Upcoming Regulatory Challenges

ECB OMG WebEx on 8th December 2021

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Agenda

1. EMIR Refit – Trade reporting
2. EMIR – RTS on Initial Margin Model Validation
3. EMIR – Clearing (UK Equivalence)
4. PRIIPS
5. Benchmark Regulation

EMIR Refit – Trade Reporting

- Draft EMIR Reporting Technical Standards (RTS) to comply with the EMIR Refit regulation available.
- No final version yet (waiting for endorsement by EC and afterwards approval by the EU Parliament)
- Once published in the Official Journal a time window of 18 months to be compliant.
- No confirmed timeline but we can predict the following ***tentative timeline***:

Q1 2022
- Endorsement by EC/EU Parliament of the draft RTS published by ESMA

Q3 2022
- Publication by ESMA of key information for reporting

Q3 2023
- Reporting start date (RSD)

RSD + 6 months
- Update of outstanding trades

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EMIR Refit – Trade Reporting

- Assessment and impact analyses currently ongoing in KBC.
- Major changes and impacts:
  - The reporting obligation and the complexity of reporting under EMIR Refit is increasing

Item	EMIR Now	EMIR REFIT
Reportable fields	129	195
Repeatable fields	9	32
Reconcilable fields	56	149
Repeatable and Reconcilable fields	N/A	32
Section 2c - Valuation Reconcilable fields	N/A	4
1st Wave: **RSD**	N/A	82
2nd Wave: **RSD + 2 Years**	N/A	67

Increase of reporting obligations

- 50% more fields to report
- 3x more repeatable fields
- Increased complexity

Increase of reconciliation obligations

- 3x more fields to reconcile
- Increased complexity
- ➢ Reconciliation of repeatable fields:
- ➢ Reconciliation of dynamic information, Valuation information.

Reconciliation process will roll-out in 2 waves

- There are 2 implementations waves for the new reconcilable fields.

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EMIR Refit – Trade Reporting

- <u>Major changes and impacts:</u>
  - The implementation of a standardized reporting format as the reporting templates and schemas will differ in REFIT: Use of ISO 20022 XML + validation against XSD
  - Introduction UPI (**U**niversal **P**roduct **I**dentifier)
    - The <u>FSB announced</u> on 2nd May 2019 its decision to designate the Derivatives Service Bureau (DSB) as the sole service provider for the future Unique Product Identifier (UPI) as well as the UPI Reference Data Library, describing it as a key step in completing the governance framework for the UPI System.
    - Alongside the provision of International Securities Identification Number (ISIN), Classification of Financial Instruments (CFI), the DSB will be providing UPIs in the near future to enable authorities to aggregate OTC derivatives data reported to trade repositories to help assess systemic risk and detect market abuse.
    - CFI → UPI → ISIN
    - It’s expected that UPI’s are needed for those OTC Derivatives for which no reporting is required under MIFIR/MIFID 2
    - Expected by Q3 2022

CFI	Asset class
	Instrument Type
	Underlying asset type
	Notional shedule
	Single/multi currency
	Delivery Type
UPI	Reference Rate
	Currency Reference Rate
	Name Reference Rate
ISIN	Standardized ISO reference rate name
	Price multiplier
	Full name and short names of the instrument
	Expiry date

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EMIR Refit – Trade Reporting

- <u>Major changes and impacts:</u>
  - Reporting of lifecycle events: action type + event type (new field)
    - Action type only is insufficient to describe the business event
    - Action type: creates, modifies, corrects, terminates etc. a record pertaining to the trade in question
    - Event Type: providing information about the type of business event triggering a given report.

		Event Type											
		TRADE	STEP-IN	PTRR	EARLY TERMINATION	CLEARING	EXERCISE	ALLOCATION	CREDIT EVENT	INCLUSION IN POSITION	CORPORATE EVENT	UPDATE	No Event Type required
Action Type	NEW	T	T,P	T		T	T	T		P	T, P		
	MODIFY	T,P	T,P	T,P	T,P		T, P	T	T,P	P	T,P	T, P	P
	CORRECT												T,P
	TERMINATE		T,P	T,P	T,P	T	T,P	T	T,P	T,P	T,P		
	ERROR												T,P
	REVIVE												T,P
	VALUATION												T,P
	MARGIN UPDATE												T,P
	POSITION COMPONENT												T

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EMIR Refit – Trade Reporting

- Major changes and impacts:
  - LEI: ESMA proposes that the renewal of the LEI will be validated only for the reporting counterparty and the entity responsible for reporting, while for entities other than the counterparty 1 and the entity responsible for reporting a lapsed LEI should be allowed.

