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The outlook for financial services regulation

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2020 vision: What lies ahead

A rapidly changing world is causing regulators to update their strategies to address, amongst other issues, digital innovation, operational resilience and sustainable finance.

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The **Financial Stability Board's** (FSB) work programme for 2020 gives a good overview of the high level issues that financial services regulators and legislators will be focused on in the coming year and decade:

— The resilience of non-bank financing and intermediation

— Systemic risk in the insurance sector

— Monitoring and supporting progress on implementing interest rate benchmark reforms, specifically the remaining challenges in the transition away from LIBOR by end-2021

— Financial resources to support central counterparty (CCP) resolution

— Market fragmentation

— The impact of digital technology, specifically:

  – developing a toolkit on effective practices for cyber incident response and recovery

  – reviewing ways RegTech and SupTech could make the interaction between regulators and financial institutions more effective

  – addressing regulatory issues of stablecoins

The **EU's regulatory agenda** echoes these points but includes other important topics, such as sustainable finance, completing Banking Union and progressing Capital Markets Union, as well as reviews of post-crisis regulation, including MiFID II.

Croatia holds the Presidency of the Council until June – the first time since it joined the EU in 2013. Its priorities are driven by the motto "**A strong Europe in a world of challenges**". The Presidency will pay special attention to promoting initiatives that encourage reform processes and convergence among Member States; implementing initiatives that support the deepening of the single market; strengthening the EU's international economic and financial role, including the role of the euro; and promoting measures and activities aimed at mitigating the negative fiscal effects of demographic trends.

It will continue discussions on the European Deposit Insurance Scheme (EDIS), the reduction of non-performing loans, the next stage of Capital Markets Union, strengthening the resilience of the financial system and its infrastructure, managing risks arising from innovations in markets and the incomplete application of rules, and contributing to the sustainable finance agenda.

The **European Supervisory Authorities** (ESAs) have set out their regulatory stalls for 2020, which reflect their enhanced powers and responsibilities. Our report "EU financial services regulation – a new agenda demands a new approach" gave an early warning on all these points.

The message for the industry is clear – there is new legislation to implement, more to come, and heightened supervisory expectations and scrutiny. 2020 will be a busy year on the regulatory front and heralds a challenging decade, for firms and regulators.

James Lewis
Head of EMA Financial Services Risk & Regulatory Insight Centre

The ESAs set out their stalls for 2020 and beyond

The three European Supervisory Authorities (ESAs) have issued a number of reports and papers that indicate increased activity and areas of focus.

The recent reports are in addition to their published work programmes for 2020, discussed in the November edition. The overarching message is that they intend to make full use of their new responsibilities and powers.

As described in Chapter 6 of our report "EU financial services regulation – a new agenda demands a new approach", as a result of the 2018/19 review and new legislative mandates, the ESAs have been given new powers and responsibilities in a number of areas – supervisory convergence, investor protection, financial innovation and sustainable finance. EBA has new powers in relation to anti-money laundering and ESMA has additional direct supervisory responsibilities.

Anti-money laundering and countering the financing of terrorism (AML/CFT)

The ESAs have issued Joint Guidelines on AML/CFT co-operation and information exchange, including on the establishment and operation of supervisory colleges, which will enable a common approach and coordinated actions. The guidelines are consistent with the framework of banking prudential supervisory colleges, but encompass all financial sectors.

The ESAs observe that recent high profile AML/CFT cases involving EU banks suggest that where firms operate in different countries, failure by AML/CFT supervisors to communicate effectively with their EU counterparts created gaps that allowed serious compliance failures to continue for long periods of time. Going forward, national authorities have a formal co-operation framework to ensure adequate and effective AML/CFT supervision of firms operating on a cross-border basis, including with third country authorities where appropriate.

ESMA increases scope and size

ESMA's **Strategic Orientation for 2020-22** explains how it will exercise its new powers and meet its new responsibilities. These include the assessment and monitoring of third country equivalence, and ESMA notes that interaction with non-EU regulators is likely to increase.

ESMA says it will significantly expand its digital communication by creating a more responsive, informative and user-friendly website. It will enhance its IT systems and data analysis capacity. It will increasingly become the data hub for EU securities markets and aims to become the international leader in developing data reporting. It also has the ambition to be a driving force in enhancing the EU's enforcement culture in securities markets.

