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Transaction Services Newsletter June 2013

Transaction Services Newsletter

Feature article

Ofpay? A new UK Payment Regulator

After a political furore over the retirement of central cheque clearing, the days of the bank-led Payments Council, which sets policy for payments in the UK, were numbered. In a speech and consultation document issued by George Osborne, the Chancellor of the Exchequer, in March, the replacement regime was outlined. It will take the form of a statutory regulator, such as those currently in place in the UK for utilities: Ofgem (which regulates prices and distribution of energy services), Ofwat (which does the same for water), and so on.

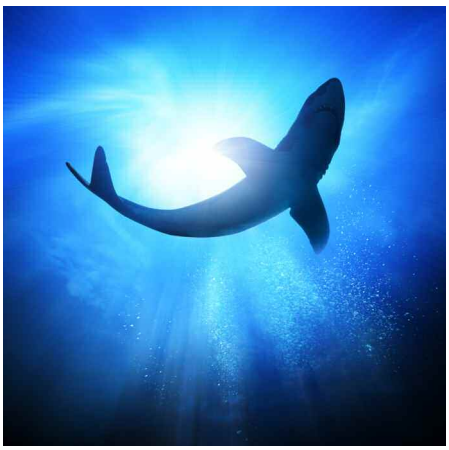
The principal objective of the new regulator will be the "promotion of the interests of current and future end-users of payment systems" and the means by which this is to be achieved is by "promoting competition and innovation" and ensuring that there is "adequate funding to achieve this". The Treasury has indicated that in its mind the key to a successful regulatory regime for payments systems will be to shift the focus of the regulator towards meeting the needs of end-users (i.e. small and non-bank financial institutions, corporate and retail customers) and away from serving the purposes of direct members of payment systems (i.e. large banks).

The proposals would equip the new regulator with extensive powers, broadly categorised as 'competition powers', 'licensing powers' and 'regulatory powers'. These powers will be substantive: they will enable investigatory and enforcement action to be taken (including the ability to impose fines), will allow fees to be levied, and will allow the regulator to intervene to set pricing for direct and indirect access, access conditions and interchange fees.

Of particular interest are the licensing powers, which would require not only payment system operators, but also their direct members, to be licensed, with conditions relating to pricing, access, governance, etc. needing to be met to obtain approval. Licence-holders will also be required to co-operate with each other – for example, where projects can best be taken forward collaboratively. Quite how and whether the regulator can or would force banks to co-operate with each other in practice (particularly where their interests may not be aligned), and how this would sit as a competition matter, is not clear.

One proposal which will make payment system owners sit up is the explicit reference to the regulator being given power to 'end the ownership of payment systems by their users' by 'divesting from the banks of their stakes in the payment systems'. Is this a plan for nationalisation, coming from a Conservative-led government?

And where do these plans leave the Payments Council? It is clear that the fact that industry self-regulation is out of favour with the UK Government, particularly in light of the LIBOR scandal, and that the fostering of competition in all aspects of the financial services industry (including infrastructure and payment systems) is being strongly pursued at both a European and UK level, has led the Treasury to conclude that the Payments Council is not adequate or effective, and that an independent utility-style (either brand new or possibly a separate function of the FCA or PRA) regulator is not only desirable but necessary. Any suggestion that the outcome will leave regulatory powers with a body susceptible to strong industry influence has been resoundingly rejected in the Treasury's paper. But the Payments Council is not a statutory creature, so, there is nothing to prohibit its members maintaining the Payments



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Council in some more limited form – for example, to set commercial strategy (subject to independent regulatory approval). The Treasury has explicitly recognised this in its paper.

And are there indications in this initiative as to how the European Commission may reform the governance of payments policy in Europe generally? There is currently an alphabet soup of expert groups and associations which have different roles: COGEPS, SEPA Council, PSMEG, and of course the EPC. The EPC – the European Payments Council – is, like the UK Payments Council, made up predominantly of banks which fund its activities in creating rulebooks and implementing the SEPA vision. But the EPC has been criticised in recent years in various ways, facing an enquiry from DG Competition over its e-payments framework, and the absorption of its rule-making capacity into the SEPA Regulation. Self-regulation by the banking industry seems to be over. But it is probably not right to push the analogy between the two payments councils much further. The European authorities may not have the appetite for funding the services which the EPC currently provides, in terms of creating and overseeing the operation of payment schemes. Although the ECB and the European Commission may wish to shake up the EPC's governance structure, when all is said and done someone has to pay for it; and banks will withdraw their funding if they do not have control over where their money goes.

