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Briefing note

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International Regulatory Group Contacts

Chris Bates +44 (0)20 7006 1041

Nick O'Neill +1 212 878 3119

Marc Benzler +49 69 7199 3304

Thomas Pax +1 202 912 5168

Steven Gatti +1 202 912 5095

Martin Rogers +852 2826 2437

Mark Shipman + 852 2826 8992

International Regulatory Update Editor

Julia Milosh +44 (0)20 7006 4171

To email one of the above, please use firstname.lastname@cliffordchance.com

Clifford Chance LLP, 10 Upper Bank Street, London, E14 5JJ, UK
www.cliffordchance.com

- SEC grants further extension for certain non-US transactions from compliance with rule 17g-5(a)(3)
- Recent Clifford Chance briefings: US OTC derivatives reforms – Impact on UK and other non-US asset managers (first update); and more. Follow this link to the briefings section.

Wheatley Review: Government consults on regulation of LIBOR

The UK government has launched a consultation on the regulation of the London Interbank Offered Rate (LIBOR). The consultation seeks the views of industry and the public on draft secondary legislation to implement the key recommendations of the Wheatley Review of LIBOR.

The consultation paper invites comment on two pieces of secondary legislation bringing LIBOR within the scope of regulation and making the manipulation of LIBOR a criminal offence. The government hopes to implement the recommendations as soon as possible by amending the Financial Services Bill, which is currently before Parliament. The Bill is expected to receive Royal Assent by early 2013, subject to the Parliamentary timetable.

The final chapter of the consultation paper discusses the potential for other benchmarks to be covered by secondary legislation. The government has indicated that additional benchmarks could be included within the scope of regulation or the application of the criminal offence.

Comments are due by 24 December 2012.

CRR/CRD 4: EU Council Presidency publishes progress report; EBA raises concerns regarding definition of own funds and methodology for calculation of transitional floors

The Cyprus EU Council Presidency has published a progress report on the trialogue discussions of the Capital Requirements Regulation/CRD 4 package.

Amongst other things, the report indicates that:

- elements of the package relating to lending to small and medium sized enterprises, treatment of covered bonds, repo reporting, disclosures and other risk weights have been provisionally agreed by the Presidency, the European Commission and the European Parliament;
- debate on a number of areas, including capital, leverage and liquidity rules has been narrowed down to a limited number of issues;
- progress has been made with regard to the introduction of a capital buffer for global systemically important institutions and of a systemic risk buffer; and
- work is ongoing on a number of other topics, such as the framework regulating the ratios of the fixed and variable components of remuneration in institutions and the scope of the EBA powers in the legislative package.

The Presidency hopes to finalise the negotiations by the end of December 2012.

In addition, the EBA has sent two opinions relating to the trialogue discussions of the Capital Requirements Regulation/CRD 4 package to the Cyprus EU Council Presidency, the European Commission and the European Parliament.

The opinion dated 5 November 2012, raises concerns with respect to some of the proposals under consideration in the definition of own funds. In particular, the EBA is concerned about:

- several amendments regarding cooperative institutions which have been introduced in the draft text (Articles 25(1)(aa)(iv), 46);
- the introduction of multiple dividends for some type of capital instruments (articles 26(1)(h)(i) and 27(5a)); and
- the potential introduction of an amendment which would allow instruments (other than State Aid instruments) that did not qualify as Core Tier 1 capital and that were disqualified as hybrid instruments under the Capital Requirements Directive to qualify as CET1 capital under the CRR.

The opinion dated 21 November 2012, underlines the need for harmonising the different methodologies currently being used for the calculation of transitional floors and proposes the use of a consistent method based on the standardised approach.

Banking union: ECON Committee sets out position on Commission proposals for single supervisory mechanism; ECB opinion on Commission proposals published

The European Parliament's ECON Committee has voted on the European Commission's proposal to set up a single supervisory mechanism (SSM) for banks in the euro area,

comprising a Council regulation conferring specific tasks on the ECB concerning policies relating to the prudential supervision of credit institutions and a regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing the EBA.

