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Briefing note

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EU Commission proposes to strengthen shareholder engagement and introduce 'say on pay' for Europe's largest companies

The EU Commission has set out a package of measures intended to improve corporate governance in the EU, comprising:

- a proposal for the revision of the Shareholder Rights Directive;
- a recommendation on corporate governance reporting ('comply or explain'); and
- a proposal for a directive on single-member private limited liability companies.

The proposal to revise the existing Shareholder Rights Directive is intended to address certain corporate governance shortcomings relating to the behaviour of companies and their boards, shareholders (institutional investors and asset managers), intermediaries and proxy advisors (i.e. firms providing services to shareholders, notably voting advice). Key elements of the proposal include stronger transparency requirements for institutional investors and asset managers on their investment and engagement policies regarding the companies in which they invest, as well as a framework to make it easier to identify shareholders so they can more easily exercise their rights, in particular in cross-border situations. For the first time, the directive would also introduce a European 'say on pay'. The proposals would oblige companies to disclose clear, comparable and comprehensive information on their remuneration policies and how they were put into practice. There would be no binding cap on remuneration at EU level but each company would have to put its remuneration policy to a binding shareholder vote.

The recommendation aims to improve corporate governance reporting by listed companies more broadly and provides guidance to listed companies, investors and other interested parties in order to improve the overall quality of corporate governance statements published by companies.

The proposed directive on single-member private limited liability companies aims to facilitate the creation of companies with a single shareholder across the EU, thus making it easier for businesses to establish subsidiaries in other Member States (as, in most cases, subsidiaries tend to have only one shareholder – a parent company).

EU Commission consults on FX financial instruments

The EU Commission has launched a consultation seeking stakeholders' views on where the boundary between what is an FX financial instrument and a spot FX contract should be set. The consultation follows concerns about the lack of harmonisation between the EU Member States on where this boundary lies. The consultation is narrow in scope and has the purpose of bringing clarity on this delineation to ensure that there is clear, adequate and consistent application of the relevant financial regulation across the EU.

Comments are due by 9 May 2014.

EBA consults on revised guidelines on remuneration benchmarking and data collection for high earners

The European Banking Authority (EBA) has launched a consultation on its revised 'Guidelines on the remuneration benchmarking exercise' and 'Guidelines on the data collection exercise for high earners' following implementation of the Capital Requirements Directive (CRD 4) and Regulation (CRR). The proposed changes include revisions to the reporting templates to introduce:

- a more granular collection of remuneration data for the benchmarking exercise including different business areas, control and corporate functions to ensure data can be benchmarked for different classes of staff; and
- information collected on high earners to include pay brackets of EUR 1 million or more per financial year and corresponding job responsibilities.

The new reporting formats will apply to data collection from the financial year 2013. Comments are due by 7 May 2014.

European Payments Council sets out criteria for participation in SEPA schemes by non-EEA payment service providers

The European Payments Council (EPC) has published a list of evaluation criteria to be used for determining whether a community of banks or financial institutions that are equivalent to payment service providers (PSPs) in the EU/EEA but from outside the EEA and not within the geographical scope of the SEPA (Single Euro Payments Area) Schemes should be considered eligible to participate in the SEPA Schemes. The EPC has also provided information relating to its procedure for making a decision to admit non-EEA applicants to the SEPA Schemes. The criteria were adopted on 26 March 2014.

Basel Committee issues final capital standard for bank exposures to central counterparties

The Basel Committee on Banking Supervision (BCBS) has published the final standard for calculating regulatory capital for banks' exposures to central counterparties (CCPs) following a collaborative effort with the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) to improve the interim rules published in July 2012 to reflect results and feedback from the joint quantitative impact study (JQIS) published in June 2013. The final standard differs from the interim requirements by including:

- a single approach for calculating capital requirements for a bank's exposure that arises from its contributions to the mutualised default fund of a qualifying CCP (QCCP);
- a standardised approach for counterparty credit risk to measure the hypothetical capital requirement of a CCP;
- an explicit cap on the capital charges applicable to a bank's exposures to a QCCP; and
- specification of the treatment for multi-level client structures.

The final standard will take effect on 1 January 2017; the interim requirements will continue to apply until that time.

Basel Committee reports on implementation of Basel regulatory framework

The Basel Committee on Banking Supervision has published an updated progress report on implementation of the Basel regulatory framework, which provides a high-level view of Basel Committee members' progress in adopting Basel II, Basel 2.5 and Basel III, as of end March 2014. The report focuses on the status of domestic rule-making processes to ensure that the Committee's capital standards are transformed into national law or regulation according to the internationally agreed timeframes.

