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Briefing note

International Regulatory Update

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- Recent Clifford Chance Briefings: Singapore Court of Appeal accepts frustration in 'Sand Ban' case appeal; and more. Follow this link to the briefings section.

Italian EU Council Presidency sets out work programme

The Italian Presidency of the Council of the European Union, which began on 1 July 2014 and ends on 31 December 2014, has published its programme, which sets out the strategic framework for the Presidency and covers issues in all areas of competence.

Amongst other things, the Italian Presidency intends to:

- seek agreement within the Council on possible improvements to the functioning of the European System of Financial Supervision following the review of the first few years of its activities;
- finalise the proposed regulation on European long-term investment funds;
- make further progress on the proposed regulation on benchmarks;
- continue work on the revision of the Insurance Mediation Directive (IMD 2), whose negotiation is expected to achieve significant progress under the Italian Presidency;
- finalise the new directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing as well as the regulation on information accompanying transfers of funds; and
- steer the Council's oversight of and communications relating to the finalisation of the agreed comprehensive balance sheet assessment as part of the Banking Union.

Payment services: EU Council Presidency publishes PSD 2 compromise proposal

The EU Council Presidency has published a compromise text for the proposed Directive on payment services in the internal market (PSD 2).

CRR: Implementing Regulation on supervisory reporting published in Official Journal

Commission Implementing Regulation (EU) No 680/2014 laying down implementing technical standards with regard to supervisory reporting of institutions according to the Capital Requirements Regulation (CRR) has been published in the Official Journal.

The Implementing Regulation entered into force on 29 June 2014.

ESRB publishes recommendation on setting countercyclical buffer rates

The European Systemic Risk Board (ESRB) has published its recommendation (ESRB 2014/1) on guidance to EU Member States for setting countercyclical buffer (CCB) rates. The recommendation is intended to advise authorities tasked with setting the CCB and to establish a common approach across Europe.

The ESRB has also published an occasional paper setting out the analysis that has informed the recommendation. The analysis discusses early warning models that indicate the types of crises the CCB is designed to mitigate and identifies indicators and thresholds that signal that the CCB may need to be built up or reduced. The paper suggests thresholds for each indicator and multivariate model.

EBA consults on draft RTS on countercyclical buffer disclosure

The European Banking Authority (EBA) has launched a consultation on draft regulatory technical standards (RTS) on disclosure of information in relation to the compliance of institutions with the requirement for a countercyclical capital buffer under the CRR. The consultation paper includes a set of draft RTS and two templates for disclosure of:

- the geographical distribution of exposure value and own fund requirements for an institution's exposures with relevance to countercyclical capital buffers; and
- the amount of the institution-specific countercyclical capital buffer.

The RTS are intended to facilitate the geographical comparison of the amounts that enter the calculation of

countercyclical buffers and the finalised RTS will form part of the EU Single Rulebook.

Comments are due by 27 September 2014.

EBA consults on technical standards on home host cooperation in EU banking sector

The EBA has published two consultation papers on technical standards for:

- the functioning of colleges of supervisors; and
- the joint decision process for prudential requirements.

The consultation paper on the functioning of colleges of supervisors includes draft regulatory technical standards (RTS) that set out general conditions for the establishment and functioning of a college and implementing technical standards (ITS) on the procedures for the interaction between the consolidating supervisor and relevant competent authorities. The RTS and ITS each consider general conditions for the functioning of colleges and aspects of planning and coordinating supervisory activities both in going-concern and emergency situations.

The second consultation paper sets out draft ITS for the joint decision process to be followed by competent authorities when assessing applications for institutions to be permitted to use the internal-ratings based approach (IRB) for credit risk, the internal model method for counterparty risk (IMM), the advanced measurement approach for operational risk (AMA) and the internal models for market risk. The draft ITS set out in detail aspects relating to an initial application and for material extensions or changes to internal models.

Comments on both consultation papers are due by 3 October 2014.

EBA publishes technical advice on prudential filter for gains and losses arising from own credit risk related to derivative liabilities

The EBA has published its technical advice to the EU Commission on the use of a prudential filter for gains and losses arising from banks' own credit risk of derivatives. The EBA considers it appropriate not to deviate from the current prudential approach applied at the international level under the Basel III rules, i.e. full deduction of institutions' own credit risk of derivatives.

The measurement of own credit risk of derivatives (debit valuation adjustment – DVA) depends on several valuation inputs such as interest rates, an institution's own credit standing and other market factors that can affect the exposure value. The analysis of the EBA highlighted that at present it is challenging to measure own credit risk in a robust way. In addition, it is difficult to isolate in a consistent way the changes in own credit risk that stem only from changes in an institution's own credit standing.