Proprietary risk assessment and data will increasingly form the starting point for the setting of ESMA's agenda and priorities. In exercising its new direct supervisory responsibilities for:

- third country central counterparties
- critical benchmarks, third country benchmarks and data service providers, from 1 January 2022
- securitisation repositories under the Securitisation Regulation
- securities financing transactions under the Securities Financing Transactions Regulation

ESMA will prioritise those areas it believes pose the greatest risks.

To accommodate these new responsibilities, ESMA will grow its staff by 2022 and is undergoing an internal re-organisation.

EBA Risk Reduction Package Roadmaps

In November 2019, EBA published a set of roadmaps for delivering the mandates stemming from the EU Risk Reduction Measures Package adopted in May 2019. The package represents an important step towards the completion of the European post-crisis regulatory reforms. It results in around 100 new mandates for EBA under the revised Capital Requirements Directive and Regulation (CRD V/CRR II) and the revised Bank Recovery and Resolution Directive (BRRD II). The mandates focus on six key areas: governance and remuneration, large exposures, Pillar 2, resolution, disclosure and supervisory reporting.

The roadmaps set out the proposed timelines for publication of further Regulatory Technical Standards, Implementing Technical Standards and guidelines, which are expected from Q2 2020 to Q4 2022. They provide the rationale for prioritisation of the mandates combined with some policy guidance. They also contain 30 reports or sets of monitoring actions to support the effective and consistent implementation of the Single Rule Book and supervisory convergence.

Consumer trends in insurance and supervisory concerns

For the insurance industry, the findings in [EIOPA's Consumer Trends Report 2019] provide a clear indication of supervisory focus in 2020:

— Despite evidence of improved disclosure practices, problems remain with product design and review processes. Implementation of the product oversight and governance (POG) requirements in the Insurance Distribution Directive require product manufacturers to take into account consumers' needs throughout the product lifecycle (not just at point of sale).

— Complex unit-linked contracts raise concerns about lack of transparency, lack of consumers' understanding of products, product complexity, conflicts of interests and lack of adequate returns, and increased sales to vulnerable consumer groups.

— For credit life and credit protection products, evidence indicates significant potential consumer detriment stemming from group policies and generally high commissions for all types of policies, leading to conflicts of interests and some aggressive sales techniques.

— Accident and health insurance products continue to offer value-for-money compared with other non-life insurance products, with the exception of some Member States, where the number of complaints increased and where issues with renewals have been observed.

— Claims management in motor insurance remains an area of concern in some markets.

— Add-on insurance is a source of potential consumer detriment across several European markets, with concerns relating to the possible exploitation of behavioural biases in the context of an increase in cross-selling practices.

Financial innovations are reported across the whole insurance value chain, which are having an overall impact on the relationship between insurance manufacturers, insurance distributors and consumers.

EIOPA notes that digital ecosystems (platforms through which different products and services are provided) are on the rise and, when adequately designed and taking into account target market's needs, can be beneficial. They allow insurers to access large pools of new customers, whose demands and needs are aligned with the relevant product offer, and can lower the costs of distribution.

They allow consumers to access more targeted and tailored products. However, competition is still limited and there are risks relating to over- and under-insurance. From a supervisory perspective, blurred lines between insurance manufacturing, distribution and other services raise challenges.

Price comparison websites and price-aggregators continue to increase their presence across the EU, offering a "first port of call" for consumers wishing to compare different types of insurance products and enhance their choice. If adequately supervised and operated, these can offer more choice to consumers and facilitate the overall process of buying insurance. However, they can also lead to an over-focus on price and lack of transparency in terms of remuneration and coverage offered by the products, says the report.

Risks and vulnerabilities in the EU financial sector

The latest report by the Joint Committee of the ESAs on cross-sectoral risks and vulnerabilities in the EU financial system highlights three main cross-sectoral risks and potential sources of financial instability.

Uncertainties associated with **Brexit and the future EU-UK relationship** remain a key risk. However, given the broad range of measures already put in place by the European Commission, the ESAs, national competent authorities (NCAs) and others, the ESAs believe that the EU financial services industry should be well-equipped to manage Brexit risks from a micro-perspective.

