instruments Directive (MiFID)[22] replaced the Investment Services Directive (ISD),[23] which had constituted one of the foundations upon which the single European market in financial services was developed in the 1990s. The ISD introduced a system of passports under which an investment firm authorised in one Member State could carry out certain regulated activities for which it was so authorised in other Member States, or establish a branch in other Member States, without having to obtain additional authorisation from the regulators in those other Member States. MiFID retained and expanded this passporting framework.

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

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

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

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

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

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

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

A legislative package amending MiFID (MiFID II) came into force on 2 July 2014. MiFID II comprises the MiFID II Directive and the Markets in Financial Instruments Regulation (MiFIR)[24] (the latter also amended the European Market Infrastructure Regulation (EMIR), which is discussed in Section VIII). Member States had until 3 July 2017 to transpose the majority of measures contained in the MiFID II Directive into their national laws, and have had to apply those provisions, and MiFIR, since 3 January 2018.

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

22 Directive 2004/39/EC (as amended). This Directive was supplemented by implementing measures in the form of an EU regulation (Commission Regulation (EC) No. 1287/2006/EC) and a further directive (Commission Directive 2006/73/EC).

23 Council Directive 93/22/EEC.

24 Regulation (EU) No. 600/2014.

a a new type of trading venue, the organised trading facility (OTF), was brought within the scope of MiFID II. OTFs are subject to the same core requirements for a trading venue's operation as existing platforms, and are defined broadly to capture all forms of organised trading not matching existing categories;
b all trading of derivatives that are eligible for clearing and are sufficiently liquid was moved to regulated markets, MTFs or the new OTFs;
c improved transparency of trading activities in equity markets, including dark pools, and a new trade transparency regime for non-equity markets;
d new safeguards for algorithmic and high-frequency trading activities;
e in coordination with ESMA or the EBA and under defined circumstances, supervisors were given the ability to ban specific products, services or practices in the case of threats to investor protection, financial stability or the orderly functioning of markets;
f new powers for regulators to monitor and intervene in commodity derivatives trading, including the imposition of position limits;
g stricter requirements for portfolio management, investment advice and the offer of complex financial products, such as structured deposits; and
h a ban (subject to exceptions) on third-party inducements in the case of portfolio management and for firms providing independent advice.

Following a consultation, the Commission adopted two legislative proposals in November 2021to amend the MiFID II Directive and MiFIR.[25] The proposals seek to promote market transparency by enabling smaller and retail investors to access consolidated market data. The proposals also include changes relating to trade transparency, the share trading obligation and the derivatives trading obligation. At the time of writing, the proposals are due to be discussed by the Parliament and the Council.

VIII EUROPEAN MARKET INFRASTRUCTURE REGULATION

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

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

a a reporting obligation in respect of derivatives entered into by EU financial and non-financial counterparties, requiring detailed information to be reported to trade repositories and made accessible to supervisory authorities;
b a clearing obligation for derivatives that meet certain eligibility criteria set by ESMA;
c measures to reduce counterparty credit risk and operational risk for uncleared OTC derivatives, including risk mitigation standards (such as exchanges of collateral);
d prudential requirements for CCPs and trade repositories, including requirements for authorisation, capital, the provision of margin, the establishment of a default fund,

25 COM(2021) 726 final (2021/0385 (COD) and COM(2021) 726 final (2021/0384 (COD).

organisational rules and conduct of business standards. These include an obligation on trade repositories to publish aggregate positions by classes of derivatives accessible to all market participants; and

e rules on the interoperability of CCPs.

The EMIR Refit Regulation[26] (the EMIR Refit), which amended EMIR, was adopted on 14 May 2019 and, subject to certain exceptions, entered into force on 17 June 2019. Among other things, EMIR Refit:

a permits the Commission to suspend the clearing obligation;

b streamlines requirements for small financial counterparties and non-financial counterparties;

c delays the application of the clearing obligation to certain transactions; and

d provides that Member States' national insolvency laws shall not prevent a CCP from acting in accordance with certain of its EMIR obligations.

EMIR Refit is distinct from the regulation to amend EMIR with respect to the authorisation of CCPs and recognition of third-country CCPs (EMIR 2.2),[27] which was adopted on 15 October 2019 and came into force on 1 January 2020. EMIR 2.2, among other things, takes into particular account the effects of Brexit on the European financial system, and establishes a CCP Supervisory Committee within ESMA mandated to handle tasks related to CCPs, as well as supervising EU and third-country CCPs.

EMIR is supported by a Q&A document published by ESMA, which addresses questions posed by the general public, market participants and national regulators in relation to the implementation and practical application of EMIR. The document aims to promote common supervisory approaches and practices in the application of EMIR. It is frequently updated to take account of regulatory developments, and was, at the time of writing, last updated on 19 November 2021.

