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Briefing note

International Regulatory Update

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- HKMA and SFC publish consultation conclusions on reporting and record keeping rules for OTC derivatives
- HKMA issues circular on implementation of Basel III
- FSA publishes amendments regarding central clearing, notification and reporting requirements for OTC derivatives transactions
- FSA publishes regulations regarding electronic trading facilities for OTC derivative transactions
- FSC announces plan to revitalise Korea's stock market
- Recent Clifford Chance briefings: UK government sets out plans to extend scope of individual accountability regimes. Follow this link to the briefings section.

European Long-Term Investment Funds: EU Parliament and Council reach provisional agreement on proposed regulation

The EU Parliament has reached a provisional agreement with the EU Council on the proposed regulation on European Long-Term Investment Funds (ELTIFs).

The proposed regulation creates a new investment fund framework designed for investors who want to put money into companies and projects for the long term. These private ELTIFs would only invest in businesses that need money to be committed to them for long periods of time.

Funds that want to use the ELTIF label have to meet a range of requirements designed to ensure investors understand the risks they are taking on and the amount of time they must wait before they can get their money back. In addition, retail investors must be given a Key Information Document (KID) detailing all of the risks involved before they can decide whether or not to invest in an ELTIF. In return managers of ELTIFs, who must also comply with all the rules of the Alternative Investment Fund Managers Directive (AIFMD), can market their funds to investors in all EU Member States.

Following the political agreement, a common text will now need to be finalised and voted on by the EU Parliament and the Council.

Money Market Funds: EU Council Presidency publishes compromise proposal

The EU Council Presidency has published a compromise text for the proposed regulation on money market funds.

Benchmarks Regulation: EU Council Presidency publishes compromise proposal

The EU Council Presidency has published a compromise text for the proposed regulation on indices used as benchmarks in financial instruments and financial contracts.

PSD 2: EU Council Presidency publishes compromise proposal

The EU Council Presidency has published a compromise text for the proposal for a second Payment Services Directive (PSD 2) to repeal the current Directive 2007/64/EC.

EBA publishes opinion on perimeter of credit institutions

The European Banking Authority (EBA) has published an opinion on matters relating to the perimeter of credit institutions under EU legislation. The opinion responds to an EU Commission request on 23 October 2013 to carry out a comprehensive study of credit institutions, as defined in the Capital Requirements Regulation (CRR), and other entities carrying on bank-like activities within the scope of credit intermediation. The EBA has published a report on the perimeter of credit institutions established in the EU and entities engaged in credit intermediation that are not credit institutions alongside its opinion.

The opinion discusses the definition of 'credit institution' and highlights that certain key terms within the CRR definition are not defined and, as such, there is a degree of variation in the interpretation of the term between Member States. The opinion also observes a wide variation between Member States as to the prudential treatment of relevant entities, which is set out in detail in the EBA's report that discusses solo-prudential requirements, prudential requirements for shadow banking entities and prudential requirements under the AIFMD and UCITS Directive. The EBA report follows a comprehensive study that surveyed approaches taken by competent authorities in Member States.

The EBA opinion also highlights the importance of ensuring the perimeter of 'credit institution' and other relevant terms, such as 'financial institution', are clearly defined before future work is carried out on the shadow banking sector.

EMIR: ESMA delays delivery of draft RTS on CDS clearing obligation

The European Securities and Markets Authority (ESMA) has sent a letter to the EU Commission announcing that it will delay delivery of the draft regulatory technical standards

(RTS) on the clearing obligation for credit derivatives under the European Market Infrastructure Regulation (EMIR) until the Commission has concluded its assessment process of the RTS on interest rate derivatives (IRDs), as the outcome could affect the content of the credit derivatives RTS.

The letter states that ESMA has finalised the draft RTS on credit derivatives and stands ready to deliver them once the Commission has finalised its assessment of the IRD RTS.

