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Briefing note

International Regulatory Update

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Central securities depositories: European Commission proposes regulation

The European Commission has published its proposal for a regulation on improving securities settlement in the EU and on central securities depositories (CSDs).

Amongst other things, under the proposal:

- the settlement period will be harmonised and set at a maximum of two days after the trading day for securities traded on stock exchanges or other regulated markets;
- market participants that fail to deliver their securities on the agreed settlement date will be subject to penalties, and will have to buy those securities in the market and deliver them to their counterparties;
- issuers and investors will be required to keep an electronic record for virtually all securities, and to record them in CSDs if they are traded on stock exchanges or other regulated markets;
- CSDs will have to comply with certain organisational, conduct of business and prudential requirements, which are intended to ensure their viability and the protection of their users – they will also have to be authorised and supervised by their national competent authorities;
- authorised CSDs will be granted a 'passport' to provide their services in other Member States; and
- CSDs in the EU will have access to any other CSDs or other market infrastructures such as trading venues or central counterparties (CCPs), whichever country they are based in.

The proposal now passes to the EU Parliament and the Council for negotiation and adoption.

Impact assessment – full text
Impact assessment – summary
FAQs

OTC derivatives and market infrastructures: EBA publishes discussion paper on draft regulatory technical standards on capital requirements for CCPs; ESAs publish discussion paper on risk mitigation techniques for OTC derivatives not cleared by CCPs

The EBA has published a discussion paper inviting feedback on planned regulatory technical standards on the capital requirements for central counterparties (CCPs) under the regulation on OTC derivatives and market infrastructures.

The EBA's preliminary view is that the capital of a CCP, including retained earnings and reserves, should be at all times at least equal to the higher of the following two amounts: (1) the CCP's operational expenses during an appropriate time span for winding-down or restructuring its activities; and (2) the capital requirements for those risks that according to the regulation must be covered by appropriate capital. Risk exposures and capital requirements are calculated using approaches set out for banks by the Capital Requirements Directive (CRD). Capital held under international risk-based capital standards should be included as appropriate to avoid double regulation.

Comments are due by 2 April 2012. Based on the responses received, the EBA intends to prepare draft technical standards, to be subject to consultation around summer 2012.

In addition, the EBA, EIOPA and ESMA have published a joint discussion paper inviting feedback on planned regulatory technical standards covering risk mitigation techniques for OTC derivatives not cleared by central counterparties (CCPs) under the regulation on OTC derivatives and market infrastructures. The regulation acknowledges that not all OTC derivatives will meet the necessary requirements to be centrally cleared, and introduces provisions on risk mitigation techniques for OTC derivatives not cleared by a CCP.

In this respect, the regulation delegates powers to the European Commission to adopt regulatory technical standards on the level of capital and collateral counterparties to derivatives transactions need to maintain, the type of collateral and segregation arrangements, as well as on the procedures to apply to an intragroup exemption. The ESAs are required jointly to develop draft regulatory technical standards on these matters and to submit them to the Commission by 30 September 2012. The discussion paper analyses possible options that the ESAs are currently considering for the development of these draft technical standards.

Comments are due by 2 April 2012. On the basis of the feedback received, the ESAs will prepare draft technical standards to be included in a consultation paper, which they expect to publish around summer 2012.

CRD 4: Danish EU Council Presidency publishes compromise proposals

The Danish EU Council Presidency has published compromise texts for the proposed fourth package of amendments to the Capital Requirements Directive (CRD 4), comprising a directive governing access to deposit-taking activities and the prudential supervision of credit institutions and investment firms and a regulation on prudential requirements for credit institutions and investment firms.

Proposed directive – Presidency compromise
Proposed regulation – Presidency compromise

BIS publishes working paper on collateral requirements for mandatory central clearing of OTC derivatives

The Bank for International Settlements (BIS) has published a working paper on collateral requirements for mandatory central clearing of OTC derivatives. The paper estimates the amount of collateral that central counterparties (CCPs) should demand to clear safely all interest rate swap and credit default swap positions of the major derivatives dealers. The estimates are based on potential losses on a set of hypothetical dealer portfolios intended to replicate several aspects of the way that derivatives positions are distributed within and across dealer portfolios in practice. The results suggest that major dealers already have sufficient unencumbered assets to meet initial margin requirements, but that some of them may need to increase their cash holdings to meet variation margin calls. The authors also conclude that default funds worth only a small fraction of dealers' equity appear sufficient to protect CCPs against almost all possible losses that could arise from the default of one or more dealers, especially if initial margin requirements take into account the tail risks and time variation in risk of cleared portfolios. Finally, the paper argues that concentrating clearing of OTC derivatives in a single CCP could economise on collateral requirements without undermining the robustness of central clearing.