As a consequence of the heavy reliance of the EU financial system on clearing services provided by UK-based CCPs, there were fears in the run up to the end of the Transition Period about the financial stability of the EU. To address this problem, in September 2020, the Commission adopted a decision stating that the three CCPs established in the United Kingdom – ICE Clear Europe Limited, LCH Limited and LME Clear Limited – would be recognised under EMIR as third-country CCPs eligible to continue providing their services in the EU after the end of the Transition Period.[28] This equivalence decision was originally due to expire on 30 June 2022. However, to reduce the risks to financial stability of a cliff-edge, the Commission adopted a decision[29] on 10 February 2022 extending equivalence until 30 June 2025.

26 Regulation (EU) 2019/834, amending Regulation (EU) No. 648/2012.

27 Regulation (EU) 2019/2099, amending Regulation (EU) No. 648/2012.

28 Commission Implementing Decision (EU) 2020/1308.

29 Commission Implementing Decision (EU) 2022/174.

IX THE BANKING UNION, SSM AND SINGLE RESOLUTION MECHANISM

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

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

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

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

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

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

i The SSM

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

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

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

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

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

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

Although non-eurozone Member States do not participate in the SSM, the SSM Regulation allows those countries to enter into close supervisory cooperation with the ECB. Bulgaria and Croatia initiated requests for close cooperation in July 2018 and May 2019, respectively. As a result, after establishing such close cooperation, the ECB announced in September 2020 that it would start directly supervising five banks in Bulgaria and eight banks in Croatia from 1 October 2020.

ii The single resolution mechanism

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

a the establishment of a single resolution board (SRB). The SRB's main role is to assess whether an individual bank needs to be placed under resolution, and to determine the application of the resolution tools and use of the Single Bank Resolution Fund (SBRF);

b the establishment of the SBRF, which is funded through contributions made by all banks established in participating Member States. The level of contributions payable by banks reflects their respective size and business model; and

c the establishment of a resolution mechanism that is intended to reflect the mechanism used by national authorities under the BRRD, discussed below. The framework includes preparatory and preventive measures, early intervention measures and resolution tools, including bail-in.

The SRB signed a memorandum of understanding with the Commission on 1 August 2019, which sets out working methods between the SRB and the Commission in line with the legal framework established by the SRM Regulation. This includes cooperation on resolution, regulatory and communication matters.

The SRM has recently been amended by the SRM II Regulation as part of the Risk Reduction Measures legislative package (see Section III). The amendments are intended to mirror those made under BRRD II (see Section X) and relate to the implementation of the TLAC requirements and revisions to MREL. The SRM II Regulation has applied since 28 December 2020.

X RECOVERY AND RESOLUTION PLANS

Since the financial crisis of 2007 to 2009, both the G20 and the FSB have advocated for the development of recovery and resolution plans – living wills – for financial institutions. The numerous high-profile banking failures in the EU during the crisis (including, for example, Fortis and Anglo Irish Bank) revealed shortcomings in the existing arrangements for organising an orderly wind-down of ailing banks and financial institutions, which left Member States with no choice but to bail out their banking sectors.

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

The BRRD is the framework legislation passed as a result of the Commission's proposal to deal with future bank failures that came into force between 2 July 2014 and 1 January 2016. It established new tools and powers for national regulators to deal with crises, including: (1) rules requiring banks to prepare recovery plans and requiring resolution authorities to prepare resolution plans based on consultations with the institution concerned; (2) new powers facilitating supervisory intervention at an early stage of, and during, a crisis, designed to prevent a failure of the institution (such as the power to require a bank to implement its recovery plan); and (3) new tools to deal with the failure of the institution once it occurred (such as sale-of-business bridge institution, asset-separation and bail-in mechanisms). The BRRD also introduced new procedures for cross-border cooperation.

As discussed in Section III, the Commission adopted a broad reform package in November 2016 that contained reforms to the BRRD (BRRD II). The purpose of these reforms, which form part of the Commission's efforts to implement the TLAC Standard, was primarily to amend existing MREL provisions to align them with the TLAC Standard. The reforms included:

a targeted amendments to the insolvency ranking of holders of debt instruments issued by EU banks for the purposes of the BRRD and TLAC requirements concerning loss absorption and recapitalisation capacity of banks;

b a requirement for contractual recognition of (1) the fact that a relevant liability may be subject to write-down and conversion powers and (2) resolution stay powers in the BRRD; and

c a moratorium power on banks' payment or delivery obligations.

As with the broader legislative package, BRRD II entered into force on 27 June 2019, and Member States were expected to publish and adopt compliance measures by 28 December 2020. In addition, the BRRD Insolvency Hierarchy Directive entered into force on 28 December 2017, and Member States were required to transpose it into their national laws by 29 December 2018.

On 10 November 2020, the Commission published a road map and an inception impact assessment as part of an initiative to review the bank crisis management and deposit insurance framework, including the BRRD, the SRM Regulation and the Deposit Guarantee Schemes Directive (DGSD). This has been followed by a public consultation, which ran from January to May 2021 and focused on: (1) assessing how the current crisis management and depositor insurance framework works; (2) finding ways to make the framework more proportionate, efficient and consistent in handling the resolution or liquidation of any bank in the EU, including by securing appropriate funding within and outside the banking union; and (3) improving the synergies between crisis management and depositor protection, including taking steps to complete the banking union. Following this work, the Commission has indicated that it might seek to adopt legislative proposals to amend the BBRD, the SRM Regulation and the DGSD in July 2022.

