Highly regulated sectors such as utilities and telecoms have their own regulatory considerations to contend with in Europe, but it is the financial services sector that will bear the brunt of impending regulation.

**MiFID II**

Arguably the biggest shake-up of legislation in the European financial sector for over a decade is due on 3 January 2018. The purpose of the second Markets in Financial Instruments Directive, or MiFID II as it’s better known, is to strengthen investor protection, prevent market abuse and increase the transparency of trading in investment products such as stocks, bonds and swaps, and touches on all aspects of electronic trading, reporting and storing of information. Efforts to implement the required changes should be equally directed at how the organisation’s control environment needs to change to maintain compliance after the legislation goes live.

Its implementation had to be delayed by a year because firms and regulators did not have their systems in place to comply with it. Even as recently as July 2017 research showed that 90% of institutional investors in Europe risked being non-compliant, and were under-prepared and overstretched in their efforts to comply. This isn’t helped by the fact that midway through 2017 approximately a third of the rules were yet to be formalised, either by national regulators or through technical guidance detailing exactly how they should be implemented.

**Compliance clash**

The picture is complicated further by the apparent incompatibility of MiFID II and the GDPR. Under the former, any telephone calls, emails and other electronic communications that are intended to result in trades and transactions are expected to be recorded. Meanwhile, the GDPR imposes much tougher rules on the protection of personal data.

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**New accounting standards impending**

2018 will see the introduction of two new IFRS Standards and the early adoption of IFRS 17.

- **IFRS 9 Financial Instruments** requires an entity to recognise a financial asset or liability in its statement of financial position when it becomes party to the contractual provisions of the instrument, measured by its fair value.

- **IFRS 15 Revenue from Contracts with Customers** establishes principles an entity applies when reporting information about the nature, amount, timing and uncertainty of revenue from a contract with a customer.

- **IFRS 17 Insurance Contracts** discloses information that shows the effect that insurance contracts have on the financial position, financial performance and cash flows of an entity.

For more information, visit [www.ifrs.org](http://www.ifrs.org)

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“We find contradictions between what local regulators say and what the European Central Bank requires for the entire group. This affects multinationals and is a huge headache for us. Knowing how to address many regulators while being a profitable, well organised company is very difficult. That has incentivised dialogue with regulators.”

Chief Audit Executive, multinational Spanish banking group
“The regulatory agenda connected to Brexit in terms of where we do certain types of business and who that will be regulated by is huge. The ongoing pace, scale and complexity of regulatory change is something that our emerging risk team is having to air-traffic control and understand what the organisation must focus on - whether it’s changing systems, processes or reporting required by regulators and our ability to land that change at the appropriate times.”

Chief Audit Executive, multinational UK banking group

Preparing for MiFID II

90% of institutional investors in Europe risked being non-compliant with MiFID II

Source: PwC

Risk of regulatory scrutiny

66% Regulatory change and heightened regulatory scrutiny is seen as a “significant impact” risk for 66% of board members

Source: PwC
of sensitive data captured by any means of recording, with potentially huge penalties for any breaches. By strengthening the rights of individuals to choose not to have data captured by call recording and other means, the GDPR appears to conflict with interpretations of MiFID II.

If exceptions to this discretionary data collection can be made under MiFID II, it still leaves financial services firms exposed to potential data breach risk as they will be expected to adequately safeguard a whole new set of personal communications data.

Also going live in January 2018 is the Payment Services Directive II (PSD2), which as well as putting an end to credit card surcharges is designed to increase competition by lowering the barriers to entry for fintech start-ups. It aims to do this by obliging banks, which are seen to have the unfair advantage of having years or decades-long headstarts over fintechs, to provide other organisations with access to their customers’ financial information. Once again, this is seen as being at odds with GDPR’s data protection measures. PSD2 means that banks are likely to be sharing customer data with dozens of fintech companies. GDPR is concerned with making customer data traceable, secure and easy to erase. Reconciling the two will be a challenge.

Personal accountability
In the UK, financial services firms are under pressure to comply with the Senior Managers and Certification Regime (SM&CR), which was introduced in the banking sector in 2016. In 2017 the Financial Conduct Authority (FCA) extended the rules to the rest of the financial services sector, with the wider scope expected to be implemented in 2018. The set of rules apply to all staff and require that individuals must act with integrity, due care, skill and diligence, be open and co-operative with regulators, pay due regard to customer interests and treat them fairly, and observe proper standards of market conduct. The FCA recently published a consultation document on its website and is seeking feedback on the roll-out of the rules until 3 November 2017.

