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Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

SAFE Finance Blog

The SAFE Regulatory Radar in April

04/30/2020

European initiative towards sustainable finance, new standards for the assessment of market risk, and guidelines on fees in investment funds: a selection of financial regulatory developments from this month



At the end of each month, the SAFE Regulatory Radar highlights a selection of important news and developments on financial regulation at the national and EU level.

Sustainable finance: defining benchmark criteria

On 8 April 2020, the European Commission published three draft delegated regulations (CDRs) providing sustainability criteria for benchmarks. The regulations are prepared under the Regulation (EU) 2016/1011 (<https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32016R1011>) (Benchmarks Regulation, BMR) on indices that are used as benchmarks for financial instruments and contracts or to measure the performance of investment funds. They will be finalized after the consultation period.

The first [CDR \(draft delegated regulations\)](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12020-Minimum-standards-for-benchmarks-labelled-as-EU-Climate-Transition-and-EU-Paris-aligned-Benchmarks) (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12020-Minimum-standards-for-benchmarks-labelled-as-EU-Climate-Transition-and-EU-Paris-aligned-Benchmarks>) sets out the minimum standards that benchmarks have to meet to be labeled as EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks. These are voluntary labels that are designed to help investors looking to adopt a low-carbon investment strategy. The regulation further establishes transparency requirements on the methodology for both benchmarks and enumerates types of companies that have to be excluded from benchmark calculations.

The [BMR \(Benchmarks Regulation\)](https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32016R1011) requires benchmark administrators to publish an explanation of how the key elements of the benchmark methodology reflect environmental, social and governance (ESG) factors. The second [CDR \(draft delegated regulations\)](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12018-Key-elements-of-the-methodology-reflecting-environmental-social-or-governance-ESG-factors) (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12018-Key-elements-of-the-methodology-reflecting-environmental-social-or-governance-ESG-factors>) provides the minimum content of the explanation that includes information on data and standards used.

The third [CDR \(draft delegated regulations\)](https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12019-References-to-ESG-factors-enabling-market-participants-to-make-well-informed-choices) (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12019-References-to-ESG-factors-enabling-market-participants-to-make-well-informed-choices>) lays down specific factors to be disclosed depending on the type of benchmark (equity, fixed income corporate, sovereign debt, commodity, private equity, private debt and other benchmarks), the degree of exposure of the portfolio to climate-related opportunities and risks, and measures for the planning and management of resources.

Capital Markets Union: New guidelines for market risk

On 27 March 2020, the European Banking Authority (EBA) published its final draft Regulatory Technical Standards (<https://eba.europa.eu/eba-publishes-final-draft-standards-key-areas-eu-implementation-frtb>) (RTS) on the new Internal Model Approach (IMA) under the Fundamental Review of the Trading Book (FRTB). These [RTS \(Regulatory Technical Standards\)](https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0876&from=EN&usg=AOvVaw2Xn4jsBLuPRQyLZTb0hKpg) have been developed according to the revised Capital Requirements Regulation (<https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=2&ved=2ahUKEwjMnsP0wfn0AhWRyaQKHRpQDt4QFjABegQIAhAB>;

[lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0876&from=EN&usg=AOvVaw2Xn4jsBLuPRQyLZTb0hKpg](https://eba.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32019R0876&from=EN&usg=AOvVaw2Xn4jsBLuPRQyLZTb0hKpg))(CRR 2) and constitute the first phase of the EBA roadmap ([https://eba.europa.eu/sites/default/documents/files/documents/10180/2844544/ab272ad0-f256-4d70-9563-376e1d772feb/EBA roadmap for the new market and counterparty credit risk approaches.pdf](https://eba.europa.eu/sites/default/documents/files/documents/10180/2844544/ab272ad0-f256-4d70-9563-376e1d772feb/EBA%20roadmap%20for%20the%20new%20market%20and%20counterparty%20credit%20risk%20approaches.pdf)) towards the implementation of the market and counterparty credit risk frameworks in the EU.

The standards consist of the RTS on Liquidity Horizon

(https://eba.europa.eu/sites/default/documents/files/document_library/EBA-RTS-2020-%2001%20Final%20draft%20RTS%20on%20Liquidity%20Horizon%20for%20the%20IMA.pdf) for the IMA. They clarify how institutions map the risk factors to the relevant category and subcategory. Besides, it specifies the definition of small and large capitalization for equities. Large market capitalization is considered when it is equal to or greater than 1.75 billion euros.

The second ([https://eba.europa.eu/sites/default/documents/files/document_library/EBA-RTS-2020-01 Final draft](https://eba.europa.eu/sites/default/documents/files/document_library/EBA-RTS-2020-01%20Final%20draft%20RTS%20on%20back-testing%20and%20profit%20and%20loss%20attribution.pdf) <abbr title=>RTS on back-testing and profit and loss attribution ([https://eba.europa.eu/sites/default/documents/files/document_library/EBA-RTS-2020-02 Final draft](https://eba.europa.eu/sites/default/documents/files/document_library/EBA-RTS-2020-02%20Final%20draft%20RTS%20on%20back-testing%20and%20profit%20and%20loss%20attribution.pdf) RTS on

Backtesting and PLA requirements.pdf) (PLA) sets out the elements of the hypothetical, actual, and risk-theoretical profit and loss calculations for the purpose of back-testing. In detail, the standards specify that the actual and hypothetical changes in the relevant portfolio's value should be computed based on the pricing methods, the model parametrizations and market data used by the institution in the end-of-day valuation process.