On 21 December 2021, the Council announced that it had agreed a mandate to negotiate with the Parliament on a proposed regulation amending the CRR and BRRD, known as the 'Daisy Chain' proposal. The proposal aims to improve the resolvability of G-SIIs by incorporating dedicated treatment for the indirect subscription for instruments eligible for internal MREL; further aligning the treatment of G-SII groups with a multiple point-of-entry resolution strategy with the TLAC Standard; and clarifying the eligibility of instruments in the context of internal TLAC. The Daisy Chain proposal is due to be discussed between the incoming presidency and the Parliament, with a view to agreeing a final text.

XI SHORT SELLING REGULATION

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

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

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

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

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

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

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

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

In September 2021, ESMA published a consultation paper[30] proposing a review of the current framework for the calculation of, and framework governing, net short positions. The consultation closed in November 2021 and ESMA expects to publish a final report by the end of the first quarter of 2022.

As a result of the exceptional market circumstances resulting from the covid-19 pandemic, in March 2020, ESMA temporarily lowered the threshold for the reporting of short positions to the regulator from 0.2 per cent of share capital to 0.1 per cent. The decision

30 ESMA70-156-3914 dated 21 September 2021.

was allowed to expire a year later, but ESMA subsequently recommended, in May 2021, that the reporting threshold be permanently lowered. A delegated regulation amending the SSR in line with ESMA's recommendation came into force on 31 January 2022.

XII CONSUMER PROTECTION DIRECTIVES RELEVANT TO THE BANKING SECTOR

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

i DGSD

This Directive[31] establishes minimum levels of protection that Member States are required to provide to depositors of banks that their national regulators supervise. The minimum deposit coverage level is currently €100,000.

On 2 July 2014, a recast version of the DGSD[32] came into force. The overwhelming majority of its provisions had to be implemented by 3 July 2015. Its key provisions include:

a reducing the time permitted for payout from 25 to seven working days by 2024, requiring managers of schemes to inform authorities of likely bank failures (to facilitate payouts on the shorter timeline), and requiring banks to be able to provide a breakdown of the aggregated deposits of a depositor at any time;

b requiring the provision of standard information to depositors about the scheme that applies to them;

c requiring funds of schemes to reach 0.8 per cent of covered deposits within 10 years of the Directive coming into force. The Commission may permit a Member State to set a lower level (although not less than 0.5 per cent) where that Member State has a concentrated banking sector; and

d introducing a principle of risk-based contributions, whereby riskier banks are required to make greater contributions to the relevant DGS.

The DGSD requires the Commission to submit two reports:

a one setting out how DGSs operating in the EU may cooperate through a European scheme to manage risks inherent in cross-border activities and protect deposits from such risks (and, if appropriate, to submit a legislative proposal); and

b one, with the support of the EBA, on the progress towards the implementation of the DGSD, having regard to a number of topics, such as the adequacy of the current coverage level for depositors and the impact on the diversity of banking models.

The EBA has published four opinions in connection with the second report. The first opinion, on the eligibility of deposits, coverage level and cooperation between DGSs, was published in August 2019. The EBA published its second opinion on strengthening depositor protection in the EU in October 2019. In February 2020, the EBA published its third opinion, which concerned sources of funds for DGSs and how DGS funds should be used. The EBA

31 Directive 94/19/EC.

32 Directive 2014/49/EU.

published a fourth opinion in October 2021, focusing on the treatment of client funds under the DGSD. The EBA invited the Commission to consider the amendments proposed in the opinions when preparing its final report to the Parliament and the Council.

As stated above, an inception impact assessment concerning the Commission's review of the BRRD, the SRM Regulation and the DGSD was published in November 2020 and the Commission has subsequently indicated that it might seek to adopt legislative proposals to amend the BBRD, the SRM Regulation and the DGSD in July 2022.

ii Unfair Terms in Consumer Contracts Directive and Consumer Rights Directive

The Unfair Terms in Consumer Contracts Directive (the Unfair Terms Directive)[33] adopted in 1993 is the original EU legislation governing terms of contracts with consumers. It requires Member States, among other things, to enact provisions in their national laws that would render certain unfair terms in consumer contracts unenforceable. In particular, a term of such a contract that has not been individually negotiated is unfair (and therefore unenforceable) if, 'contrary to the requirement of good faith', it causes a 'significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer'. An annex to the Directive contains an indicative and non-exhaustive list of terms that may be regarded as unfair.

The Directive also introduced a requirement that Member States implement measures ensuring that contracts to which the Directive relates be drafted in plain, intelligible language. On 22 July 2019, the Commission issued guidance on interpretation of the Unfair Terms Directive in light of subsequent case law and legislative developments.