2. EMIR – RTS on Initial Margin Model Validation

BACKGROUND:

- Prior to EMIR Refit (Regulation (EU) No 2019/834), IM model regulatory initial validation had been a requirement in the US, HK, Australia, and South Africa only.

- On 17 May 2019, a group of industry bodies, led by ISDA, collectively submitted a letter to the ESAs requesting that the authorities draft the RTS on IM model approval to specify that:

  - Initial Margin Validation would not apply to existing models that have been reviewed by NCAs in the EU, and
  - Initial Margin Validation would apply to dealers only, and would exclude firms impacted by UMR in Phase 4 and in phases subsequent to Phase 4

- Draft RTS was anticipated for quite a while, especially by IM Phase 5 counterparties.

2. EMIR – RTS on Initial Margin Model Validation

- **Two different issues the RTS tries to address:**

1. Large variety of counterparties in the scope of the validation requirement

   - ✓ RTS proposes a **standard** and a **simplified process** to IMMV based on AANA of uncleared OTC derivatives of counterparties
   - ✓ Above EUR 750 bn threshold: standard process (approximately 20 institutions)
   - ✓ Below threshold: simplified process with a less stringent threshold for model changes, a simplified back testing program and less granular governance requirements

2. Large number of counterparties will apply for IMMV at the same time

   - ✓ RTS propose a transitional solution for counterparties already using an IM model

     → if application for supervisory validation in due time (one month from entry into application of RTS) counterparties would be allowed to keep using the IM model

   - ✓ RTS proposes that the application of the IMMV requirements is phased in with respect to the size of the counterparties

     → Three phases: application 1/2/3 year from entry into force of RTS based on AANA of non cleared OTC derivatives
     → Phase 1: EUR 750 bn threshold, Phase 2: above EUR 50 bn threshold, Phase 3: below EUR 50 bn threshold

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3. EMIR – Clearing (UK Equivalence)

- **In September 2020**, the Commission adopted a **time-limited equivalence** decision for UK-based CCPs until **30 June 2022**.
- EU Financial Services Commissioner Mairead McGuinness announced on 10 November 2021 that she will propose an **extension of the equivalence decision for UK CCPs in early 2022**, following industry warnings over potential market disruption.
- No specification on how long the extension will be but **view of EC remains** that
  - ✓ over-reliance on UK-based central counterparties (CCPs) for some clearing activities is a source of financial stability risk
  - ✓ EC's aim remains to shift euro clearing to the continent post Brexit
  - ✓ EU's own clearing capacity must be expanded (including by boosting liquidity and expanding offerings)
  - ✓ measures to make EU-based CCPs more attractive to market participants, taking into account the results of the assessment currently being undertaken by ESMA on the systemic importance of UK-based CCPs => Extension should be long enough to allow EC to revise the EU supervisory system for CCPs

4. PRIIPS: Packaged Retail and Insurance-based Investment Product

- **Background**
  - KIDs are specific documents provided to investors, free of charge, in good time before the subscription of a financial instrument, in order to help them to reach informed investment decisions.
  - KID: PRIIPs regulation since 01/01/2018
    - Key Information Document (PRIIPs Regulation)
    - Warrants, Turbo's, Structured Notes, OTC Derivatives
    - 3 A4 sides
    - Allocate Market Risk Measure based on the volatility of the PRIIP or type of PRIIP
    - Ongoing costs
    - Performance scenarios (forward looking) in tabular form

Layout/Content

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4. PRIIPS: Packaged Retail and Insurance-based Investment Product

- Key changes to the PRIIPs KID template:

  - Change in performance scenarios

    ✓ The new PRIIPs RTS require a new calculation methodology and significant effort to gather the relevant price history

    ✓ Performance scenario model, based on historical returns, replaces the Cornish-Fisher model for favourable, moderate and unfavourable scenarios.

    ✓ Minimum of 10-year history of NAV/benchmark prices, and at least Recommended Holding Period ("RHP") plus 5 years price data is needed for calculation

  - Changes in cost structure and presentation:

    ✓ **Transaction costs** are split into **explicit** and **implicit** costs (a calculation of the aggregate explicit costs over the previous three years expressed as an annual percentage of the net asset values

    ✓ Important addition concerns the calculation of transaction costs for OTC instruments

    ✓ **Multi-option products** – separate KID for each underlying investment option OR a generic KID describing the PRIIP including a description of where the specific information on each underlying investment option can be found.