Link:
"Opening up UK Payments" HM Treasury consultation paper
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/188397/consult_opening_up_uk_payments.pdf.pdf

Feature Article

Jaws II

Just when you thought it was safe to go back into the water…the European Commission services issued a non-paper on the perennial subject of EU-wide legislation on legal rights and obligations where securities are held by means of book-entries in accounts – the Securities Law Legislation.

In our December 2012 issue we reported on proposals to reform the rights of holders of securities to rehypothecate them. The new non-paper covers this topic but also a large number of other concepts, and in effect sets out the likely table of contents of the forthcoming legislative proposal. There's plenty in it to make swimmers wary:

- Some countries (mainly in Scandinavia) have a "direct holding model" under which investors hold their securities in their own name direct at the CSD, and "intermediated" models involving a broker or custodian are restricted. One idea in the SLL may be to allow investors in all countries to choose the direct model or the intermediated model, and to be provided with risk analyses of the options. The default option would be direct holding.
- The concept of "ownership" is causing a surprising amount of difficulty. The latest idea is that, where there is a chain of account-providers and account-holders, "ownership" can exist at only one securities account. But which?
- Transactions such as acquisitions, disposals and pledges could only be carried out using one of a limited prescribed set of methods. In particular, collateral techniques would only take priority if they are carried out by "earmarking", ostensibly because this has "greater visibility" than other techniques.
- Rehypothecation will not be outlawed but any funds raised from re-use of securities could not be used to finance the rehypothecator's own-account activities.
- Securities lending and repo transactions could be required to be reported to a Trade Repository.
- Investors' identity may have to be made known, possibly via market infrastructures, to the issuer of the securities. Issuers may be required to provide standardised information on corporate actions and comply with a statutory timetable. Exercise by investors of voting and other rights by account-providers might be subject to limitations "to limit the impact on account providers".
- Most curious of all, the well-established "PRIMA" principle – which says that the law governing property-law issues is that of the place of the relevant intermediary – may be abandoned. The new idea is that the law of the place of issue of the securities would apply instead. So questions like who has a priority right to the securities in the case of a fraud or error could, in the case of a multinational portfolio of securities, be governed by a range of different laws.

Many of these proposals will be controversial; many will need much more detailed elaboration before their full implications are clear. Some will never make it ashore. Others will bite. What's clear, though, is that the legislative proposal will need very careful scrutiny when it is finally published.

The coastguard says that the Great White may be released in time for the summer holidays: pack your harpoon. Oh, and rumours that the law will be called the Securities Jaws Regulation are unfounded.

Market Developments – Cash Management and Payment Services

1 Pay and display

The European Commission has published a proposal for a directive on the comparability of fees related to payment accounts, payment account switching and access to payment accounts with basic features. The proposed directive is intended to improve the transparency and comparability of fee information relating to payment accounts, facilitate switching between payment accounts, allow non-resident accounts, and provide access to a payment account with basic features within the EU. Payment service providers will have to provide consumers with a fee tariff for the most common services, a statement of fees charged during the previous 12 months, and, upon request, a glossary of terms used in relation to payment accounts.

The proposed directive also seeks to facilitate the process involved in switching bank accounts. When a consumer requests a transfer to another provider, payment service providers must complete a prescribed procedure within 15 days (or 30 days if the switch is made between providers located in different EU countries) and without charge.

In addition, consumers will be entitled to have access to a payment account with basic features whatever their place of residence in the EU or their personal financial situation. Member States must ensure that at least one payment service provider offers a payment account with basic features in their territory; the payment services provider will not be able to use the financial situation of the person as a reason to refuse an account. The proposed directive lists the essential services to be provided with this account, which include withdrawals, bank transfers and a debit card.

Link:
Proposal for a directive
http://f.datasrvr.com/fr1/713/44203/Directive_of_the_European_Parliament_and_of_the_Council.pdf

2 House of cards set to collapse

At the same time as issuing its proposals for the second Payment Services Directive, the European Commission is expected to propose a new EU Regulation in July to regulate the payment-card industry. The plan is to cut back interchange fees in "four-party" card schemes, and to try to ensure that interchange fees are not permitted for e-payments or mobile payments. The thinking is that merchants are unfairly disadvantaged by high interchange fees. The scope may extend to corporate as well as retail cards, but may stop short of capping the fees which card schemes can levy on merchants. Banks and other card-scheme participants may have to rethink their income models if the worst fears of the community are realised.

3 All settled, then

The UK Treasury is consulting on possible legislation for a special insolvency regime for operators of recognised inter-bank payment systems, operators of securities settlement systems, and key service providers to these firms. The idea is to keep the infrastructure going despite the problems of the system-operator. The plans will be good news for users of infrastructure, but suppliers of software and other critical services will have to think about their termination rights, which are likely to be disapplied in order to make the plans work.