The Consumer Rights Directive,[34] which came into force on 12 December 2011, made minor amendments to the Unfair Terms Directive. Among its key provisions were an extension of consumer withdrawal rights on distance purchases to 14 days across the EU; a cap on fees for use of means of payment equal to the cost borne by the trader for the use of such means; and the provision of mandatory information by the trader to the consumer on distance and off-premises contracts. Member States were required to implement the measures contained in the Consumer Rights Directive by 13 December 2013, and to apply those measures from 13 June 2014.

On 11 April 2018, the Commission proposed a package of legislative changes (referred to as the New Deal for Consumers), including the amendment of the Unfair Terms Directive and the Consumer Rights Directive, to modernise and ensure better enforcement of EU consumer protection rules, in particular in light of increasing digitalisation. The legislative changes were adopted in the Enforcement and Modernisation Directive[35] (otherwise known as the Omnibus Directive), which entered into force on 7 January 2020. The Omnibus Directive extends consumers' rights, traders' disclosure obligations and enforcement powers of national authorities. It provides, among other things, that:

a national authorities have the power to impose effective and proportionate penalties in a coordinated matter when they jointly investigate major cross-border infringements across a number of EU Member States. National authorities can impose fines of up to 4 per cent of a trader's annual turnover for breaches of EU consumer law in the Member

33 Directive 93/13/EEC.

34 Directive 2011/83/EEC.

35 Directive (EU) 2019/2161.

State or States where the breach occurred, or €2 million in cases where information on turnover is unavailable, with individual Member States able to introduce even higher fees;

b EU consumers have a direct right to remedies for unfair compensation practices, including rights of termination and financial compensation;

c national authorities have stronger powers to stop the misleading marketing of dual-quality goods;

d traders must inform consumers of whether an item is bought from a private individual or a trader; if the seller is a private individual, consumers must be warned that EU consumer protection rules will not apply to the transaction;

e consumers must be informed each time a price is presented to them based on a personalised pricing algorithm to ensure that consumers know that the asking price may have increased specifically for them;

f the definition of payment is extended to include payment with personal data to cover 'free digital services'. Hence, providers of these free services will now have to provide information about the main characteristics of the service, the contract duration and the termination conditions. Consumers will also have a 14-day cancellation right in these circumstances; and

g submitting, or commissioning someone to submit, a fake review or endorsement is prohibited, and traders are required to justify the reasonable and proportionate steps they have taken to ensure that the reviews on their site are genuine.

Member States must transpose these new requirements into national law from 28 May 2022.

iii AML legislation

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

XIII SECURITIES FINANCING TRANSACTION REGULATION

In its September 2013 Communication on shadow banking, the Commission identified increasing the transparency of securities financing transactions (SFTs) as a priority area. This prompted it to publish a proposal for a regulation on the reporting and transparency of SFTs in January 2014 (the SFTR). The SFTR[36] came into force on 12 January 2016.

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

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

36 Regulation (EU) 2015/2365.

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

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

The reporting obligation was introduced incrementally for different types of firm, and has been fully effective since 11 January 2021.

ESMA has published a number of materials on the SFTR. On 6 January 2020, ESMA published guidelines on reporting under the SFTR, which were most recently updated on 29 March 2021. The guidelines clarify a number of SFTR provisions and provide practical guidance on their implementation.

XIV MARKET ABUSE REGULATION

The Market Abuse Regulation (MAR)[37] and the Directive on Criminal Sanctions for Market Abuse (CSMAD)[38] were published on 12 June 2014 and came into force on 2 July 2014.

MAR was intended to expand and develop the existing EU market abuse regime by establishing a common regulatory framework on market abuse and to complement the MiFID II legislative package. The framework established by MAR prohibits insider dealing, unlawful disclosure of inside information and market manipulation. MAR introduced new safe harbour provisions in regard to market soundings and expanded the pre-existing EU market abuse regime to cover:

a financial instruments traded on an OTF or MTF, certain OTC activities and, in some cases, spot commodity contracts;

b behaviour both within and, where such behaviour relates to instruments traded on an EU trading venue, outside the EU;

c attempted market manipulation; and

d manipulation of benchmarks.

The majority of MAR's provisions have applied since 3 July 2016. In a report dated September 2020, ESMA concluded that MAR has worked well in practice and set out a proposal for targeted amendments to MAR. The proposals included setting out ways to improve buy-back programmes and simplification of the market sounding procedures and requirements. The Commission has, at the time of writing, yet to take up any of these proposals.

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

37 Regulation (EU) No. 596/2014.

38 Directive 2014/57/EU.

Member States were required to transpose CSMAD provisions into domestic law by 3 July 2016 but, as the CSMAD is a minimum harmonisation directive, Member States are free to impose more stringent requirements. Two Member States, Denmark and the UK, opted out of the CSMAD (which they were able to do as a result of their particular status in the EU at the relevant time). As the UK has since left the EU, Denmark remains the only EU Member State that has opted out of the CSMAD.

XV MORTGAGE CREDIT DIRECTIVE

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

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

In November 2021, the Commission launched a consultation on its review of the MCD with the stated aims of assessing whether to adapt the rules in the face of challenges such as digitalisation and covid-19 and ensuring the rules guarantee high levels of consumer protection. The consultation closed on 28 February 2022.