FSB publishes seventh progress report on implementation of OTC derivatives market reforms

The Financial Stability Board (FSB) has published its seventh six-monthly progress report on the implementation of over-the-counter (OTC) derivatives market reforms.

The report finds that substantial progress has been made toward meeting the commitments made by G20 leaders at the Pittsburgh 2009 summit, through international policy development, jurisdictions' adoption of legislation and regulation, and expansion in the use of market infrastructure. Amongst other things, the report notes that:

- more than three-quarters of FSB member jurisdictions have regulations in place to require transactions to be reported to trade repositories;
- frameworks for central clearing requirements are in place in jurisdictions with the largest derivatives markets, with some specific mandatory clearing rules now in effect;
- although legislative frameworks are in place to support increased use of exchanges and trading platforms for OTC derivatives contracts, where appropriate, there continue to be differences across jurisdictions in their approaches and timing of implementation in this reform area;
- key international policy standards have already been finalised in most commitment areas and work on the few remaining standards is on track to be finalised by end-2014 or earlier; and
- effective implementation of reform will need satisfactory resolution of cross-border regulatory issues.

The report also discusses areas where further work is needed to complete the reforms and achieve the G20 objectives, including for authorities to:

- put in place their remaining legislation and regulation promptly and in a form flexible enough to respond to issues of cross-border consistency and other issues that may arise;
- provide clarity on their processes for making equivalency or comparability decisions (including whether additional authority may be needed to defer to other jurisdictions' regimes, where appropriate) – the FSB will report to the G20 by September 2014 on jurisdictions' frameworks in this regard; and
- continue to closely coordinate and cooperate as needed to promptly seek to resolve cross-border regulatory issues when they are identified.

The FSB has invited feedback on the report by 8 May 2014.

FSB sets out framework for assessing risk culture and reports on progress on enhanced supervision

The FSB has published:

- a framework for assessing risk culture, which takes into account public responses received on the consultative document issued on 18 November 2013; and
- a progress report on enhanced supervision, which describes the changes in supervisory practices since the financial crisis and identifies areas where more work is needed.

The two documents are intended to take forward the FSB's work to end the too-big-to-fail problem by increasing supervisory effectiveness.

Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) (Amendment) Regulations 2014 published

The Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) (Amendment) Regulations 2014 have been published. The Regulations amend the existing provisions relating to the clearing of financial transactions through recognised clearing houses under the Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations 2013 and exempt Recognised Overseas Clearing Houses (ROCHs) from the requirement to produce and maintain recovery plans as of 1 May 2014.

The Regulations come into force on 1 May 2014.

FCA publishes thematic review on adviser charges and services of retail investment firms

The Financial Conduct Authority (FCA) has published the findings of its thematic review into advisor charges and services by retail investment firms. The review is part of the second stage of a three-cycle assessment of the implementation of the Retail Distribution Review (RDR) and considers whether firms are complying with disclosure requirements. It identifies failings in relation to:

- the cost of advice (both initial and ongoing);
- the type of service offered;
- the nature of a firm's restriction (if applicable); and
- the service consumers can expect to receive in return for an on-going fee.

The FCA will start the third cycle of its review in the third quarter of 2014.

PRA clarifies procedure to increase permitted ratio of fixed to variable remuneration

The Prudential Regulation Authority (PRA) has written a letter to Category 1 and 2 firms explaining the procedure to be followed for a firm to increase the permitted ratio of fixed to variable remuneration above the 1:1 basic limit. The PRA notes that its rules on this issue are intended to reflect the corresponding provisions of the Capital Requirements Directive (CRD) and that the interpretation of CRD is ultimately a matter for the Courts and may be the subject of communications by the EU Commission or European Banking Authority (EBA). However, in the absence of any such communications, the PRA's letter sets out its approach to these provisions in order to provide clarity for firms should they consider putting this issue to a shareholder vote. The PRA is also considering whether to amend its rules to clarify its approach in due course.

CSRC and SFC jointly introduce Shanghai-Hong Kong Stock Connect pilot programme

The China Securities Regulatory Commission (CSRC) and the Hong Kong Securities and Futures Commission (SFC) have jointly set out the framework and principles for a pilot programme that will allow eligible investors in Hong Kong and Mainland China respectively to invest in listed shares in the other jurisdiction.

