

# International Regulatory Update

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### European Commission issues communication on restoring confidence in euro area and EU

The European Commission has issued a [communication](#) which outlines its five areas of action to restore confidence in the euro area and the EU as a whole: (1) a decisive response to the situation in Greece; (2) enhancing the euro area's backstops against the crisis; (3) a coordinated approach to strengthen Europe's banks; (4) frontloading stability and growth enhancing policies; and (5) building robust and integrated economic governance for the future.

The communication calls for a recapitalisation strategy that, amongst other things, requires a temporary significantly higher capital ratio of highest quality capital after accounting for exposure. The communication states that banks should first use private sources of capital, including through restructuring and conversion of debt to equity instruments. If necessary the national government should provide support, and if this support is not available, recapitalisation should be funded via a loan from the European Financial Stability Facility (EFSF). The communication emphasises that any recapitalisation from public sources should be compatible with the EU State aid rules. The Commission intends to extend the applicability of the existing State aid framework for bank support beyond 2011.

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The Commission has also indicated that it will present its remaining proposals on financial regulatory reform by the end of 2011, namely reinforced rules on credit rating agencies, transparency and market conduct on all trading platforms, a strengthened framework to combat market abuse, including criminal sanctions, and a European framework on bank resolution. The Commission hopes that these proposals will be adopted by the European Parliament and Council within 12 months of their presentation by the Commission.

Finally, the communication calls for the proposed Financial Transaction Tax (FTT) to be adopted on the EU level within the same timeframe and calls on the EU to continue to advocate its adoption at the global level.

[Barroso speech](#)

### **Lending in foreign currencies: ESRB publishes recommendations**

The European Systemic Risk Board (ESRB) has published a set of [recommendations](#) on foreign currency lending. According to the ESRB, foreign currency lending has, in some cases, led to a build-up of substantial mismatches between the currencies in which the non-financial private sector receives its income and those in which it pays back loans, thus making it more vulnerable to unfavourable movements in the exchange rate.

The recommendations cover borrowers without a natural or financial hedge and address the risks identified by the ESRB. For credit and market risk, the recommendations are intended to limit the probability and consequences of such risks materialising by increasing the resilience of the financial system and ensuring the creditworthiness of new borrowers. The ESRB has also recommended that borrowers be given appropriate information to make well-informed decisions. Moreover, the recommendations call on credit institutions to properly incorporate foreign currency lending risks into their internal risk management systems, which the ESRB expects to contribute to improved risk pricing.

Regarding excessive credit growth induced by foreign currency lending and the possibility of the emergence of asset price misalignments, the ESRB has recommended that national authorities tighten their rules on foreign currency lending. With respect to funding and liquidity risks, the ESRB has urged credit institutions to move towards sustainable funding structures. The ESRB has emphasised that one of the key features of the framework is the principle of reciprocity, which means that for financial institutions operating through the provision of cross-border services or through branches in other Member States, home Member States' authorities should impose measures on foreign currency lending at least as stringent as those in force in the host Member States.

The implementation deadlines for the recommendations vary between June 2012 and December 2013, depending on the recommendation and the addressee.

[Annex](#)

### **Common European Sales Law: European Commission proposes regulation**

The European Commission has published a [proposal for a regulation](#) on a Common European Sales Law. The proposal is intended to provide an optional regime of EU contract law identical for all 27 Member States that would exist alongside national contract law.

The Commission has indicated that the Common European Sales Law would be applicable: (1) only if both parties voluntarily and expressly agree to it; (2) to cross-border contracts, although Member States will have the choice to make the Common European Sales Law applicable to domestic contracts as well; (3) to contracts for the sale of goods as well as digital content contracts; (4) for both business-to-consumer and business-to-business transactions; and (5) if one party is established in a Member State of the EU.

