



Management Solutions

Making things happen

Regulation Outlook

3Q18

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Executive summary

During the third quarter of 2018, the BCBS published the G-SIBs revised assessment methodology and the HLA requirement. In Europe, the EBA published three Final Guidelines regarding SREP, IRRBB and stress testing, while the ECB published several documents on TRIM. At local level, it should be highlighted that the Fed, the FDIC and the OCC published a Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act.

Global publications

- At international level, the BCBS published the **G-SIBs revised assessment methodology and the higher loss absorbency (HLA) requirement**, which maintains the core elements and fundamental structure of the G-SIBs' framework set out in 2013, although introduces certain enhancements, regarding, among others, the definition of cross-jurisdictional indicators or the introduction of a trading volume indicator.

European publications (continuation)

- Finally, the ECB published a **Draft Regulation on the materiality threshold for credit obligations past due** which defines an absolute minimum amount, expressed as the sum of all amounts past due owed by an obligor, and a relative component, expressed as a percentage reflecting the amount of the credit obligation past due in relation to the total amount of all on-balance sheet exposures to that obligor.

European publications

- Regarding the Pillar 2, the EBA published **three Final Guidelines (GLs)** on the following aspects: i) **common procedures and methodology for SREP and supervisory stress testing**, ii) **the management of interest rate risk arising from non-trading activities (IRRBB)**, and iii) **institution's stress testing**. These final GLs aim to update the existing regulation on this regard, i.e. the EBA GL on SREP published in 2014, the EBA GL on the management of the IRRBB published in 2015, and the Committee of European Banking Supervisors GL on stress testing (CEBS GL 32) published in 2010, respectively.
- Moreover, the EBA announced the release of its **2018 EU-wide transparency exercise**, which implies the beginning of the interaction of the EBA with banks for supervisory reporting data population and verification.
- Further, the ECB published a **Draft Guide to internal models** which covers the consultative update of the risk-type-specific chapters of the Guide to the TRIM. In addition, the ECB published a **Guide to on-site inspections and internal model investigations** which aims at providing a useful reference document for the supervised entities and other legal entities for which the ECB has decided to launch an on-site inspection.

Local publications

- In Spain, the Government published an **Anteproyecto de Ley (APL) de medidas para la transformación digital del sistema financiero**, which mainly addresses the concept of regulatory sandbox, its functioning, and the adoption of other measures to facilitate digital transformation.
- In USA, the Fed, the FDIC and the OCC published a **Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)**, which covers certain areas (e.g. stress testing, resolution plans or Volcker Rule).
- Moreover, the Fed and the FDIC published a **Proposed Guidance on resolution planning for eight large, complex U.S. Banking Organizations**, that updates the agencies' expectations for how a firm's resolution strategy should address certain aspects (e.g. capital or liquidity).
- In UK, the PRA published a **Consultation Paper (CP) 17/18 on credit risk: definition of default**, which sets out the PRA's approach to implementing the thresholds for determining when a credit obligation is considered material with respect to the CRR default definition. Further, this CP updates the PRA's expectation in Supervisory Statement (SS) 11/13 on IRB approaches.

Regulatory projections

At European level, the EBA will publish the results for the 2018 EU-wide stress test and transparency exercise, as well as the final GL on disclosure of non-performing and forbore exposures. Moreover, the FSB will publish the new list of G-SIBs and the BCBS revised standards on IRRBB will be applied. In UK, the BoE will publish the stress test results for 2018.

Regulatory projections

1. Next quarter

- **(Europe) November 2018:** the EBA will publish the EU-wide stress test results for 2018.
- **(Global) December 2018:** the BCBS revised standards on IRRBB will be applicable.
- **(Global) December 2018:** the FSB will publish the new list of G-SIBs.
- **(Europe) December 2018:** the EBA will publish the final GL on disclosure of NPE and FBE.
- **(Europe) December 2018:** the EBA expects to release the results of its 2018 EU-wide transparency exercise.
- **(UK) December 2018:** the BoE will publish the stress test results for 2018.

2. Next year

- **(Europe) To be determined:** the European Parliament (EP) and the Council are expected to approve the reform package of the financial system proposed by the EC, amending several legislative acts (CRD IV, CRR, BRRD, SRMR and EMIR).
- **(Europe) To be determined:** the EBA will publish several documents related to FinTech, among others, on cybersecurity or consumer protection.
- **(Global) January 2019:** G-SIBs not headquartered in an emerging market economy will be required to comply with a minimum TLAC requirement of 16% of RWAs and 6% of the LR exposure, in accordance with the FSB.
- **(Global) January 2019:** the BCBS's large exposures framework will be applicable.
- **(Global) January 2019:** IFRS 16 on leases published by the IASB will be applied.
- **(Europe) January 2019:** the EBA Final Guidelines on the treatment of connected clients will come into force.
- **(Europe) January 2019:** the Final Guidelines on the ICAAP and the ILAAP will be considered according to the SREP framework.
- **(Europe) January 2019:** the EBA Guidelines on management of NPLs and FBE will be applicable.
- **(Europe) January 2019:** the EBA Final Guidelines on SREP and stress testing will be applicable.
- **(Spain) January 2019:** the Circular of the Bank of Spain amending Circular 4/2017 and the Circular 1/2013, will enter into force.
- **(USA) January 2019:** the new requirements on Long-Term Debt (LTD) and TLAC will be applicable.
- **(UK) January 2019:** the BoE ring-fencing rules will be implemented.
- **(Europe) May 2019:** the EBA will update the O-SII list.
- **(Europe) June 2019:** the EBA Final Guidelines on IRRBB will be applicable.

3. More than a year

- **(Global) December 2019:** the BCBS will monitor G-SIBs' progress in adopting the RDA&RR principles.
- **(Global) December 2019:** the FSB is expected to conduct a review of the technical implementation of TLAC.
- **(Global) December 2019:** the EBA Final RTS on economic downturn will enter into force.
- **(Global) December 2020:** the BCBS Guidelines on step-in risk will be applicable.
- **(Europe) December 2020:** the ECB Regulation on the materiality threshold for credit obligations past due will be applicable.
- **(Europe) January 2021:** the EBA Guidelines on IRB parameters estimation will be applicable.
- **(Global) December 2021:** the BCBS new assessment methodology for G-SIBs will be applicable.
- **(Global) January 2022:** the revised SA for credit risk, the revised IRB framework, the revised CVA framework, the revised operational and market risk framework published in Basel III by the BCBS will be implemented. Moreover, the LR framework using the revised exposure definition and the G-SIB buffer will be applicable.
- **(Global) January 2022:** most of the new disclosure requirements of the BCBS Pillar III updated framework will be implemented.
- **(UK) January 2022:** the PRA will require firms to comply with an end-state MREL.
- **(Europe) December 2022:** the application of IFRS 9 transitional arrangements will finish.
- **(Global) January 2027:** an output floor of 72.5% will be applicable according to the Basel III reform.