The **persistent low interest rates** environment is an ongoing concern. Subdued profitability continues to pose challenges for financial institutions and market participants, and incentivises search-for-yield strategies, which exert pressure on equity returns and increase securities valuation risks. Together with high indebtedness levels and asset liquidity considerations, these give rise to financial stability concerns.

The ESAs response is that:

— Supervisors should monitor sectoral implications and utilise appropriate supervisory tools.

— In the investment fund sector, the ESAs will seek convergence in the application of the liquidity management and eligible asset rules, and of stress testing.

— There should be a focus on further addressing reduced bank profitability, improving the resilience of the banking sector, further investment into new financial technologies and exploring bank consolidation opportunities (for which transparency and the consistent application of common prudential requirements and supervisory rules across jurisdictions are preconditions).

— Lack of clarity about the total volume of leveraged loans outstanding and the ultimate holders of risk of many tranches of collateralised loan obligations underpins supervisory concerns about a possible under-pricing of risks, which should be identified and further explored.

The ESAs observe that **climate change** and the transition to a low-carbon economy carries significant risks to financial stability. A disorderly transition could potentially be de-stabilising and create long-term business model viability challenges for financial institutions with high exposures to climate-sensitive sectors. Environmental, social and governance (ESG) factors more generally are a key consideration for the ESAs. (See also page 10.)

The ESAs will incorporate sustainability considerations into Level 2 rules and Level 3 guidance, and promote a coherent implementation of regulatory provisions. They also note that:

— Development of scenario analysis and stress-testing supervisory tools can help to identify risks to the financial sector and to assess the extent to which the development of counter-acting buffers may be required.

— Climate risk and ESG factors should be embedded within regulated firms' risk management frameworks and decision-making processes, and firms should play an active role in the evaluation of the impact of the activities of portfolio companies on ESG factors.

— The ESAs, NCAs and regulated firms should continue to work on identifying climate risk-related exposures and to facilitate access to investment in sustainable assets.

All these points were aired in ESMA's risk dashboard for EU securities markets for the third quarter of 2019. The dashboard also noted that large intra-day movements confirm that markets remain sensitive to news flow about global geopolitical tensions.

Short-termism

The Commission asserts that "many companies still focus too much on short-term financial performance" (see page 10). In early 2019, it asked each ESA to investigate potential sources of undue short-termism on corporations from the financial sector and to provide advice on areas that regulators should address. The ESAs have found no or little evidence of short-termism, but recommend some actions.

EBA identified some limited concrete evidence of short-termism (but not systemically "undue") and highlighted the need to promote long-term approaches. It recommends that policy actions should provide relevant information and incentives for EU banks to incorporate long-term time horizons in their strategies, governance, business activities and risk management, in particular:

- Maintenance of a robust regulatory prudential framework, while continuing to monitor potential unintended consequences of financial regulations on the supply of sustainable investment financing
- Fostering the adoption of longer-term perspectives by institutions through more explicit legal provisions on sustainability in the Capital Requirements Directive
- Enhancing disclosures of long-term risks and opportunities by setting principles and requirements that can ensure comparability and reliability of disclosure, e.g. through amendments to the Non-Financial Reporting Directive (NFRD)
- Improving information flows and data access, and supporting the role of the banking sector in raising awareness on sustainability challenges and ESG risks, for example through the development of platforms or by setting-up a centralised database on environmental data for financial sector

EIOPA found no clear evidence of undue short-termism in insurance and occupational pension funds, although firms' investment practices are sensitive to macroeconomic circumstances such as the persistent low interest rate environment. More specifically, adaptation to macroeconomic circumstances may imply a shift in their role as long-term investors and as insurance and pensions providers. EIOPA therefore recommends:

1. Developing a cross-sectorial framework with the aim of promoting long-term investments and supporting sustainable economic growth at European level, with consistent implementation and assessment against concrete targets. It should respect the principle of freedom of investment, be commensurate with the risks taken, ensure the viability of individual business models, be compatible with an adequate level of policyholder protection and be stable at a systemic level.
2. Facilitating the generation and publication of long-term performance benchmarks to increase the focus on long-term value creation rather than immediate shareholders' interests or excessively short-term profitability objectives.