Link:
Consultation paper
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/192483/consult_special_administration_regime_for_payment_and_settlement_systems.pdf

4 Cash is king. Or maybe not.

The European Payments Council thinks that cash, and cash handling, are costly. Together with the European Security Transport Association, they are consulting on how to improve existing processes and reduce the overall cost of cash. Comments are due by 14 July 2013.

Link:
EPC homepage
http://www.europeanpaymentscouncil.eu/

5 Client money

The Financial Conduct Authority is reviewing its requirements for notification and acknowledgment letters under the UK client money rules. Firms which place client money with banks or third parties need to notify the bank or third party that the money does not belong to the firm itself, and to ask that any set-off rights are disapplied. The FCA may decide to standardise the notification and acknowledgment into a pair of templates, for use with either a client money bank account or a client transaction account.

Link:
FCA survey
http://fcasurveys.org.uk/votingmodule/s180/f/504441/12a3/

6 End of term report (1) UK payment and settlement systems

The Bank of England issued its annual "Payment Systems Oversight Report". The report notes various improvements to practices over the past year. Not bad then. The Bank also observes that on 1 April 2013 it assumed wider supervisory responsibilities for financial market infrastructures including central counterparties and securities settlement systems. The Bank of England also published a policy statement setting out its approach to the supervision of securities settlement systems, central counterparties and recognised payment systems.

Links:
Policy statement
http://www.bankofengland.co.uk/financialstability/Documents/fmi/fmisupervision.pdf

Report
http://www.bankofengland.co.uk/publications/Documents/psor/psor2012.pdf

7 End of term report (2) SEPA

The European Central Bank has published its first report on the migration towards SEPA, which describes the state of play of the migration process in euro area countries, and provides guidance on the management of the transition process. The report indicates that most corporations have already completed the planning phase and know what SEPA will mean for them in practical terms. However, the report further notes that, when it comes to the actual implementation, a number of companies have adopted very late internal deadlines. According to the ECB, this is a source of concern. Could do better, then.

Link:
Report
http://www.ecb.europa.eu/pub/pdf/other/sepamigrationreport201303en.pdf

8 Bad penny turns up again

Like the proverbial bad penny, money laundering never fails to get its mention in *Transaction Services Newsletter.* This time we feature new guidance from the Financial Action Task Force, covering:

- general principles that should be taken into account when conducting money laundering and terrorist financing risk assessments;
- planning and organisation of a national-level money laundering/terrorist financing risk assessment;
- the three main stages involved in the risk assessment process (identification, analysis and evaluation); and
- the outcome of the risk assessment.

And there has been important litigation, too. In the case of *Stone v National Westminster Bank*, EWHC 208 (Ch) a claim was brought against the Bank by investors who had been defrauded in a Ponzi scheme. One of the issues was whether or not the Bank had done enough to monitor transactions through the relevant accounts in order to detect suspicious transactions. The Bank had relied on automated systems to conduct anti-money laundering monitoring. The court decided that this was sufficient to comply with obligations under the Money Laundering Regulations 2007 and the case provides some indications of how judges will consider compliance with anti-money laundering legislation in the context of claims against banks.

Links:

Guidance
http://www.fatf-gafi.org/media/fatf/content/images/National_ML_TF_Risk_Assessment.pdf

Clifford Chance briefing paper on *Stone* case (pdf)
http://www.cliffordchance.com/publicationviews/publications/2013/02/automated_aml_monitoringinthedockth.html

Market Developments – Clearing

1 Part 7 – a spinechiller?

Alas, not the latest instalment in a heart-racing drama but nevertheless important. In the UK, there is protective legislation to enable CCPs (and other market infrastructures) to close out, net, and apply collateral in the event of default by one of their members, without fear of challenge from insolvency practitioners. This thrilling stuff is called Part 7 of the Companies Act 1989. Amendments had to be made to accommodate EMIR, in particular the obligation which EMIR imposes on CCPs to have effective rules for transfer of a client's positions and margin to a replacement clearing member if its first-choice clearer goes bust. Sounds like a happy ending, but all good thrillers leave a question unanswered at the very end. Like the hand reaching up from Carrie's grave at the end of the movie, the redrafted Part 7 appears to take away something which helped clearing members when the *CCP* is bust – namely the ability to guarantee that netting clauses in a CCP's rulebook work free from challenge. That might be scary. But probably it means that a new episode can be expected.