Publications of this quarter

Summary of outstanding publications of this quarter

Topic	Title	Date	Page
	Basel Committee on Banking Supervision		
G-SIBs	<ul style="list-style-type: none"> G-SIBs revised assessment methodology and the higher loss absorbency requirement 	06/07/2018	8
	European Banking Authority		
FinTech	<ul style="list-style-type: none"> Thematic Report on the impact of FinTech on incumbent credit institutions' business models Thematic Report on the prudential risks and opportunities arising for institutions from FinTech 	04/07/2018	10
Pillar 2	<ul style="list-style-type: none"> Final Guidelines on the revised common procedures and methodologies for the SREP and supervisory stress testing Final Guidelines on common procedures and methodologies for SREP and supervisory stress testing - Consolidated version Final Guidelines on the management of IRRBB Final Guidelines on institutions stress testing 	23/07/2018	11
Transparency exercise	<ul style="list-style-type: none"> 2018 EU-wide transparency exercise 	25/09/2018	13
	European Central Bank		
Materiality Threshold	<ul style="list-style-type: none"> Draft Regulation on the materiality threshold for credit obligations past due 	04/07/2018	14
TRIM	<ul style="list-style-type: none"> Draft Guide to internal models – Risk-type-specific chapters Guide to on-site inspections and internal model investigations 	10/09/2018 24/09/2018	15 17
	Government of Spain		
Digital Transformation	<ul style="list-style-type: none"> Anteproyecto de Ley de medidas para la transformación digital del sistema financiero 	12/07/2018	20
	Federal Reserve / Federal Deposit Insurance Corporation		
Resolution planning	<ul style="list-style-type: none"> Proposed Guidance on resolution planning for eight large, complex U.S. Banking Organizations 	02/07/2018	21
 	Federal Reserve / Federal Deposit Insurance Corporation / Office of the Comptroller of the Currency		
EGRRCPA	<ul style="list-style-type: none"> Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) Statement describing how, consistent with the EGRRCPA, the Fed will no longer subject primarily smaller, less complex banking organizations to certain Fed regulations 	09/07/2018	22
	Prudential Regulatory Authority		
Definition of default	<ul style="list-style-type: none"> Consultation Paper 17/18 on credit risk: definition of default 	30/07/2019	24



Publications of the quarter

Global publications



06/07/2018

G-SIBs revised assessment methodology and the higher loss absorbency requirement.

1. Context

In July 2013, the BCBS published the global systemically important banks (G-SIB) assessment methodology and the higher loss absorbency (HLA) requirement. This methodology assesses the relative systemic importance of internationally active banks based on 13 indicators in 5 categories (i.e. cross-jurisdictional activity, size, interconnectedness, substitutability, and complexity) resulting in a score of systemic importance for each bank. The FSB publishes the list of G-SIBs according to this methodology.

When the G-SIB assessment framework was first published, the BCBS agreed to review the framework every 3 years. In this context, following the consultation launched in March 2017, the BCBS has now published the **G-SIBs revised assessment methodology and the HLA requirement**, which maintains the core elements and fundamental structure of the G-SIBs' framework set out in 2013, although introduces certain enhancements.

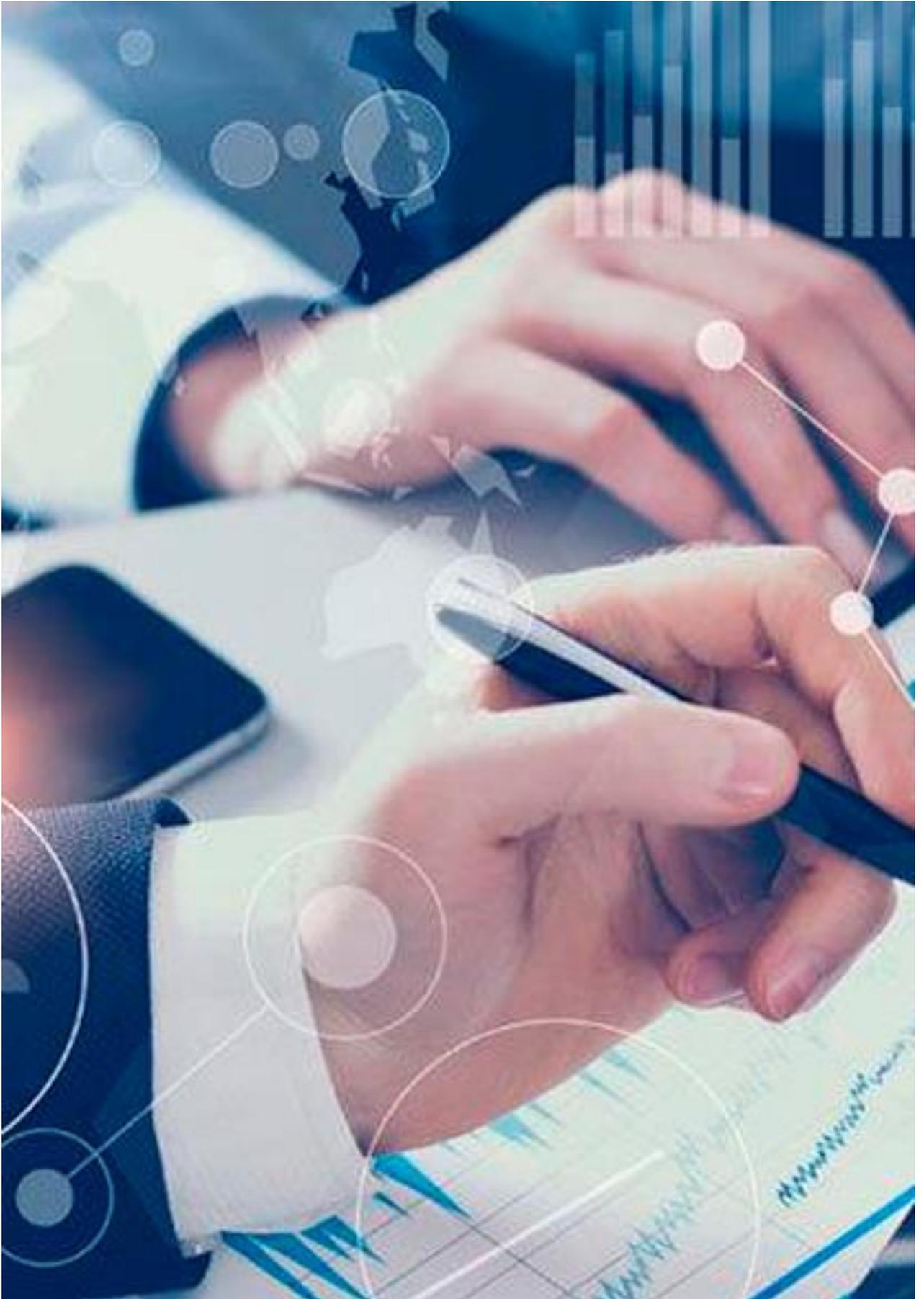
In particular, the BCBS has introduced 6 changes to the G-SIB assessment methodology and the HLA requirement regarding: i) the definition of cross-jurisdictional indicators, ii) the introduction of a trading volume indicator and modification of the substitutability category's weights, iii) the extension of the scope of consolidation, iv) the review of the disclosure requirements, v) the provision of further guidance regarding bucket migration and the associated HLA surcharge, and vi) the adoption of a transitional schedule.