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4. PRIIPS: Packaged Retail and Insurance-based Investment Product

- Timeline
  - EUR-Lex - C(2021)6325 - EN - EUR-Lex (europa.eu) recently adopted by the European Commission on Sept 7th but not yet entered into force
  - Originally planned to apply as of 01/01/2022
  - Delayed till 01/07/2022
- Challenges
  - implementation of these changes within a fluctuating timeframe and less than clear guidance

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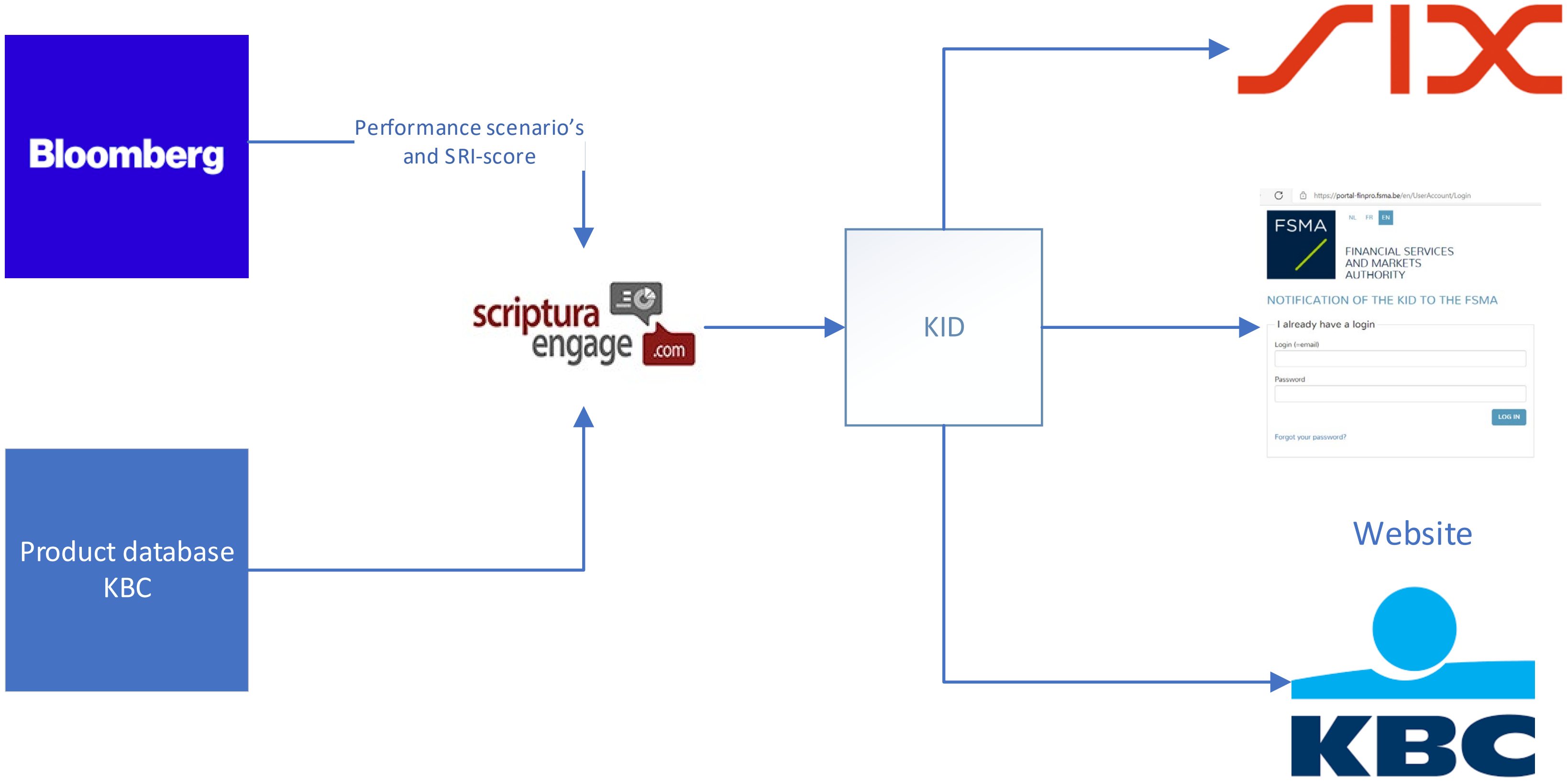
4. PRIIPS

