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Briefing note

International Regulatory Update

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- Recent Clifford Chance Briefings: Schemes of Arrangement; Alternative investment protection strategies for Indonesia; and more. Follow this link to the briefings section.

Banking Union: EU Parliament approves Recovery and Resolution Directive, Single Resolution Mechanism and revised Deposit Guarantee Schemes Directive

The EU Parliament's plenary session has approved the Bank Recovery and Resolution Directive (BRRD), the Single Resolution Mechanism (SRM), and the revised Deposit Guarantee Schemes Directive, three key measures for the establishment of the Banking Union.

The BRRD is a single rulebook for the resolution of banks and large investment firms for all EU Member States and is intended to harmonise responses to banking crises across the EU. The provisions include the requirement for failing banks to 'bail-in', requiring losses to be absorbed by shareholders and creditors before outside sources of finance may be called upon. Authorities will be granted powers to intervene in the operations of a bank to avoid it failing and restructure banks that do face failure.

The SRM will implement the BRRD in the euro area and other Member States that opt to participate. The SRM will establish a Single Resolution Board with responsibility over resolution of cross-border and domestic banks in participating Member States. Resolution funds in participating states will be pooled into one Single Resolution Fund and administered by the Board. The fund has a target level of EUR 55 billion over eight years. Non-participating Member States will be required to set up their own bank-financed funds amounting to 1% of deposits within ten years.

The revised Directive on Deposit Guarantee Schemes will establish bank-financed guarantee schemes in each Member State reimbursing guaranteed deposits up to EUR 100,000 when a bank is unable to do so itself. The target level for funding of the deposit guarantee scheme is 0.8% of covered deposits to be collected from banks over ten years. In addition, deadlines for repayment of guaranteed deposits will be reduced from twenty working days to seven days by 2024.

EU Parliament approves MiFIR/MiFID 2

The EU Parliament's plenary session has approved the proposals for a directive on markets in financial instruments repealing Directive 2004/39/EC (MiFID 2) and a regulation on markets in financial instruments and amending the regulation on OTC derivatives, central counterparties and trade repositories (MiFIR).

Amongst other things, under the new rules:

- firms will be required to trade on organised venues, including regulated markets (RMs) such as stock exchanges, multilateral trading facilities (MTFs) controlled by approved market operators or larger investment firms and organised trading facilities (OTFs) for non-equities, such as interests in bonds, emission allowances or derivatives
- firms will be required to design investment products for specified groups of clients according to their needs, withdraw products deemed to be 'toxic' from trading and ensure that any marketing information is clearly identifiable as such and not misleading – clients should also be informed whether the advice offered is independent or not and about the risks associated with proposed investment products and strategies;
- positions in commodity derivatives (traded on trading venues and over the counter), will be limited, to support orderly pricing and prevent market distorting positions and market abuse – the European Securities and Markets Authority will determine the methodology for calculating these limits, to be applied by the competent authorities;
- any investment firm engaging in algorithmic trading in financial instruments will have to have effective systems and controls in place, such as 'circuit breakers' that stop the trading process if price volatility gets too high; and
- third countries whose rules are equivalent to the new EU rules will be able to benefit from the EU passport when providing services to professionals.

The proposals still need to be formally adopted by the EU Council. The publication of the new rules in the Official Journal is foreseen for the second quarter of 2014, with entry into application 30 months later.

Central securities depositories: EU Parliament approves proposed regulation

The EU Parliament's plenary session has approved the proposed regulation on improving securities settlement in the European Union and on central securities depositories (CSDs) and amending Directive 98/26/EC.

Amongst other things, the regulation provides for:

- shorter settlement periods;

- deterrent settlement discipline measures (mandatory cash penalties and 'buy-ins' for settlement fails);
- strict prudential and conduct of business rules for CSDs;
- strict access rights to CSD services; and
- increased prudential and supervisory requirements for CSDs and other institutions providing banking services ancillary to securities settlement.