2. Main points

- **Definition of cross-jurisdictional indicators.** The BCBS has agreed to review this definition in order to harmonise it with the definition of BIS consolidated statistics and to include derivatives calculated on a consolidated basis in both indicators, cross-jurisdictional claims and liabilities.
- **Introduction of a trading volume indicator and modification of the substitutability category's weights.** The BCBS has agreed to include a new indicator of trading volume in the substitutability category weighted at 3.33%, and reduction of the underwriting indicator from 6.67% to 3.33%.
- **Extension of the scope of consolidation.** The BCBS has agreed to include exposures under insurance subsidiaries in the categories that best reflect the systemic risks common to banks and insurers (i.e. size, interconnectedness and complexity).
- **Review of the disclosure requirements.** The BCBS has agreed to revise these requirements to ensure consistency with the revised Pillar 3 reporting requirements. In this regard:
 - Banks are required to disclose at least the 13 indicators used in the G-SIB assessment based on financial year-end data, on an annual basis.
 - They must further publicly disclose if the data used to calculate the G-SIB scores differ from the figures previously disclosed.
 - Their disclosures must follow Pillar 3 reporting requirements and timelines.
- **Provision of further guidance regarding bucket migration and the associated HLA surcharge.** The BCBS has agreed that where a bank's G-SIB score has declined substantially from one year to the next resulting in a lower HLA requirement, it is allowed to immediately adhere to the new, lower HLA requirement (instead of waiting 12 months before doing so).
- **Adoption of a transitional schedule.** In order to allow banks to maintain a certain degree of consistency with the 2013 G-SIB assessment methodology and to provide national authorities with the time to implement the changes in their respective regulatory frameworks, the BCBS has agreed that the revised assessment methodology will take effect in 2021 (based on end-2020 data), and the resulting HLA requirement would be applied in January 2023.

3. Next steps

- The revised G-SIB assessment methodology is expected to be implemented in member jurisdictions by **2021**.



Publications of the quarter

European publications



04/07/2018

- **Thematic Report on the impact of FinTech on incumbent credit institutions' business models**
- **Thematic Report on the prudential risks and opportunities arising for institutions from FinTech**

1. Context

The rapid evolution of FinTech with its multiple applications and interactions within the financial services sector may fundamentally change the institutions' business models and risk profiles. In this regard, in March 2018 the EBA issued a Roadmap on FinTech setting out its priorities for 2018/2019 and covering a set of issues such as the impact on incumbent institutions' business models and prudential risks and opportunities arising from the use of FinTech.

In this context, the EBA has now published a **Thematic Report on the impact of FinTech on incumbent credit institutions' business models** which covers, among others, the categorisation of incumbents, drivers of business model's changes, and the relationships of incumbents with FinTech. Further, the EBA has also published a **Thematic Report on the prudential risks and opportunities arising for institutions from FinTech** which aims to raise awareness of current and potential FinTech applications.

2. Main points

Thematic Report on the impact of FinTech on incumbent credit institutions' business models

- **Categorisation of incumbents.** Based on the EBA's analysis, incumbents are categorised into:
 - **Proactive/front-runners:** institutions with ambitious innovation strategies, highly targeted transformation projects and growing investments in FinTech.
 - **Reactive:** institutions perceived as followers of the technological developments (wait and see approach); and institutions that appear to react to peer pressure (go with the flow approach combined with the concern of being left behind).
 - **Passive:** institutions that are left behind in terms of technological developments because of other significant priorities (e.g. high NPL levels).
- **Drivers of business models' changes.** This Report sets out factors that might significantly affect incumbents' business models from a sustainability perspective:
 - Digitalisation/innovation strategies pursued to keep up with a fast-changing environment.
 - Challenges arising from legacy Information and Communication Technology (ICT) systems.
 - Operational capacity to implement the necessary changes.
 - Concerns over retaining and attracting staff.
 - Increasing risk of competition from peers and other entities.
- **Relationship of incumbents with FinTech.** This Report addresses four types of relationships: i) partnering with new entrant FinTech firms, ii) investing in new entrant FinTech firms, iii) collaborating with other stakeholders, and iv) developing FinTech solutions internally. In this regard, the Report concludes that currently the predominant type of relationship between incumbents and FinTech is partnership with FinTech firms.

Thematic Report on the prudential risks and opportunities arising for institutions from FinTech

- **Identification of new technologies.** This Report assesses the following seven cases where new technologies are applied or considered to be applied to existing financial processes, procedures and services:
 - Biometric authentication using fingerprint recognition.
 - Use of robo-advisors for investment advice.
 - Use of Big Data and Machine Learning for credit scoring.
 - Use of distributed ledger technology and smart contracts for trade finance.
 - Use of distributed ledger technology to streamline customer due diligence processes.
 - Mobile wallet with the use of near-field communication.
 - Outsourcing core banking/payment system to the public cloud.
- **Implementation of new technologies by institutions.** This Report highlights that no significant implementation of sophisticated technologies has been noted yet by institutions, possibly because of security concerns.
- **Overall analysis of prudential risks.** This Report sets out that there is a growing shift towards operational risk, arising mainly from the accentuation of ICT risks as institutions move towards more technology-based solutions. Thus, dependencies on third-party providers, heightened legal and compliance risks and negative impact on conduct risk add to the overall increased operational risk.
- **Overall analysis of potential opportunities.** This Report highlights that the potential efficiency gains and improved customer experience are currently the predominant potential opportunities while the changing customer behaviour is an important factor triggering institutions' interest towards FinTech.