ESMA found that, while stakeholders in general considered a long-term investment horizon to be longer than six years, responses indicated that the most common time horizon for general business activities was less than five years and that investment research was perceived to have a short-term focus.

To address the latter, ESMA recommends that the Commission should monitor whether the integration of sustainability risks and factors by insurance companies, asset managers and investment firms will help to deliver greater focus on long-term risks in investment research, and should consider ESMA's findings in its ongoing work on the evaluation of the MiFID II rules on payment for research.

ESMA states that the following amendments are needed to NFRD to ensure a minimum level of comparability, relevance and reliability of current ESG disclosures:

- Adopt delegated acts to specify key general principles for high-quality non-financial information and establish a limited set of specific disclosure requirements (and as a medium-term objective, promote the adoption of an international set of ESG disclosure standards).
- Consider requiring the inclusion of the non-financial statement in the annual financial report and mandating assurance on the content of the non-financial statement, as well as its consistency with other information in the annual financial report.
- Establish the necessary coordination between the NFRD and the Transparency Directive.

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Emerging crypto-asset regulation

Reactions to the emergence of Facebook's stablecoin proposal – "Libra" – have highlighted a number of themes.

Regulators (and some established traditional financial institutions) have expressed concerns about BigTech firms' entry into financial services. The FSB highlighted in its December 2019 report that their entry has the potential for greater innovation, diversification and efficiency in the provision of financial services. However given BigTech firms' significant resources, large networks and widespread access to customer data, their financial services offerings could grow quickly, and a small number of BigTech firms may come to dominate rather than diversify the provision of financial services.

The proposal for a global, easily-accessible payment system is, in part, a reaction to the inefficiencies and high cost of existing cross-border payments systems, as well as that large parts of the global population are unable to access traditional banking services. The G7 report on stablecoins in October 2019 called for renewed focus on how existing payment systems can be improved and exploration of innovative ways to make payments better, cheaper, more efficient and more inclusive. The FSB will develop a roadmap in 2020.

Six Central Banks, including the European Central Bank and the Bank of England, formed a group in January 2020 to share experiences as they assess the potential cases for central bank digital currency in their home jurisdictions.

Regulators have been setting out their approaches to crypto-assets. The Basel Committee on Banking Standards issued a statement in March 2019 setting the expectations that banks should perform due-diligence on crypto-assets, have a robust risk management process around crypto-assets and publically disclose material crypto-asset exposures. At national level, in April 2019, the French Parliament adopted legislation that brings crypto-assets under the regulation and supervision of the AMF, and the UK FCA published guidance in July 2019 on which types of crypto-assets fall within the regulatory perimeter.

The fifth EU Anti-Money Laundering (AML) Directive, which came into force on 10 January 2020, requires member states to enact laws to make crypto-asset providers subject to the same AML obligations as other financial services firms.

The debate has now widened at European level, with the European Commission's December 2019 consultation on "An EU framework for markets in crypto-assets". The paper distinguishes between crypto-assets not covered by existing regulation (where the Commission is consulting on what would be a proportionate regulatory approach to address consumer/investor protection and market integrity concerns) and those that are, such as security tokens[1] and e-money tokens[2]. The latter types would qualify as a financial instrument under MiFID II and electronic money under Electronic Money Directive II, respectively, and the Commission is consulting on what changes need to be made to existing regulation.

Interestingly, the paper notes that although regulators strive to be technology neutral, the architecture of distributed ledger technology is so fundamentally different, with distributed control over a network, that it does not really fit the existing frameworks of EU regulation and supervision, which are based on centralised governance and risk control. It remains to be seen how this will be resolved.

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1 A crypto-asset issued on distributed ledger technology that provide rights and obligations akin to traditional instruments likes shares, debentures or units in collective investment scheme

2 A crypto-asset that stores monetary value as represented by a claim on the issuer which is issued on receipt of funds for the purpose of making payment transactions and accepted by a person other than the issuer

Operational resilience – "a shift in mind-set"

Strengthening of financial institutions' operational resilience remains a key priority for regulators.

