



April 2014

CRD IV Update

As explained in some detail below, Ireland transposed Directive 2013/36/EU (the “**CRD IV Directive**”) into domestic law on March 31, 2014 by means of two regulations, namely the European Union (Capital Requirements) Regulations 2014 which gives effect to the CRD IV Directive and the European Union (Capital Requirements) (No. 2) Regulations 2014, which gives effect to a number of technical requirements in order that Regulation (EU) No. 575/2013 (the “**CRR**”) can operate effectively in Irish law. These national implementing regulations will hereinafter be referred to collectively as the (“**CRD IV Regulations**”).

This is a welcome development, particularly as the almost impenetrable S.I. 660 and S.I. 661 of 2006 are now revoked. It is intended that the Central Bank will finalise its CRD IV/CRR Implementation Notice which was originally published in December 2013 (the “**Implementation Notice**”) ¹ by mid-May.

In considering the application of CRD IV, MiFID investment firms need to remember that the definition of “investment firm” under the CRR differs from that under the prior legal framework and that there is now a category of “CRD IV exempt firms” which are not subject to the full scope of CRR/CRD IV Regulations.

Those treated as “CRD IV exempt firms” are MiFID firms which are not authorised to hold client money, are not authorised to provide the MiFID ancillary service of safekeeping and administration, and are

¹ <http://www.centralbank.ie/regulation/industry-sectors/credit-institutions/Pages/WhatsNew.aspx?ListID=d88fd52f-acf6-4e3a-b5f1-0d6d0ca1cc76&ListItemID=27>

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only authorised for a combination of the MiFID investment services and activities of reception and transmission of orders, execution of orders on behalf of clients, portfolio management and investment advice. All three criteria must be met for the exclusion to apply.

These so called “CRD IV exempt firms” are, however, still captured by a number of provisions of the CRR and the CRD IV Regulations. In particular, the Central Bank has exercised its discretion which is set out in Article 95(2) of the CRR in relation to a sub-set of CRD IV exempt firms that are authorized to execute client orders and/or conduct portfolio management. This in effect means that the Pillar 1 Capital Requirements and Pillar 2 Internal Capital Adequacy Assessment Process (“ICAAP”) and the Supervisory Review and Evaluation Process (“SREP”) continue to apply to this sub-set of CRD IV exempt firms both on an individual and consolidated basis as applicable. In addition, these types of firms will be obliged to continue to submit the COREP return through the Central Bank’s Online Reporting System; i.e. there is no requirement to submit the COREP return using XBRL. In addition, the Central Bank has amended the remittance dates for the submission of COREP returns in order to bring them in line with the reporting requirements which are imposed on MiFID firms which are subject to CRD IV requirements.

It is hoped that the new framework will make banks and investment firms in the European Union more solid and will mean that they will be able to absorb any losses they may occur while doing business. In this way financial stability in the financial sector will be improved.

(i) Regulations to give effect to CRD IV signed into Irish law

CRD IV represents the European Union’s implementation of Basel III and as outlined above comprises of two legislative instruments; (i) CRD IV Directive and (ii) CRR.

The CRR deals with the rules relating to capital, liquidity, leverage, credit operational and market risks, large exposure whereas the CRD IV Directive deals with the rules relating to access to corporate governance, remuneration policies, capital buffers and sanctions. The CRR is directly applicable in all Member States from 1 January 2014 and does not require national implementing measures. The CRR provides for the single rulebook (the “**Single Rulebook**”) in the sense that it will contain for the first time a single set of prudential rules for firms that will be directly applicable in all Member States. In this way it is hoped that all Member States will apply the rules which are contained in Basel III in a consistent manner.

The CRD IV Directive replaces Directive 2006/48/EC (as amended) and Directive 2006/49/EC (as amended) in their entirety, with effect from 1 January 2014. The CRD IV Directive was transposed into Irish law by the CRD IV Regulations.