The regulation still needs to be formally adopted by the EU Council. The publication of the regulation in the Official Journal is foreseen for the third quarter of 2014.

PRIPS: EU Parliament approves proposed regulation on key information documents

The EU Parliament's plenary session has approved the proposed regulation on key information documents for investment products. The regulation requires the financial services industry to provide basic information about investment products, the risk and return that can be expected as well as the overall aggregate cost that will arise in making the investment. Clear, comparable and complete information on investment products is to be provided in a mandatory, three-page A4 key information document (KID), which will cover a wide range of investment products offered to retail customers, either through banking channels, financial advisors or via the internet. Products within the scope will include structured products offered by banks, insurance-based investments (including unit-linked and 'with-profit' products) and investment funds.

The regulation still needs to be formally adopted by the EU Council before being published in the Official Journal. It would then take effect within two years.

EU Parliament approves UCITS V

The EU Parliament's plenary session has approved the proposed directive amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities as regards depositary functions, remuneration policies and sanctions (UCITS V).

Amongst other things, the proposed directive introduces specific provisions on the depositary's safekeeping and oversight duties, and defines the conditions in which safekeeping duties can be delegated to a sub-custodian. It sets out a list of entities that are eligible to act as UCITS depositaries, and clarifies the depositary's liability in the event of the loss of a financial instrument held in custody. It also includes provisions on redress.

As concerns remuneration, the proposed directive introduces a requirement for the UCITS management company to implement a policy that is consistent with sound risk management and complies with minimum principles. According to the agreement, fund managers would be required not to take investment risks beyond what is accepted by their UCITS investors. At least half of the variable part of their remuneration would be paid in the assets of their UCITS, unless the management of UCITS accounts for less than half of the total portfolio. Payment of at least a further 40% of this variable remuneration would be deferred for at least 3 years, to encourage managers to take a long-run view. On sanctions, it lists the main breaches to Directive 2009/65/EC and lays down the administrative sanctions and measures that the authorities should be empowered to apply.

The proposed directive still needs to be formally adopted by the EU Council before being published in the Official Journal. Member States will have 18 months to transpose the directive into national law, and depositories will be given an additional 24-month transition period after the transposition deadline.

Payment accounts: EU Parliament approves proposed directive

The EU Parliament's plenary session has approved the proposed directive on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features.

The proposed directive:

- provides for all EU consumers, without being residents of the country where the credit institution is located and irrespective of their financial situation, a right to open a payment account that allows them to perform essential operations, such as receiving their salary, pensions and allowances or payment of utility bills etc.;
- seeks to make it easier for consumers to compare the fees charged for payment accounts by payment service providers in the EU; and
- establishes a new procedure for consumers who wish to switch their payment account to one with another payment service provider within the same Member State, and facilitates the process of closing a bank account in one Member State and opening it in another.

The proposed directive still needs to be formally adopted by the EU Council before being published in the Official Journal. Member States will then have 24 months to transpose it into their national laws.

EU Parliament approves creation of European Account Preservation Order

The EU Parliament's plenary session has approved the regulation creating a European Account Preservation Order, which is intended to facilitate cross-border debt recovery in civil and commercial matters and establishes a new and self-standing European procedure for the preservation of bank accounts to enable a creditor to prevent the transfer or withdrawal of his debtor's assets in any bank account located in the European Union. The European procedure would be available to citizens and companies as an alternative to procedures existing under national law.

The regulation still needs to be formally adopted by the EU Council before being published in the Official Journal.

EU Council approves Omnibus II

The EU Council has given its formal approval to the Omnibus II Directive, which complements the Solvency II Directive and finalises the new framework for insurance regulation and supervision in the EU.

The amendments introduced by Omnibus II include the provision of specific tasks for the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA). They clarify the role of EIOPA in ensuring harmonised technical approaches on the calculation of technical provisions and capital requirements.