UCITS: ESMA submits technical advice on delegated acts to EU Commission

ESMA has published a report setting out its final advice to the EU Commission on two delegated acts on depositaries required by the Undertakings for Collective Investments in Transferable Securities Directive (UCITS V). The report sets out ESMA's advice on the insolvency protection of UCITS assets when delegating safekeeping and on the independence requirement.

ESMA's advice was written in light of feedback it received from stakeholders from a consultation setting out its draft advice in September 2014. ESMA will now work with the EU Commission on the transformation of the technical advice into formal delegated acts.

PRIIPs: EIOPA consults on technical advice on product intervention powers

The European Insurance and Occupational Pensions Authority (EIOPA) has launched a consultation on the technical advice it will provide to the EU Commission on completing new rules on the intervention powers of national supervisors and EIOPA. The technical advice will concern powers and procedures for temporarily prohibiting or restricting the marketing, distribution and sale of specific insurance-based investment products.

The regulation on key information documents (KIDs) for packaged retail and insurance-based investment products (PRIIPs) confers upon EIOPA and the national competent authorities (NCAs) specific intervention powers in relation to insurance-based investment products. Bans should be imposed only if serious concerns exist regarding investor protection, orderly functioning and integrity of financial markets, or the stability of the whole or part of the financial system.

Comments are due by 27 February 2015 and EIOPA will consider feedback from stakeholders when drafting its final advice to the EU Commission.

Bank structural reform: BBA and FBF call on EU Commission to reconsider need for proposed regulation

The British Bankers' Association (BBA) and Fédération Bancaire Français (FBF) have published a joint letter to EU Commissioner Frans Timmermans regarding the proposed regulation on structural measures to improve the resilience of EU credit institutions.

Commissioner Timmermans' remit includes the Better Regulation initiative, which is intended to ensure that every Commission proposal respects the principles of subsidiarity and proportionality. The letter sets out the associations' concerns about the Commission proposals for bank structural reform, and urges the Commission to review the current policy and consider whether it is relevant to the Better Regulation initiative. In particular, the BBA and FBF refer to the test for subsidarity, the principle under which the EU should not take action unless it is more effective than action taken at national, regional or local level.

The letter sets out the BBA's and FBF's view that the proposals are not necessary in light of:

- the results of the recent combined asset quality review (AQR) and stress test exercises;
- the potential negative impact on the EU economy of the proposals, particularly in relation to corporate finance, and the implications of the proposals on the Juncker Commission plan for a Capital Markets Union;
- national measures that have been taken in the UK and France on bank structure and the question this raises in relation to whether the EU proposals meet the test for subsidarity; and
- the date of the impact assessment for the proposals from 2010, which was prior to EU reforms through the Capital Requirements Directive (CRD 4) and Bank Recovery and Resolution Directive (BRRD).

ISDA publishes principles on CCP recovery

The International Swaps and Derivatives Association (ISDA) has published a set of principles on the adequacy and structure of central counterparty (CCP) loss-absorbing resources and on CCP recovery and resolution. The principles identify key issues to be addressed, and make recommendations on how to proceed, including:

- transparent risk management standards, practices and methodologies;
- mandatory, standardised and transparent stress testing;

- CCPs' contributions to the loss-absorbing resources pool should incentivise robust risk management, align CCP management incentives with those of the clearing members, and be fully funded, material and substantial;
- clearly defined CCP recovery plans; and
- clearing service termination or resolution so that recovery efforts are only undertaken as long as the CCP default management process is effective and the clearing service is viable.

IOSCO consults on cross-border regulation

The International Organization of Securities Commissions (IOSCO) has published a consultation report from the IOSCO Task Force on cross-border regulation, which identifies and describes cross-border regulatory tools and challenges.