Link:
Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations 2013
http://www.legislation.gov.uk/uksi/2013/504/pdfs/uksi_20130504_en.pdf

2 Foreign affairs

One of the more controversial articles of EMIR, the EU Regulation on clearing, is the provision requiring non-EEA CCPs to obtain "recognition" from ESMA to provide services in the EU. This might not seem problematic until you understand that "providing services in the EU" includes accepting EU-headquartered persons as members of the CCP. So, essentially, all non-EEA CCPs must apply for recognition or find a way to discontinue direct clearing for EU persons. Recognition is not entirely in the gift of ESMA either: in order to recognise a non-EEA CCP, the European Commission has to brand the CCP's home country "equivalent" to the EU in terms of its legal approach to clearing. ESMA has published some guidance on how it will go about the recognition process, and also on the assessment of equivalence.

Links:
Guidance
http://www.esma.europa.eu/news/ESMA-publishes-practical-guidance-recognition-Third-Country-CCPs-ESMA?t=326&o=home

Memo
http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/130513_equivalence-procedure_en.pdf

3 Interoperability

EMIR lays down rules for CCPs which clear equities transactions and wish to interoperate. ESMA has published its final guidelines and recommendations regarding the assessment of interoperability arrangements. The guidelines are intended to improve the rigour and uniformity of standards applied in the assessments of CCPs' interoperability arrangements; and equities CCPs applying for authorisation under EMIR will have to factor them into their plans.

Link:
Guidelines and Recommendations
http://www.esma.europa.eu/content/Guidelines-and-Recommendations-establishing-consistent-efficient-and-effective-assessments-i

4 White smoke signals new regime

Still more from ESMA, this time on the subject of colleges. A CCP which needs authorisation under EMIR will have its application scrutinised by a "college" of regulators, in the same way that a papal election is not over until the college of cardinals sends up a puff of white smoke. The proposals for establishing colleges engendered a puff of black smoke back in December: at that time, the European Commission did not endorse ESMA's draft regulatory technical standards on CCP colleges because of concerns as to the legality of some of the provisions. ESMA has now redrafted these technical standards on the basis of the Commission's proposed amendments.

Link:
ESMA opinion and revised draft RTS
http://www.esma.europa.eu/content/Regulatory-technical-standards-colleges-central-counterparties-supplementing-Regulation-EU-N

5 Compulsory clearing begins in US

The Commodity Futures Trading Commission announced that, as of 11 March 2013, all swap dealers, major swap participants and private funds active in the swaps market are required to clear certain index credit default swaps and interest rate swaps through a Derivatives Clearing Organisation. Market participants who are electing for an exception from mandatory clearing under section 2(h)(7) of the Commodity Exchange Act do not have to comply with the reporting requirements until 9 September 2013.

Link:
Press release
http://www.cftc.gov/PressRoom/PressReleases/pr6529-13

Market Developments – Securities Services

1 AIFMD – depositary licences

Firms who are managing or marketing AIFs will need to apply for authorisation to be an AIFM from 22 July 2013 in order to continue to carry out those activities. Those firms also have to ensure that a depositary has been appointed, and in the UK the depositary has to be authorised to carry out the new regulated activity of acting as trustee or depositary of an AIF. Shortly before it converted to the FCA, the FSA invited firms to provide information regarding their interest in or intention to carry out this activity. The FCA's Authorisation Division has also indicated that it would welcome early engagement with firms which want to carry out this new activity.

Link:
Text of email
http://www.fsa.gov.uk/static/pubs/international/fsa-aifmd-depositarie.pdf

2 Madeleine Yates' book: now in 4th edition

The fourth edition of "The Law of Global Custody", written by Madeleine Yates, a senior associate solicitor at Clifford Chance, and Gerald Montagu has been published by Bloomsbury Professional. As all readers of *Transaction Services Newsletter* know, "The Law of Global Custody" provides a detailed analysis of the law relating to global custody for all those wishing to review and manage legal risk in the field of global custody and related areas such as escrow services, cross-border securities collateral and the post-trade infrastructure. At a time of growing concern over the protection of client assets during the various market upheavals and subsequent explosion in regulatory development, "The Law of Global Custody" gives clear guidance on the basic concepts relevant to entities holding cash and securities for clients, including applicable law, regulatory environment and relevant tax aspects. If you don't already have it, you know what to do.

Links:
'The Law of Global Custody' on Bloomsbury Professional website
http://www.bloomsburyprofessional.com/1521/Bloomsbury-Professional-The-Law-of-Global-Custody--4th-edition.html
Publisher's Brochure
http://f.datasrvr.com/fr1/313/25092/The_Law_of_Global_Custody_fourth_edition.pdf

3 CREST sponsors

The UK regulatory system allows an exemption for firms providing investment services to affiliates, so that they do not need to obtain a licence. In March, the FSA issued guidance because of concern that some CREST sponsor firms might have misread the group exemption. The guidance clarifies when a firm can reasonably rely on the group exemption.

Link:
Guidance
http://www.fsa.gov.uk/static/pubs/guidance/fg13-03.pdf

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