[FAQs](#)

### **EU sets out goals for Cannes G20 summit**

The President of the EU Commission, José Manuel Barroso, and the President of the EU Council, Herman Van Rompuy, have written a [joint letter](#) presenting their thoughts on the key issues on the agenda of the G20 summit in Cannes from 3 to 4 November 2011. Amongst other things, the letter emphasises the need to make progress on implementing the financial market reform agenda while ensuring a level playing field. In particular, the letter notes that the EU is honouring its G20 commitments by launching the legal process for implementing the Basel III agreement, and calls on the EU's G20 partners to deliver on these reforms as well. It also highlights the need to accelerate work to advance other agreed reforms, including those relating to OTC derivatives, commodity derivatives, bank crisis prevention and resolution.

In addition, the letter calls for further work to agree measures on systemically important financial institutions, shadow banking, and a single set of globally accepted accounting standards. Finally, it calls for changes to the governance of the Financial Stability Board to underpin its monitoring function.

### **FSB reports on OTC derivatives market reforms implementation**

The Financial Stability Board (FSB) has published its second six-monthly [progress report](#) on the implementation of OTC derivatives market reforms. The report notes that, with just over one year until the end-2012 deadline for implementing the G20 commitments, few FSB members have the legislation or regulations in place to provide the framework for operationalising the commitments. While recognising the implementation challenges and the complexity of the required laws and regulations, the report concludes that jurisdictions should aggressively push forward to meet the end-2012 deadline in as many reform areas as possible.

The report emphasises that consistency in implementation across jurisdictions is critical, and although it acknowledges that smaller markets may want to see what frameworks the US and EU put in place when developing their own frameworks, the report stresses that all jurisdictions should advance development of their legislative and regulatory frameworks as far as they are able even before finalisation of the US and EU regimes.

The FSB notes that there is a risk that overlaps, gaps or conflicts in legislative and regulatory frameworks, if not addressed, could compromise achievement of the G20 objectives. One such potential gap identified in the report concerns the applicability of the G20 commitments to standardised derivatives that are moved onto exchanges or electronic trading platforms and therefore no longer traded OTC. The report clarifies that in order to achieve the G20 objective of mitigating systemic risk, full implementation of the G20 commitments needs to cover these derivatives, irrespective of whether they continue to trade OTC or are moved onto organised platforms.

Feedback is due by 30 November 2011.

### **Systemic capital requirements: Bank of England working paper published**

The Bank of England has published a [working paper](#) which describes a system-wide risk management approach to calibrating individual banks' capital requirements that takes into account the bank's size, the type of exposures it has to the real economy, and its obligations to other institutions, and which correspond to a policymaker's chosen target for systemic credit risk. The optimisation strategy identifies the minimum level of aggregate capital for the system and its distribution across banks that are consistent with a chosen objective for systemic credit risk.

The Bank has emphasised that the views expressed in the paper and the speech are not necessarily those of the Bank of England.

### **FSA consults on proposed guidance on payment for order flow**

The FSA has published [proposed guidance](#) on the practice of 'payment for order flow', i.e. an arrangement whereby a broker receives payment from market makers, in exchange for directing order flow to them. The proposed guidance is intended to clarify how this practice interacts with the FSA's rules. The FSA believes that payment for order flow arrangements create a conflict of interest between the clients of the firm and the firm itself, and are therefore unlikely to be compatible with FSA inducement rules and risk compromising compliance with best execution rules.

Comments are due by 9 November 2011.

### **FRC announces changes to UK Corporate Governance Code**

The Financial Reporting Council (FRC) has [announced](#) its decision to amend the UK Corporate Governance Code in order to strengthen the principle on boardroom diversity which was first introduced into the Code in June 2010. The amendments will require listed companies to report annually on their boardroom diversity policy, including gender, and on any measurable objectives that the board has set for implementing the policy and the progress it has made in achieving the objectives. The FRC will also update the Code to include the diversity of the board, including gender, as one of the factors to be considered when evaluating its effectiveness.

The new provisions on diversity will apply to financial years beginning on or after 1 October 2012. However, the FRC has encouraged all companies voluntarily to apply and report on the diversity additions to the Code with immediate effect.