The new rules amend Solvency II and the Prospectus Directive following the creation of EIOPA and ESMA in 2010 as part of the new European system of financial supervision. The amendments broadly fall into the following categories:

- definition of the appropriate scope of technical standards;
- enabling EIOPA and ESMA to settle disagreements;
- enabling the existing rules to operate in the context of the new supervisory system; and
- transitional requirements and other amendments to Solvency II.

Member States have until 1 January 2016 to transpose Omnibus II into national law.

Market abuse: EU Council approves new rules

The EU Council has given its formal approval to a regulation on insider dealing and market manipulation (market abuse) and a directive on criminal sanctions for insider dealing and market manipulation.

The new Market Abuse Regulation (MAR) extends the scope of Directive 2003/6/EC, which prohibits insider dealing and the manipulation of financial instruments that are admitted to trading on regulated markets, to include financial instruments traded on multilateral trading facilities and organised trading facilities, as well as OTC-traded financial instruments.

The new Market Abuse Directive (MAD 2) obliges Member States to provide in their national legislation for criminal sanctions in respect of insider dealing, market manipulation and unlawful disclosure of inside information. It will require them to ensure that inciting as well as aiding and abetting criminal offences is also punishable. To ensure that sanctions are effective and dissuasive, the directive establishes minimum levels for the maximum term of imprisonment. Offences related to insider dealing and to recommending or inducing another person to engage in insider dealing and market manipulation will be punishable by a maximum term of at least four years. Offences related to unlawful disclosure of inside information will be punishable by a maximum term of at least two years.

EU Council approves new rules on statutory audit

The EU Council has given its formal approval to the amended Directive on Statutory Audit and the Regulation on specific requirements regarding the statutory audit of public-interest entities. The new rules are intended to enhance the credibility of the audited financial statements of public-interest entities (PIEs), which are companies with a significant public interest because of the nature of their business, their size, their number of employees or their corporate status, including banks, insurance companies and listed companies. In addition, the new rules are intended to facilitate a wider choice of audit providers.

The main features of the reform include the following:

- the new legislation will impose mandatory rotation of auditors of PIEs after a period of 10 years;
- Member States may allow the auditor or audit firm to continue audit of the same PIEs up to the maximum duration of 20 years where a public tendering is conducted and up to 24 years in case of a joint audit;

- in order to avoid conflicts of interests and threats to independence a number of non-audit services, such as tax, consultancy and advisory services will be forbidden to be provided to the audited entity;
- when an audit firm provides non-audit services (other than those which are prohibited) to the audited entity for three or more years, the total fees for such services will be limited to no more than 70% of the average of the fees paid in the last three years by the audited entity; and
- the supervision of the system will be carried out within the framework of a Committee of European Auditing Oversight Bodies (CEAOB) – the European Securities and Markets Authority (ESMA) will provide assistance in the field of external relations within the structure of the CEAOB.

In addition, the regulation will (and the directive will require national legislation to) render null and void contractual provisions (in new and existing contracts) which restrict a PIE's (in the case of the regulation) or audited entity's (in the case of the directive) choice of auditor to certain categories or lists of auditors. This element of the regulation will apply three years from the date that the regulation comes into force. The directive will be required to be transposed into national law within 2 years of it entering into force.

The publication of the new rules in the Official Journal is foreseen for the second quarter of 2014.

CRR/CRD 4: EU Commission adopts implementing technical standards on supervisory reporting

The EU Commission has adopted implementing technical standards (ITS) which harmonise the content and format of data to be reported by European banks to their supervisors under the Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD 4). The ITS will enter into force following publication in the Official Journal, which is expected by mid-June 2014.

Following the later than scheduled adoption of the ITS by the Commission, and in accordance with an opinion issued by the European Banking Authority (EBA), the remittance dates of the first set of supervisory reports will be postponed from April/May 2014 to end June 2014, in order to avoid a situation where banks are asked to submit reports before the actual entry into force of the ITS.