The Committee has issued a press release setting out its position as follows:

- the ECB would be most directly involved with banks receiving public assistance and those posing a systemic risk, whereas other banks would be supervised by national authorities monitored by the ECB – draft supervisory decisions by national authorities would be deemed adopted by the ECB unless it rejected them, although the ECB would always have the power to undertake direct supervision of a bank if it felt the need to;
- MEPs would have the power to hold inquiries into alleged failures of the ECB supervisor and the Chair of the Supervisory Board would have to be approved by the EU Parliament;
- a Board of Appeal would be established to hear complaints by parties with grievances arising out of ECB supervisor decisions;
- all countries taking part in the system would have equal voting rights in the ECB Supervisory Board; and
- there would be various degrees of involvement of non-Euro countries with the ECB supervisor, ranging from 'close cooperation', through signing memoranda of understanding, to remaining outside the SSM but still interacting with it.

In addition, the European Central Bank has published its opinion on the European Commission's proposal.

European Parliament press release

European Commission presents blueprint for deep and genuine economic and monetary union

The European Commission has published a communication setting out its blueprint for a deep and genuine economic and monetary union, which involves incremental measures taken over the short, medium and longer term. Under the Commission's plans, all major economic and fiscal policy choices by Member States would be subject to deeper coordination, endorsement and surveillance at the European level.

The communication states that, in the short term (within 6 to 18 months), immediate priority should be given to implementing the governance reforms already agreed or about to be agreed. The Commission also believes that an effective banking union would not only require the setting up of a Single Supervisory Mechanism, but after its adoption, a Single Resolution Mechanism to deal with banks in difficulties. It would be in charge of the restructuring and resolution of banks within the Member States participating in the banking union.

In the medium term (18 months to 5 years), the blueprint recommends deeper coordination in the field of tax policy issues and labour markets in the euro area as further steps in strengthening the collective conduct of budgetary policy and economic policy. It also envisages the common issuance by euro area Member States of so-called eurobills – short-term government debt with a maturity of up to one or two years.

In the longer term (beyond 5 years), the Commission believes that an autonomous euro area budget providing for a fiscal capacity for the euro area to support Member States in the absorption of shocks should become possible. The Commission has further indicated that an integrated economic and fiscal governance framework could allow a common issuance of public debt.

According to the Commission, part of its agenda can be delivered on the basis of the current Treaties, though part of it requires Treaty change. This would be built on the principle that first, the deepening of EMU should build on the institutional and legal framework of the Treaties and second, that the euro area must be able to integrate quicker and deeper than the EU at large, whilst preserving the integrity of the policies conducted at 27, notably the Single Market. This means that, wherever appropriate, the euro area measures should be open to the participation of other Member States.

The blueprint is the Commission’s contribution to the report of the 'four presidents' on the next steps for economic and monetary union. A final version of the report is being prepared by the President of the European Council in coordination with President Barroso, the President of the European Central Bank and the President of the Eurogroup, and will be discussed by the European Council on 13 and 14 December 2012.

Executive summary
FAQs
Olli Rehn speech
Barroso speech

Credit rating agencies: European Parliament and Council reach provisional agreement

The European Parliament has announced that it has reached a provisional agreement with the EU Council and the European Commission on proposals for further amendments to the EU rules on credit rating agencies (CRAs), consisting of a proposed regulation amending Regulation 1060/2009 on CRAs and a proposed directive amending Directive 2009/65/EC on Undertakings for Collective Investment in Transferable Securities (UCITS IV) and the Alternative Investment Fund Managers Directive (AIFMD) in respect of the excessive reliance on credit ratings.

In particular, the European Parliament has indicated that under the agreed text:

- credit rating agencies will have to obey additional rules on sovereign debt ratings, including three set dates per year for issuing them;
- cross-ownership of agencies and the entities that they rate will be limited to prevent conflicts of interest – where an investor simultaneously holds shares in more than one credit rating agency, these shares must not exceed 5% and must be disclosed to the public, and agencies must not hold a stake of more than 10% in any entity that they rate;
- where an agency has committed, intentionally or with gross negligence, any of the infringements listed as having an impact on a credit rating, an investor or issuer may claim damages from that agency for losses due to the infringement – however, in the case of share issues, the issuer will have to first establish that the infringement was not caused by misleading and inaccurate information supplied by the issuer to the credit rating agency, directly or through publicly available information.