It is anticipated that the Central Bank will finalise its own Implementation Notice on foot of the CRD IV Regulations by mid-May, setting out its approach in relation to provisions contained within the CRD IV Directive and CRR where the competent authority (i.e. the Central Bank) can or must

exercise its discretion. The Central Bank has indicated that this Implementation Notice will not include discretions and options retained by the Member State (i.e. the Minister for Finance) in the CRD IV Directive and the CRR, except where it has been confirmed that these discretions are to be allocated to the Central Bank.

(ii) Regulatory Technical Standards and Implementing Technical Standards

The CRD IV proposals contain specific mandates for the European Banking Authority (“EBA”) to develop binding technical standards, guidelines and recommendations which will form part of the Single Rulebook. It is intended that the technical standards will flesh out the more technical aspects of the CRD IV Directive and CRR.

CRD IV makes provision for over a hundred mandates for regulatory technical standards and implementing technical standards. To date, very few of these technical standards have been published in the Official Journal, however it is expected that more of these technical standards will be published over the forthcoming months. We have set out below recent examples of certain of these technical standards;

(a) *Commission Delegated Regulation (EU) No 183/2014/EU with regard to Regulatory Technical Standards for Specifying the Calculation of Specific and General Credit Risk Adjustments*

On 27 February 2014, Commission Delegated Regulation (EU) No 183/2014/EU with regard to regulatory technical standards for specifying the calculation of specific and general credit risk adjustments was published in the Official Journal. This Regulation entered into force on 19 March 2014.

(b) *Commission Delegated Regulation with regard to Criteria to Identify Categories of Staff whose Professional Activities have a Material Impact on an Institution’s Risk Profile*

On 4 March 2014, the European Commission adopted Commission Delegated Regulation (EU) No 183/2014/EU with regard to criteria to identify categories of staff whose professional activities have a material impact on an institution’s risk profile. This Regulation supplements the requirements of CRD IV and will ensure that the CRD IV rules on remuneration are applied consistently across the EU. The European Parliament and the Council of the European Union have one month to exercise their right of scrutiny, with the possibility to extend this period for a further two months at their initiative. Following publication in the Official Journal, the Regulation will enter into force on the twentieth day after such publication.

(c) *CRD IV Package on Capital Requirements*

On 12 March 2014, the European Commission published the texts of nine delegated regulations that it has adopted containing regulatory technical standards required by the CRR. These regulatory technical standards are needed to provide detailed provisions on the ways in which national competent authorities and market participants must apply the rules contained in the CRR on a number of technical issues. The nine regulatory technical standards adopted by the European Commission which supplement the CRR are as follows:

- ▣ Commission Delegated Regulation determining proxy spread and limited smaller portfolio for credit valuation adjustment risk;
- ▣ Commission Delegated Regulation specifying the requirements for investor, sponsor, original lenders and originator institutions relating to exposures to transferred credit risk;
- ▣ Commission Delegated Regulation specifying the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration;
- ▣ Commission Delegated Regulation assessing the materiality of extensions and changes of the Internal Ratings Based Approach and the Advanced Measurement Approach;
- ▣ Commission Delegated Regulation specifying the information that national competent authorities of home and host Member States supply to one another;
- ▣ Commission Delegated Regulation for the definition of “market”;
- ▣ Commission Delegated Regulation defining non-delta risk of options in the standardised market risk approach;
- ▣ Commission Delegated Regulation further defining material exposures and thresholds for internal approaches to specific risk in the trading book; and
- ▣ Commission Delegated Regulation determining what constitutes the close correspondence between the value of an institution’s covered bonds and the value of the institution’s assets.

The European Parliament and the Council of the European Union have one month to exercise their right of objection, with the possibility to extend this period for a further two months at their initiative. Following the end of this objection period, the regulatory technical standards will be published in the Official Journal and will enter into force 20 days following that publication. Their provisions will be directly applicable in all Member States without the

need for national implementation.

In addition, the European Commission adopted regulatory technical standards supplementing the CRD IV Directive as follows;

- ▣ Commission Delegated Regulation supplementing the classes of instruments that adequately reflect the credit quality of an institution as a going concern and are appropriate to be used for the purposes of variable remuneration; and
- ▣ Commission Delegated Regulation further defining material exposures and thresholds for internal approaches to specific risk in the trading book as empowered under Article 77(4) the CRD IV Directive.