The postponement concerns banks' submissions to competent authorities of:

- the first quarterly reports on own funds, large exposures, leverage ratio, and net stable funding ratio, with reference dates as of 31 March 2014 to end June 2014, as opposed to end May 2014; and of
- the first monthly liquidity reports with reference dates as of 31 March 2014 and 30 April 2014 to end June 2014 as opposed to April 2014.

It has also been agreed to delay the implementation of the draft ITS on reporting of asset encumbrance. The first reporting reference date for asset encumbrance will be 31 December 2014 and the first remittance date will be 11 February 2015.

Delegated Regulation on publication of supplements to prospectus published in Official Journal

EU Commission Delegated Regulation (EU) No 382/2014 supplementing the Prospectus Directive with regard to regulatory technical standards for publication of supplements to the prospectus. The Delegated Regulation specifies situations where a significant new factor, material mistake or inaccuracy relating to the information included in the prospectus requires a supplement to the prospectus to be published.

The Delegated Regulation will enter into force on 5 April 2014.

EMIR: European Supervisory Authorities consult on draft technical standards

The European Supervisory Authorities (ESAs) have launched a consultation on draft Regulatory Technical Standards (RTS) outlining the framework of the European Market Infrastructure Regulation (EMIR). The RTS cover the risk management procedures for counterparties in non-centrally cleared OTC derivatives, the criteria concerning intragroup exemptions and the definitions of practical and legal impediments.

For those over-the-counter (OTC) derivative transactions that will not be subject to central clearing, the draft RTS prescribe that counterparties apply robust risk mitigation techniques to their bilateral relationships, which will include mandatory exchange of initial and variation margins. This is intended to reduce counterparty credit risk, mitigate any potential systemic risk and ensure alignment with international standards. The draft RTS elaborate on the risk-management procedures for the exchange of collateral and on the procedures concerning intragroup exemptions

including the criteria that identify practical and legal impediments to the prompt transfer of funds.

The draft RTS also lay down the methodologies for the determination of the appropriate level of margins, the criteria that define liquid high-quality collateral, the list of eligible asset classes, collateral haircuts and concentration limits. In order to ensure that margin requirements are implemented in a proportionate fashion, the consultation focuses on specific points such as the impact on small or medium-sized entities or entities from specific sectors, operational capabilities, the special treatment for covered bonds swaps, the use of internal models and concentration limits. In addition, the ESAs are proposing not to allow re-hypothecation of collateral collected for initial margins.

Comments are due by 14 July 2014.

FSB Chairman sets out progress on financial reforms

Financial Stability Board (FSB) Chairman Mark Carney has written a letter to the G20 Finance Ministers and Central Bank Governors summarising the progress towards completing the programme of global financial system reform for the Brisbane summit. Mr. Carney notes that difficult decisions remain to be taken in three particular areas:

- ending too-big-to-fail;
- transforming shadow banking to transparent and resilient market-based financing; and
- making derivatives markets safer.

The letter also begins to look ahead to plans for implementation beyond Brisbane and highlights the need for the G20 to develop an approach to financial regulation based on:

- peer reviews and impact assessments;
- outcomes-based approaches to resolving cross-border issues; and
- enhanced co-operation to avoid domestic measures that fragment the global system.

Finally, the letter summarises the initial findings of a review of the representation of jurisdictions on the FSB.

Basel Committee issues final standard for measuring and controlling large exposures

The Basel Committee on Banking Supervision has published its final standard for the supervisory framework for measuring and controlling large exposures.

The large exposure framework has been designed so that the maximum possible loss a bank could incur following a sudden default by a single counterparty or group of connected counterparties would not endanger the bank's survival as a going concern. The standard includes a general limit applied to all of a bank's exposures to single counterparties set at 25% of a bank's Tier 1 capital; this limit will also apply to a bank's exposure to identified groups of connected counterparties. The limit for exposures between global systemically important banks (G-SIBs) will be set at 15% of Tier 1 capital.