The consultation includes:

- a description of three cross-border regulatory tools that have been used, or are under consideration, by IOSCO members to help address the challenges they face in protecting investors, maintaining market quality and reducing systemic risk. These can be broadly classified as national treatment, recognition, and passporting; and
- discussion of the key challenges and experiences faced by regulators in implementing cross-border securities regulations, including how their national rules will apply to global financial markets and interact with foreign rules and international standards

The consultation aims to gather further views on experiences and understanding in connection with the use of the cross-border regulatory tools and on other cross-border issues from a broad range of stakeholders, such as members of the securities industry, representative trade bodies, market professionals, academics, regulators, self-regulatory organisations, and policy makers.

Comments are due by 23 February 2015.

BRRD: HM Treasury publishes statutory instruments to implement requirements

HM Treasury has published four draft Statutory Instruments (SIs) made under the Banking Act 2009, as amended by the Financial Services (Banking Reform) Act 2013, which implement various aspects of the EU Bank Recovery and Resolution Directive (BRRD).

The draft Bank Recovery and Resolution Order 2014 makes necessary amendments to the Banking Act 2009 and the Financial Services and Markets Act 2000, and to secondary legislation made under those Acts, in order to:

- ensure that the Special Resolution Regime set out in the Banking Act 2009 complies with the BRRD;
- extend the powers of the Bank of England to intervene before it becomes necessary to resolve a failing bank; and
- ensure that the PRA and FCA are able to comply with requirements on competent authorities under the BRRD.

The other draft SIs relate to areas for transposition within the BRRD:

- the draft Banks and Building Societies (Depositor Preference and Priorities) Order 2014 – this SI is intended to ensure that deposits of UK banks eligible for compensation schemes (eligible deposits) and certain deposits of UK banks outside of the EEA are treated as preferential debts and that eligible deposits are given higher priority within the class of preferential debts than other deposits. Additionally the SI alters the priorities for the distribution of the assets of a building society on winding up;
- the draft Banking Act 2009 (Mandatory Compensation Arrangements Following Bail-In) Regulations 2014 – this SI specifies provisions to be included in a compensation order made under the Banking Act following the exercise of the power to make special-bail in provision in respect of banks, banking group companies, investment firms or (with modifications) building societies and, in particular, relates to the treatment of those who were pre-resolution shareholders and creditors, or in the case of building societies shareholding members of the building society; and
- the draft Banking Act 2009 (Restriction of Special Bail-in Provision, etc.) Order 2014 – this SI sets out the restrictions on making special bail-in provision in any instrument made by a bank or banking group under Part 1 of the Banking Act, including protected liabilities.

All four draft SIs will be made in order to come into force on 1 January 2015.

Financial Services (Banking Reform) Act 2013 (Commencement No. 7) Order 2014 published

The Financial Services (Banking Reform) Act 2013 (Commencement No. 7) Order 2014 (SI 2014/3160) has been published. The Order brings into force on 31 December 2014 certain provisions of the Financial Services

(Banking Reform) Act 2013 relating to preferential debts, the powers of the Bank of England to bail in liabilities of a bank, and the power of the Prudential Regulation Authority and the Financial Conduct Authority to make rules applying to certain holding companies in relation to resolution.

PRA consults on changes to Handbook

The Prudential Regulation Authority (PRA) has launched a consultation (CP25/14) which sets out proposals to redraft certain modules of the PRA Handbook, including:

- draft rules that will be incorporated into the PRA Rulebook covering status disclosure, controllers, close links, notifications and systems and controls;
- four draft supervisory statements which set out the PRA's expectations of firms in relation to the aggregation of holdings for the purpose of the prudential assessment of controllers, the internal governance of firms, the exercise of certain functions of building societies under the Building Societies Act 1986, and the treasury and lending activities of building societies; and
- a statement of policy that sets out the PRA's approach to insurance business transfers.

Comments are due by 23 January 2015.

PRA consults on liquidity coverage requirement and changes to existing liquidity regime

The PRA has published a consultation paper on changes to its rules intended to ensure that the PRA's approach to liquidity supervision complements the liquidity coverage requirement (LCR) set out in an EU Commission delegated act supplementing the CRR, which will enter into force on 31 December 2014 and become directly applicable from 1 October 2015. The delegated act only relates to credit institutions, but the PRA proposes to make the rules apply to UK-designated investment firms as well to ensure consistency in its approach.

