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International Regulatory Update

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Commission progress report on reform of financial services regulation published

The European Commission has published a progress report on its initiatives to reform financial services regulation. The report discusses a number of measures currently under negotiation, including: (1) the proposed OTC derivatives and market infrastructures Regulation; (2) the proposed Regulation on short selling and certain aspects of credit default swaps; (3) the proposed SEPA Regulation; and (4) the Omnibus II Directive.

In addition, the report sets out indicative timings for the Commission's adoption of initiatives on, amongst other things: (1) a legislative proposal on access to a basic payment account; (2) a Directive on mortgage credit; (3) the Securities Law Directive; (4) the Market Abuse Directive review; (5) the MiFID review; (6) the revision of the Capital Requirements Directive (CRD4); and (7) legislation on corporate governance in financial institutions.

UK Government launches further consultation on financial regulation reforms

The government has issued a consultation paper, entitled 'A new approach to financial regulation: building a stronger system', which provides further detail on its proposals for reforming the framework of financial regulation in the UK. The paper builds on the government's July 2010 consultation paper entitled 'A new approach to financial regulation: judgement, focus and stability' and the summary of consultation responses published on 24 November 2010.

Amongst other things, the new consultation paper covers: (1) the proposed wording of the statutory objectives for the Financial Policy Committee (FPC), the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) (which previously had the working title 'Consumer Protection and Markets Authority'); (2) the new authorities' internal and external mechanisms of accountability, transparency and engagement; (3) the FCA's specialist markets regulation function, which will include the UK Listing Authority and the FSA's criminal prosecution powers in relation to market abuse being retained within the FCA; (4) the European and international engagement of the new authorities; and (5) coordination mechanisms to determine how the regulatory authorities will work together, and with regulated firms.

Comments on the proposals are due by 14 April 2011. The government intends to present a further White Paper including a draft Bill for pre-legislative scrutiny, and it expects the new regulatory structure to be in place by the end of 2012.

The government has also announced that Alastair Clark, Michael Cohrs, Donald Kohn and Sir Richard Lambert have been appointed as external members to the interim FPC, which is being established to prepare the ground, in advance of legislation, for the creation of the FPC.

UCITS V: Commission publishes feedback on changes to depositary function and managers' remuneration

The European Commission has published the responses received to its December 2010 consultation on the review of the EU rules for setting up and operating UCITS. It has also published a feedback statement summarising the responses.

Although stakeholders encourage the use of similar and consistent terminology between the AIFM Directive and the UCITS provisions, a pure alignment of the AIFM Directive is not considered appropriate, in particular as UCITS investors addressed through fund passporting are mostly retail investors. The two most controversial aspects of the liability regime relate to the reference to 'force majeure', to allow a liability discharge of the UCITS depositary, and the obligation to return 'lost' assets 'with no delay' (whereas according to the AIFM Directive standards, AIF depositaries must return 'lost' assets 'without any undue delay').

These views will feed into the impact assessment study which will be published with its proposal for amendments to the UCITS Directive in July 2011.

EU Council approves new comitology rules

The EU Council has approved a new mechanism for controlling the European Commission's use of implementing powers. The new Lisbon Treaty system for implementing EU legislation replaces the old 'comitology' procedure (which provided for the Commission to be assisted by committees of Member State representatives) with a two-tier structure of delegated and implementing acts (in accordance with articles 290 and 291 of the Treaty on the Functioning of the European Union). By way of exception to the rule that Member States are responsible for implementing EU legislation, where uniform conditions are needed in order to implement legally-binding EU acts, the power to adopt the necessary implementing acts will be conferred on the Commission.

The new system includes the following two procedures for the implementation of EU legislation: (1) an advisory procedure where Member States give non-binding advice to the Commission; and (2) an examination procedure for matters such as agriculture policy, environmental policy, commercial policy and taxation.

The examination procedure is intended to provide a more robust system of control by Member States of the Commission's implementing powers, and includes the following rules: (1) the Commission has to find the widest possible support among Member States in order to adopt an implementing act, and has to take account of their comments; (2) Member States can halt the Commission by a qualified majority; and (3) in sensitive cases where Member States cannot reach an opinion, the matter is referred to an Appeal Committee, which can meet at a higher political level.

The new system will apply from 1 March 2011.

IOSCO reports on trading of OTC derivatives

IOSCO has published a report on trading of OTC derivatives. The report analyses the benefits, costs, and challenges associated with increasing exchange and electronic trading of OTC derivative products, and contains recommendations to assist the transition of trading in standardised derivatives products from OTC venues onto exchanges and electronic trading platforms while preserving the efficacy of those transactions for counterparties.