XVI BENCHMARKS REGULATION

Following global investigations into the conduct of a number of banks in relation to their attempts to manipulate two key financial market benchmarks – the London interbank offered rate (LIBOR) and the Euro interbank offered rate (EURIBOR) – the Commission consulted on and proposed a regulation on indices used as benchmarks in financial instruments and financial contracts (the Benchmarks Regulation or BMR).[39] Adopted by the Parliament in April 2016, the majority of the provisions of the Benchmarks Regulation applied from 1 January 2018.

The key elements of the Regulation are as follows:

a the activity of the provision of benchmarks is subject to prior authorisation and continuing supervision at national and EU level. Different governance and control requirements apply to administrators depending on whether they administer critical, significant or non-significant benchmarks. For critical benchmarks (a class that includes LIBOR, Euro overnight index average (EONIA), Stockholm interbank offered rate (STIBOR) and EURIBOR), colleges of supervisors should be formed to enhance the exchange of information and ensure uniform authorisation and supervision;

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

39 Regulation (EU) 2016/1011.

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

d annexes to the BMR contain further rules for commodity benchmarks and interest rate benchmarks to take account of the risks and specificities of these benchmarks in a proportionate manner with additional requirements imposed on critical benchmarks; and

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

In March 2020, the Commission published an impact inception assessment relating to its review of the BMR. The Commission found that it was necessary to amend the BMR because it did not address the possibility of the cessation of a critical benchmark (for example, LIBOR, which ceased to be representative on 31 December 2021). As a result, a regulation amending the BMR as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements for certain benchmarks in cessation (the BMR Amending Regulation)[40] was adopted, entering into force on 13 February 2021. The BMR Amending Regulation created a framework for the statutory replacement of LIBOR. The new rules:

a give the Commission the power to designate a statutory replacement rate to take the place of all references to a benchmark whose cessation would significantly disrupt the EU financial market;

b ensure that EU benchmark users can, for the time being, continue to rely on certain designated third-country spot exchange rates to hedge exchange rate risks; and

c delay the application of the rules on third-country benchmarks until 31 December 2023, with the possibility of an extension by the Commission thereafter.

On 10 December 2019, the Low Carbon Benchmark Regulation[41] entered into force. Most of the proposals under the Regulation have applied since 20 April 2020; however, certain additional obligations will only apply from 31 December 2022. The Low Carbon Benchmark Regulation forms part of the EU's action plan on sustainable finance. In light of the increasing number of investors pursuing low-carbon investment strategies and using low-carbon benchmarks to measure the performance of investment portfolios, the Low Carbon Benchmark Regulation aims to increase transparency and help prevent 'greenwashing' by introducing minimum standards for two new categories of green benchmarks:

a an EU climate transition benchmark, which is a benchmark where the underlying assets are selected, weighted or excluded in a way that the resulting benchmark portfolio is on a decarbonisation trajectory, and is constructed in accordance with the minimum standards laid down in secondary legislation; and

b an EU 'Paris-aligned' benchmark, which is a benchmark: (1) where the underlying assets are selected, weighted or excluded in a way that the resulting benchmark portfolio's carbon emissions are aligned with the objectives of the Paris Agreement on

40 Regulation (EU) 2021/168.

41 Regulation (EU) 2019/2089.

climate change signed in 2016; (2) that is constructed in accordance with the minimum standards laid down in secondary legislation; and (3) where the activities relating to its underlying assets do not significantly harm other ESG objectives.

The Commission announced in January 2021[42] that it would review the Benchmarks Regulation in 2022 to facilitate the emergence of euro-denominated indices covering, in particular, nascent energy markets such as hydrogen. The Commission also intends to use the review to determine whether further reforms are required to enhance the robustness of euro-denominated interest rate benchmarks.

XVII SECURITISATION REGULATION

In September 2015, the Commission published a legislative proposal for a regulation establishing a European framework for simple, transparent and standardised (STS) securitisations (the Securitisation Regulation),[43] one of the building blocks of the Capital Markets Union action plan adopted by the Commission. In parallel, it published a proposal for a regulation amending the CRR (the CRR Amendment Regulation).[44] Both regulations have applied since January 2019.

The Securitisation Regulation introduces certain requirements in relation to securitisations, requiring defined institutional investors to conduct due diligence before investing in securitisation instruments and imposing risk retention, reporting and transparency requirements on originators, sponsors and original lenders. The Securitisation Regulation also sets out what constitutes an STS securitisation and establishes a more risk-sensitive prudential framework in respect of such securitisations. The CRR Amendment Regulation amends the CRR to give STS securitisations more favourable capital treatment.

The Securitisation Regulation and the CRR were both amended[45] in April 2021 in response to the financial and economic shock caused by covid-19 in order to, among other things, extend the STS securitisation framework to synthetic securitisations and maximise the capacity of financial institutions to lend and absorb losses related to the covid-19 crisis.