The consultation paper (CP27/14) sets out the PRA's proposal to revoke liquidity standards contained in Chapter 12 of the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU 12) but carry forward these broad principles in the new regime. The consultation paper restates the PRA's approach to regulating liquidity and sets out draft rules and draft supervisory statements. The consultation paper discusses:

- proposals relating to the transition to the new regime, including carrying forward existing add-ons not covered in the LCR as the new pillar 2 add-ons until each firm's next liquidity review and maintaining current PRA regulatory returns;
- the requirements the PRA proposes to place on firms beyond meeting the LCR; and
- elements of the proposed PRA regime that relate to investment firms, UK branches of third country firms and LCR disclosure that are not covered by the scope of the EU legislation.

Comments on the consultation are due by 27 February 2015.

BaFin consolidates German derivatives ordinance

The German Federal Financial Supervisory Authority (BaFin) has proposed a draft ordinance to update the German Derivatives Regulation (Derivateverordnung) (DerivateV) and implement the new ESMA guidelines regarding exchange traded funds. The DerivateV regulates investments by funds in derivatives and structured products.

CSSF issues new circular on central administration, internal governance and risk management

The Luxembourg financial sector supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), has published a new circular (no 14/597) updating and modifying CSSF circular no 12/552 on central administration, internal governance and risk management.

The new circular implements the Recommendation of the European Systemic Risk Board on the financing of credit institutions – sub-recommendation B – (ESRB/2012/2) by adding a new chapter 6 on a general risk management framework for asset encumbrance of credit institutions to CSSF circular no 12/552.

Furthermore, in relation to the CSSF authorisation requirement for outsourcing of material activities, the has CSSF clarified that, where the material activity is outsourced to a duly licensed Luxembourg support professional of the financial sector or a Luxembourg credit institution, a notification to the CSSF confirming that the outsourcing conditions set out in circular no 12/552 are complied with is sufficient.

The modifications made to CSSF circular no 12/552 will enter into force on 31 December 2014.

Polish government introduces material changes to Act on Sureties and Guarantees Granted by the State Treasury and Certain Legal Persons

The Polish government has published an amendment to the Act on Sureties and Guarantees Granted by the State

Treasury and Certain Legal Persons, which will enter into force on 1 January 2015. The amendment excludes the following commercial entities from the application of detailed provisions of the Act regulating the issue of sureties and guarantees they grant:

- commercial companies in which the shares owned by the State Treasury represent more than half of the share capital;
- cooperatives in which the value of shares owned by the State Treasury represents more than half of the share fund; and
- legal persons in which the shares owned by the State Treasury or legal persons referred to in the first and second bullet points represent more than half of the share capital or the share fund.

The exclusion of the above commercial entities means, among other things, that they will no longer be obliged to obtain a permit from the Minister of Finance in cases in which his/her consent is necessary for a surety or guarantee to be granted.

CBRC consults on new leverage ratio requirements for commercial banks

The China Banking Regulatory Commission (CBRC) has published a consultation draft of the 'Administrative Measures on the Leverage Ratio of Commercial Banks'. The consultation draft follows the essentials of the Basel III leverage ratio framework and disclosure requirements finalised in June 2014, with a view to introducing a simple, transparent, non-risk based leverage ratio to act as a credible supplementary measure to the risk-based capital requirements.

In particular, the consultation draft introduces the following technical modifications to the existing leverage ratio rules:

- a bank shall meet a minimum requirement of 4% for the leverage ratio in respect of both consolidated assets and unconsolidated assets;
- a bank's total exposure measure is the sum of the following exposures: (a) on-balance sheet exposures; (b) derivative exposures; (c) securities financing transaction (SFT) exposures; and (d) off-balance sheet (OBS) items;
- with respect to derivatives exposures, only eligible cash variation margin may be used to reduce the leverage ratio's exposure measure;
- with respect to SFT, the accounting assets and counterparty credit risk associated with SFT shall be duly reflected in the leverage ratio's exposure measure;
- with respect to OBS, instead of using a uniform 100% credit conversion factor (CCF), which converts an off-balance sheet exposure to an on-balance sheet equivalent, the new leverage ratio will use the same CCFs that are used in the standardised approach for credit risk under the risk-based capital requirements, subject to a floor of 10%; and
- to achieve more transparency, the consultation draft brings in more stringent disclosure requirements.