The agreement still needs to be formally approved by the Parliament's plenary session and by the Council. The Parliament is expected to vote on the agreement at its January 2013 plenary session.

European Parliament press release
EU Council Presidency press release

PRIPs: EU Council Presidency publishes compromise text

The Cyprus EU Council Presidency has published a compromise text for the proposed regulation on key information documents for packaged retail investment products (PRIPS).

OTC derivatives and market infrastructures: European Commission invites ESMA's technical advice on equivalence of certain third country frameworks

The European Commission has given ESMA a formal request for technical advice seeking its technical advice on possible implementing acts concerning the equivalence between the legal and supervisory frameworks of certain third countries and the regulation on OTC derivative transactions, central counterparties and trade repositories (EMIR).

Under Articles 25(6) and 75(1) of EMIR, the Commission may adopt an implementing act determining that the legal and supervisory arrangements of a third country ensure that CCPs and trade repositories established or authorised in a specific third country comply with legally binding requirements which are equivalent to the requirements laid down in EMIR. Under Article 13(2), the Commission may also adopt implementing acts declaring that the legal, supervisory and enforcement arrangements of a third country are equivalent to the clearing and reporting requirements laid down in EMIR to avoid duplicative or conflicting rules. The Commission is requesting the technical advice of ESMA in view of the preparation of the possible implementing acts to be adopted pursuant to these provisions. The Commission has emphasised that the technical advice it receives on the basis of the mandate will not prejudge its final decision in any way.

The mandate sets out an indicative timetable for the delivery of ESMA's technical advice in two phases, with the following deadlines: Phase I – 15 March 2013; and Phase II – within 3 months after the entry into force of the Commission's regulations with regard to regulatory and implementing technical standards for EMIR but at the latest by 15 June 2013.

IOSCO publishes principles for ongoing disclosure for asset-backed securities

IOSCO has published a report setting out a set of principles for ongoing disclosure for asset-backed securities (ABS), which are designed to provide guidance to securities regulators who are developing or reviewing their regulatory regimes for ongoing disclosure for ABS. The principles were developed as a complement to IOSCO's disclosure principles for public offerings and listings of ABS, which were issued in 2010, and are intended to enhance investor protection by facilitating a better understanding of the

issues that should be considered by regulators in relation to ongoing disclosure regimes for ABS.

The principles recommend disclosures for those securities that are primarily serviced by the cash flows of a discrete pool of receivables or other financial assets – either fixed or revolving – that by their terms convert into cash within a finite period of time. They would not apply to securities backed by asset pools that are actively managed, such as securities issued by investment companies or collateralised debt obligations, or that contain assets that do not by their terms convert to cash.

Regulatory reform: FSA consults on FCA Handbook updates relating to supervision and threshold conditions and new power of direction over qualifying parent undertakings

The FSA has published a consultation paper (CP12/34) on proposed updates to the FCA Handbook relating to supervision and threshold conditions, as well as a statement on how the FCA proposes to approach its new power of direction over qualifying parent undertakings.

CP12/34 is part of a series of papers setting out proposed changes to the regulatory requirements needed to create the new rulebooks and policies for the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). These proposals are intended to be in place for when the new regulators acquire their legal powers in 2013.

Comments are due by 29 January 2013.

Bank Levy: International Tax Enforcement Arrangements (Federal Republic of Germany) Order 2012 published

The Bank Levy: International Tax Enforcement Arrangements (Federal Republic of Germany) Order 2012 (2012 No. 2933) has been published.

The Order brings into effect international tax enforcement arrangements in respect of the exchange of information foreseeably relevant to the administration or enforcement of the UK bank levy and the equivalent German levy. The arrangements are contained in a Convention and Protocol made between the United Kingdom and the Federal Republic of Germany for the Avoidance of Double Charging of Bank Levies.

The Order will enter into force on 15 December 2012.