The report concludes that it is appropriate to trade standardised derivatives contracts with a suitable degree of liquidity on organised platforms, and that a flexible approach to defining what constitutes an organised platform for derivatives trading would maximise the number of standardised derivative products that can be appropriately traded on these venues. It identifies characteristics that an organised platform should exhibit in order to fulfil the G20 leaders' objectives of improving transparency, mitigating systemic risk, and protecting against market abuse in the derivatives markets, as well as the benefits and costs associated with transitioning trading of derivatives from OTC venues onto organised platforms. It also presents a range of actions that regulators may choose to take to increase organised platform trading of OTC derivatives products.

IOSCO reports on price verification of structured finance products and liquidity risk management

The IOSCO Technical Committee has published its final report on intermediary internal controls associated with price verification of structured finance products and regulatory approaches to liquidity risk management.

Amongst other things, the report recommends that firms: (1) develop an in-house expertise to facilitate a comprehensive understanding of structured finance products (SFPs) and their underlying assets, and any other complex product; (2) develop a formal reporting system and escalation process to senior management by the risk management function regarding the activities of SFP business lines and associated risks; and (3) recognise the limits of both hedging done to limit the risks posed to a firm by SFPs and of the value of third party ratings of SFPs. The report also contains a number of recommendations to regulators for the enhancement of firms' internal controls.

In addition, the report recommends that regulators take steps to increase supervisory attention paid to liquidity risks at securities firms, including increased scrutiny of liquidity risks at firms and greater dialogue between firm and regulator.

Basel Committee publishes revisions to Basel II market risk framework

The Basel Committee on Banking Supervision has published revisions to the Basel II market risk framework. The document has been updated as of 31 December 2010 to reflect the adjustments to the Basel II market risk framework announced by the Basel Committee in its 18 June 2010 press release and the stress testing guidance for the correlation trading portfolio referred to in paragraph 9 of the July 2009 version of the document. Changes introduced by the Basel III framework are not yet reflected in the text.

In a separate document entitled 'Interpretive issues with respect to the revisions to the market risk framework', the Committee provides responses to interpretive issues regarding the revisions to the Basel II market risk framework and the guidelines for computing capital for incremental risk in the trading book.

Remuneration: Hector Sants responds to Treasury Committee request for more disclosure

The FSA Chief Executive, Hector Sants, has responded to the Chairman of the Treasury Committee Andrew Tyrie's letter, dated 31 January 2011, asking for the FSA to provide more disclosure on remuneration of highly paid individuals in FTSE 100-listed banks and comparable unlisted entities, in aggregate form.

Mr. Sants confirmed that the FSA collects aggregated information on the remuneration of 'high end employees' in each of the major firms, although not in quite as much detail by pay band as envisaged in Sir David Walker's Review. However, he stressed that this is sensitive information provided by firms for the purpose of the FSA's regulatory functions. Mr. Sants noted that, given the small data set, firms may consider even the aggregated figures to be sensitive and, in view of this, the FSA intends to seek the consent of all the firms concerned on their 2010 remuneration awards before it passes this aggregated information to the Committee.

FSA issues guidance on enhancing frameworks in standardised approach to operational risk

The FSA has published a guidance note, dated October 2010, to assist firms and supervisors in understanding, assessing and enhancing the adequacy and effectiveness of frameworks introduced to implement the standardised approach to operational risk.

In particular, the guidance covers: (1) operational risk governance and risk management structures; (2) operational risk identification, measurement, monitoring and reporting; and (3) the use test.

CRD 3: Belgian supervisor issues circular implementing remuneration requirements

The Banking, Finance and Insurance Commission (CBFA) has issued a circular on good remuneration policies to be put in place by financial institutions. The circular is the first step towards the implementation in Belgium of the remuneration policy requirements of the revised Capital Requirements Directive (CRD 3 – as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies).

The circular indicates that the CEBS guidelines on remuneration policies and practices are applicable to all Belgian financial institutions irrespective of their size, subject to certain Belgium-specific requirements. Amongst other things, these Belgian particularities relate to the definition of 'identified staff', the regime applicable to institutions benefiting from government support, and the duration of the retention period (the circular requires that retention periods be expressed in full years).