A raft of new guidelines and consultations were published in 2019, broadening the scope of regulatory scrutiny and pointing to increased supervisory activity.

An evolving landscape

In December 2019 the FSB published two reports on Market developments and potential financial stability implications of BigTech in finance and Third party dependencies in cloud services, concluding that, although there were no immediate financial stability risks, further discussion was merited.

Expanding on proposals from its 2018 Fintech Action Plan, the European Commission is currently consulting on digital operational resilience in financial services with a view to potentially developing an EU cross-sectoral framework.

The ESAs have already issued more granular expectations and supervisory guidance for firms, for example:

— Final EBA Guidelines on outsourcing arrangements (February 2019) followed by Final EBA Guidelines on ICT and security risk management (November 2019), to be implemented by national competent authorities.

— EIOPA draft Guidelines on outsourcing to cloud service providers (July 2019), which are expected to be finalised in 2020.

As noted in the November edition, the ESAs have all put operational resilience high on their agenda for 2020. In its most recent Risk Assessment of the European Banking System, EBA called out operational resilience as a key risk alongside capital, profitability and macro-economic factors. The ECB, too, has stated that its supervisory focus for 2020 will be on IT, cyber and governance. Cyber risk also forms part of EIOPA's stress tests.

Regulatory guidance is becoming increasingly detailed. Leading the charge, the EBA's guidelines on outsourcing laid clearer foundations for supervisory expectations around governance frameworks, documentation, definition of critical or important functions, data management, business continuity, access, information and audit rights, impact and risk assessments (including assessment of concentration risk) and exit strategies. Title V provides guidance for effective supervision by national regulators of financial firms' outsourcing arrangements.

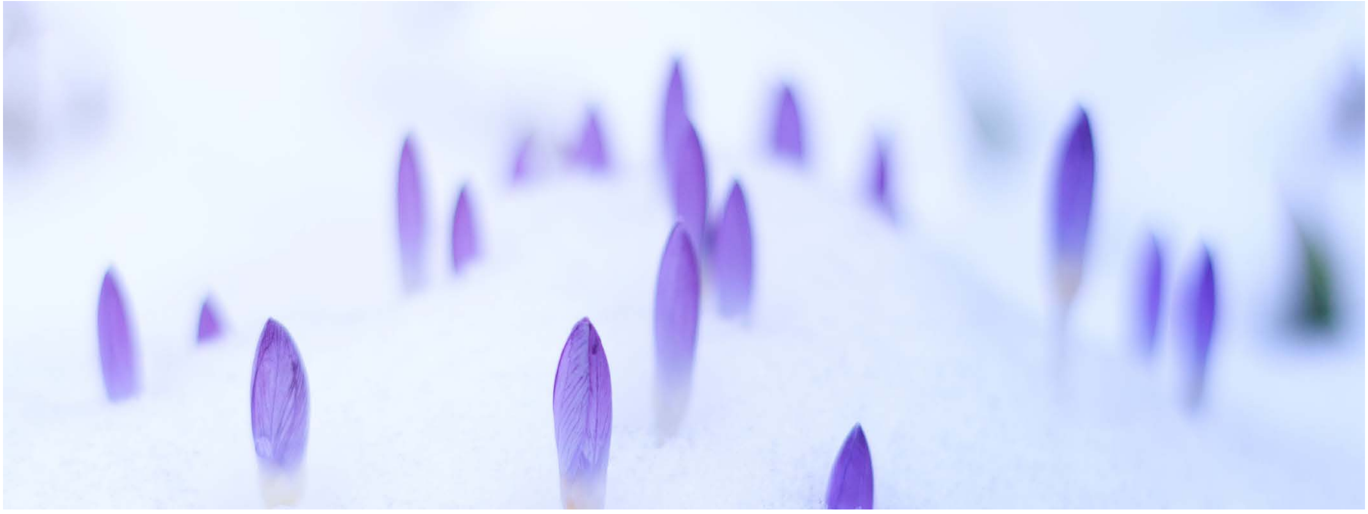
Same direction, different speeds

At national level, scope and speed of progress varies. As early as September 2018, the German regulator, BaFin[3] issued its "Supervisory Requirements for IT in Financial Institutions", covering IT strategy, governance, risk and security management, outsourcing and critical infrastructure.