Explanatory memorandum

SFC consults on proposals to enhance regulatory regime for non-corporate listed entities

The Securities and Futures Commission (SFC) has published a consultation paper on proposals to enhance the regulatory regime for non-corporate entities that are listed on the Stock Exchange of Hong Kong Ltd (SEHK). The proposals are intended to promote consistency of regulation and enhance market transparency for all listed entities, whether they are companies or other types of business organisation.

Amongst other things, the proposals include:

- amending the provisions of Parts XIII to XV of the Securities and Futures Ordinance (SFO) regarding market misconduct and disclosure of interests to expressly cover all forms of listed entities;
- extending the SFC's powers to investigate and take action against breaches under Parts VIII and X to cover all listed entities, regardless of their legal form;
- extending the statutory disclosure requirement for price-sensitive information regarding listed corporations under Part XIVA of the SFO to all listed collective investment schemes (CIS) and other non-corporate-form listed entities – this requirement will come into effect on 1 January 2013;
- clarifying that, for the purposes of the SFO, the 'issuer' or the 'listed corporation' of a listed depository receipt is the issuer of the underlying shares or units (and not the depository bank); and
- excluding from the disclosure of interest regime entities whose only listed securities are debentures.

Comments are due by 24 December 2012.

Australian Treasury consults on strengthening APRA's crisis management powers

The Australian Treasury has published a consultation paper on strengthening the Australian Prudential Regulation Authority's (APRA's) crisis management powers.

The consultation paper sets out options to: (1) strengthen APRA's crisis management powers; (2) simplify APRA's regulatory powers across the various Acts it administers; (3) make a series of minor and technical amendments to enhance the effectiveness of legislation administered by APRA; and (4) align Australia's regulatory regime with international best practice.

Comments are due by 14 December 2012.

CFTC issues time-limited no-action relief from required clearing for swaps between affiliated counterparties

The CFTC's Division of Clearing and Risk has issued a time-limited no-action letter granting relief from required clearing under section 2(h)(1)(A) of the Commodity Exchange Act and the CFTC's newly adopted Part 50 regulations for certain swaps entered into by qualifying affiliated counterparties.

The no-action letter states that the Division of Clearing and Risk will not recommend an enforcement action for failure to clear a swap entered into by affiliated counterparties if one of the counterparties to the swap is majority owned by the other counterparty or both counterparties are majority owned by a third party and the financial statements of both counterparties and the third party majority owner, if any, are reported for accounting purposes on a consolidated basis. In addition, both affiliates must agree not to clear the swap.

On August 21, 2012, the CFTC published for public comment in the Federal Register a notice of proposed rulemaking to exempt swaps between two affiliated counterparties from required clearing. The proposed rule is not yet final. The no-action relief will remain in effect until either 1 April 2013, or the effective date of a CFTC rulemaking finalizing the proposed inter-affiliate clearing exemption rule.

CFTC issues clearing determination for certain credit default swaps and interest rate swaps

The CFTC has announced new rules requiring certain credit default swaps (CDS) and interest rate swaps to be cleared by registered derivatives clearing organizations (DCOs). The rules establish the first clearing determination by the CFTC under the Dodd-Frank Act.

Under the rules, market participants are required to submit a swap that is identified in the rule for clearing by a DCO as soon as technologically practicable and no later than the end of the day of execution. The rules codify statutory provisions clarifying that any swaps entered into prior to the enactment of the Dodd-Frank Act, or prior to the application of the clearing requirement, are not required to be cleared. The CFTC is also issuing a regulation to prevent evasion of the clearing requirement and related provisions. This regulation aims to prevent abuse of any exemption or exception to the clearing requirement under the Dodd-Frank Act. In addition, pursuant to the clearing requirement determination, a DCO is required to post on its website a list of all swaps that it will accept for clearing and clearly indicate which of those swaps the CFTC has determined are required to be cleared.

The final rule clarifies that swap dealers and private funds active in the swaps market will be required to comply beginning on 11 March 2013, for swaps they enter into on or after that date. Accounts managed by third party investment managers, as well as ERISA pension plans, will have until 9 September 2013 to begin clearing swaps entered into on or after that date. All other financial entities will be required to clear swaps beginning on 10 June 2013, for swaps entered into on or after that date. With regard to iTraxx, the CDS index on European corporate names, if no DCO offers iTraxx for client clearing by 11 February 2013, the CFTC will delay compliance for those swaps until 60 days after an eligible DCO offers iTraxx indices for client clearing.