Circular (French)
Circular (Dutch)

Dutch Minister of Finance announces new vision on meta-supervision of financial regulatory authorities

The Dutch Minister of Finance, Jan Kees de Jager, has sent a letter to the Dutch Parliament setting out the way in which he currently performs his supervision of the Dutch Central Bank (DCB) and the Netherlands Authority for the Financial Markets (AFM) and the proposed measures to strengthen his position in this respect. Amongst other things, Mr. Jager proposes that the Minister of Finance should be able to issue policy rules on the financial regulators' tasks, responsibilities and cooperation. He also proposes to increase his power to approve the regulators' budgets in such a way that the Minister will be able to prescribe certain parameters that have to be met by those budgets.

In addition, the Minister's letter describes the cooperation between the AFM and DCB, their internal governance and the changes that are planned in this respect. For example, the current absence of any limitation on the reappointment of a member of the DCB's board will be replaced by a limitation to one reappointment of a DCB board member in the same role. Finally, the Minister's letter includes a report which discusses the progress on implementation of the plan to change the DCB's supervisory culture that was presented in August 2010. In the report, the Minister states that all proposed actions that had to be implemented by 1 January 2011 have been realised.

Press release

CRD 2 implemented in Czech Republic

The President of the Czech Republic has signed an Act amending, amongst other things, the Act on Banks and the Act on Conduct of Business on Capital Markets in relation to the revised Capital Requirements Directive (CRD 2 – as regards banks affiliated to central institutions, certain own funds items, large exposures, supervisory arrangements, and crisis management). Together with already effective amendments to Decree no. 123/2007 Coll., on rules of prudential conduct of business of credit institutions and investment firms, the Amendment Act completes the full implementation of CRD 2 in the Czech Republic.

The Amendment Act has to be officially pronounced in the Collection of Acts of the Czech Republic to become effective law.

Procedural file

Swiss Financial Market Supervisory Authority calls for regulation of unregulated asset managers

The Swiss Financial Market Supervisory Authority (FINMA) has published a press release on changes in the Swiss asset management industry. According to FINMA, the pressure on the asset management industry in Switzerland to be subject to supervision is rising, with increasing demands from clients who wish to, or are required to, work exclusively with supervised asset managers.

Under the Collective Investment Schemes Act, only managers of Swiss collective investment schemes are subject to mandatory supervision, although managers of foreign collective investment schemes may under certain conditions submit to supervision voluntarily. There is no prudential regulation of other asset management activities and no option to be supervised.

Amongst other things, the press release notes that: (1) FINMA supervises institutions which come under its regulation on a comprehensive basis, i.e. including unregulated activities; (2) FINMA only possesses suitable tools for risk-orientated monitoring in areas which are legally regulated, and only has restricted abilities to influence permitted but legally unregulated activities conducted by a licence holder; and (3) where such legally unregulated activities are the main activity of a licence holder, FINMA is not able to provide suitable, risk-oriented supervision; and asset managers who need supervision are increasingly attempting to achieve this by pro forma launches of statutory supervised activities.

FINMA has emphasised that it is unable to supervise asset managers on the basis of pro forma activities knowing that this supervision will contribute to misleading Swiss and foreign authorities and market participants. Instead, it believes that a legislative basis must be created that brings previously unregulated activities under its supervision.

SFC issues circular on preparation for listed renminbi denominated securities business

The Securities and Futures Commission (SFC) has issued a circular advising exchange participants of the Stock Exchange of Hong Kong Limited (SEHK) and Central Clearing and Settlement System (CCASS) on their preparation to trade or clear renminbi (RMB) denominated securities to be listed on the SEHK.

Amongst other things, the SFC advises participants to: (1) open RMB accounts with banks and secure appropriate RMB banking facilities (such as overdraft facility and foreign exchange line) for working capital purposes; (2) set up RMB designated bank accounts at CCASS for clearing purposes; (3) examine their operational capabilities to conduct listed RMB securities business and make all necessary changes and arrangements immediately; (4) attend the joint briefing session to be held by the SFC and the Hong Kong Exchanges and Clearing Limited (HKEx) on 28 February 2011; and (5) participate in the end-to-end testing session and the payment pilot run to be held by the HKEx and respond to the HKEx's request for confirmation of readiness after completion of the tests.

The SFC has indicated that participants who fail to ensure their readiness to conduct listed RMB securities business should refrain from dealing in listed RMB securities or clearing transactions in such securities.

Central Bank of Bahrain consults on proposed rules on attendance of directors at board meetings

The Central Bank of Bahrain (CBB) has launched a consultation on proposed rules on the attendance of directors at board meetings, which will require the directors of investment firms licensed by the CBB to attend a minimum of 75% of all board meetings held in the investment firm's financial year.