The most crucial aspect of SM&CR is that it introduced accountability for senior managers, so that should something that falls under their remit go wrong they can be held personally liable. The rules apply to all firms operating in the UK including foreign organisations operating in the country via a single branch.

With so much change taking place, it is little wonder that compliance functions are feeling the pressure to keep up. Data show that the volume and pace of regulatory change is the top concern for not only compliance professionals in the financial services sector but their boards, ahead of cyber and technology resilience. Looking across all industries, regulatory change and heightened regulatory scrutiny is seen as a “significant impact” risk for 66% of board members and executives. This suggests that boards and audit committees are likely to require assurance that compliance is being effectively managed.

An internal audit perspective
Compliance and regulatory risk is a constant concern for organisations. But with so many milestone rule changes either on the horizon or having recently passed, there is more pressure than ever to ensure compliance is being effectively managed. This has not been helped by the Brexit referendum and US Presidential vote, which represent major regulatory unknowns for countless organisations, particularly where future trade rules are concerned. Internal audit has a role to play in assessing whether compliance functions are on top of the latest applicable regulations and that appropriate steps have been taken to ensure that the organisation is compliant, and - where there is uncertainty or conflict with existing or other incoming rules - that dialogue with the relevant regulator/s has been established.

Key questions:
- Is the organisation confident that it has done everything in its powers to comply with all relevant regulations?
- Does the organisation have systems and procedures in place for reporting non-compliance incidents and disciplinary deterrents to prevent them from occurring in the first place?
- Does the organisation review compliance breaches and take steps to ensure they are not repeated?
- Is the compliance function adequately resourced and capable of effectively monitoring, prioritising and implementing forthcoming regulations?
- Are training programmes in place to ensure that employees and other company representatives are aware of their compliance responsibilities?
- If the organisation is a multinational has it identified any regulatory clashes between jurisdictions, and where these can’t be reconciled has this been reported to the appropriate regulator?
- Is the business flexible and adaptable enough to remain fully compliant while maintaining growth?
Tax planning

In August 2016 the European Union ordered Apple to pay a record-breaking €13bn in back taxes to Ireland after it was ruled that an arrangement between the world’s largest company and the Irish tax authorities amounted to illegal state aid. Apple had been levied as little as 0.5% under the deal instead of the country’s 12.5% corporate tax rate.

By booking profits at an Irish head office that existed only on paper, the company avoided paying tax on virtually all of the profits made on the billions of euros of products sold across the EU’s single market. Both Apple and Ireland have appealed the decision in court, which will take years to resolve. If the European Commission wins it will establish it as the ultimate arbiter on taxation in Europe, superseding national government policy.

The Apple ruling and fine were well-timed. A month prior the EU had introduced the Anti Tax Avoidance Directive (ATAD), aimed at preventing this exact exploitation of tax mismatches between member states. Less than a year later in May 2017 and ATAD II was introduced, extending the mismatch treatment between member states and non-EU countries. The new rules will come into force on 1 January 2020.

The directive was largely prompted by the Organisation for Economic Co-operation and Development’s BEPS (Base Erosion and Profit Shifting) framework, published in December 2015. So far more than 100 countries have issued rules on implementing these reporting requirements, which were written to create a fairer and more effective international tax system, including increasing efforts to close loopholes, improve transparency and ensure that multinational enterprises pay tax where they carry out their activities.

Tax planning is unlikely to fall off the agenda any time soon, with the public and national governments paying close attention to how businesses treat this issue. Ninety-one per cent of multinationals say that tax structures are under greater scrutiny from authorities now than they were a year ago, although encouragingly, 86% of multinationals say that their organisation has assessed the potential impact of changes related to BEPS.

However, the political uncertainty seen today, including Brexit, the future stability of the EU and the new US administration, requires organisations to pay close attention to potential tax changes and their associated impact on strategic decisions.

Many boards will want to understand how the BEPS framework impacts upon the business’s operations and financial reporting processes, and what must be done to respond to national policy changes in response to the BEPS initiative. In some cases assurance will be required around the alignment of tax planning strategies with the organisation’s strategic goals and public image, and around contingency plans in the event that any reputational controversies emerge.

“Regulatory aspects change often and are very complex, for example the EU’s unbundling requirements under the ‘Third Package’ legislation, which have forced the separation of energy groups’ sales and distribution activities. The result is an ad hoc setup for selling and another one for distribution. The audit plan needs headroom as laws and regulations change. It also needs to be flexible so that internal audit can respond to requests coming from the regulator.”

Chief Audit Executive, Italian multiutility group