## **CONSOB consults on remuneration policies to be published by issuers with securities admitted to trading on regulated markets**

The Commissione Nazionale per le Società e la Borsa (CONSOB) has launched a consultation on amendments to its Resolution No. 11971/1999 on issuers. The amendments are intended to implement Art. 123-ter of Legislative Decree 58/1998 (Consolidated Law on Finance, TUF) on the report on remuneration policies to be published by issuers with securities admitted to trading on regulated markets.

Amongst other things, the consultation paper proposes the following amendments:

- that share issuers are required to publish only the report on remuneration policies ex Art. 123-bis TUF, and there is no further obligation to publish a note to the balance sheet pointing out the remuneration of members of the administrative and control bodies and general management; and
- that the document including information on the assignment of financial instruments to corporate officers, employees and collaborators is simplified, and, for more detailed information, it is possible to cross refer to the report on remuneration policies drawn up in compliance with Art. 123-bis TUF.

Comments are due by 11 November 2011.

[Consultation paper \(Italian\)](#)  
[Consultation paper \(English\)](#)

## **Hong Kong SAR government sets out proposals to improve regulatory regime**

The Hong Kong Special Administrative Region's Chief Executive Donald Tsang has given his [2011-2012 policy address](#), in which he set out the government's policy direction and announced a number of measures intended to enhance Hong Kong's financial sector. Amongst other things, the proposed measures for the financial sector include:

- enacting legislation within this legislative year to oblige listed corporations to disclose price-sensitive information;
- enhancing the regulatory regime on listing to attract more enterprises from the European, US and emerging markets to list in Hong Kong;
- broadening and deepening the bond market;
- completing the update of the Companies Ordinance in this legislative year;
- reinforcing the offshore Reminbi business platforms;
- taking forward the establishment of an Independent Insurance Authority; and
- preparing proposals for the establishment of a policyholders' protection fund.

## **IFSB consults on guiding principles on liquidity risk management and stress testing**

The Islamic Financial Services Board (IFSB) has published the following two exposure drafts for public consultation:

- the '[Guiding Principles on Liquidity Risk Management](#)', which address the management of liquidity risk by institutions offering Islamic financial services and its supervision and monitoring by supervisory authorities, taking into consideration the specificities of Islamic financial services institutions and complementing relevant existing and emerging international standards and best practices; and
- the '[Guiding Principles on Stress Testing](#)', which are intended to complement the existing international stress testing framework taking into consideration the specificities of institutions offering Islamic financial services as well as lessons learned from the financial crisis in order to contribute to the soundness and stability of the particular institution and the Islamic financial services industry as a whole.

Comments are due by 12 January 2012.

## **DFSA consults on proposals relating to controllers and legal forms of authorised persons**

The Dubai Financial Services Authority (DFSA) has published a [consultation paper \(No. 80\)](#) containing proposals relating to controllers and legal forms of authorised persons.

The consultation paper proposes granting new powers to the DFSA to enable it to impose conditions subject to which controllers of authorised persons are approved, and to require an existing controller of an authorised firm to dispose of its holdings, or not exert management influence over, an authorised person where the controller's circumstances or conduct are found to have an adverse impact on the fitness and propriety of the authorised person or its ability to conduct its business prudently or soundly. Under the proposals, the DFSA's use of these

powers will be checked by the procedural due process which will be incorporated into the framework legislation and supporting rules.

The consultation paper also proposes making changes regarding the permissible legal forms that authorised firms/persons can take. The DFSA considers unincorporated associations to be an unsuitable corporate vehicle for an authorised firm. With respect to authorised persons, the consultation paper proposes that only the general partner in a limited partnership be required to register with the DFSA as a licensed partner and, where the general partner is not a natural person, a natural person be nominated and registered as the licensed partner.

Comments are due by 8 December 2011.