23/09/2018

- **Final Guidelines on the revised common procedures and methodologies for the SREP and supervisory stress testing**
- **Final Guidelines on common procedures and methodologies for SREP and supervisory stress testing - Consolidated version**
- **Final Guidelines on the management of interest rate risk arising from non-trading activities**
- **Final Guidelines on institutions stress testing**

1. Context

In April 2017, the EBA published its Pillar 2 Roadmap aiming to enhance institutions' risk management and supervisory convergence in the supervisory review and examination process (SREP). Following the global regulatory developments, as well as the EBA's supervisory assessments, specific changes are now needed to reinforce the framework as set in the Roadmap.

In this context, following the public consultation launched in November 2017, the EBA has now published **three Final Guidelines (GLs) regarding: i) common procedures and methodology for SREP and supervisory stress testing, ii) the management of interest rate risk arising from non-trading activities (IRRBB), and iii) institution's stress testing.** These GLs aim to update the existing regulation on these aspects, i.e. the EBA GL on SREP published in 2014, the EBA GL on the management of the IRRBB published in 2015, and the Committee of European Banking Supervisors GL on stress testing (CEBS GL 32) published in 2010, respectively.

2. Main points

Final GL on the revised common procedures and methodologies for the SREP and supervisory stress testing

- Despite the overall SREP framework remain intact, these Final GL cover **several elements of the EU SREP framework that have been updated** to reflect the ongoing policy initiatives related to Pillar 2/SREP, which include amongst other things:
 - The introduction of Pillar 2 Capital Guidance (P2G).
 - The integration of supervisory stress testing requirements and supervisory assessment of banks' stress testing from the EBA CP GL on stress testing and supervisory stress testing.
 - Clarification of certain aspects regarding the scoring framework (e.g. definitions, measures set out from the SREP scoring framework).
 - Further details on the articulation of own funds requirements regarding Total SREP Capital Requirements (TSCR) and Overall Capital Requirements (OCR).
 - Consistency checks with relevant EBA standards and guidelines that came into force after the publication of the original SREP Guidelines in 2014.

Final GL on the management of interest rate risk arising from non-trading activities (IRRBB)

- These Final GL set out **supervisory expectations** on the management of IRRBB considering the development introduced in the BCBS Standard on IRRBB.
- In particular, these GL cover several aspects regarding, among others:
 - General provisions. The scope of the current GL has been expanded covering credit spread risk from non-trading book activities (CSRBB), providing a definition of CSRBB and a high level expectation for institutions to identify CSRBB exposures and ensure it is adequately monitored and assessed.
 - Capital identification, calculation and allocation. Despite the existing expectations on internal capital allocation have been retained, more detailed guidance is provided regarding the capital adequacy assessments of IRRBB.
 - Governance. New guidance is provided on the appropriate assessment of new products and activities, delegation and monitoring and management of IRRBB, risk appetite, etc.
 - Measurement. The existing guidelines have been retained although some additional expectations originating in the BCBS Standard have been added (e.g. provision on currency specific shocks for material currencies).
 - Supervisory outlier test. A set of principles that institutions should use when calculating this test is provided (e.g. all interest rate sensitive instruments should be included).

2. Main points (continue)

Final GL on institutions' stress testing

- These Final GL aim at achieving **convergence of practices** followed by institutions for stress testing across the EU by providing detailed guidance to be complied with by institutions when designing and conducting a stress testing programme/framework.
- In particular, these GL focus on the following aspects:
 - Stress testing governance structures and their use including the application of the GL on internal governance of stress testing.
 - Data infrastructure, including data aggregation capabilities and reporting practices.
 - Stress testing scope and coverage, including general requirements; portfolio and individual risk level stress testing; and institution-wide stress testing.
 - Possible methodologies including importance of undertaking both simple and complex scenarios.
 - Range of, non-exhaustive, individual risk categories in relation to stress testing in order to enhance risk management and capital planning and liquidity processes.
 - Application of stress testing programmes, including interaction with recovery and resolution plans, the use of stress test to assess viability of the capital plan, etc.

3. Next steps

- The Final GL on SREP replace the existing GL and will apply from **1 January 2019**.
- The Final GL on IRRBB replace the existing GL and will be applicable from **30 June 2019** with transitional arrangements for specific provisions until **31 December 2019**.
- The Final GL on institutions' stress testing replace the existing GL and will be applicable from **1 January 2019**.



25/09/2018

2018 EU-wide transparency exercise.

1. Context

The EBA has been conducting transparency exercises at EU-wide level on an annual basis since 2011, either linked to concurrent stress test exercises or to specific sole transparency exercises. However, unlike the stress tests, transparency exercises are purely disclosure exercises where only bank-by-bank data are published and no shocks are applied to the actual data.

In this regard, the EBA has announced the release of its **2018 EU-wide transparency exercise** in order to provide the wider with a consistent tool to access data on the EU banking system. In particular, this announcement implies the beginning of the interaction with banks for supervisory reporting data population and verification.

2. Main points

- **Scope.** This transparency exercise will cover data capital, leverage ratio, risk exposure amounts, profit and losses, market risk, securitisation, credit risk, exposures to sovereign, non-performing exposures and forborne exposures. The information reported will be mostly in line with the previous exercises, although the introduction of IFRS 9 has required a revision of FINREP based templates.
- **Sample.** It will be aligned with the one used for the 2018 EBA Risk Assessment Report (RAR), so it will cover a wide sample of banks (about 130 EU banks) and countries.
- **Reference dates.** December 2017 and June 2018.

3. Next steps

- The EBA expects to release the results of its 2018 EU-wide transparency exercise in **December 2018**, together with the EBA 2018 RAR.



EUROPEAN CENTRAL BANK

EUROSYSTEM

04/07/2018

Draft Regulation on the materiality threshold for credit obligations past due.

1. Context

According to the CRR, the ECB has the power to set a threshold for assessing the materiality of a credit obligation past due that should remain consistent over time. In particular, such materiality threshold brings the added benefit of increased comparability of bank's defaulted exposures among institutions in the same jurisdiction.

