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Briefing note

International Regulatory Update

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- Recent Clifford Chance Briefings: New sanctions targeting Russia and Japanese Companies Act reform. Follow this link to the briefings section.

Banking Union: SRM Regulation published in Official Journal

The Regulation establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism (SRM) and a Single Resolution Fund (SRF) (Regulation 806/2014) has been published in the Official Journal of the EU. The Regulation is intended to ensure orderly resolution without recourse to public funds. The regulation establishes:

- the SRF, which will be built up over eight years to reach a target level equal to at least 1% of covered deposits of all credit institutions authorised in all Member States participating in the SRM, estimated at around EUR 55 billion; and
- a central decision-making resolution board to determine the application of resolution tools and the use of the SRF.

The Regulation will enter into force on 19 August 2014. Provisions relating to the cooperation between the Single Resolution Board and the national resolution authorities for the preparation of the banks' resolution plans will apply from 1 January 2015 and the SRM should be fully operational by 1 January 2016.

EU Commission writes to ESMA regarding definition of financial instruments relating to foreign currency

The EU Commission has written to the European Securities and Markets Authority (ESMA) regarding the need to clarify the definition of a financial instrument relating to foreign currency (FX contract), in particular in order to ensure the effective application of the reporting regime under the European Market Infrastructure Regulation (EMIR).

The Commission notes that, while it no longer has the power to address this issue by way of a MIFID 1 implementing measure, the implementing measures to be adopted under the new Markets in Financial Instruments Directive (MiFID 2), which will come into application on 3 January 2017, will provide an opportunity to ensure legal certainty on what an FX contract is.

The Commission suggests that ESMA carefully considers whether the current approach by Member States achieves a sufficiently harmonised application of the EMIR reporting obligation in the period before application of MIFID 2 or whether further measures by ESMA, e.g. guidelines, are necessary. However, it adds that a proportionate approach requires consideration that any measures, e.g. guidelines, that are adopted now, and might require changes by Member States to legislation and by stakeholders to their practices and authorisations, may need to be changed again in 2017 if these measures are not fully aligned with the future MIFID 2 implementing measures.

In this context, the Commission notes that a broad consensus seems already to have been reached along the following lines with respect to defining FX spot contracts:

- to use a T+2 settlement period to define FX spot contracts for European and other major currency pairs;
- to use the 'standard delivery period' for all other currency pairs to define an FX spot contract;
- where contracts for the exchange of currencies are used for the sale of a transferable security, to use the accepted market settlement period of that transferable security to define an FX spot contract, subject to a cap of 5 days; and
- an FX contract that is used as a means of payment to facilitate payment for goods and services should also be also considered an FX spot contract.

EBA issues amended technical standards on supervisory reporting

The European Banking Authority (EBA) has published its final draft implementing technical standards (ITS) amending the EU Commission's Implementing Regulation (EU) No 680/2014 on supervisory reporting under the Capital Requirements Regulation (CRR). The final draft ITS include minor changes to templates and instructions which the EBA deemed necessary to publish in order to reflect some of the answers published in its Single Rulebook Q&As, as well as to correct legal references and other clerical errors.

The amendments are expected to be applicable for reporting as of December 2014.

EBA updates ITS on asset encumbrance, forbearance and non-performing exposures and additional monitoring metrics

The EBA has published updated versions of three sets of final draft ITS on reporting requirements for asset encumbrance, forbearance and non-performing exposures and additional monitoring metrics (AMM) other than those used to report liquidity coverage and stable funding requirements.

Changes contained in the revised ITS include:

- format changes related to Data Point Model/taxonomy development;
- deletion of inconsistencies within the ITS;
- additional specifications required for reporting amounts;
- removal of inconsistencies between instructions and corresponding templates; and
- corrected legal references.

ESMA publishes official translations of its updated guidelines on ETFs and other UCITS issues

ESMA has published the official translations of its updated guidelines on exchange-traded funds (ETFs) and other UCITS issues. The new version of the guidelines modifies the original provision on diversification of collateral received by UCITS in the context of efficient portfolio management techniques and over-the-counter financial derivative transactions.