The BIS has emphasised that the views expressed in the paper are those of its authors and not necessarily the views of the BIS.

LSE consults on proposed rule amendments regarding obligations of member firms to market makers in quote-driven securities

The London Stock Exchange (LSE) has issued a Notice (N07/12) outlining proposed amendments to its rules relating to the obligations of member firms trading on Exchange in quote-driven securities. The proposed amendment seeks to introduce new rules and guidance specifying that a member firm shall not execute a trade on Exchange in a quote-driven security which is on terms that are less favourable than the firm quotes in that security on the SETSqx and SEAQ trading services. The proposed rule change is intended to ensure an efficient price formation process in quote-driven securities whereby trades executed off order book that are subsequently trade reported to the Exchange are done so with reference to the displayed firm quotes.

The Exchange proposes to amend the rules to remove any inconsistencies on the pricing of an on Exchange trade executed on the quote-driven trading services. Irrespective of whether the member firm concerned is a market maker, or whether the security concerned is an EU regulated market security, when conducting an off order book trade in a quote driven security, all member firms will be required to consider the firm quotes displayed by each registered market maker before concluding and reporting that trade to the Exchange. A member firm should not execute a trade on Exchange which is on terms that are worse than any of the individual firm quotes available on the relevant quote-driven trading service. This obligation will extend across all securities available on the SETSqx and SEAQ trading services.

Comments are due by 4 April 2012.

Attachment

FSA issues policy statement on protecting with-profits policyholders

The FSA has published a policy statement (PS12/04) which reports on the main issues arising from its February 2011 consultation paper (CP11/05) on protecting with-profits policyholders, summarises the comments the FSA received and also sets out the FSA's final rules in this area.

FSA issues Quarterly Consultation No. 32

The FSA has published its Quarterly Consultation (No. 32) (CP12/05), in which it invites comments on miscellaneous amendments to the Handbook. Amongst other things, the consultation paper proposes amendments to:

- the qualification standards that advisers have to meet as part of the Retail Distribution Review (RDR);
- clarify the liquidity rules in the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) and the liquidity reporting rules in the Supervision manual (SUP);
- implement the Significant Risk Transfer (SRT) into the trading book, to ensure that firms comply with the SRT requirements;

- achieve a single regulatory regime for all credit unions in the UK by making minor amendments to the Credit Unions New sourcebook (CREDS);
- clarify when related party relationships arise between issuers and investment banks undertaking certain transactions, where shares are held for a short period and to cease providing individual guidance on a 'no names' basis; and
- the Collective Investment Schemes sourcebook (COLL) and other areas of the Handbook to allow the FSA to authorise another two legal forms of collective investment scheme – a co-ownership scheme and a limited partnership scheme.

Comments on chapter 2 are due by 6 April 2012 and on chapters 3 to 8 by 6 May 2012.

FSA consults on proposed guidance on PPI customer contact letters

The FSA has published proposed guidance for firms that sold payment protection insurance (PPI) and are beginning to contact customers who may have been mis-sold a policy, but have yet to complain. The guidance outlines steps firms should take when writing to these customers. It stresses the importance of these communications explaining clearly why the customer may have been mis-sold and could be entitled to redress, what the customer should do to respond to the firm, the time limits involved and the need to act promptly.

The guidance consultation also stresses the importance of keeping records of any response from the customer and the subsequent actions taken by the firm.

Comments are due by 3 April 2012.

CRD 3: Bank of Italy and CONSOB consult on implementation

The Bank of Italy (BOI) and CONSOB have launched a joint consultation on amendments to the joint BOI/CONSOB regulation on 'obligations of investment companies and asset management companies on capital adequacy, limitation of risk, and permissible shareholdings', which are intended to implement in Italy the provisions concerning remuneration policies of CRD 3. Amongst other things, the consultation paper specifies that the amendments apply only to investment companies, investment company groups, and Italian branches of non-EU investment companies, and proposes to modify the BOI/CONSOB regulation by cross referring to the provisions on remuneration policies applicable to banks issued by the BOI on 30 March 2011.

In particular, according to these provisions on remuneration policies, different sub-sets of rules apply in accordance with the relevant entity's classification, which is based on certain dimensional thresholds, whether the investment company is classified as an international/large, medium-size, or small investment company. International/large investment companies must apply the provisions on remuneration policies in full. Small investment companies are exempt from many of the provisions, in particular those relating to the composition, retention period and deferral of the variable component of the remuneration. Medium-size investment companies must comply with these derogable provisions, but they must apply these provisions to an extent which is reasonable in accordance with a principle of proportionality (i.e, in such a way that the application is consistent with the characteristics of the entity, considering whether or not the investment company is listed on a regulated market, the size of the portfolio under management, and the type of activity being carried out).