The Shanghai-Hong Kong Stock Connect will operate among the Shanghai Stock Exchange (SSE), the Stock Exchange of Hong Kong (SEHK), the China Securities Depositary and Clearing Corporation (CSDCC) and the Hong Kong Securities Clearing Company Limited (HKSCC), and comprises:

- a Northbound Trading Link – Hong Kong investors, through their Hong Kong brokers and a securities trading service company to be established by SEHK, will be able to place orders to trade eligible shares listed on SSE by routing orders to SSE; and
- a Southbound Trading Link – eligible investors in Mainland China, through domestic securities firms and a securities trading service company to be established by SSE, will be able to place orders to trade eligible shares listed on SEHK by routing orders to SEHK.

Key aspects of the pilot programme include the following:

- trading time – the Shanghai-Hong Kong Stock Connect will be open on any day that both SSE and SEHK are open for trading;

- clearing – CSDCC and HKSCC will become each other's clearing participant to provide clearing services for the Shanghai-Hong Kong Stock Connect;
- eligible shares – shares eligible to be traded through the Northbound Trading Link include all the constituents of SSE 180 Index and SSE 380 Index, and shares of all SSE-listed companies which have issued both A shares and H shares, whereas eligible shares under the Southbound Trading Link comprise all the constituents of the Hang Seng Composite LargeCap Index and Hang Seng Composite MidCap Index, and shares of all companies listed on both SSE and SEHK;
- quotas – subject to further adjustment by regulators, trading through the Northbound Trading Link will be limited to an aggregate quota of RMB 300 billion and a daily quota of RMB 13 billion, and trading through the Southbound Trading Link will be limited to an aggregate quota of RMB 250 billion and a daily quota of RMB 10.5 billion;
- eligible investors – the SFC requires Mainland China investors participating in the Southbound Trading Link to be limited to institutional investors and individual investors with an aggregate balance of not less than RMB 500,000 in their securities and cash accounts; and
- timeframe – regulators estimate it will take approximately six months to prepare for formal launch.
- The Shanghai-Hong Kong Stock Connect is intended to open China's capital market and enhance capital market connectivity between Mainland China and Hong Kong.

Securities and Futures (Amendment) Ordinance 2014 gazetted

The Financial Services and the Treasury Bureau (FSTB) has announced the gazettal of the Securities and Futures (Amendment) Ordinance 2014. The amendment ordinance aims to provide for a regulatory framework for the over-the-counter (OTC) derivative market in Hong Kong meeting the relevant commitments of the Group of Twenty (G20).

The amendment ordinance will enable Hong Kong's financial regulators to introduce mandatory reporting, clearing and trading obligations, and a record-keeping requirement to supplement the implementation of such obligations. The obligations will apply to those OTC derivative transactions to be specified in subsidiary legislation, which would initially include certain types of interest rate swaps and non-deliverable forwards that could be standardised. Further, the amendment ordinance will provide for the regulation of the relevant market infrastructure and the oversight of key players in the OTC derivative market, including authorised financial institutions, approved money brokers, licensed corporations and other persons to be prescribed by the subsidiary legislation.

In addition, the amendment ordinance incorporates other amendments. First, certain specified notifications and reports under Part XV, 'Disclosure of Interests' of the Securities and Futures Ordinance (SFO), will have to be filed electronically. Second, criminal courts will be empowered under the Organised and Serious Crimes Ordinance to make restraint, charging and confiscation orders over the proceeds of market misconduct offences.

The amendment ordinance will commence operation on a date to be appointed by the Secretary for Financial Services and the Treasury by notice published in the Gazette.

Details of the regulation of the OTC derivative market will be set out in subsidiary legislation to be made by the SFC with the consent of the Hong Kong Monetary Authority (HKMA). In addition, the amendment ordinance empowers the Chief Executive in Council to make subsidiary legislation on fees to be charged by the HKMA for using the trade repository. The HKMA and the SFC will conduct a public consultation on the subsidiary legislation in phases. The government aims to lay the first batch of subsidiary legislation before the Legislative Council by the end of 2014.

FSS examines domestic banks' first capital disclosures under Basel III

The Financial Supervisory Service (FSS) has published the findings of its examination of domestic banks' first capital disclosures under Basel III standards. The Basel Committee on Banking Supervision published a set of disclosure requirements on the composition of banks' capital in June 2012 with the aim of improving market discipline by enhancing both the transparency and credibility of its capital regulations, along with the adoption of Basel III. Accordingly, the FSS revised the uniform standards for the public announcement of financial business in November 2013 so that domestic banks can make capital disclosures under Basel III. A total of 17 domestic banks subject to Basel III capital regulations, excluding the National Federation of Fisheries Cooperatives, made their first capital disclosures in March 2014.

In its examination, the FSS found that the first capital disclosures under Basel III made by all 17 domestic banks complied with the disclosure requirements. The total capital ratio of banks averaged 14.55%, and Tier 1 capital ratio 11.84% and CET1 ratio 11.19%, all meeting the minimum capital requirements under Basel III.