The publication of the translations triggers a period of two months within which competent authorities subject to the guidelines have to notify ESMA of their compliance position.

ESA Joint Committee reminds institutions of requirements regarding self-placement and ESMA underlines risks from investing in CoCos

The Joint Committee of the European Supervisory Authorities (EBA, EIOPA and ESMA) has published a reminder to banks and insurance companies across the EU on the consumer protection requirements that apply to certain financial instruments they issue. In addition, ESMA has highlighted specific risks posed to investors by contingent convertible instruments (CoCos).

As part of their mandates to protect investors, depositors and policyholders, EBA, ESMA and EIOPA have analysed the practices employed by some financial institutions to comply with the new EU capital rules and requirements. These practices concern institutions engaging in 'self-placement', i.e. placing with their clients financial instruments that they, or their group companies, have issued and that are eligible to comply with specific prudential requirements. The ESAs have stressed that these practices may breach some of the rules governing financial institutions and may result in significant consumer detriment. The Joint Committee has emphasised that institutions should not allow the pressure on their capitalisation needs to affect their compliance with EU requirements in terms of provision of services to consumers.

In particular, the Joint Committee notes that the loss bearing features of many self-placement products expose consumers to significant risks that do not exist for most other financial instruments, such as the risk of having to share losses (risk of bail-in). The Joint Committee has reminded financial institutions across the EU about their responsibility to comply with rules governing conflicts of interest, remuneration, provision of advice and suitability and appropriateness of products.

In addition, ESMA has issued a separate additional statement on potential risks associated with contingent convertible instruments (CoCos). According to ESMA, investing in CoCos requires a sophisticated level of financial literacy and a high risk appetite, and they may therefore not be appropriate for retail investors. ESMA has recommended that investors take into account the relevant risks before investing.

Ukraine: EU and US impose further sanctions targeting Russia

The EU Council has announced a further set of restrictive measures in light of the ongoing situation in Ukraine. In particular, EU nationals and companies may no longer buy or sell new bonds, equity or similar financial instruments with a maturity exceeding 90 days issued by certain Russian banks, development banks, their subsidiaries and those acting on their behalf. Services related to the issuing of such financial instruments, e.g. brokering, are also prohibited. The full details of the new restrictive measures are expected to be published in the Official Journal of the EU on 31 July 2014.

In addition, an embargo on the import and export of arms and related material from/to Russia has been agreed. There is a prohibition on exports of dual use goods and technology for military use in Russia, and exports of certain energy-related equipment and technology to Russia will be subject to prior authorisation by competent authorities of Member States. These measures apply to new contracts only, and are scheduled to take effect from 1 August onwards.

The US government has also announced similar new measures, including the addition of the three further banks to its sectoral sanctions identification list (SSI List). US persons are prohibited from transacting in, providing financing for, or otherwise dealing in new debt of longer than 90 days maturity or new equity for the Russian banks and energy companies on the SSI List, their property, or their interests in property. The Office of Foreign Assets Control (OFAC) has broadly defined 'debt' to include bonds, loans, extensions of credit, loan guarantees, letters of credit, drafts, bankers acceptances, discount notes or bills, or commercial paper. A general license was issued by OFAC clarifying that these sanctions generally do not apply to derivative instruments. These sanctions only apply to new debt (and, if applicable, new equity), so do not apply to pre-existing debt or equity.

PRA publishes final rules on clawback and jointly consults with FCA on improving individual responsibility in banking sector

The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) have published two joint consultation papers on proposals to improve responsibility in the banking sector, through new regulatory frameworks on individual accountability and remuneration. The proposals incorporate and build on the June 2013 recommendations from the Parliamentary Commission for Banking Standards and rules under the Banking Reform Act 2013.