In its advice, the EBA analyses different approaches of treating fair value gains and losses arising from institutions' own credit standing and concludes that it would be appropriate not to deviate from the Basel approach, i.e. full deduction of own credit risk adjustment from capital at inception.

The EBA's technical advice follows a call for advice from the Commission on the appropriateness of the application of Article 33(1)(c) of the CRR, which states that institutions shall not include in any element of own funds fair value gains and losses on derivative liabilities of the institution that result from changes in the own credit standing of the institution. Taking into account the work of the EBA, the EU Commission will prepare a report on this issue that needs to be delivered to the EU Parliament and the Council by 31 December 2014.

EBA publishes lists for calculation of capital requirements for credit risk

The EBA has published a series of lists in relation to credit risk in accordance with provisions under the CRR. The lists are intended to assist institutions in determining their capital requirements for credit risk and cover:

- the treatment of exposures to specified EU regional governments and local authorities as exposures to central governments;
- changes to risk weights or stricter criteria for exposures secured by immovable property;
- changes to minimum LGD for retail exposures secured by residential or commercial immovable property;
- exposures to be treated according to the Standardised Approach; and
- types of physical collateral with relevance to article 199 of the CRR.

EBA publishes final guidelines on disclosure of encumbered and unencumbered assets

The EBA has published its final guidelines on disclosure of encumbered and unencumbered assets. Developing these guidelines is mandated under the CRR and takes into account recommendations from the ESRB to produce guidelines and accompanying templates that provide a first step in a harmonised disclosure framework for asset

encumbrance. The guidelines will be reviewed after one year and will form the basis of regulatory technical standards on disclosure to be developed by the EBA by 2016.

The guidelines are directed at institutions with disclosure requirements under Part 8 of the CRR and provide three disclosure templates and a space for narrative information on the importance of encumbrance in an institution's funding model and their amounts of encumbered and unencumbered assets.

EBA publishes guidelines on harmonised definitions and templates for funding plans of credit institutions

The EBA has published its final guidelines on harmonised definitions and templates for funding plans of credit institutions, which are intended to harmonise reporting of funding plans across the EU. The common templates and definitions provide a tool for competent authorities to assess the feasibility, viability and soundness of funding plans, as well as their impact on the supply of credit to the real economy. They are also intended to enable the EBA to fulfil its mandate of coordinating the assessment of funding plans and assessing their viability across the EU banking system.

EBA publishes opinion and report on preferential capital treatment of covered bonds

The EBA has published an opinion and report to the EU Commission on the preferential capital treatment of covered bonds. The publications are in response to the Commission's call for advice in December 2013 in relation to the Capital Requirements Regulation and the European Systemic Risk Board (ESRB) Recommendation on the funding of credit institutions of December 2012 (ESRB/12/2).

The opinion supports the approach laid down under the CRR but recommends additional criteria for preferential treatment qualification in order to strengthen the current framework. It also advises that current disclosure requirements are further clarified.

The report is intended to provide a comprehensive regulatory and supervisory overview of national covered bond frameworks and assesses the various elements that the EBA considers to be important for a prudentially sound covered bond system. It sets out recommendations in relation to best practice and the qualifying criteria for preferential risk weight treatment, and also discusses:

- the extent and impact of current preferential risk weighting of certain types of covered bond;
- a comparative analysis of current national frameworks and supervisory practices;
- transparency initiatives in relation to covered bonds;
- the features of specific classes of cover assets and the appropriateness of each class falling under the scope of preferential risk weight treatment;
- a cash flow sensitivity model to measure covered bond performance; and
- covered bonds within the context of encumbrance.

EBA proposes potential regulatory regime for virtual currencies

The EBA has published an opinion addressed to the EU Council, Commission and Parliament setting out the requirements that would be needed to regulate 'virtual currencies'.

Following an assessment of virtual currencies carried out jointly with other European authorities, the EBA has concluded that, while there are some potential benefits from virtual currencies, such as faster and cheaper transactions, as well as financial inclusion, the risks outweigh the benefits, which remain less pronounced in the EU.

Based on this assessment, the EBA is of the view that a regulatory approach to address these risks would require a substantial body of regulation, some components of which would need to be developed in more detail. In particular, the opinion states that a regulatory approach would need to cover governance requirements for several market participants, the segregation of client accounts, capital requirements and, most importantly, the creation of 'scheme governing authorities' accountable for the integrity of a particular virtual currency scheme and its key components, including its protocol and transaction ledger.

However, as no such regime is currently in place, the EBA believes that some of the more pressing risks will need to be mitigated in other ways. As an immediate response, the opinion therefore advises national supervisory authorities to discourage credit institutions, payment institutions and e-money institutions from buying, holding, or selling virtual currencies.