In this context, the ECB has published a **Draft Regulation on the materiality threshold for credit obligations past due** in order to define the absolute and relative components of materiality threshold. In particular, this threshold will comprise an absolute component, expressed as a specific maximum amount for the sum of all amounts past due owed by an obligor, and a relative component, expressed as a percentage reflecting the amount of the credit obligation past due in relation to the total amount of all on-balance sheet exposures to that obligor.

2. Main points

- **Scope.** The definition of the materiality threshold will be applied to all significant credit institutions within the SSM, both for retail and for non-retail exposures, irrespective of the method used for the calculation of capital requirements.
- **Definition of the materiality threshold.** Credit institutions shall assess the materiality of a credit obligation past due against a threshold, which comprises the following two components:
 - A limit in terms of the sum of all amounts past due owed by the obligor to the credit institution, the parent undertaking of that credit institution or any of its subsidiaries, equal:
 - For retail exposures, to **100€**.
 - For exposures other than retail exposures, to **500€**.
 - A limit in terms of the amount of the credit obligation past due in relation to the total amount of all on-balance sheet exposures to that obligor for the credit institution, the parent undertaking or any of its subsidiaries, excluding equity exposures, equal to 1%.
- **Default of an obligor.** It shall be deemed to have occurred when both of the above-mentioned limits set out are exceeded for 90 consecutive days.

3. Next steps

- Comments to this Draft Regulation shall be submitted by **17 August 2018**.
- The Regulation shall enter into force on the **twentieth day following** that of its publication in the Official Journal of the European Union (OJEU), and shall apply from **31 December 2020**.



EUROPEAN CENTRAL BANK

EUROSYSTEM

10/09/2018

Draft Guide to internal models – Risk-type-specific chapters.

1. Context

In February 2017, the ECB issued a Guide to the Targeted Review of Internal Models (TRIM) addressed to the management of significant institutions, which sets out its view on the appropriate supervisory practices and spells out how the ECB intends to interpret the relevant EU law on internal models and on general model governance topics. The Guide to the TRIM covers four main chapters: general topics, credit risk, market risk, and counterparty credit risk.

Following the consultation on the general topics chapter of the guide in March 2018, the ECB has now published a **Draft Guide to internal models**, which covers the update of the risk-type-specific chapters of the Guide to the TRIM, for consultation. In particular, this consultation covers credit risk, market risk and counterparty credit risk and aims at ensuring a common and consistent approach to the most relevant aspects of the applicable regulations on internal models for banks directly supervised by the ECB.

In this updated version of the ECB Guide to internal models the section on data quality, which was included in the general topics chapter, has now been moved to the credit risk chapter, and the credit risk chapter has been modified and completed. Further, the content of several sections on market and counterparty credit risks have been clarified and completed.

2. Main points

- **Credit risk.** This Draft Guide provides transparency on how the ECB understands a set of topics related to internal models used for the IRB approach, including:
 - Data maintenance for the IRB approach, which covers IT systems (infrastructure and implementation testing); policies roles and responsibilities in data processing and data quality management; and components of the data quality management framework.
 - Data requirements, which covers the use of external data, use of external bureau scores, or the use of human judgement, among others.
 - Probability of default (PD), which covers the structure of PD-models (including risk differentiation) and PD risk quantification. Certain sections have been completed (e.g. calculation of the default rate or use of PD direct estimates), and other possible treatments have been included (e.g. PD quantification based on mapping to external grades).
 - Loss given default (LGD), which covers the concept of realised LGD, its structure, risk quantification, and the estimation of ELBE and LGD in-default. The structure of the previous version is maintained although the most of sections have been completed.
 - Credit Conversion Factors (CCF), which covers the commitments, unadvised limits and scope of application of the CCFs; the realised CCFs; its structure and risk quantification. The structure and the content of this section have been revised.
 - Others aspects, such as the model-related Margin of Conservatism (MoC), whose framework has been adapted to the EBA Final Guidelines on PD and LGD; the review of estimates; and the calculation of maturity for non-retail exposures.
- **Market risk.** This Draft Guide provides transparency on how the ECB understands a set of topics related to internal models used in the calculation of own funds requirements for market risk, including:
 - Scope of the internal model approach (IMA), which covers the delimitation of the regulatory trading book, treatment of banking book positions, or partial use models, among others.
 - Regulatory back-testing of Value at Risk (VaR) models, which covers, among others, its scope of application; historical period used to perform back-testing, definition of business days, and documentation; calculation of actual P&L; or valuation adjustments.
 - Aspects of internal validation of market risk models, which covers those aspects related to the frequency of internal validation, internal back-testing of VaR models, or the tests to be performed in internal back-testing.
 - Methodology for VaR and stressed VaR, which covers, among others, general requirements; data inputs, length of the time series used to calibrate VaR and sVaR, and quantile estimation, or data quality.
 - Methodology for Incremental Default and Migration Risk Charge (IRC) models focusing on default risk, which covers aspects related to data inputs; distributions and correlation assumptions; or ratings, probabilities of default and recovery rate assumptions.
 - Risks not in the model engines (RNIME), which covers its identification, quantification, as well as its management and implementation in an institution.

2. Main points (continues)

- **Counterparty credit risk.** This Draft Guide provides transparency on how the ECB understands a set of topics related to the principles defined for the Internal Model Method (IMM), including:
 - Trade coverage, which covers different types of treatment for IMM transactions for which the related exposure is not fully simulated, and the principles for ECB banking supervision.
 - Margin period of risk (MPOR) and cash flows, which covers the treatment of margin call and trade-related cash flows in all currencies, among other aspects.
 - Collateral modelling, which mainly covers the modelling of cash and non-cash collateral.
 - Modelling of Initial Margin (IM), which covers its implementation under the IMM.
 - Maturity, which covers the estimation of the parameter M used in the calculation of RW for counterparties.
 - Granularity, number of time steps and scenarios, which covers the chosen time grid for the future exposure calculation and the number of scenarios generated.
 - Other aspects, such as the calibration frequency and stress calibration; validation, effective expected positive exposure (EEPE), and the alpha parameter.

3. Next steps

- Comments to this Draft Guide shall be submitted by **7 November 2018**.



EUROPEAN CENTRAL BANK

EUROSYSTEM

24/09/2018

Guide to on-site inspections and internal model investigations.