The consultation paper on accountability (CP14/14) sets out a framework that is intended to encourage greater responsibility for the actions of individuals and will enable firms and regulators to more easily hold individuals to account. The proposals relate to individuals working for UK banks, building societies, credit unions and PRA-designated firms and include:

- a new senior managers regime relating to staff subject to regulatory approval, which will focus accountability on a narrower group than the current approved persons regime;
- a certification regime relating to the fitness of employees that could pose significant harm to a firm or its customers; and
- a new set of conduct rules.

CP14/14 includes a draft Handbook text and rules, a draft statement of policy and draft supervisory statements, and seeks views on the proposed timetable for implementing the new rules.

The consultation paper on remuneration (CP15/14) relates to all banks and building societies and PRA-designated investment firms which are dual regulated by the PRA and FCA. It sets out proposed changes that address weaknesses in the alignment between risk and reward and will amend the Remuneration Code in the Senior Management Arrangements, Systems and Controls (SYSC) rulebook and introduce a remuneration section to the new PRA Rulebook. Proposals for the FCA Handbook and PRA Rulebook sections are included in CP15/14. As with the Remuneration Code, the PRA Rulebook section will apply to all material risk takers in a firm. In particular, revisions address:

- deferral of variable remuneration;
- strengthening the presumption against discretionary payments at bailed-out banks;
- buy-outs;
- risk adjustment (PRA only); and
- the remuneration of non-executive directors.

Both consultations close on 31 October 2014.

The PRA has also published its final policy statement (PS7/14) on clawback, which requires firms to be able to apply clawback to vested variable remuneration on a group-wide basis and introduces a minimum seven year period for clawback from the date of award. These rules come into force on 1 January 2015.

Best execution: FCA sets out findings of thematic review

The FCA has published the findings of its thematic review of best execution and payment for order flow.

The FCA found that many firms do not understand key elements of the rules and are not adequately controlling client costs when executing orders. These failings were compounded by insufficient managerial oversight or engagement from front office staff for delivering best execution. The FCA expects all firms to review their best execution arrangements in light of these findings and take immediate action to ensure that they comply with its rules.

The review comes ahead of the introduction of enhanced EU-wide rules on best execution and is linked to the FCA's work on firms' use of client dealing commission and how they discharge their duty to act as good agents.

FSMA issues communication on online distribution of non-mainstream financial products

The Belgian Financial Services and Markets Authority (FSMA) has issued a communication to undertakings that distribute certain 'non-mainstream financial products' online to retail investors in Belgium. The communication defines 'non-mainstream financial products' as being 'derivatives, which are often unlisted (sold over-the-counter), generally have short maturity periods and are often very risky, but are usually presented to clients as very simple products that offer high returns quickly and easily'. These non-mainstream financial products include contracts for difference (CFDs) and so-called 'binary' options.

In its communication, the FSMA reminds undertakings that distribute these types of products in Belgium of the applicable regulatory framework, namely:

- legislation governing public offers;
- the MiFID rules of conduct;
- consumer protection rules; and
- the additional information requirements that will become applicable from 12 June 2015.

German Federal Ministries of Finance and Justice publish proposed draft Act to protect retail investors

The German Federal Ministries of Finance and Justice have published draft legislation to protect retail investors.

Amongst other things, the draft Act provides for:

- enhanced protection of investors when investing in non- or less regulated types of investment products (Grauer Kapitalmarkt);
- the implementation of a Product Governance Process which requires the offeror to specify the market it aims to target with its product;
- the implementation of a 'product intervention tool' which, amongst other things, enables the German Federal Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) to warn investors regarding a specific product, to prohibit the marketing and distribution of a product and to conduct a special audit of the issuer;
- the implementation of rules regarding the distribution of investment products – product fact sheets (Vermögensanlagen-Informationsblatt), which are already required under German law, will include a warning and the investors will have to sign the fact sheet; and
- administrative fines for issuers will be increased for the violation of the financial reporting requirements – furthermore, large issuers will be required to implement the capital flow in their financial report.