It is expected that the Administrative Measures will raise the leverage ratio of the banking sector as a whole.

The consultation period ends on 20 December 2014.

AMAC issues guidelines on outsourced fund services

The Asset Management Association of China (AMAC) has issued the 'Guidelines on Outsourced Fund Services (Provisional)', which will take effect from 1 February 2015. Under the guidelines, which will apply to both public funds and private funds:

- covered fund services generally include distribution, distribution payment, unit registration, valuation and IT services;
- covered service providers would be required to file with AMAC and become members of AMAC before providing covered services and will be subject to certain on-going periodic reporting to AMAC;
- minimum qualification requirements for various service providers such as asset segregation and internal risk control are provided; and
- where a service provider to a fund also acts as the custodian of the fund, separate teams and systems must be established to ring-fence the services and prevent conflicts of interests.

HKMA and SFC publish consultation conclusions on reporting and record keeping rules for OTC derivatives

The Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) have published their conclusions on a joint public consultation on the mandatory reporting and related record keeping obligations under the new over-the-counter (OTC) derivatives regime. The conclusions paper includes revised proposals which were formulated after taking into account feedback from the respondents and also seeks further views on three ancillary matters.

The major revisions include the following:

- the mandatory reporting and related record keeping obligations will commence first for authorised institutions, approved money brokers, licensed corporations and central counterparties, but the implementation of the same obligations will be deferred for other persons that are based in or operating from Hong Kong – this approach has been adopted in response to market feedback that the reporting obligation should be introduced in phases by type of reporting entity, based on the principle that the more significant market participants should be subject to mandatory reporting first while others should be given more time to prepare for the new regime;
- deferring the proposal to require authorised institutions and licensed corporations to report transactions that they have entered into in their capacity as persons registered or licensed to carry on Type 9 regulated activity (asset management) – this will allow the market more time to sort out some of the reporting difficulties that arise in view of practices in the fund industry; and
- further extending or relaxing some of the exemptions and concessions in response to market feedback.

The ancillary matters on which views are sought relate to the reporting of valuation transaction information (including the details of this requirement and the proposed implementation timetable); the designation of a list of jurisdictions for the purpose of the masking relief; and the list of stock markets, futures markets and clearing houses to be prescribed for the purposes of defining the scope of the OTC derivatives regime.

A revised draft of the Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules is attached with the conclusions paper.

Comments on the ancillary matters are requested by 23 December 2014.

HKMA issues circular on implementation of Basel III

Further to its letter of 24 October 2014 regarding the implementation of Basel III standards, the HKMA has issued a circular informing authorised institutions that the 28-day period for negative vetting by the Legislative Council of the Banking (Amendment) Ordinance 2012 (Commencement) Notice 2014, the Banking (Capital) (Amendment) Rules 2014, and the Banking (Liquidity) Rules has expired without extension. As a result, the three pieces of subsidiary legislation will come into operation on 1 January 2015.

FSA publishes amendments regarding central clearing, notification and reporting requirements for OTC derivatives transactions

The Financial Services Agency (FSA) has published amendments to the ordinance under the Financial Instruments and Exchange Act regarding central clearing, notification and reporting requirements for OTC derivatives transactions.

The central clearing requirement generally applies to locally licensed Financial Instruments Business Operators (i.e. securities houses, investment managers and investment advisors) (FIBOs) and Registered Financial Institutions (RFIs), with certain exemptions. The amendments will narrow the scope of each of the exemptions.