XVIII CCP RESOLUTION FRAMEWORK

The CCP Recovery and Resolution Regulation[46] entered into force on 11 February 2021. The rules aim to ensure that the critical functions of CCPs are preserved, while maintaining financial stability and helping to avoid the costs associated with the restructuring and resolution of failing CCPs falling on taxpayers. Setting out provisions comparable to those in the BRRD (see Section X), while using CCP-specific tools, key elements of the rules are as follows:

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

42 COM(2021) 32 final, dated 19 January 2021.

43 Regulation (EU) 2017/2402.

44 Regulation (EU) 2017/2401.

45 Regulation (EU) 2021/557 and Regulation (EU) 2021/558.

46 Regulation (EU) 2021/23.

b a requirement for resolution authorities to prepare resolution plans for how CCPs would be restructured, and their critical functions maintained, in the event of their failure;
c specific powers that are to be granted to CCP supervisors to intervene in the operations of CCPs where their viability is at risk, but before they reach the point of failure or where their actions may be detrimental to overall financial stability;
d a requirement to place a CCP in resolution when it is failing or likely to fail and no private sector alternative can avert failure, if its failure would jeopardise the public interest; and
e the establishment of resolution colleges for each CCP containing all the relevant authorities, including ESMA and the EBA.

However, the provisions of the CCP Recovery and Resolution Regulation will only apply from 12 August 2022 to ensure that CCPs have adequate time to establish implementing measures and take all necessary steps for compliance purposes, with certain limited exceptions:
a certain provisions regarding recovery plans, including the obligation to submit a recovery plan, have applied from 12 February 2022; and
b the requirement to use dedicated own resources in recovery and the provisions to recompense clearing members for variation margin gains haircutting in recovery will apply from 12 February 2023.

XIX NON-PERFORMING LOANS

Following the establishment of the Council's action plan to reduce stocks of non-performing loans (NPLs) in July 2017, thereby making progress on completing the banking union by accelerating risk reduction in the EU banking sector, in March 2018 the Commission proposed a package of actions to address the high stock of NPLs and prevent their possible future accumulation. These actions target four key areas:
a ensuring that banks set aside funds to cover the risks associated with loans issued in the future that may become non-performing. This was achieved via a regulation amending the CRR[47] that introduced common minimum coverage levels for newly originated loans that become non-performing;
b encouraging the development of secondary markets where banks can sell their NPLs to credit servicers and investors. In December 2021, the Directive on credit services and credit purchasers[48] (the NPLs Directive) came into force to seek to achieve this aim. The Directive sets out common standards to facilitate, and regulate, the transfer of NPLs from credit institutions to credit purchasers by removing impediments to, and laying down safeguards for, such transfers while, at the same time, safeguarding borrowers' rights. It also sets out provisions for the authorisation and supervision of credit servicers by national authorities. Member States have until 30 December 2023 to apply measures implementing the Directive. Entities carrying out credit servicing activities, as defined in the Directive, have until 29 June 2024 to obtain an authorisation under the Directive;
c facilitating debt recovery, where banks and borrowers can agree in advance on an accelerated mechanism to recover the value from corporate loans guaranteed with

47 Regulation (EU) 2019/630.
48 Directive (EU) 2021/2167.

collateral (subject to specified safeguards). This proposed accelerated extrajudicial collateral enforcement mechanism (AECE) originally formed part of the legislative proposal for the NPLs Directive. However, reaching political consensus on the AECE proved to be more difficult than expected and the mechanism was therefore split into a separate legislative proposal to avoid delays in introducing the NPLs Directive. At the time of writing, the consensus on the AECE has not yet been reached; and

d assisting Member States that so wish in the restructuring of banks, by providing non-binding guidance for establishing asset management companies or other measures dealing with NPLs. A technical blueprint[49] was published to achieve this aim.

In addition to this package, a directive on restructuring, second chance and efficiency of insolvency[50] entered into force on 16 July 2019 and was required to be implemented by Member States by 17 July 2021, subject to a one-year extension. The key features of this directive – in particular the availability of restructuring procedures enabling viable companies in financial difficulties to avoid insolvency, and measures to enhance the effectiveness of restructuring and insolvency proceedings – are intended to contribute to reducing NPLs and preventing their accumulation in the future.

On 16 December 2020, the Commission announced a new action plan to tackle NPLs in the aftermath of covid-19 and to prevent a build-up of NPLs on banks' balance sheets. This has resulted in a number of initiatives:

a EBA's review of its NPL data templates based on a consultation with market participants, both on the buyer and seller side, in 2021;

b a proposal for establishing a central data hub at the EU level, which would act as a data repository underpinning the NPL market;

c a targeted consultation in June 2021 on improving transparency and efficiency in secondary markets for NPLs;

d a proposal to develop guidance for the sellers of NPLs, which would include recommendations on what constitutes a 'best execution' sales process for transactions on the secondary markets; and

e amendments to technical standards on credit risk adjustments published on 13 December 2021, in order to decrease the risk weight of the capital charge resulting from the purchase of defaulted assets to an appropriate level.