Central Bank of Ireland consults on rules for loan origination by investment funds

The Central Bank of Ireland has launched a consultation on the proposed regulatory framework for lending by investment firms, due to the Central Bank's intention to lift its long-standing prohibition on lending by alternative investment funds (AIFs). The consultation paper proposes authorisation of lending to institutional and professional investors by 'loan originating Qualifying Investor AIFs', which would be funds authorised under Irish law by the Central Bank with an authorised alternative investment fund manager (AIFM) under the Alternative Investment Fund Managers Directive (AIFMD).

The Central Bank has identified a number of risks arising from loan origination by investment funds, particularly in relation to:

- regulatory arbitrage with other segments of the financial sector, including a potential lack of regulation around credit risk management;
- the risk of runs in investment funds due to potential discrepancy between liquidity and maturity of a fund's assets and liabilities;
- a risk of contagion in the banking sector; and
- risks related to excessive credit growth and pro-cyclicality.

The Central Bank notes that these risks may be mitigated in part through the AIFMD and also proposes supplementary measures to fully address them. The consultation paper seeks views on the Central Bank's approach and sets out the draft rules that would apply to loan originating Qualifying Investor AIFs.

Comments are due by 25 August 2014.

CBRC issues rules for specialised subsidiaries of financial leasing companies

The China Banking Regulatory Commission (CBRC) has issued the 'Interim Provisions on Specialised Subsidiaries of Financial Leasing Companies'. Amongst other things, the Interim Provisions:

- permit a financial leasing company to establish subsidiaries that are specialised in financial leasing businesses in certain areas (including aircraft and shipping financing) either in the free trade zones and bonded areas in China or outside of China, subject to the CBRC's approval;
- require a financial leasing company intending to establish a specialised subsidiary to satisfy certain eligibility requirements, including that (i) its equity investment may not exceed 50% of its net assets (on a consolidated basis), (ii) it can only use proprietary funds to set up the specialised subsidiary, and (iii) to

establish an offshore specialised subsidiary, it has been profitable in the last two years;

- require the minimum registered capital of a domestic specialized subsidiary to be RMB 50 million;
- allow a financial leasing company to bring in other qualified investors to set up a specialised subsidiary provided the financial leasing company shall hold no less than 51% of shares in the specialised subsidiary;
- permit a financial leasing company to authorise its specialised subsidiaries to carry out business within its own business scope except for inter-bank lending and fixed-income products investment; and
- allow specialised subsidiaries to issue bonds outside China (although the Interim Provisions are silent as to whether it is permitted for the parent company to provide guarantees) and set up offshore SPVs to carry out financial leasing business.

The Interim Provisions became effective immediately.

Shanghai's lawmakers pass FTZ rules

The Standing Committee of the Shanghai Municipal People's Congress, the city's legislative body, has unanimously voted to pass the 'Basic Rules of the China (Shanghai) Pilot Free Trade Zone', which are intended to further implement the reforms that are being tested in the China (Shanghai) Pilot Free Trade Zone (FTZ) and create a law-oriented market in the FTZ. As a general principle, market participants are encouraged to carry out reform and innovation activities in the FTZ to the extent that they are not prohibited by laws and regulations.

The Basic Rules include nine chapters and 57 articles, covering supervision system, opening-up to foreign investment, trading facility, financial services and taxation, etc. The existing reformed policies relating to the registration system for business setting up, the negative list for foreign investment, simplified customs clearance procedures and various financial initiatives are all covered under the Basic Rules.

The Basic Rules became effective on 1 August 2014.

HKMA publishes circular on sale of investment products

The Hong Kong Monetary Authority (HKMA) has issued a circular to authorised institutions to share with them certain issues and good practices in relation to the sale of investment products identified during its supervisory process, and to reiterate the applicable regulatory requirements as well as the HKMA's expected standards.

In its recent rounds of on-site examinations and off-site surveillance of authorised institutions' controls in respect of the sale of investment products, the HKMA has observed that whilst authorised institutions in general had put in place policies and procedures to comply with relevant regulatory requirements, some issues and good practices identified warrant further attention by authorised institutions. The details of these issues and good practices are set out in the Annex of the circular.