Comments are due by 6 April 2012.

Luxembourg Parliament adopts amendments to law on specialised investment funds

The Luxembourg Parliament has adopted a new law (Bill No. 6318) amending the law of 13 February 2007 on specialised investment funds (SIFs). The new law anticipates some of the requirements to be introduced by the AIFM Directive, in particular as regards risk management, conflicts of interests and the delegation of functions to third parties, but does not yet comprehensively implement these or other requirements of the Directive.

The new law also strengthens the supervisory framework for SIFs (e.g. by requiring SIFs to obtain approval by the Luxembourg supervisory authority prior to carrying out their activities) and makes available to SIFs some of the innovations introduced by the law of 17 December 2010 on undertakings for collective investment, such as the relief for some types of corporate SIFs from some of the requirements of the law of 10 August 1915 on commercial companies or the possibility of cross sub-fund investments for umbrella SIFs.

Procedure file

Dutch Finance Ministry sets out position on use of 'bail-in' debt instruments by banks and ringfencing of investment banking activities

The Dutch Minister of Finance, Jan Kees De Jager, and the Dutch Central Bank (DCB) have indicated that, in principle, they are not in favour of requiring Dutch banks to separate retail from investment banking activities (i.e. 'ringfencing'). The reaction by the Dutch government and the banking supervisor comes after several Dutch parliamentarians indicated that they favour the introduction of the Volcker Rule, which requires such a separation, in the Netherlands. Although the Minister and the DCB support the objectives underlying the Volcker Rule, as well as the conclusions of the UK's Independent Commission on Banking regarding ringfencing, they have emphasised the difficulty of distinguishing retail from investment banking activities. They also argue that the Volcker Rule and the recommendations of the Independent Commission on Banking seem inappropriate for the Dutch financial sector, where the lending activities of banks have to be funded on the institutional market and through investment banking. They note that in the Netherlands, credit demand significantly exceeds local savings. Nonetheless, the Finance Ministry and the DCB have indicated that they will investigate how the Volcker Rule could possibly be applied in the Netherlands. At the same time, the Minister has stated that the Volcker Rule should preferably be introduced at the EU level.

Currently, Dutch banks must make themselves ringfence-ready by drafting recovery and resolution plans. Such 'living wills' will be complemented with the new resolution powers to be assigned to the DCB under the Intervention Act (Interventiewet), which is currently under the scrutiny of the Dutch Senate (Eerste Kamer).

The joint publication also addresses the use of bail-in debt by banks, i.e. debt instruments which can mandatorily be converted into equity in stress scenarios. The Minister and the DCB have indicated that they will not require Dutch banks to issue bail-in debt as long as the European regime for the resolution of significantly important financial institutions is being drafted by the European legislator.

Press release

Hong Kong Banking (Amendment) Ordinance 2012 gazetted

The Hong Kong Monetary Authority (HKMA) has announced the gazettal of the Banking (Amendment) Ordinance 2012, which is intended to put in place a legal framework for the implementation of Basel III in Hong Kong. In particular, the ordinance empowers the HKMA to make rules to prescribe the capital, liquidity and disclosure requirements applicable to authorised institutions. The rules will be developed by the HKMA in consultation with the banking industry, and will be subsidiary legislation subject to negative vetting by the Legislative Council. The ordinance is also intended to: (1) enable the HKMA to issue, or approve, codes of practice for the purpose of providing guidance to authorised institutions in respect of the rules; and (2) enlarge the review remit of the present Capital Adequacy Review Tribunal (CART) to cover matters related to liquidity and disclosure for Basel III implementation, and rename CART the 'Banking Review Tribunal'.

The HKMA has indicated that the provisions of the ordinance will be brought into operation in phases. The HKMA plans to follow the Basel Committee's transitional timeline for the introduction of Basel III. Accordingly, the provisions in the ordinance enabling the first phase of the Basel Committee's implementation process will be brought into effect on 1 January 2013. Principally, these cover minimum capital adequacy requirements and corresponding disclosure requirements. The provisions relating to liquidity requirements will come into operation at a later date.

Circular

Short selling: Canadian regulator announces changes to rules

The Investment Industry Regulatory Organization of Canada (IIROC) has announced that it is repealing the short sale 'tick test' restrictions on the price at which a short sale may be made on Canadian equity market places, with effect from 1 September 2012. The IIROC has determined that the tick test had no appreciable impact on price movement and other mechanisms are more suited to detect and curtail abusive short selling practices.