In the event that a director does not meet the minimum attendance threshold, the investment firm will be required to immediately notify the CBB. The CBB may then make a decision to commence disciplinary action, including potential disqualification of the director in question. The proposed rules also prohibit directors appointing proxies for attending board meetings, and investment firms will be required to communicate the percentage of attendance of each director at the general assembly meeting when directors stand for re-election.

The consultation paper encourages investment firms to have a minimum of four board meetings each financial year. Furthermore, investment firms are encouraged to amend their articles of association to provide for

telephonic and video-conference meetings, as directors' participation through such media will be considered satisfactory attendance of board meetings for the purposes of the proposed rules.

Comments are due by 10 March 2011.

Dodd-Frank Act swaps provisions: Gensler and Shapiro testify before House Committee on Financial Services

The United States House Committee on Financial Services has heard testimony concerning Titles VII and VIII of the Dodd-Frank Act from, amongst others, SEC Chairman Mary Shapiro, and CTFC Chairman Gary Gensler.

Chairman Schapiro indicated that the SEC has proposed nine rulemakings under Title VII and also plans to propose: (1) rules on the standards for the operation and governance of clearing agencies, including those designated systemically significant under Title VIII; (2) rules to establish procedures for security-based swap dealers and major security-based swap participants to register with the SEC; and (3) rules regarding business conduct, capital, margin, segregation, and recordkeeping for security-based swaps.

Chairman Gensler noted that the CFTC has approved 39 notices of proposed rulemaking, two interim final rules, four advanced notices of proposed rulemaking and one final rule. He also stated that, in his opinion, margin requirements should focus on transactions between financial entities rather than those that involve nonfinancial companies. In addition, Gensler noted that the current federal budget does not provide enough funding for the CFTC to fulfill its expanded responsibilities.

Treasury Department proposes mortgage market reforms

The Treasury Department has issued a report to Congress outlining plans to reform the US mortgage market, which are intended to ensure that private markets will be the primary source of mortgage credit and improve the long-term stability of the housing market. The reforms include the winding down of the Federal National Mortgage Association ('Fannie Mae') and the Federal Home Loan Mortgage Corporation ('Freddie Mac').

Short-term reforms include increased guarantee pricing, and increased down payment requirements to bring in more private capital into the mortgage market.

The three long-term reform options proposed are: (1) privatizing the system of housing finance; (2) privatizing the system of housing finance with assistance from FHA, USDA and Department of Veterans' Affairs for narrowly targeted groups of borrowers; or (3) privatizing the system of housing finance where the mortgage market outside of the FHA, USDA and Department of Veterans' Affairs assistance would be driven by private investment decisions with private capital taking the primary credit risk.

FINRA consults on proposed consolidated rules governing markups, commissions and fees

As part of the process of developing a new consolidated rulebook, FINRA has issued a regulatory notice requesting comment on proposed rules governing markups, markdowns, commissions and fees.

Among other things, FINRA is proposing to eliminate the '5% policy' in NASD Rule IM-2440-1 because it believes that markups, markdowns and commissions that members currently charge in equity and debt transactions are generally lower than 5%. FINRA is also proposing to: (1) eliminate the 'proceeds provision', which requires that certain trades be treated as a single transaction for markup, markdown or commission purposes; (2) require firms to provide commission schedule(s) for equity securities to retail customers; and (3) notify and obtain consent from a customer to charge a commission when a firm misses the market and trades with the customer on a principal basis.

Comments are due by 28 March 2011.

SEC proposes amendments to remove references to credit ratings

The SEC has voted to propose amendments to its rules that would remove credit ratings as one of the conditions for companies seeking to use short-form registration when registering securities for public sale. The SEC has indicated that this is the first in a series of upcoming proposals in accordance with the Dodd-Frank Act to remove references to credit ratings contained within existing SEC rules and replace them with alternative criteria. Section 939A of the Dodd-Frank Act requires federal agencies to review how existing regulations rely on credit ratings and remove such references from their rules as appropriate.

Comments are due by 28 March 2011

FDIC approves interagency rule implementing incentive-based compensation requirement under Dodd-Frank Act for public comment

The FDIC Board of Directors has approved a proposed rulemaking to implement Section 956 of the Dodd-Frank Act. Section 956 prohibits incentive-based compensation arrangements that encourage inappropriate risk taking by covered financial institutions and are deemed to be excessive, or that may lead to material losses. The proposal is a joint rule making by the five federal members of the Federal Financial Institutions Examination Council, the SEC and the Federal Housing Finance Agency, who must each independently approve the proposed rule. These agencies have not yet approved the proposed rule, and the rule may change prior to approval. According to the FDIC, the proposed rule would move the US closer to international compensation standards.