The HKMA has advised authorised institutions to give due regard to these issues, review their own policies and procedures, and implement necessary enhancement measures. Authorised institutions are also encouraged to adopt the good practices, as applicable, to improve their sales practices and relevant controls.

Hong Kong and Thailand launch new cross-border payment-versus-payment link

The Hong Kong Monetary Authority (HKMA) and Bank of Thailand (BOT) have jointly announced the official launch of the new cross-border payment-versus-payment (PvP) link between Hong Kong's US Dollar real time gross settlement (RTGS) system and Thailand's Thai Baht RTGS system (BAHTNET).

The PvP link, which commenced operation effective from 28 July 2014, is intended to eliminate settlement risk in foreign exchange transactions between the US Dollars and Thai Baht by ensuring the simultaneous delivery of US Dollars in Hong Kong and Thai Baht in Thailand. Under this arrangement, banks in Thailand can better manage their counterparty risks arising from US Dollar-Thai Baht foreign exchange transactions and enhance their operational efficiency in settling those transactions in a coordinated manner during Asian hours. Meanwhile, banks in Hong Kong will find new correspondent banking opportunities of serving banks in Thailand.

The link is operated in Thailand by BOT and in Hong Kong by Hong Kong Interbank Clearing Limited (HKICL), which operates the interbank clearing systems in Hong Kong, and is equally owned by the HKMA and the Hong Kong Association of Banks.

Ministry of Strategy and Finance eases foreign exchange transaction regulations

The Ministry of Strategy and Finance (MOSF) has announced its decision to ease the foreign exchange transaction regulations to improve customer convenience.

Regarding corporate foreign exchange transactions, the MOSF intends to:

- increase the time within which funds owed in foreign currencies have to be sent to Korea from one and a half to three years, which is intended to help corporations manage foreign currency funds more efficiently;
- allow businesses to report investments up to USD 500,000 overseas annually after the investments have been made, instead of prior reporting; and
- allow importers to send up to USD 2 million in advance payments without reporting the transaction if the imports take time to be manufactured, such as vessels, airplanes, trains and industrial facilities.

Regarding individual foreign exchange transactions, the MOSF intends to:

- raise the ceiling of foreign exchange transactions that are not required to be verified by banks from USD 1,000 to USD 2,000; and
- allow people to wire USD 30,000 annually via branches of National Agricultural Cooperative Federation.

In addition, the MOSF intends to remove duties on annual reporting of Koreans' foreign stock ownership and operating fund in foreign companies' Korean branches, and quarterly reporting budget plans by corporations that do businesses both in Korea and overseas. Further, the MOSF has indicated that the easing of foreign exchange regulations regarding non-banking institutions, such as allowing them to extend loans in won and deal with repurchase agreements in foreign currencies, will be discussed later in 2014.

Financial benchmarks: MAS responds to feedback on proposed regulatory framework and consults on proposed amendments to Securities and Futures Act

The Monetary Authority of Singapore (MAS) has published its responses to the feedback it received to its 14 June 2013 consultation paper on the proposed regulatory framework for financial benchmarks. The proposed framework is intended to enhance the integrity of the processes for the setting of such benchmarks.

Amongst other things, the MAS has confirmed that:

- the definition of a financial benchmark will clarify that benchmarks not made available to the public and benchmarks that are only intended for use by its administrator are not within the definition;
- a public consultation will be conducted before the MAS prescribes any new rate or index, subject to market impact and specific circumstances involving such benchmarks; and
- regulatory sanctions for benchmark manipulation offences could range from supervisory warnings or formal reprimands, to fines, to revocation of licenses – the sanctions may apply to individuals, supervisors, and/or the corporate entity itself depending on the culpability of the parties involved.

The MAS has also issued a further consultation paper on proposed amendments to the SFA on regulation of financial benchmarks, to effect the policy proposals set out in the Regulatory Framework Consultation Paper and the corresponding MAS response to feedback received.