1. Context

In accordance with the SSM, the supervision of the ECB over supervised entities is exercised through off and on-site supervision, the combination of which aims to ensure a detailed and thorough analysis of the supervised entities' business. On-site supervision is performed through on-site inspections (OSIs), which are in-depth investigations of risk, risk controls and governance; or internal model investigations (IMIs), which are in-depth assessments of internal models used for the calculation of own fund requirements.

In this context, the ECB has published a **Guide to on-site inspections and internal model investigations** which aims at providing a useful reference document for the supervised entities and other legal entities for which the ECB has decided to launch an on-site inspection, as well as for the work of the on-site inspection teams. In particular, this Guide describes the general framework, the process, and the applicable principles for inspections.

This Guide applies to the inspections conducted in significant institutions (SIs), less significant institutions (LSIs), when the ECB decides to exercise directly all the relevant supervisory powers for an LSI, and other legal entities (including third parties to whom credit institutions have outsourced functions or activities, and any other undertaking included in supervision on a consolidated basis where the ECB is the consolidating supervisor).

2. Main points

- **General framework for inspections.** This Guide establishes the following aspects:
 - **Organisation of the supervision of SIs.** The ECB supervision is exercised by: i) the Supervisory Board (SB) of the ECB which is in charge of the planning and execution of the banking supervision tasks conferred on the ECB; ii) the Joint Supervisory Teams (JSTs), which are assigned to the ongoing supervision of each SI; and iii) the relevant divisions within the Directorate General IV which are responsible for the ongoing monitoring of inspections.
 - **Decision-making process for inspections.** Inspections are decided upon on the basis of formal planning (annually adopted) while inspections without prior notification to the supervised entity are triggered in reaction to an event or incident which has arisen.
 - **Objective of inspections.** They aim to, among others, examine and assess the level, nature and features of the inherent risks to which the entity is exposed, or the quality of the inspected legal entity's corporate governance. Further, inspections must be risk-based, proportionate, intrusive, forward-looking, and action-oriented.
 - **Independence of inspections.** The Head of Mission (HoM), who is in charge of producing a report that includes the findings of the inspection team, and the inspection team act independently of the JST.
 - **Composition of the inspection team.** These teams can be composed of ECB inspectors, supervisors employed by the national competent authority (NCA) of the inspected legal entity's participating Member State, and supervisors from other NCAs, as well as JST members. Other persons authorised by the ECB might be, for example, external consultants who are considered as regular team members during the inspection.
 - **Other aspects** (i.e. role of HoM and cross-border cooperation).
- **Inspection process.** This Guide describes the main steps of an inspection and the inspection outcomes:
 - **Preparatory phase**, which covers: i) the confirmation step where the availability and readiness of all parties involved is confirmed; ii) notification of the commencement of an inspection, where the ECB notifies the inspected legal entity of its decision to launch an inspection through a letter which mentions the name of the HoM, the subject matter and the purpose of the inspection; iii) inspection memo where the rationale, scope and objectives of the inspection are set out; and iv) first request for information, where the inspection team request information that it understand is necessary to have as a starting point for the inspection (e.g. organisation chart, or data tapes with portfolio information).
 - **Investigation phase**, which covers: i) kick-off meeting, which officially launches the inspection and where the inspected legal entity gives a general presentation on its organisational structure, business model, strategy, governance policy, etc.; ii) execution of the work programme, where interviews and an examination of procedures, reports and files take place (using inspection techniques, including model testing, or walk-through); and iii) reporting phase, where the conclusions of the investigations conducted throughout the inspection are formalised in an inspection report.

2. Main points (continue)

- Inspection outcomes, which covers: i) the presentation of the requested remedial actions, which may include a letter expressing supervisory expectations (not legally binding and does not require a decision by the SB) or an ECB supervisory decision addressed to the inspected legal entity and containing legally binding supervisory measures; and ii) the follow-up phase, which also includes recommendations and action plan where JSTs must ensure that the inspected legal entity addresses; and a follow-up of the measures required of the inspected legal entity, where the JSTC is responsible for following up on the implementation of the corrective measures by the inspected legal entity until they have been completed.
- **Applicable principles for inspections.** This Guide sets out the following principles regarding: i) inspection team's supervisory and investigatory powers, including right of access to business premises, right to request any information or document, right to receive explanations, exchange of information with the statutory auditors, and right to ask NCAs for assistance in the event of opposition; ii) inspection team's practices, including professional secrecy, independence and objectivity, and compliance with the internal rules of the inspected legal entity; iii) inspected legal entities' rights (e.g. right to be informed of the start of the inspection) and the supervisor's expectations (e.g. professional working conditions); and iv) language used during the inspection, which may be one official EU language although it should be agreed with the HoM, as a matter of efficiency (nonetheless, the inspection report is delivered to the ECB and the inspected legal entity in English).



Publications of the quarter

Local publications



12/07/2018

Anteproyecto de Ley de medidas para la transformación digital del sistema financiero.

1. Context

The digital transformation of the economy and in particular of the financial system entails a structural challenge that allows a deep transformation of manufacturing, commercialising and distributing processes of goods and services in the economy. In this regard, the possibility of establishing a regulatory sandbox, i.e. a set of provisions that entail the realization of controlled and defined tests within a project which could provide a technology-based financial innovation, has been analysed in Spain, in accordance with other similar systems established in other jurisdictions.

In this context, the Spanish Government has published an **Anteproyecto de Ley (APL) de medidas para la transformación digital del sistema financiero**, with the aim of maintaining the effectiveness of the financial policy through an organised digital transformation, reinforcing legal certainty and ensuring protection of consumers of financial services. In particular, this APL mainly addresses the concept of regulatory sandbox, the functioning of the regulatory sandbox, and the adoption of other measures that facilitate digital transformation.