The third RTS clarify the criteria for assessing the modellability of risk factors (https://eba.europa.eu/sites/default/documents/files/document_library/EBA-RTS-2020-03_Final_draft_RTS_on_Risk_factor_modellability.pdf) under the IMA (Internal Model Approach). They set out the criteria for identifying the risk factors that are modellable and that institutions are allowed to include in their expected shortfall calculations. It also specifies the requirements under which verifiable prices can be considered representative for risk factors.

The technical standards are submitted to the European Commission for adoption. The RTS (Regulatory Technical Standards) have to trigger a three year period after which institutions with the permission to use the FRTB (Fundamental Review of the Trading Book) internal models are required to calculate their own funds requirements for market risk.

Capital Markets Union: ESMA publishes guidance on performance fees in UCITS and certain AIFs

On 3 April 2020, the European Securities and Markets Authority (ESMA) presented its final guidelines (https://www.esma.europa.eu/sites/default/files/library/esma_34-39-968_final_report_guidelines_on_performance_fees.pdf) on performance fees in investment funds that are applicable to Undertakings for the Collective Investment in Transferable Securities (UCITS (<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:02009L0065-20140917>)) and certain types of Alternative Investment Funds (AIFs (<https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32011L0061>)).

The guidelines aim to help investors to understand the main features and effects of the application of the performance fee as well as to provide supervisory convergence. This technical act provides a comprehensive explanation of the general principles on performance fee calculation methods, including the assessment of the consistency between the performance fee model and the fund's investment objective. In addition, ESMA (European Securities and Markets Authority) sets the minimum pace regarding the frequency of the crystallization of the performance fee and requests that investors should be adequately informed about performance fees and their potential impact on investment return. Further, the guidelines clarify the concept of negative performance (loss) recovery.

In a two-month period after the publication, the national competent authorities (NCAs) must notify ESMA (European Securities and Markets Authority) whether they comply or intend to comply with the guidelines. After that, they will come into force.

Current public consultations

European Commission

- Public consultation (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12020-Minimum-standards-for-benchmarks-labelled-as-EU-Climate-Transition-and-EU-Paris-aligned-Benchmarks>) on the Draft Commission Delegated Regulation on the minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks. The deadline is Wednesday, 6 May 2020.
- Public consultation (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12018-elements-of-the-methodology-reflecting-environmental-social-or-governance-ESG-factors>) on the Commission Delegated Regulation on the minimum content of the explanation on how Environmental, Social and Governance (ESG) factors are reflected in the methodology. The deadline is Wednesday, 6 May 2020.
- Public consultation (<https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12019>)

- Public consultation (<https://ec.europa.eu/finance/better-regulation/make-your-voice-count/12019-References-to-ESG-factors-enabling-market-participants-to-make-well-informed-choices>) on the Commission Delegated Regulation on the explanation in the benchmark statement of how environmental and governance factors are reflected in each benchmark provided and published. The deadline is Wednesday, 3 May 2020.
- Public consultation (https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-strategy-consultation-document_en.pdf) on its forthcoming Renewed Sustainable Finance Action Plan. The deadline is Wednesday, 15 July 2020.
- Public consultation (<https://ec.europa.eu/info/consultations/finance-2020-retail-payments-strategy-blank>) on a retail payments strategy for the EU. The deadline is Friday, 26 June 2020.

European Securities and Markets Authority

- Public consultation (<https://www.esma.europa.eu/press-news/esma-news/esma-consults-clearing-solutions-pension-scheme-arrangements-under-emir>) on a range of issues regarding potential central clearing solutions for Pension Scheme Arrangements (PSAs) under the European Market Infrastructure Regulation (EMIR). The deadline is Monday, 15 June 2020.
- Public consultation (<https://www.esma.europa.eu/press-news/esma-news/esma-consults-standard-information-facilitate-cross-border-funds>) on the standard forms, templates, and procedures that NCAs (national competent authorities) should use to publish information on their websites to facilitate cross-border distribution of funds. The deadline is Tuesday, 30 June 2020.
- Public consultation (<https://www.esma.europa.eu/press-news/consultations/consultation-guidelines-25-aifmd>) on its draft guidance to address leverage risks in the Alternative Investment Fund (AIF) sector. The deadline is Tuesday, 1 September 2020.
- Public consultation (https://www.esma.europa.eu/sites/default/files/library/esma74-362-47_cp_on_the_ts_on_reporting_data_quality_data_access_and_registration_of_trs_under_emir) on draft Regulatory and Implementing Technical Standards (RTS and ITS) under the EMIR REFIT, covering reporting to Trade Repositories (TRs), procedures to reconcile and validate the data, data access by the authorities and registration of the TRs. The deadline is Friday, 19 June 2020.
- Public consultation (https://www.esma.europa.eu/sites/default/files/library/esma70-151-2852_consultation_report_ptrr_services_-_article_853a_of_emir.pdf) on Post Trade Risk Reduction (PTRR) under the European Market Infrastructure Regulation (EMIR). The deadline is Monday, 15 June 2020.

Anastasia Kotovskaia (<https://safe-frankfurt.de/policy-center/policy-center-team.html>) is Research Assistant at the SAFE Policy Center and currently pursuing a Ph.D. in Law at Goethe University.

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Contact

Leibniz Institute for Financial Research SAFE

Theodor-W.-Adorno-Platz 3
60323 Frankfurt am Main

Phone: +49 69 798 30080

Fax: +49 69 798 30077

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