In the Netherlands, DNB[4]'s 2018-2022 Supervisory Strategy notes, "we will focus particularly on the risks associated with IT outsourcing, such as cloud computing ... in the coming years we want to apply uniform criteria to assess IT outsourcing and cloud applications, based on the principle that institutions must actively manage the entire chain of outsourcing relationships."

The French regulator, AMF[5], also highlights cybersecurity as a supervisory priority for 2020, with a focus on asset management companies.

3 Bundesanstalt für Finanzdienstleistungsaufsicht
4 De Nederlandsche Bank
5 Autorité des Marchés Financiers



In December 2019, the Bank of England (BoE), Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) issued a co-ordinated package of proposals. Building on the EBA Guidelines, these are focused not just on banks, insurers and some investment firms, but extend to central counterparties, central securities depositories, recognised payment system operators and specified service providers. The package sent a clear signal that going forwards operational resilience will be scrutinised as much as financial resilience in the UK.

"Operational resilience … is an outcome. It is a step change, where we expect you to be forward looking and making decisions today that help prevent harm tomorrow… it's the resilience outcome that's most important to the supervisory authorities, not simply a firm's ability to demonstrate compliance" observed Megan Butler, Director of Supervision at the FCA.

The papers stress the need to prioritise a firm's most important business services, to articulate clearly the maximum tolerable level of disruption to these services and to identify metrics to monitor and measure their ability to remain within tolerance. In addition firms will be required to identify "severe but plausible scenarios" to test their ability to respond and recover within tolerances.

For the first time the UK regulators explicitly state that they expect firms to take responsibility for understanding and testing the resilience of the end-to-end supply chain, whether internal or supported by third parties.

What lies ahead?

In November 2019, Felix Hufeld, BaFin President said, "New types of risks could develop under the supervisory radar, and in extreme cases these risks could jeopardise financial stability itself. We would therefore be well advised to consider whether and to what extent we should formulate specific requirements for certain service providers, in particular cloud service providers, focusing on relevant activities as opposed to supervising whole entities. The supervisory toolbox has to be adjusted to serve both stability and a level playing field."

It remains to be seen whether international standard-setting bodies such as the FSB, the Basel Committee for Banking Supervision, IOSCO and IAIS will come any closer to developing and implementing a common approach to cyber and operational resilience in 2020. In contrast to the more established frameworks for capital, liquidity and resolution, there are currently no agreed international standards for operational resilience, but that should not be taken as a lack of interest or commitment.

It is clear that the focus on operational resilience is here to stay and that scrutiny by regulators will only increase as risks emerge and evolve. Expect a greater focus on end-to-end resilience of the supply chain. Strong governance, prioritisation of the business functions that pose the greatest risk of harm to consumers and financial stability, robust testing of operational stress scenarios and effective management of third party arrangements will need to become the cornerstones of all financial firms' resilience models.

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ESG Regulation: the race has begun

Political, social and investor pressure has led to the introduction of a swathe of new European rules, to be implemented in stages over the next three years, with more to come.

In the October 2019 edition we noted that sustainable finance is now firmly in the regulatory mainstream. The package of legislative proposals issued by the European Commission in May 2018 have all been adopted and further work is now underway under the new European Green Deal.

Sustainable finance legislation – first package

The first legislative package is aimed at asset managers, investment funds, investing institutions (including insurance companies and pension funds), intermediaries (including banks and insurers) and benchmark providers. It comprises:

1. Harmonised criteria (a taxonomy) for determining whether an economic activity is "environmentally-sustainable"
2. Disclosure requirements for institutional investors, intermediaries and investment products, and incorporating sustainability factors into investment processes and remuneration policies
3. The creation of new categories of low-carbon benchmarks
4. Amendments to MiFID II[6] and IDD[7] rules to integrate sustainability preferences into financial advisers' suitability tests

The core Taxonomy Regulation was the most hotly debated. The nub of the debate was the differentiation between end goals and how to get there (the transition), with different Member State economies more or less dependent on particular energy sources, for instance.