The final standard differs from the initial March 2013 proposals following comments by including:

- the definition and reporting thresholds at 10% of the eligible capital base;
- a modification of the treatment of a limited range of credit default swaps (CDS) used as hedges in the trading book in order to be more closely aligned with the risk-based capital framework;
- a materiality threshold related to the capital base of the bank (calibrated at 0.25% of the capital base) rather than the initially proposed granularity threshold for exposures to securitisation vehicles; and
- a treatment that recognises particular features of some covered bonds.

The final standard will take effect on 1 January 2019.

Asia Region Funds Passport: Joint consultation on proposed rules and arrangements governing operations launched

Singapore, Australia, Korea, New Zealand, Philippines and Thailand have released a joint consultation paper on the proposed rules and arrangements that will govern the operation of the Asia Region Funds Passport (ARFP).

The ARFP is an initiative conceived under the Asia-Pacific Economic Cooperation (APEC) Finance Ministers Process. In September 2013, the finance ministers of Singapore, Australia, Korea and New Zealand signed a statement of intent to jointly develop the ARFP to facilitate the cross-border offering of funds in Asia. When implemented, the ARFP will allow fund managers operating in a passport member economy to offer their funds in other passport member economies under a streamlined authorisation process.

The consultation paper sets out the substantive rules that will apply to participating fund managers and passport funds. It also sets out common standards and expectations

amongst regulators from passport member economies on the supervision of passport funds, including the protection of investor interests. Following the consultation, the economies that decide to participate in the passport will work together towards the launch of the ARFP in 2016.

Comments are due by 11 July 2014.

NDRC amends its outbound direct investment rules

The National Development and Reform Commission (NDRC) has amended its outbound direct investment (ODI) rules and promulgated the 'Administrative Measures on Filing and Approval of Outbound Direct Investment Projects'. The new rules will become effective on 8 May 2014 and apply to PRC entities with legal person status.

Amongst other things, under the amended rules:

- only ODI projects with an investment amount of USD 1 billion, or which relate to sensitive jurisdictions (e.g. those that have no diplomatic relations with China, are sanctioned, or are subject to war or civil commotion) or sensitive industries (e.g. basic telecommunication, cross-border hydro resources development, land development on a large scale, main electricity transmission line, grid, media), require approval;
- ODI projects with an investment amount of more than USD 2 billion and which relate to sensitive jurisdictions or industries require the approval of the State Council after the NDRC's preliminary review;
- other ODI projects only require prior filing with the NDRC, and projects with investments of less than USD 300 million should be filed with the NDRC counterpart at provincial level;
- it is clarified that as long as there is no financing or security provided by a PRC company, no approval/filing is required for its offshore affiliate to make ODI;
- for the first time, investments in offshore PE fund as GPs or LPs are subject to the same rules; and
- the approval procedures are streamlined with a clearer timeline.

HKMA issues circular on implementation of final standard for capital treatment of bank exposures to central counterparties

The Hong Kong Monetary Authority (HKMA) has issued a circular to all locally incorporated authorised institutions on the implementation of the final standard on capital requirements for bank exposures to central counterparties (CCPs). The final standard, issued by the Basel Committee on Banking Supervision (BCBS) on 10 April 2014, replaces the interim capital requirements for bank exposures to CCPs published in July 2012.

Scheduled to take effect on 1 January 2017 when the interim capital requirements will be replaced, the standard introduces a number of changes to simplify the underlying policy framework and to complement relevant initiatives undertaken by other supervisory bodies. The major changes include:

- for the purpose of calculating the capital requirements of a bank's exposures arising from its default fund contributions to qualifying CCPs (QCCPs), replacing the existing methodology (which can be found in the interim capital requirements) with a single approach which is simpler and uses the new standardised approach for counterparty credit risk (instead of the current exposure method) to measure a QCCP's hypothetical capital requirement;
- setting a cap on a bank's total capital charges for its exposures to a QCCP such that those charges will not exceed the charges that would otherwise be applicable if the CCP were a non-qualifying CCP; and
- specifying the treatment for multi-level client structures whereby a bank centrally clears its trades through a client of a clearing member or a client of that client.