- Operational flow KBC



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5. Benchmark

- **Transition plan KBC Bank for USD - GBP - CHF LIBOR → Milestones**
- **USD LIBOR**
  - By **31 Dec 2021**, financial institutions to stop using USD LIBOR as an interest rate in new agreements;
  - By **31 Dec 2021**, IBA will stop publishing the less used 1-week and 2-month USD LIBOR;
  - By **30 Jun 2023**, IBA will stop publishing the remaining USD LIBOR's (O/N, 1, 3, 6 & 12 months);
  - On **05 Mar 2021**, the FCA announced that the IBA's announced LIBOR cessations served as a "LIBOR Cessation Event" under ISDA, which led to the fixing of the credit adjustment spreads ("**CAS**") for use by ISDA (derivatives) and the cash (business loan) markets;
  - On **29 Jul 2021**, ARRC formally began "SOFR First", by recommending the use of CME Term SOFR in (1) syndicated and bilateral business loans, (2) trade finance loans, where transitioning from a forward-looking rate to an O/N rate has been difficult, and (3) derivatives linked to Term Rates.
  - As of **Oct 2021**,SOFR trading accounts for 30% of the USD derivatives market.
- **GBP/CHF LIBOR**
  - By **1 April 2021**, financial institutions to stop using GBP LIBOR as an interest rate in new agreements
  - By **31 Dec 2021**, IBA will stop publishing the GBP/CHF Libor

5. Benchmark

▪ Transition plan KBC Bank for USD - GBP - CHF LIBOR

New transactions

- All LIBOR origination of credits will end by December 31, 2021, so no new LIBOR loans as of January 2022
- Drawdowns on existing loans permitted until 30 June 2023 for USD LIBOR only
- New credit origination in:
  - USD : as of January 2022 (at the latest) : CME Term SOFR or Cost of funds or SOFR (backward looking rate) depending on the type of transaction
  - UK : since April 2021 : SONIA (backward looking rate) or Cost of funds, depending on the type of transaction
  - CHF : as of January 2022 (at the latest) : SARON (backward looking rates)
- Derivatives: Aligned with above-mentioned timings and rates => internal guideline not to enter into new LIBOR transactions, because of low liquidity sometimes difficult to implement in practice.

5. Benchmark

▪ Transition plan KBC Bank for USD - GBP - CHF LIBOR

Legacy transactions

- Transition of current bilateral loans and syndicated deals referencing GBP/CHF LIBOR (on track to meet the end-2021 deadline (transition almost all done in BE and finalized by end 2021 in branches)
- Transition of current deals referencing USD LIBOR up to June 2023 (but already included in planned client conversations or covered by fallback clause)
- Transition for derivatives governed by the ISDA documentation:
    - IBOR Fallbacks Supplement amending the 2006 Definitions - that automatically incorporate fallbacks for IBOR rates - included in trades concluded from 25/01/2021 onward
    - IBOR Fallbacks Protocol:
        - Incorporates IBOR Fallbacks Supplement in legacy transactions
        - Substantial industry-wide take up
        - KBC group entities adhered to IBOR Fallbacks Protocol

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5. Benchmark

- **Transition plan KBC Bank for USD - GBP - CHF LIBOR**

Legacy transactions

- ISDA 2006 Definitions are being replaced by 2021 Definitions
    - ISDA has announced that it will stop supporting the 2006 ISDA Definitions following October 4th, 2021
    - Cleared market:
        - LCH, CME, EUREX, HKEX, KRX and ASX adopted the 2021 Definitions with effect from October 4th, 2021. JSCC has announced it will adopt the 2021 Definitions from December 6th, 2021.
        - CCPs accept both 2006 and 2021 trades, cleared exposure is subject to rulebooks that refer to 2021 Definitions for lifecycle events.
    - Non-cleared market: no big-bang adoption

- **Transition plan KBC Bank for EURIBOR**

Implementation of fallback clauses aligned with the ECB WG's Recommendations on EURIBOR fallbacks and trigger events published on 11 May 2021.

Questions

1. Can you elaborate how dispute management procedures in the context of EMIR Initial Margin have been implemented in your organization? What is your internal policy and which thresholds do you consider as material for further investigation and disputes?

2. Are members actively attempting to switch euro clearing from UK CCP’s to Eurex?

3. When will other members make the transition to the ISDA 2021 Definitions?

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Thank you!

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