2. Main points

- **Regulatory sandbox.** This APL establishes three structural elements which could act as key aspects within the regulatory sandbox, in particular:
 - It is a secured and safe framework which ensures personal data protection, the protection of consumers of financial services, and anti-money laundering and financing of terrorism.
 - It is a supervisory tool which allows to acknowledge the developments and potential effects of digital transformation regarding the provisions of financial services, the protection of consumers and financial stability.
 - It will be implemented through a legal framework that consist of this law, which set outs the general framework (including rights and obligations), and a test protocol that includes the details of any tests that will be carried out, and that will be carried out between those authorities in charge of monitoring these tests and the project's promoters.
- **Functioning of the regulatory sandbox.** This APL establishes three phases:
 - Access regime: it is a system that exhibits all projects where a technology firm, a financial institution, a research centre or any other interested promoter submits an advanced project which will be accepted, after a previous favourable assessment (only if it provides added value for enhancing regulatory compliance). Following this evaluation, a protocol will be hold between the supervisor and the promoter which will detail the tests' trials (e.g. duration and scope), from where the tests could be initiated if certain safeguards are met.
 - Guarantees regime and consumer protection during the tests: it implies the compliance of seven main guarantees, specifically in those cases where the consumers participate in the tests: i) detailed consent and data protection; ii) withdrawal right in any case; iii) promoter's responsibility in case of any physical, material or non-material damage as a direct consequence of the tests trials; iv) damages' guarantees; v) confidentiality; vi) supervisory monitoring during the test; and vii) possibility of test's interruption.
 - Exit regime: it covers three elements that aim at establishing those effects after the conclusion of the tests' trials.
 - **Tests results**, which will be carried out by the test's promoter and will be included in a memory that should be sent to those supervisory authorities in charge of monitoring the tests.
 - **Gateway to access to the activity**, which implies a substantial reduction of the procedures' requirements where there was not a license for the activity at that point (e.g. if the activity is carried out with technology and tested business models).
 - **Proportionality**, it will be applied to, among others, the supervisor's discretion regarding the compliance of these requirements.
- **Adoption of other measures that facilitate digital transformation.** This APL sets out other measures beyond the regulatory sandbox, that promote digital transformation such as the establishment of channels for an agile, transparent and direct communication with public authorities, or the formulation of written consultations on regulatory issues.

3. Next steps

- Comments to this Anteproyecto de Ley shall be submitted by **7 September 2018**.



02/07/2018

Proposed Guidance on resolution planning for eight large, complex U.S. Banking Organizations.

1. Context

According to the Dodd-Frank Act, certain financial companies are required to report periodically to the Fed and the FDIC (the agencies) their plans for rapid and orderly resolution under the U.S. Bankruptcy Code in the event of material financial distress or failure. In this regard, in April 2016 the agencies issued a Guidance on resolution planning in order to assist the development of the covered companies' 2017 resolution plans.

In this context, the Fed and the FDIC have now published a **Proposed Guidance on resolution planning for eight large, complex U.S. Banking Organizations**, that updates the agencies' expectations for how a firm's resolution strategy should address the following aspects: i) capital, ii) liquidity, iii) governance mechanisms, iv) operational, v) legal entity rationalization and separability and vi) derivatives and trading activities.

This Proposal is addressed to these eight firms: Bank of America Corporation, the Bank of New York Mellon Corporation, Citigroup Inc., the Goldman Sachs Group, Inc., JPMorgan Chase & Co., Morgan Stanley, State Street Corporation and Wells Fargo & Company.

2. Main points

- **Capital.** The Proposal describes expectations concerning:
 - The appropriate positioning of capital and other loss-absorbing instruments (e.g. debt that the parent may forgive or convert to equity) among the material entities within the firm (resolution capital adequacy and positioning or RCAP).
 - A methodology for periodically estimating the amount of capital that may be needed to support each material entity after the bankruptcy filing (resolution capital execution need or RCEN).
- **Liquidity.** The Proposal establishes that a firm's ability to reliably estimate and meet its liquidity needs prior to, and in, resolution is important to the execution of a Covered Company's resolution strategy in that it enables the firm to respond quickly to demands from stakeholders and counterparties, including regulatory authorities in other jurisdictions and financial market utilities.
- **Governance mechanisms.** The Proposal sets out, among others, expectations that firms:
 - Have playbooks that detail the board and senior management actions necessary to execute the firm's preferred strategy.
 - Have triggers that are linked to specific actions outlined in these playbooks to ensure the timely escalation of information to senior management and the board, to address the successful recapitalization of subsidiaries, etc.
 - Identify and analyze potential legal challenges to the provision of capital and liquidity to subsidiaries that would precede the parent's bankruptcy filing.
- **Operational.** The Proposal establishes that firms should, among others:
 - Possess fully developed capabilities related to managing, identifying, and valuing the collateral that is received from external parties and its affiliates.
 - Have management information systems that readily produce key data on financial resources and positions on a legal entity basis.
 - Develop a clear set of actions to be taken to maintain payment, clearing and settlement activities.
 - Maintain an actionable plan to ensure the continuity of all of the shared and outsourced services that their critical operations rely on.
- **Legal entity rationalization and separability.** The Proposal states that firms should develop criteria supporting the preferred resolution strategy and integrate them into day-to-day decision making processes. It also provides that the firm should identify discrete and actionable operations that could be sold or transferred in resolution to provide meaningful optionality for the resolution strategy under a range of potential failure scenarios.
- **Derivatives and trading activities.** The Proposal sets out that firms should have capabilities to identify and mitigate the risks associated with their derivatives and trading activities and with the implementation of their preferred strategies.

3. Next steps

- Comments on this Proposal will be accepted for **60 days after date of publication** in the Federal Register.



09/07/2018

- **Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)**
- **Statement describing how, consistent with the EGRRCPA, the Fed will no longer subject primarily smaller, less complex banking organizations to certain Fed regulations**

1. Context

In May 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) was enacted in order to introduce amendments to the Dodd-Frank Act as well as to other rules published by the Fed, the FDIC and the OCC (the agencies).

In this context, the Fed, the FDIC and the OCC has published a **Statement regarding the impact of the EGRRCPA**, which provides information on rules and associated reporting requirements that the agencies jointly administer and that EGRRCPA immediately affected. In particular, this document covers the following areas: company-run stress testing, resolution plans, Volcker Rule, high volatility commercial real estate (HVCRE) exposures, examination cycle, municipal obligations as high-quality liquid assets (HQLA), appraisals for qualifying rural transactions, and other provisions.

Further, the Fed has published a **Statement describing how, consistent with the EGRRCPA, the Fed will no longer subject primarily smaller, less complex banking organizations to certain Fed regulations**. In particular, this document highlights regulatory and reporting requirements related to prudential standards that the Fed will no longer require to certain firms.