Comments will be accepted for 45 days after publication in the Federal Register.

RECENT CLIFFORD CHANCE BRIEFINGS

Interacting with Retail Clients – Suitability, Financial Promotions and Future Reform

The retail investment market has recently attracted considerable scrutiny by the FSA, particularly on the topic of suitability and proper disclosure of risk to investors. The regulator, which has recently published a guidance paper on this area, is emphatic in its conclusions. It states that 'the level of failure in this area is unacceptable' and that it 'has taken, and will continue to take, tough action to address these failings with individual firms.' The FSA is willing to take robust measures to sanction any failings which defeat the objective of consumer protection and the fair treatment of customers.

This briefing highlights what firms should look out for when interacting with retail clients.

http://www.cliffordchance.com/publicationviews/publications/2011/02/interacting_withretailclientssuitability.html

FSA Discussion Paper on Product Intervention

On 25 January, the FSA released its first discussion paper of the year: DP11/1 Product Intervention. The title is blunt, even provocative. Since the onset of the financial crisis, the FSA has sought to distance itself from its reputation as a light touch regulator and to take 'a more interventionist and pre-emptive approach to regulating conduct'. The discussion paper proposes to advance this agenda by restricting or prohibiting the retail sale of certain products.

This briefing provides an overview of DP11/1.

http://www.cliffordchance.com/publicationviews/publications/2011/02/fsa_discussion_paperonproductintervention.html

An 'air of unreality' – the mis-selling claim in Michael Wilson -v- MF Global UK Limited

In a judgment handed down earlier this month the High Court has once again taken a robust approach in dismissing a mis-selling claim against a financial institution. The case demonstrates that customers operating under execution-only arrangements will face considerable hurdles in trying to argue that they were owed advisory duties. The judgment also provides useful clarification of some of the regulatory obligations that arise under the Financial Services and Markets Act 2000.

This briefing discusses the case.

Please contact Barbara Kahn by email at barbara.kahn@cliffordchance.com for a copy of this briefing.

Cross-Border Litigation Series – Delaware Court Supports Poison Pill Defense in Air Products v. Air Gas

This briefing discusses the decision of Chancellor William B. Chandler, III of the Delaware Chancery Court, who simultaneously affirmed the vitality of the poison pill to ward off an unwanted hostile tender offer and confirmed that the decision-making authority to accept or reject a hostile takeover remains firmly in the province of the Board of Directors rather than the target's shareholders.

http://www.cliffordchance.com/publicationviews/publications/2011/02/cross-border_litigationseriesdelawarecour.html

Breaking news – Italian government finally reforms the tax regime of investment funds investing in securities

With a last-minute amendment to a piece of legislation currently receiving approval before the Italian Parliament, the Italian government has introduced a reform in the tax regime of investment funds investing in securities (the new regime does not affect real estate investment funds). The introduction of the new regime follows intense lobbying by industry associations. The Parliament is expected to approve the government's proposal; if so the new regime will apply as of 1 July 2011.

This briefing discusses the proposal.

Please contact Barbara Kahn by email at barbara.kahn@cliffordchance.com for a copy of this briefing.

New laws regarding mortgages in Poland

On 20 February 2011, the laws amending the existing regulations on Polish mortgages will take effect. The amendments introduced by the new legislation will have a significant impact on the real estate finance market in Poland. For this reason the new legislation has already attracted the attention of real estate practitioners.

This briefing provides a summary of the new legislation and brief answers to frequently asked questions.

http://www.cliffordchance.com/publicationviews/publications/2011/02/new_laws_regardingmortgagesinpoland.html

Polish Legislation Newsletter

The Polish Legislation Newsletter for January 2011 summarises selected recent changes to Polish law.

http://www.cliffordchance.com/publicationviews/publications/2011/02/polish_legislationnewsletterjanuary2011.html

China launches national security review system for foreign M&A

Foreign investors considering M&A activities in China may soon be subject to a security review system in addition to the existing antitrust review mechanism. With a view to protecting national security and preserving social and economic stability, the State Council has published a circular that subjects certain M&A transactions in certain industry sectors to a security review.

This briefing explains the scope of application of the circular, the content and process of the security review, and how it impacts potential M&A activities in China.

Please contact Barbara Kahn by email at barbara.kahn@cliffordchance.com for a copy of this briefing.

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