Further, on 26 November 2020, the BCBS published a technical amendment setting out prudent and risk-sensitive capital requirements for NPL securitisations. The amendment clarifies the definition of NPL securitisations and introduces certain rules in relation to risk-weighting of related exposures. It is likely to be implemented by no later than 1 January 2023.

XX FUTURE LEGISLATIVE DEVELOPMENTS

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

49 COM(2018) 133 final.

50 Directive (EU) 2019/1023.

i The European deposit insurance scheme

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

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

On 11 October 2017, the Commission – noting that it had been two years since the presentation of the EDIS proposal, which remains on the table unchanged – proposed revisions to the operation of the EDIS regulation, with a view to ensuring agreement by the end of 2018. These revisions included introducing the EDIS in a more gradual manner, starting with a more limited reinsurance phase and moving gradually to co-insurance. Progress has since stalled and there is some indication that the proposal may be dropped in the context of the EU's broader review of its bank crisis management and deposit insurance framework (see Section X).

ii Markets in crypto-assets

On 24 September 2020, the Commission adopted a legislative proposal for a regulation on markets in crypto-assets (MiCA) as part of its Digital Finance Strategy (DFS). The DFS is a package of measures designed to support digital finance and promote innovation and competition, while mitigating against the risks that may arise from it.

MiCA aims to: create legal certainty by defining the regulatory treatment of crypto-assets not currently covered by existing financial services legislation; support innovation and promote the development of crypto-assets; ensure consumer and investor protection and promote market integrity; and ensure financial stability.

In November 2021, the Council adopted its position on MICA and, at the time of writing, is in trialogue negotiations with the Parliament and the Commission.

iii The Digital Operational Resilience Act

On 24 September 2020, as part of the DFS, the Commission also adopted a legislative proposal for a regulation on digital operational resilience (the Digital Operational Resilience Act (DORA)). DORA would cover a broad range of financial entities, including crypto-asset service providers and issuers, CCPs, trade repositories, credit rating agencies and insurance and reinsurance undertakings. As above, in November 2021, the Council adopted its position on DORA. At the time of writing, it is in trialogue negotiations with the Parliament and the Commission.

XXI EU REGULATORY BODIES

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

i The ESFS

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

The regulations that created the ESAs (the ESA Regulations)[51] are supported by the Omnibus I Directive,[52] which amended financial services legislation (other than Solvency II).[53] Together, these pieces of legislation give the ESAs significant powers, including the power:

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

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

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

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

Technical standards

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

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

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

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

The ESAs do not themselves have the power to set binding technical standards: the Commission must enact the standards, usually in the form of a decision or a directly

51 The EBA was created by Regulation (EU) No. 1093/2010, ESMA by Regulation (EU) No. 1095/2010 and EIOPA by Regulation (EU) No. 1094/2010. Together these are referred to as the ESA Regulations.

52 Directive 2010/78/EU.

53 Solvency II has been amended by the Omnibus II Directive 2014/51/EU, which came into force on 23 May 2014. The Solvency II regime came into force on 1 January 2016.

applicable EU regulation, for them to be binding. The Commission can refuse to endorse technical standards submitted by an ESA, or to endorse them only in part. In addition, both the Council and the Parliament have the right to object to technical standards, in which case those standards will not enter into force or will only enter into force with amendments.

Consistent application of rules

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

> *[A] competent authority has not applied the [provisions of the relevant EU legislation], or has applied them in a way which appears to be a breach of Union law, including the regulatory technical standards and implementing technical standards . . ., in particular by failing to ensure that a [financial institution or financial market participant] satisfies the requirements laid down in those acts.*[54]

The purpose of the power, therefore, is to enable an ESA to step in to remedy a national regulator's failure to properly supervise a financial institution.

The power would be exercised as follows:

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

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

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

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

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

However, there are limited circumstances in which an ESA may take its own action without the involvement of the Commission. If the relevant requirement of EU legislation that is the subject of a Commission formal opinion is directly applicable to financial institutions (i.e., it is contained in an EU regulation) and the national regulator has not complied with the formal opinion within the time specified, then the ESA may adopt an

54 EU Regulations Nos. 1093/2010, 1094/2010 and 1095/2010

individual decision addressed to a particular financial institution requiring it to take the necessary action to comply with EU law. This power is exercisable where, in the ESA's opinion, it is necessary to remedy non-compliance in a timely manner to maintain or restore neutral conditions of competition in the market or to ensure the orderly functioning and integrity of the financial system.

Action in emergency situations

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

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

In these circumstances, an ESA may temporarily prohibit or restrict certain financial activities if those financial activities threaten the orderly functioning and integrity of financial markets, or the financial stability of the whole or part of the financial system in the EU. An ESA must review these decisions at least every three months, and the decision automatically expires after three months if it is not renewed. The ESA must also reconsider its decision if requested to do so by a Member State. Where the ESA considers that a permanent restriction or prohibition on a particular financial activity is required, it can inform the Commission, which will consider facilitating the action.

An ESA is not permitted to take such actions where it would impinge in any way on the fiscal responsibilities of Member States (e.g., by requiring the financial rescue of an institution).