### **DFSA consults on Shari'a governance and accounting and auditing standards for Islamic firms and securities**

The Dubai Financial Services Authority (DFSA) has published a [consultation paper \(No. 79\)](#) containing proposals relating to Shari'a governance and accounting and auditing standards for Islamic firms and securities.

The DFSA currently mandates the use of the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) standards for Islamic financial business. However, following informal consultation with industry practitioners, the DFSA is proposing to change the financial standards applicable to Islamic financial business, Islamic funds and Islamic securities from AAOIFI to the International Financial Reporting Standards (IFRS). It is proposed that IFRS will be used in conjunction with specific required disclosures, including disclosures in respect of Profit Sharing Investment Accounts and Takaful.

The consultation paper acknowledges that firms will require time to implement the changes to accounting and auditing standards and therefore a two year transitional period is proposed. In addition, the DFSA has explicitly stated that it will consider waiver applications for those persons wishing to continue using the AAOIFI standards.

The consultation is open for comment until 25 November 2011.

### **FRB seeks comment on proposal to implement Volcker Rule**

The Board of Governors of the Federal Reserve System (FRB) has [requested public comment](#) on a proposed regulation implementing the 'Volcker Rule', as outlined in section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 619 generally contains two prohibitions. First, it prohibits insured depository institutions, bank holding companies, and their subsidiaries or affiliates from engaging in short-term proprietary trading of any security, derivative, and certain other financial instruments for a banking entity's own account, subject to certain exemptions. Second, it prohibits owning, sponsoring, or having certain relationships with, a hedge fund or private equity fund, subject to certain exemptions.

The proposed regulation clarifies the scope of the Act's prohibitions and provides certain exemptions. In particular, transactions in certain instruments, including obligations of the US government or a US government agency, the government-sponsored enterprises, and state and local governments, are exempt from the statute's prohibitions. Other exempted activities include market making, underwriting, and risk-mitigating hedging. The statute also permits banking entities to organize, offer, and invest in a hedge fund or private equity fund subject to a number of conditions. The proposed rule would require banking entities that engage in these activities to establish an internal compliance program that is designed to ensure and monitor compliance with the statute's prohibitions and restrictions, and implementing regulations. The proposed rule provides commentary intended to assist banking entities in distinguishing permitted market making-related activities from prohibited proprietary trading activities.

The proposal also requires banking entities with significant trading operations to report to the appropriate federal supervisory agency certain quantitative measurements designed to assist the federal supervisory agencies and banking entities in identifying prohibited proprietary trading in the context of certain exempt activities and identifying high-risk assets or trading strategies.

## **RECENT CLIFFORD CHANCE BRIEFINGS**

### **US Regulators Propose Regulations to Implement the Volcker Rule**

On Tuesday, 11 October 2011, the FDIC unveiled proposed regulations to implement the Volcker Rule that will be issued jointly by the Federal Reserve, the FDIC, the Office of the Comptroller of the Currency, and the SEC. Enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Volcker Rule generally prohibits banking organizations from conducting proprietary trading and from sponsoring or acquiring an interest in a hedge fund or a private equity fund. In the proposed regulations, the agencies attempt to take the very broad



concepts of the Volcker Rule and create a workable framework for doing business under its prohibitions and exceptions. This is no simple task. The complete package from the agencies is 298 pages long and includes nearly 400 specific questions that the agencies hope will be answered in the public comment process. Comments are due by 13 January 2012. The Volcker Rule becomes effective on 21 July 2012.

This briefing provides a general overview of the proposal and encourages the broadest possible participation in this rulemaking process. In many instances the agencies have interpreted the scope of permitted activities narrowly. We note, in particular, the narrow interpretation of the exemption for proprietary trading conducted outside the United States by non-US banking organizations and the constraints imposed by the proposed regulations on fund co-investment activities. The agencies clearly want and need, however, thoughtful comments on the proposal. The Volcker Rule will transform a significant segment of the financial services industry. The best opportunity to limit the compliance burden and ensure reasonable implementation is to provide input now.