2. Main points

Statement regarding the impact of the EGRRCPA

- **Company-run stress testing.** According to the EGRRCPA, financial companies with total consolidated assets of less than \$250 billion that are not bank holding companies (BHCs) will not be subject to the Dodd-Frank Act's stress test, 18 months after the EGRRCPA's enactment; whereas BHCs under \$100 billion in total consolidated assets were no longer to such stress test. In this regard, the agencies' regulations implementing the stress testing provide that they may extend any deadline relating to it.
- **Resolution plans.** The Fed and the FDIC will enforce the final rules establishing resolution planning requirements in a manner consistent with the EGRRCPA's amendments.
- **Volcker Rule.** The agencies will enforce the final rule implementing section 13 of the BHC Act in a manner consistent with the amendments made by EGRRCPA, which narrow the definition of banking entity and revising the statutory provisions related to the naming of covered funds.
- **HVCRE exposures.** According to the EGRRCPA, the agencies may only require a depository institution to assign a 150% risk weight to an HVCRE exposure if such exposure is an HVCRE acquisition, development or construction (ADC) Loan (e.g. if it is secured by land or improved real property).
- **Examination cycle.** The agencies intend to engage in rulemaking to implement EGRRCPA provisions that increase the total asset threshold for well-capitalized insured depository institutions to be eligible for an 18-month examination cycle from \$1 billion to \$3 billion.
- **Municipal obligations as HQLA.** The agencies intend to engage in rulemaking to address the EGRRCPA provisions that set out that the agencies shall treat certain municipal obligations as HQLA for purposes of their final rules establishing a liquidity coverage ratio and in other liquidity regulations.
- **Appraisals for Qualifying Rural Transactions.** The agencies are reviewing the statutory provisions to determine whether further action is necessary regarding the EGRRCPA provisions that set out an exemption to the appraisal requirements for certain transactions with values of less than \$400,000 involving real property or an interest in real property that is located in a rural area.
- **Other provisions.** The agencies intend to engage in rulemaking to address other provisions (e.g. reduced reporting requirement for certain small depository institutions) at a later date.

2. Main points (continue)

Statement describing how, consistent with the EGRRCPA, the Fed will no longer subject primarily smaller, less complex banking organizations to certain Fed regulations

- **BHCs with total consolidated assets of less than \$50 billion.** The Fed will not require these institutions to comply with the following requirements:
 - Regulation YY (company-run stress test).
 - Regulation YY (risk committee) for those BHCs that are publicly traded.
 - Reporting and recordkeeping requirements associated with Regulation YY, including FFIEC 016: Annual DFAST Report for depository institutions and holding companies with \$10- \$50 billion in total consolidated assets (OMB Number 7100-0356).
- **BHCs with total consolidated assets greater than or equal to \$50 billion but less than \$100 billion.** The Fed will not require these institutions to comply with the following requirements:
 - Regulation Y (capital planning).
 - Regulation QQ (resolution planning).
 - Regulation WW (modified liquidity coverage ratio, and liquidity-related disclosures).
 - Regulation YY (Part D, except risk-management and risk committee requirements; supervisory stress test; company-run stress test; debt-to-equity limits).
 - Reporting and recordkeeping requirements associated with Regulation Y, Regulation QQ, Regulation WW, and Regulation YY, including Complex Institution Liquidity Monitoring Report (FR 2052a); Capital Assessments and Stress Testing (FR Y-14A; Y-14M; Y-14Q); and Banking Organization Systemic Risk Report (FR Y-15).
- **Savings and loan holding companies (SLHC) with less than \$100 billion in total consolidated assets that are not substantially engaged in commercial or insurance activities.** The Fed will not require these institutions to comply with the following requirements:
 - Regulation WW (modified liquidity coverage ratio, and liquidity-related disclosures).
 - Reporting and recordkeeping requirements associated with Regulation WW, including the following:
 - **FR Y-15:** Banking Organization Systemic Risk Report (OMB Number 7100-0352).
 - **FR 2052a:** Complex Institution Liquidity Monitoring Report (OMB Number 7100-0361).

3. Next steps

- The agencies will continue to supervise and regulate financial institutions. Thus, the agencies will not take action to require company-run stress testing by depository institutions with assets less than \$100 billion, although the capital planning and risk management practices of these institutions would continue to be reviewed through the regular supervisory process.
- The agencies are delaying the compliance date for all regulatory requirements related to company-run stress testing for depository institutions with average total consolidated assets of less than \$100 billion until **November 25, 2019**.



30/07/2018

Consultation Paper 17/18 on credit risk: definition of default.

1. Context

In September 2016, the EBA published RTS for the materiality threshold for credit obligations past due and Guidelines (GL) on the application of the definition of default according to the CRR which establishes the definition of default of an obligor that is used for the purpose of the IRB Approach and for the Standardised Approach (SA) for credit risk. Moreover, it also issued an Opinion on the use of the 180 days past due criterion in the days past due component of the definition of default.

In this context, the PRA has published a **Consultation Paper (CP) 17/18 on credit risk: definition of default**, which sets out the PRA's approach to implementing the EBA's three recent regulatory products relating to the definition of default. In particular, this CP proposes to set thresholds for determining whether a credit obligation is material for the purpose of the CRR's definition of default; and to update the PRA's expectation in Supervisory Statement (SS) 11/13 on IRB approaches.

This CP is aimed at UK banks, building societies and PRA-designated UK investment firms, and applies to those firms using the SA and the IRB approach for calculating capital requirements for credit risk.

2. Main points

- **Materiality thresholds.** The PRA proposes the following:
 - To insert a new chapter into the Credit Risk Part of the PRA Rulebook to set a:
 - **0% relative** materiality threshold and a **zero absolute** materiality threshold for **retail exposure classes**.
 - **1% relative** materiality threshold and a sterling equivalent of **€500 absolute** materiality threshold for **non-retail exposure classes**.
 - Firms would be required to use these materiality thresholds when applying the days past due criterion of the CRR's definition of default.
- **Removal of the PRA's use of the discretion to replace 90 days with 180 days in the days past due component of the definition of default.** The PRA proposes the following:
 - To change its expectation in SS11/13, removing the discretion to replace 90 days with 180 days in the days past due component of the CRR's definition of default for exposures secured by residential or SME commercial real estate in the retail exposure class and/or exposures to public sector entities (PSEs).
 - Thus, firms use 90 days past due in the definition of default for all exposure classes.
- **Guidelines on the application of the definition of default.** The PRA proposes to amend SS11/13 to reflect that firms should comply with the EBA GL when applying the CRR definition of default. The PRA considers that firm's compliance with the GL will reduce unwarranted variability and improve the comparability of IRB risk parameters and capital requirements.

3. Next steps

- Comments to this CP shall be submitted by **29 October 2018**.
- The proposals set out in this CP should be implemented by **31 December 2020**.



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