In light of the coronavirus pandemic, the ESAs published their first joint risk assessment report of the financial sector on 22 September 2020. The report highlights the economic and market uncertainty caused by the pandemic and the need to implement various policy actions including enhanced risk-monitoring, stress-testing and appropriate use of capital and liquidity buffers.

Settlement of disagreements

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

In that case:

a where, despite such assistance, no agreement is reached, the ESA may make a binding decision requiring one or more of the national regulators to take action to comply with EU law; and *b* where a national regulator fails to comply with an ESA's decision and thereby fails to ensure that a financial institution complies with directly applicable requirements of EU law, the ESA may make a further decision addressed to the relevant financial institution requiring it to take any necessary action to comply.

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

ii The ESRB

The establishment of the ESRB addressed a structural flaw exposed by the financial crisis of 2007 to 2009, namely that, at an EU level, responsibility for macroprudential analysis was fragmented between various authorities. As a result, decision-making was conducted at different levels with no mechanism to ensure that macroprudential risks were adequately identified, and warnings and recommendations issued clearly, followed up and translated into action.

Unlike the ESAs, the ESRB is a pan-sectoral body, which covers the banking, investment services and insurance sectors.

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

Information

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

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

Warnings and recommendations

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

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

iii Reform

On 20 September 2017, the Commission published a communication and adopted a package of measures to strengthen the ESFS and the ESRB. These proposals comprise an Omnibus Regulation and an Omnibus Directive, which make amendments to various other regulations and directives (including the ESA Regulations). The Commission proposed:

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

b the extension of direct supervision by ESMA to selected capital market sectors. The Commission proposed that ESMA would have direct supervisory powers over critical benchmarks and data reporting services, and a greater coordinating role over market abuse regulation. It would also supervise certain prospectuses and be responsible for direct supervision of European venture capital funds, European social entrepreneurship funds and European long-term investment funds. The measures also extend its product intervention powers to fund managers. The Commission did not propose to change the responsibilities of national authorities to supervise other areas, such as central depositories, money market funds, trading venues, undertakings for collective investment in transferable securities and alternative investment funds;

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

d the promotion of sustainable finance and fintech by ESAs.

On 12 September 2018, the Commission published a revised proposal containing additional measures seeking to concentrate AML powers in relation to the financial sector within the EBA, and to strengthen its mandate to ensure that risks of money laundering are effectively and consistently supervised by all relevant authorities, and that the relevant authorities cooperate and share information. Among other changes, it proposed that the EBA should be able to request national AML supervisors to investigate potential material breaches, and to request them to consider targeted actions such as sanctions.

The revised Omnibus Regulation[55] and Omnibus Directive[56] were adopted on 18 December 2019 and came into force on 30 December 2019. The amendments took effect on 1 January 2020. The Omnibus Regulation extended the EBA's powers in respect of money laundering as described above, while the Omnibus Directive amended the fourth Money Laundering Directive, Solvency II and MiFID II to grant new powers to EIOPA, the EBA and ESMA.

55 Regulation (EU) 2019/2175.

56 Directive (EU) 2019/2177.

ABOUT THE AUTHORS

JAN PUTNIS

Slaughter and May

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

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

BEN GOLDSTEIN

Slaughter and May

Ben Goldstein is an associate in the financial regulation group at Slaughter and May in London. His practice incorporates transactional, contentious and advisory work for a wide variety of financial and non-financial institutions. During his time at Slaughter and May, he has advised on a range of regulatory and supervisory matters for investment firms, banks and lenders, including advising on M&A activity, CCP regulation, customer protection and governance issues. Ben graduated with a first-class degree in politics, philosophy and economics from the University of Oxford in 2015 and has also studied at the Hebrew University of Jerusalem. Ben qualified as a solicitor in England and Wales in 2020.

DAVID KASAL

Slaughter and May

David Kasal is an associate in the financial regulation group at Slaughter and May in London. His practice incorporates transactional, contentious and advisory work for a wide variety of financial and non-financial institutions. During his time at Slaughter and May, he has advised on the supervision and regulation of investment firms and banks, including advising on M&A transactions, regulated payment services, capital requirements and regulation of energy suppliers. David graduated with a degree in law from the University of Oxford in 2017 and also holds a degree in French law from Paris II Panthéon-Assas University. David qualified as a solicitor in England and Wales in 2020.

SLAUGHTER AND MAY

47th Floor, Jardine House
One Connaught Place
Central
Hong Kong
Tel: +852 2521 0551
Fax: +852 2845 2125
peter.lake@slaughterandmay.com

One Bunhill Row
London EC1Y 8YY
United Kingdom
Tel: +44 20 7600 1200
Fax: +44 20 7090 5000
jan.putnis@slaughterandmay.com
tolek.petch@slaughterandmay.com
ben.goldstein@slaughterandmay.com
david.kasal@slaughterandmay.com
nick.bonsall@slaughterandmay.com
david.shone@slaughterandmay.com
www.slaughterandmay.com

www.slaughterandmay.com

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