Parties to interest rate swap (IRS) transactions which are booked as trust assets (trust transactions) are currently exempt from the central clearing requirement. After the amendment comes into force, however, parties to trust transactions in which the average notional outstanding principal is JPY 300 billion or more will no longer be covered by this exemption.

Parties to an IRS transaction are currently exempt from the central clearing requirement if at least one of the parties is not (i) a Type I FIBO (i.e. a securities house), (ii) a bank registered as an RFI or (iii) on the list of certain other banking financial institutions (e.g. Development Bank of Japan Inc.) (obligated operators). The amendments will add locally licensed insurance companies registered as RFIs (insurance RFIs) to the list of the obligated operators.

These amendments are scheduled to enter into force on 1 December 2016.

Obligated operators are required to store and report transaction information (the reporting requirement). In addition, if the average of the monthly totals of the notional outstanding principal of the transactions is equal to or more than JPY 1 trillion (from 1 December 2014 to 30 November 2015) or JPY 300 billion (from 1 December 2015), obligated operators are required to notify the transaction scale to the FSA during April or May of the following year (the notification requirement).

Before the extension of the scope of the central clearing requirement mentioned above, from 1 April 2015, insurance RFIs will be made subject to the reporting requirement and the notification requirement and trust transactions will be made subject to the notification requirement.

FSA publishes regulations regarding electronic trading facilities for OTC derivative transactions

The Financial Services Agency (FSA) has issued regulations on the mandatory use of electronic trading facilities for OTC derivative transactions. The FSA has also published its responses to the public consultation process on the regulations.

Under the new regulations, certain Financial Instruments Business Operators and Registered Financial Institutions will be required to use electronic trading facilities in order to enter into certain derivative transactions. In addition, operators of electronic trading facilities will be obliged to publish certain information on derivative transactions conducted through the relevant electronic trading facilities.

Amongst other things, the regulations set out:

- the types of derivative transactions subject to the requirement to use electronic trading facilities (e.g., JPY-denominated interest rate swaps, although these are yet to be specified by the FSA);
- certain exemptions to the requirement;
- the methods by which an operator of an electronic trading facility must publish information on the related derivative transactions; and
- the procedures for application to the FSA to act as an operator of an electronic trading facility. As long as a foreign electronic trading facility obtains permission from the FSA, it can engage in business in Japan.

The FSA has provided additional clarification on the new regulations through its responses to public comments, including the following:

- the obligation to use an electronic trading facility is not satisfied simply by recording general transaction information; rather, the parties need to reach agreement on the major elements of the contract on such electronic trading facility; and
- an operator of an electronic trading facility can delegate (to a certain extent) to a third party part of the operational responsibilities, such as the publication of information on the relevant derivative transactions.

The new regulations will come into effect on 1 September 2015.

FSC announces plan to revitalise Korea's stock market

The Financial Services Commission (FSC) has announced a set of measures to revitalise Korea's stock market. Under the plan, the FSC intends to:

- boost stock market trading by allowing the listing of more blue-chip stocks and new derivatives products and by encouraging a more active role for institutional investors;
- enhance efficiency of the market infrastructure and trading system by, amongst other things, creating a new stock index, introducing electronic securities, and strengthening stabilising measures; and
- strengthen investor protection and trust by improving disclosure rules.

The FSC has indicated that the Capital Markets Act and the Enforcement Decree of the Capital Markets Act will be revised in 2015 and the Korea Exchange (KRX) regulations will be revised in 2015-2016 to incorporate the proposed measures.

RECENT CLIFFORD CHANCE BRIEFINGS

Branching out – UK government sets out plans to extend scope of individual accountability regimes

HM Treasury has published a draft statutory instrument to bring UK branches of overseas banks within the scope of the Senior Managers and Certification regimes and conduct rules due to come into force in 2015.

This briefing discusses the implications of the proposed order.

http://www.cliffordchance.com/briefings/2014/11/branching_out_ukgovernmentsetsoutplanst.html