Cabinet approves Enforcement Decree of Covered Bond Act

The Financial Services Commission (FSC) has announced the approval of the Enforcement Decree of the Covered Bond Act by the Cabinet. The Covered Bond Act was passed by the National Assembly on 19 December 2013 to provide a statutory foundation for financial companies to issue covered bonds. The Enforcement Decree, which will take effect on 15 April 2014, stipulates details mandated by the Covered Bond Act such as qualifications for cover assets, evaluation basis and issuance cap.

The key requirements relating to the issuance of covered bonds include the following:

- eligible issuers – banks, Korea Housing Finance Corporation, Korea Finance Corporation, and other equivalent institutions designated by the Enforcement Decree can issue covered bonds provided they have equity capital of more than KRW 100 billion, a BIS ratio of more than 10%, and a risk management system in place;
- cover pool – the minimum ratio of collateralisation is 105%, and underlying assets in a cover pool need to be evaluated by market prices if there are credible market prices as a reference price (in the absence of market prices, the assets can be evaluated by book value or acquisition prices); and
- issuance cap – covered bond issuance is limited to 4% of the issuer's total assets.

Federal banking agencies pass final rule strengthening leverage ratio standards for largest US banking organizations

The Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency have adopted a final rule toughening leverage ratio standards for the largest, most interconnected US banking organizations. The final rule currently applies to eight large US banking organizations that meet the size thresholds and their insured depository institution (IDI) subsidiaries, and is substantively the same as the rule proposed by the banking agencies in July 2013.

The final rule, which has an effective date of 1 January 2018, applies to US top-tier bank holding companies with more than USD 700 billion in consolidated total assets or more than USD 10 trillion in assets under custody (covered BHCs) and their IDI subsidiaries. Under the new rule, covered BHCs must maintain a leverage buffer greater than 2 percentage points above the minimum supplementary leverage ratio requirement of 3%, for a total of more than 5%, to avoid restrictions on capital distributions and discretionary bonus payments. IDI subsidiaries of covered BHCs must maintain at least a 6% supplementary leverage ratio to be considered 'well capitalized' under the agencies' prompt corrective action framework.

The banking agencies have also issued a notice of proposed rulemaking (NPR) that would modify the denominator calculation for the supplementary leverage ratio in a manner consistent with recent changes agreed to by the Basel Committee on Banking Supervision. Additionally, the agencies have issued a separate NPR proposing a technical correction to the definition of 'eligible guarantee' in the agencies' risk-based capital rules. Comments on both NPRs will be welcomed through 13 June 2014.

In a separate action, the FDIC Board has also adopted as final its Basel III interim final rule, which is substantively identical to the final rules adopted by the Federal Reserve Board and the OCC in July 2013.

RECENT CLIFFORD CHANCE BRIEFINGS

Case law of interest in terms of project financing

This briefing summarises the most relevant points of law on which judgment number 38/2014 handed down on 12 February 2014 by Commercial Court no. 1 in Alicante was based, in the context of the insolvency of Ciralsa Sociedad Anónima Concesionaria del Estado (CIRALSA), in relation to the financing of the project for the construction, operation and maintenance of the Alicante toll ring-road and other obligations derived from the administrative concession awarded by RD 282/2004 of 13 February.

http://www.cliffordchance.com/briefings/2014/04/case_law_of_interestintermsofprojectfinancing.html

Hong Kong enacts its primary legislation relating to the proposed changes to the regulatory regime for the Hong Kong OTC derivatives market

Hong Kong has now enacted its primary legislation concerning reform of the OTC derivatives market in line with the agenda set down by the G20. The Securities and

Futures (Amendment) Bill was enacted on 3 April 2014 as the Securities and Futures (Amendment) Ordinance. The Amendment Ordinance provides for a broad regulatory framework designed to implement the proposals set out in (i) the Hong Kong Monetary Authority (HKMA) and the Securities and Futures Commission (SFC) joint consultation conclusions for the new regulatory regime for the OTC derivatives market in Hong Kong published in 2012 and (ii) the HKMA and SFC joint supplemental consultation conclusions published in 2013. While the Amendment Ordinance provides an outline of the mandatory reporting, clearing and trading obligations to be introduced for OTC derivatives, further details (in the form of subsidiary legislation) will be required before such mandatory obligations become effective.

This briefing discusses the Amendment Ordinance.

http://www.cliffordchance.com/briefings/2014/04/hong_kong_enactsitsprimarylegislationrelatin.html