OVERVIEW OF CURRENT REGULATORY ISSUES

ECB Operations Managers Group
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KBC Bank NV

BENCHMARKS (Derivatives)

EONIA to €STR transition:

- Switch discounting rate to €STR seems to be industry standard. However:
  - Amending the VM** CSA's** to €STR is proving cumbersome
  - Process is taking up a lot of recourses and is advancing slowly
  - Other members' experience ?

- LCH/Eurex:
  - Proposal to target a mandatory conversion to €STR-flat with cash compensation for all outstanding cleared trades referencing EONIA
  - Leads to discrepancy with bilateral trades, which will fallback to €STR plus spread.
  - Other members' view – will this have impact on approach for bilateral trades ?

* Variation Margin
** Credit Support Annex

BENCHMARKS (Derivatives)

ISDA IBOR Fallbacks Protocol :

- Industry standard to adhere – currently more than adherents

  - Tough legacy contracts
    - o Transactions that form part of complex structures
    - o KBC examining but minor and isolated positions – most are internal transactions – tackled on case-by-case basis
    - o Other members' view ?

  - Approach towards corporate counterparties (no adherence)
    - o Mismatches between loans and related hedges which could harm the essential symmetry
    - o Use of bilateral amendments – fallback of hedge needs to be mirrored in the hedged instrument
    - o Work in progress but deadlines are tight – other members' experience ?

BENCHMARKS (Cash markets)

Transition LIBOR :

- Divergent market approaches emerge (depending on jurisdiction, currency and type of contract) so that a one-size-fits-all approach will not meet the needs of our clients

- Local input is crucial to assess the needs of our clients, and to be informed on market evolutions per region

- The core scenario remains a backward-looking compounded rate but no firm decision regarding the compounding method (cumulative or non-cumulative) nor the day methodology (observation shift or lag days)

- In contract negotiation, the amendment approach is often chosen, i.e. (for LMA*) the inclusion of the revised version of the 'Replacement of Screen Rate' where an amendment process is agreed, and not yet the effective terms of the new RFRs**. This approach is supported by main law firms.

*Loan Market Association
**Risk Free Rates

BENCHMARKS (Cash markets)

Transition LIBOR : Amendments agreed to EU rules

- Agreement reached by the European Parliament and the Council on amendments to EU rules on financial benchmarks proposed by the Commission on 24 July 2020. The agreed amendments empower the Commission to designate a replacement benchmark that covers all references to a widely used reference rate that is phased out, such as LIBOR, when this is necessary to avoid disruption of the financial markets in the EU

- The scope of this replacement is unfortunately limited, principally to listed financial instruments, mortgage and consumer loans (given the restrictive definitions of financial instrument and financial contract in the benchmark directive).

BENCHMARKS (Cash markets)

Transition LIBOR : hedging of credits

- Differences in fallbacks between derivative and cash markets are likely to create potential mismatches between loans and related hedges which could harm the essential symmetry

- Most relevant differences apply to (i) timing of the transition & trigger events, (ii) calculation methods of replacement rates (compounded interest v/overnight rates - days in lookback period and (iii) definition of adjustment spreads

- Legal approach : credit agreement is to be adjusted to be made consistent with ISDA fallbacks

EMIR - Initial Margin

Draft RTS* on bilateral margin published by ESMA (23/11/20)

- Proposal to extend the temporary exemption for single-stock equity options or index options for three years (4 January 2024)
    - o EU derogation refers to single-stock equity options or index equity options
    - o Does the wide interpretation of index equity options include baskets ? Broad approach justified since other jurisdictions' derogations are worded more broadly, and since the purpose of derogation is :
        - to facilitate international regulatory convergence regarding risk management procedures
        - to avoid undue costs and an unlevel playing field situation for EU counterparties
- Discrepancies in approach can lead to disputes between parties when exchanging initial margin so a uniform approach is advised. View of other members ?

*Regulatory Technical Standards

BREXIT

UK EMIR reporting

EU firms that offer NFC* reporting for their UK corporate counterparties

- Repapering required of agreements (because switch from mandatory reporting for NFC's under EMIR Refit to delegated reporting under UK EMIR)

- Issues:
  - Sharp deadline of 31/12
  - What if NFC's refuse to sign delegated reporting agreement ? EU firms have no obligation to report for NFC's
  - Other members' experiences ?

*Non-Financial Counterparty

BREXIT

Derivatives trading obligation (DTO):

- If no equivalence is given, EU firms will not be able to use UK trading venues for in-scope products.
  - Migration from UK to EU trading venues ongoing but use of EU trading venues only partly a solution as this would lead to duplicative DTO's (when dealing with UK counterparties)
  - In the absence of equivalence, EU and UK counterparties subject to the DTO will not be able to interact with each other in trading venues in either jurisdiction in contracts subject to the DTO
- Difficult given uncertainty of future regulatory environment but ISDA lobbying ongoing
- Impact for KBC is limited => switch to EU venues as much as possible but limited problems remain since certain counterparties still do not have access to the EU venues - other members' experience ?

KBC

BREXIT

Shares trading obligation (STO):

- Absence of mutual equivalence will cause issues for shares listed on both a UK and EU exchanges

- KBC still analysing impact but difficult given uncertainty of future regulatory environment:

    - UK branches of EU firms, subject to UK STO will only be able to trade on EU venues if they have obtained permissions (not all venues have done that)

    - European firms will not be able to trade a share on UK venues if it is also traded on an EU venue leading potentially to dilution of liquidity on any particular exchange. Pressing matter for those dual-listed shares of EU companies which are traded in substantial volumes on UK markets as well.

BREXIT

Transition from UK to EU counterparties:

- Newly created EU entities of non-EU counterparties
- Repapering largely done (i.e., making sure the right contracts are in place with the newly created EU entities)
- Migration of activity to EU entities ongoing => many operational issues
    - Setting correct limits, migration only for some products, access to necessary trading venues, confirmation issues
    - Other members' experience ?

Fundamental Review of Trading Book - Equity derivatives

- FRTB is a comprehensive suite of capital rules developed by the Basel Committee on Banking Supervision intended to be applied to bank's wholesale activities
- Banks will see significant increases to their cost of capital, in particular to support their trading activities
- Stricter rules as to what goes into the banking book and what goes into the trading book and any re-allocation
- Concern about equity derivatives vs ALM as new rules prevent portfolio hedging approach and require external hedging