Similarly to the position outlined above, the European Parliament and the Council of the European Union have one month to exercise their right of objection with the possibility to extend this period for a further two months at their initiative. Following the end of this objection period, the regulatory technical standards will be published in the Official Journal and will enter into force 20 days following their publication.

(d) Commission Delegated Regulation (EU) No 241/2014 with regard to Regulatory Technical Standards for Own Funds Requirements for Institutions

On 14 March 2014, Commission Delegated Regulation (EU) No 241/2014 with regards to regulatory technical standards for Own Funds requirements for institutions was published in the Official Journal. This Regulation enters into force 20 days after publication on 3 April 2014.

(e) EBA Publishes Final Draft Regulatory Technical Standards on Own Funds Requirements for Investment Firms

On 29 January 2014, the EBA published its final draft Regulatory Technical Standards on own funds requirements for investment firms based on fixed overheads. These regulatory technical standards harmonise the calculation of capital requirements for those investment firms that have limited authorisation to provide investment services, as well as the conditions under which national competent authorities can make adjustments to such requirements, in order to ensure that a consistent framework for investment firms will be implemented. The final draft regulatory technical standards will be part of the Single Rulebook aimed at enhancing regulatory harmonisation in the banking sector in Europe.

For the calculation of the fixed overheads, the final draft regulatory technical standards use the so-called “subtractive” approach whereby variable cost items are deducted from the total expenses as calculated according to the applicable accounting framework.

The final draft regulatory technical standards also introduce special treatment for tied agents, since a tied agent exposes an investment firm to the same risk to which it is exposed when it carries out business on its own. Furthermore it is thought that there should not be incentives for firms to reduce their capital requirements through the use of these agents and, moreover, a firm should maintain a capital component for tied agents. Given the calculation of fixed overheads for tied agents in the same manner as for investment firms themselves would pose many practical problems, the use of a fixed percentage of all fees per tied agent is introduced instead. This addresses the fact that tied agents have some element of variability in some cases but probably cannot be considered a fully variable cost item.

The EBA has finalised these draft regulatory technical standards taking into account the responses to the consultation that ended on 30 September 2013.

The final draft is available at the following link:

<http://www.eba.europa.eu/documents/10180/561374/EBA-RTS-2014-01+%28Own+Funds+-+Fixed+Overheads%29.pdf>.

(f) EBA Publishes Final Draft RTS on Own Funds – Multiple Dividends and Differentiated Distributions (Part Four) Required under the Capital Requirements Regulation

On 27 March 2014, the EBA published its final draft regulatory technical standards on own funds - multiple dividends and differentiated distributions (part four) required under the CRR. Article 28(5) of the CRR requires the EBA to develop draft regulatory technical standards specifying whether and when multiple distributions would constitute a disproportionate drag on own funds and to specify the meaning of preferential dividends - namely preferential rights to payments of distributions and order of payments of distribution. In addition, the regulatory technical standards deal with the consequences of not meeting the criteria provided for in the regulation in terms of (dis)qualification of instruments as CET1 capital. The draft standards have been sent to the European Commission for their adoption and once adopted will be directly applicable throughout the European Union.

(g) EBA Publishes Guidelines on the Applicable Notional Discount Rate for Variable Remuneration

On 27 March 2014, the EBA published its final guidelines for the calculation of the discount rate for variable remuneration and clarifying how it should be applied. These guidelines will support EU Member States in the calculation of the ratio between the variable and fixed component of total remuneration from 2014 onwards. Under CRD IV, firms are required to set appropriate ratios between the fixed and variable component of total remuneration for staff whose professional activities have a material impact on the risk profile of the firm. The maximum ratio

has been set at 100%, however Member States can increase this amount to 200% in certain circumstances. EU legislation allows firms to use a discount rate of 25% (or less subject to national laws) of the variable remuneration provided it is paid in instruments that are deferred over a period of not less than 5 years. Therefore the guidelines will apply in Member States which have implemented the option of applying the discount rate and to firms which make use of such rate. The guidelines will apply from 1 June 2014 for calculations of the ratio of remuneration awarded from the year 2014 onwards.

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April 2014

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