Amongst other things, the proposed amendments include:

- the amendment of section 2 of the SFA to introduce the relevant definitions required in the new regulatory regime for benchmarks;
- the introduction of a new Part VIAA (Financial Benchmarks) covering designation of financial benchmarks, administrator licensing, submitter authorisation, general powers, and the power to direct submissions;
- the amendments of Part IX (Supervision and Investigation), Part X (Assistance to Foreign Regulatory Authorities) and Part XII (Market Conduct) of the SFA, as well as corresponding consequential amendments to the SFA.

In view of other jurisdictions imposing extraterritorial requirements on benchmark administration in Singapore whose financial benchmarks are used in such jurisdictions, the MAS is also seeking views on whether there are other types of financial benchmarks apart from those proposed to be designated by MAS (Singapore Interbank Offered Rate, Swap Offer Rate, and foreign exchange spot benchmarks administered by the Association of Banks in Singapore), whose administrators may benefit from a separate voluntary regime with MAS in order to facilitate the continuation of their Singapore operations.

Comments on the consultation paper are due by 29 August 2014.

SEC adopts money market fund reform rules

The US Securities and Exchange Commission (SEC) has adopted amendments to the rules governing money market mutual funds. The amendments are intended to make structural and operational reforms to address risks of investor runs in money market funds, while preserving the benefits of the funds.

Among other things, the new rules require a floating net asset value (NAV) for institutional prime money market funds, which allows the daily share prices of these funds to fluctuate along with changes in the market-based value of fund assets. With a floating NAV, institutional prime money market funds (including institutional municipal money market funds) are required to value their portfolio securities using market-based factors and sell and redeem shares based on a floating NAV. These funds no longer will be permitted to use the special pricing and valuation conventions that currently allow them to maintain a constant share price of USD 1.00. The final rules also include enhanced diversification, disclosure and stress testing requirements, as well as updated reporting by money market funds and private funds that operate like money market funds.

The SEC has also issued a related notice proposing exemptions from certain confirmation requirements for transactions effected in shares of floating NAV money market funds. Additionally, the SEC has re-proposed amendments to its money market fund rules and Form N-MFP to address provisions that reference credit ratings.

The final rules provide a two-year transition period to enable both funds and investors time to fully adjust their systems, operations and investing practices. The rules will be effective 60 days after their publication in the Federal Register, and the re-proposal will have a 60-day public comment period following its publication in the Federal Register.

RECENT CLIFFORD CHANCE BRIEFINGS

Broad new sanctions targeting Russia

As has been widely reported, the US and the EU have adopted a package of new economic sanctions in response to the ongoing events in Eastern Ukraine, targeting, among other matters, Russia's financial, energy and defence sectors.

This briefing sets out a summary of the provisions and considers the key issues in the sanctions on both sides of the Atlantic.

http://www.cliffordchance.com/briefings/2014/07/broad_new_sanctionstargetingrussia-july2014.html

Companies Act Reform – Organisation Restructuring/M&A (Cash-out, Capital Raising)

This briefing explains the new rules regarding cash-out and capital raising by a private placement of shares as set out in the amendment to the Companies Act, which was enacted on 20 June 2014 (the Amendment). The Amendment is expected to come into effect on 1 April 2015.

The Amendment has introduced a new cash-out mechanism called a Demand for Sale of Shares. A cash-out (or squeeze out) is the compulsory acquisition of shares by majority shareholders from minority shareholders for consideration in cash and is often used to convert of a subsidiary into a wholly-owned subsidiary. Under the amended Companies Act, a Demand for Sale of Shares can be made by a shareholder holding no less than 90% of the voting rights in the target company. The amended Companies Act also provides for new minority shareholder protections for each of the existing mechanisms under current law for undertaking a cash-out: namely a 'consolidation of shares' and a 'class share scheme', the latter of which is by way of subjecting class shares to a class-wide call. In relation to capital raising, a shareholders' resolution will be required in certain types of share issuances that result in a person acquiring control of the company.

http://www.cliffordchance.com/briefings/2014/07/companies_act_reformorganisatio0.html