Still to come are the Level 2 rules, which will provide further articulation of some of the criteria. These, too, may experience challenges before adoption – the devil is invariably in the detail. The way in which "adverse impacts" are to be incorporated into the amendments to the MiFID II and IDD delegated acts, for example, has been the subject of much debate with the industry.

The ESAs are charged with producing various technical regulatory standards to underpin the Disclosure Regulation. These will apply to UCITS, all forms of alternative investment funds, occupational pension funds, asset managers, fund intermediaries and insurance intermediaries.

The new European Green Deal

In December, the Commission issued a Communication that sets out the next set of proposals to tackle climate change and environmental challenges. It includes a section on the pursuit of green finance and investment, and "ensuring a just transition". The Commission estimates that the 2030 targets will require €260 billion additional annual investment (about 1.5% of GDP) and notes that the private sector will be key to financing the green transition.

In autumn 2020, ahead of "UN COP26" in November and as heralded in our report on "EU financial services – a new agenda demands a new approach", the Commission will publish a renewed sustainable finance strategy. It will include three key policy actions:

1. Further embedding sustainability into the corporate governance framework, including a review of the Non-Financial Reporting Directive
2. Making it easier for investors to identify sustainable investments via labels for retail investment products and by developing an EU green bond standard

6 Markets in Financial Instruments Directive, revised
7 Insurance Intermediation Directive

The three-pocket approach to equity funds

At least 60% of the fund's portfolio must be invested in companies whose economic activities comply with:

— at least 20% of the fund's portfolio must be invested in companies that derive at least 50% of their revenue from green economic activities (as defined by the new Taxonomy Regulation)

— the remaining 0%-40% must be invested in companies deriving 20%-49% of their revenue from green economic activities

The remainder of the portfolio must be invested in companies deriving less than 20% of their revenue from green economic activities but not undertaking any excluded activities, or other assets or cash.

3. Better integrating climate and environmental risks into the EU prudential framework and assessing the suitability of current capital requirements for green assets

Progress on a new label for investment products

The European Commission's Joint Research Centre (JRC) has issued its Second Technical Report. It now proposes mandatory criteria for determining whether retail financial products (investment funds, insurance-based investment products and savings accounts/deposits) can use the EU ecolabel. The ecolabel will apply to the service provided by the product manufacturer, rather than to the product itself, but can feature on the product's promotional material.

A particular focus of the JRC's recent work has been to find a balance between allowing too many investment products to claim green status and excluding too many existing products that are currently advertised as green. The JRC suggests that bond funds be at least 70%-invested in bonds that comply with the Green Bond Standard, that a "three-pocket" approach be adopted for equity funds (which may be difficult to operate in practice – see box for detail), and that insurance unit-linked products should look through to the underlying funds.

Meanwhile, supervisors expect ESG stress testing

Ahead of any proposed changes to capital requirements, the ECB, EBA, EIOPA and some national regulators (in particular, the UK Prudential Regulation Authority) have set out their supervisory expectations for banks and insurers to incorporate the full panoply of sustainable finance risks and factors in their stress testing exercises.

EBA has issued its own action plan on sustainable finance. It proposes to adopt a sequential approach, starting with key metrics, strategies and risk management, and moving towards scenario analysis and evidence for any adjustments to risk weights. In particular, it encourages banks to set a "green asset ratio".

For the first time, EIOPA's biennial stress testing of occupational pension funds included consideration of ESG factors. The report, issued in December 2019, found that while the majority of the 176 pension funds sampled said they considered ESG factors, only 30% had processes in place to manage ESG risks, and less than 20% assessed the impact of ESG factors on portfolio risks and returns.

Impact on financial services firms and more widely

The various new rules must be implemented by different deadlines, ranging from 2020 to 2022.

Until the Level 2 rules are finalised, the impact on regulated firms and their services and products cannot be precisely calibrated. It is certain, though, that regulatory and client pressures will be at the forefront from now on. Firms need to incorporate ESG considerations into all aspects of their business.

Moreover, as highlighted in our report "Impact of ESG disclosures – embracing the future", because the new rules will impact the investment and lending appetites of EU financial institutions, they will have a much wider impact. **Coupled with increasing investor demands, there could be a profound impact on non-financial companies' ability to raise capital, within the EU and beyond.**

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