The HKMA intends to implement the final standard (through amendment of the Banking (Capital) Rules) in accordance with the BCBS implementation timetable. The industry will be consulted on the implementation proposals in due course. Authorised institutions that engage in derivatives activities are strongly recommended by the HKMA to review and consider the relevant implications of the final standard.

Capital Market Supervisory Board approves new requirements on independent directors of securities and derivative business operators

The Capital Market Supervisory Board (CMSB) has approved in principle an amendment to the requirements on independent directors of securities and derivatives business operators. According to the new regulations, at least one-fourth of the board of directors of a licensed securities or derivatives business operator must be independent directors who must have the qualifications and not possess prohibited characteristics as prescribed by the CMSB. Both existing and new securities and derivatives business operators will be required to comply with the above requirements by 1 January 2016.

However, the new requirements will not apply to certain business operators, including securities and derivatives investment advisors. In addition, financial institutions which are licensed by their regulators to operate securities or derivative business, such as commercial banks and insurance companies, will be deemed to have complied with the CMSB's requirements on independent directors if such financial institutions have already appointed independent directors in accordance with the requirements imposed by their regulators.

ASIC publishes review of OTC electricity derivatives market participants' risk management policies

The Australian Securities and Investments Commission (ASIC) has published a report (REP 390) setting out the findings of its review of the written risk management policies of Australian financial services (AFS) licensed entities that trade in over-the-counter (OTC) derivatives in the wholesale electricity market in Australia.

ASIC's principal findings in respect of risk management practices included that:

- although practices varied amongst licensees, the practices are generally quite comprehensive;
- ASIC did not identify any areas of significant concern; and
- risk management policies appeared to be appropriate to the nature, size and complexity of the financial services business being conducted.

ASIC's overall conclusion was that AFS licensees generally comply with their legal obligation to have adequate risk management systems.

The review was undertaken as part of ASIC's regulation of AFS licensees who trade in these financial products.

RECENT CLIFFORD CHANCE BRIEFINGS

New 'follower regime' forces taxpayer action and denies appeal rights

In future when a tax appeal is determined by a court and no appeal made, HMRC may decide that ruling is determinative of other unrelated disputes. HMRC may then designate outstanding cases as 'Followers' and demand that every taxpayer take 'corrective action'. The new 'Follower Notice' regime has unique and startling features. If you receive a 'Follower Notice' what should you do?

This briefing explores this question.

http://www.cliffordchance.com/briefings/2014/04/new_follower_regimeforcestaxpayeractionan.html

Schemes of Arrangement – Another step forward

On 14 April the English Court sanctioned schemes of arrangement for the APCOA Group, including several foreign companies within that Group. The decision is the latest in a line of cases which illustrate the willingness of the English Court to accept jurisdiction over foreign companies. For the first time jurisdiction was established on the basis of a Facilities Agreement whose governing law and jurisdiction clauses had been changed to English law and the English courts by majority lender consent.

This briefing discusses this decision and the development of schemes of arrangement.

http://www.cliffordchance.com/content/cliffordchance/briefings/2014/04/schemes_of_arrangementanotherstepforward.html

Alternative investment protection strategies for Indonesia

Clifford Chance has prepared a briefing paper considering the implications of Indonesia's termination of its Bilateral Investment Treaty (BIT) with the Netherlands and how foreign investors might structure their investments to take advantage of certain multilateral investment treaties to which Indonesia is a party, notably the Association of South East Asian Nations (ASEAN) Comprehensive Investment Agreement (ACIA).

http://www.cliffordchance.com/content/cliffordchance/briefings/2014/04/alternative_investmentprotectionstrategiesfo.html

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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