[http://www.cliffordchance.com/publicationviews/publications/2011/10/u\\_s\\_regulators\\_proposeregulationstoimplemen.html](http://www.cliffordchance.com/publicationviews/publications/2011/10/u_s_regulators_proposeregulationstoimplemen.html)

### **Prospectus Directive – Significant changes for summaries and final terms**

ESMA's technical advice to the European Commission dated 4 October 2011 on, among other things, final terms and summaries could lead to significant changes to capital markets documentation. If adopted by the Commission, proposals would include longer summaries for prospectuses and, more significantly, individual summaries to accompany each set of final terms. ESMA acknowledges that structured debt products will be most affected, but there would also be an impact on 'vanilla' debt programmes and issues.

This briefing discusses ESMA's technical advice.

[http://www.cliffordchance.com/publicationviews/publications/2011/10/prospectus\\_directivesignificantchangesfo.html](http://www.cliffordchance.com/publicationviews/publications/2011/10/prospectus_directivesignificantchangesfo.html)

### **A Guide to the European Union – November 2011**

This updated edition of the Clifford Chance Guide to the European Union provides an overview of the EU, its institutions, types of legislation and a glossary of terms.

[http://www.cliffordchance.com/publicationviews/publications/2011/10/a\\_guide\\_to\\_the\\_europeanunionnovember2011.html](http://www.cliffordchance.com/publicationviews/publications/2011/10/a_guide_to_the_europeanunionnovember2011.html)

### **Belgian Federal Budget 2012 – Anticipated Tax Measures**

The current Belgian budgetary negotiations could lead to a number of tax measures likely to result in increased fiscal pressure for companies and individuals. This briefing analyses the most important anticipated tax measures compared with the current situation.

The measures do affect the conditions under which a Belgian resident company may benefit from the Belgian participation exemption, which may then affect foreign resident companies investing in Belgium through a local subsidiary or investing through a Belgian holding company. At this stage, it is not certain which of the mentioned tax measures will ultimately be introduced. An update of this briefing will follow.

[http://www.cliffordchance.com/publicationviews/publications/2011/10/belgian\\_federal\\_budget2012anticipatedtaxmeasures.html](http://www.cliffordchance.com/publicationviews/publications/2011/10/belgian_federal_budget2012anticipatedtaxmeasures.html)

### **In Arbitration, Less is Definitely More – Seventh Circuit Reinstates Arbitration Award Observing that Silence is Just Silence**

Finding that an arbitration panel's 'failure' to address in its written decision one or more of the central issues in dispute is not a reason to vacate an award — or, as Chief Judge Easterbrook put it, 'silence is just silence' — the Seventh Circuit in *Affymax, Inc. v. Ortho-McNeil-Janssen Pharmaceuticals, Inc.* overturned a district court decision vacating in part an arbitration award based on what the District Court concluded was a manifest disregard of the law. The Seventh Circuit concluded that the district court erred in rejecting the arbitration award based on a finding that the arbitrator manifestly disregarded the law in concluding that the parties jointly owned one patent family and that one party solely owned another patent family without analyzing inventorship separately from ownership.

In holding that 'manifest disregard of the law' is not a basis for vacating an arbitration award, the Seventh Circuit deepened an existing split among circuits that have attempted to apply the Supreme Court's ruling in *Hall Street Assoc., L.L.C. v. Mattel, Inc.* Courts have disagreed on whether Hall recognized or rejected 'manifest disregard of the law' as a ground for vacating an arbitral award. It appears that final resolution of this question will only occur when the Supreme Court agrees to revisit the issue.

This briefing discusses the decision in *Affymax*.

[http://www.cliffordchance.com/publicationviews/publications/2011/10/in\\_arbitration\\_lessisdefinitelymoresevent.html](http://www.cliffordchance.com/publicationviews/publications/2011/10/in_arbitration_lessisdefinitelymoresevent.html)

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