In addition to repealing the tick test, the amendments to Rule 3.1 of Canada's Universal Market Integrity Rules (UMIR) also introduce a pre-borrow requirement in certain circumstances. Currently under UMIR, naked short selling is not permitted, meaning that an order cannot be entered without having the reasonable expectation of settling any trade that would result from the execution of the order. However, positive affirmation of the ability to borrow the securities is not required prior to entering a short sale.

The amendments would continue to require sell orders from a short position to be marked as a 'short sale', but orders for the purchase or sale of a security by certain accounts that adopt a 'directionally neutral' strategy in the trading of securities can be designated as 'short-marking exempt'.

Press release

FRB issues guidance for evaluating banking organizations' eligibility for upgrades of supervisory ratings

The Board of Governors of the Federal Reserve System (FRB) has issued guidance intended to ensure that supervisors apply consistent standards as they evaluate whether banking organizations with USD 10 billion or less in assets are eligible for upgrades of supervisory ratings. The guidance is being issued to ensure that upgrades occur in a timely manner when the banking organizations have made the requisite progress in addressing any supervisory concerns that had prompted lower ratings. To be eligible for an upgrade, banks are expected to demonstrate, amongst other things, improvement in financial condition and risk management, as well as to show that such improvement is likely to continue.

RECENT CLIFFORD CHANCE BRIEFINGS

The new world of EU data protection regulation

On 25 January 2012, the European Commission published a proposal for a new Regulation to replace Data Protection Directive 95/46/EC. This briefing summarises the highlights of the proposal, which clients will need to take into account in considering whether to lobby on the development of the proposal through the legislative process, and in preparing for eventual compliance.

http://www.cliffordchance.com/publicationviews/publications/2012/03/the_new_world_ofeudataprotectionregulation.html

Supreme Court decision on Lehman client money opens the door for recovery of unsegregated client assets

In the final chapter of protracted proceedings arising from the collapse of Lehman Brothers International (Europe) Limited (LBIE), the UK Supreme Court, interpreting Chapter 7 of the FSA's Client Assets Sourcebook (CASS 7), has ruled on what constitutes client money, and which monies are required to be returned in the event of the failure of a firm. Upholding the decision of the Court of Appeal, the court has held that client money is held on trust immediately upon receipt and that, in the event of a firm's failure, client money held in a firm's own accounts is available for return to clients, even if it has not been segregated.

This briefing discusses the Supreme Court's decision and its implications.

http://www.cliffordchance.com/publicationviews/publications/2012/03/supreme_court_decisiononlehmanclientmone.html

Amendments of the Luxembourg Law on Specialised Investment Funds

On 6 March 2012 the Luxembourg Parliament adopted a new law (Bill 6318) amending the Luxembourg law of 13 February 2007 on specialised investment funds (SIFs). The full legislative process is expected to be completed shortly. The amendments: (1) anticipate some of the requirements to be introduced by the AIFM Directive, in particular as regards risk management, conflicts of interests and the delegation of functions to third parties, but do not yet comprehensively implement these or other requirements of the AIFM Directive; (2) strengthen the supervisory framework for SIFs, e.g. by requiring SIFs to obtain approval prior to carrying out their activities; and (3) make available to SIFs some of the innovations introduced by the law of 17 December 2010 on undertakings for collective investment, such as the relief for some corporate SIFs from some of the requirements of the law of 10 August 1915 on commercial companies or the possibility of cross sub-fund investments for umbrella SIFs.

This briefing provides a short overview of the main changes to the legal regime of SIFs introduced into the law of 13 February 2007 on SIFs as amended by the new law emerged from Bill 6318.

http://www.cliffordchance.com/publicationviews/publications/2012/03/amendments_of_theluxembourglawonspecialise.html

Prospective Amendments to the Companies Act of Japan

The Interim Proposal for Amendment to the Companies Act of Japan was published in December 2011 and was subsequently submitted for public comments to be made by the end of January 2012. The Companies Act Division of the Council of Legislation (Ministry of Justice), which is in charge of amending the Companies Act of Japan, will then resume discussions with the aim of producing a final summary of the amendments.

This briefing explains the major issues set out in the proposal and the direction of discussions to date.

English Version
http://www.cliffordchance.com/publicationviews/publications/2012/03/re_prospective_amendmentstothecompaniesac0.html

Japanese Version
http://www.cliffordchance.com/publicationviews/publications/2012/03/re_prospective_amendmentstothecompaniesac.html