Federal Reserve to propose new regulatory requirements for foreign banks, including establishment of top-tier US intermediate holding companies

Federal Reserve Board Governor Daniel K. Tarullo has given a speech on the regulation of foreign banking organisations, in which he indicated that the Federal Reserve is working on a rulemaking proposal concerning enhanced regulatory requirements for non-US banks operating in the United States. He also outlined three measures that are expected to be part of this rulemaking.

First, the largest non-US banks operating in the United States would be required to establish a top-tier US intermediate holding company (IHC) over all US bank and nonbank subsidiaries. Large non-US banks that do not operate US bank subsidiaries may also be subject to the IHC requirement. US branches and agencies of the foreign parent bank would not be included in the IHC structure, but will be subject to activity restrictions and certain additional prudential requirements.

Second, US IHCs would be subject to the same capital rules that apply to domestic bank holding companies (BHCs). Similarly, other enhanced prudential standards required by the Dodd-Frank Act would be applied to the US operations of large foreign banks in a manner consistent with their application to domestic BHCs.

Third, there would be liquidity standards for large US operations of foreign banks.

Governor Tarullo indicated that a notice of proposed rulemaking that will elaborate on these measures is expected to be issued in the coming weeks.

SEC grants further extension for certain non-US transactions from compliance with rule 17g-5(a)(3)

The SEC has announced that it is extending the temporary exemption from the extraterritorial application of SEC rule 17g-5(a)(3) until 2 December 2013. The previous extension of the exemption was set to expire on 2 December 2012.

The SEC's latest order extends the relief accorded to market participants under its order of 19 May 2010, under which the exemption is available for ratings of structured finance products issued by non-US persons and where the NRSRO rating the transaction 'has a reasonable basis to conclude' that the structured finance product will be offered and sold upon issuance, and that any arranger linked to the structured finance product will effect transactions of the structured finance product after issuance, only in transactions that occur outside the US.

SEC Order of 26 November 2012 extending temporary exemption under rule 17g-5 until 2 December 2013
SEC Order of 19 May 2010 granting temporary exemption under rule 17g-5
Related Clifford Chance briefing (May 2010)

RECENT CLIFFORD CHANCE BRIEFINGS

US OTC derivatives reforms – Impact on UK and other non-US asset managers (first update)

The CFTC, the SEC and prudential regulators in the United States have made significant progress on the detailed rules to implement the swap market reforms contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The principal changes are in the process of coming into effect, and market practitioners need to understand the scope of the work ahead of them.

Working with the Investment Management Association, Clifford Chance has prepared a first update of its summary of key provisions of the draft rules as they apply to UK and other non-US asset managers and their clients. Many of the provisions described in the summary apply equally to other market participants.

http://www.cliffordchance.com/publicationviews/publications/2012/11/us_otc_derivativesreformsimpactonukan.html

Derivatives with Italian local authorities – Council of State rules against the Province of Pisa

In its decision no. 5032/2011 of 7 September 2011, the Council of State had ruled that a local authority could, subject to certain conditions, unilaterally revoke its decision to enter into certain derivative transactions, thus retroactively setting aside the transactions. The assessment whether the conditions for the unilateral annulment had been met in the case which was the subject matter of the judgment (about derivative transactions entered into between the Italian Province of Pisa and certain credit institutions) had been deferred to a subsequent decision of the Council, to be made with the benefit of technical analysis by court-appointed experts. Whether or not the transactions in question embedded any 'implicit costs' – on which the court-appointed experts would need to opine – appeared to be the critical issue.

This decision has now been handed down (Council of State's decision no. 5962/2012 of 27 November 2012), the Council of State ruling that the Province of Pisa was not entitled to unilaterally revoke its resolution in the specific circumstances, notwithstanding that the transaction did in fact bear implicit costs in the experts' view.

This briefing discusses the decision. To view a copy of this briefing, please contact Mhairi Appleton at mhairi.appleton@cliffordchance.com.