Basel Committee-IOSCO task force launches survey on securitisation markets

The Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions

(IOSCO) have established a task force that will undertake a survey of securitisation markets worldwide.

Established in consultation with the International Association of Insurance Supervisors (IAIS) and the International Accounting Standards Board (IASB), the cross-sectoral task force on securitisation markets will:

- survey securitisation markets with the aim of understanding how they are evolving in different parts of the world;
- identify factors that may be hindering the development of sustainable securitisation markets;
- assess whether there are factors inhibiting the participation of investors, particularly non-bank investors; and
- develop criteria to identify and assist in the development of simple and transparent securitisation structures.

The task force has invited interested parties to complete the online questionnaire by 25 July 2014.

FSB launches peer review on supervisory frameworks and approaches to SIFIs

The Financial Stability Board (FSB) has launched a thematic peer review on supervisory frameworks and approaches to systemically important financial institutions (SIFIs), focusing in particular on global systemically important banks (G-SIBs). The review is being conducted in collaboration with the Basel Committee on Banking Supervision, and will draw on responses to two questionnaires: one for national supervisory authorities and one for a representative sample of G-SIBs. As part of this review, the FSB has invited feedback from financial institutions, industry associations and other stakeholders on the topics covered in the questionnaires.

Comments are due by 12 September 2014.

CRD 4: PRA consults on changes to credit risk mitigation, credit risk, governance and market risk rules

The Prudential Regulation Authority (PRA) has published a consultation paper (CP12/14) on updates to the rules and supervisory statements for credit risk mitigation (CRM), credit risk, governance and market risk under the Capital Requirements Regulation and Directive (CRD 4). The updates are intended to clarify existing rules and not place new requirements on firms. The consultation seeks views on changes to:

- CRM regarding expectations for firms applying for permission to use their own estimates of volatility adjustments under the Financial Collateral Comprehensive Method (FCCM);
- credit risk rules, specifying that the PRA will not grant permission for the advanced internal ratings-based (AIRB) approach in relation to exposures to central governments, public sector entities, central banks and financial sector entities and introducing stricter criteria for the application of risk weights to certain commercial real estate exposures located outside the EEA;
- governance rules, proposing additional guidance to be included in the Senior Management Arrangements, Systems and Controls (SYSC) sourcebook for how limits on directorships held by directors of significant firms apply to individuals managing consolidated groups; and
- market risk supervision, providing guidance on how to report Risks Not in VaR (RNiV) requirements in FSA005.

Responses are due by 8 August 2014.

FCA publishes policy statement on client money rules for ISAs

The Financial Conduct Authority (FCA) has issued a policy statement (PS14/10) on client money held in individual savings accounts (ISAs) following a consultation on proposed amendments in June 2014. PS14/10 includes responses to the consultation and final rules.

The Government announced changes to ISAs in the Budget on 19 March 2014 to allow consumers to use money in stocks and shares ISAs for both cash saving and investment purposes without having to distinguish between the two. PS14/10 sets out changes to the Client Assets sourcebook (CASS), which are intended to remove potential ambiguity over the status of money held in ISAs. The new rules require investment firms managing ISAs to apply the client money rules to all money held within stocks and shares ISAs and will also allow firms to elect to hold cash ISAs as client money.

The new rules entered force on 1 July 2014.

FCA finalises Handbook changes affecting UCITS managers and AIFMs

The FCA has finalised changes to the FCA Handbook affecting Undertakings for Collective Investment in Transferable Securities (UCITS) managers, alternative investment fund managers (AIFMs), and Article 36

custodians following responses from two separate consultations (CP14/4 and CP13/9).

Key changes include:

- incorporation of amendments which allow AIFMs to passport between the UK and Gibraltar;
- incorporation of the European Securities and Markets Authority (ESMA) Alternative Investment Fund Managers Directive (AIFMD) key concepts guidelines and the ESMA AIFMD reporting guidelines and opinion;
- new rules for AIFMD and UCITS managers around risk management systems related to credit ratings;
- clarification to requirements governing Article 36 custodians; and
- further detail on certain AIFMD remuneration requirements.

Comments received to the FCA's consultations and full details of the changes are in the FCA's July 2014 Handbook Notice.

Law on EMIR sanctions approved

Law 10/2014, of 26 June, on the regulation, supervision and solvency of credit entities, has been published in the Spanish Official Gazette. Amongst other things, the Law amends the Securities Market Law in order to:

- designate the Spanish Stock Exchange Commission (CNMV) as the supervisor for all EMIR related issues, with authority over any financial entity or non-financial entity entering into transactions subject to EMIR; and
- approve the specific sanctions the CNMV can impose for breaches of EMIR obligations – for financial entities, most breaches will be deemed to be very serious offences or serious offences under the Securities Market Law, with fines that can reach 5% of own funds, and for non-financial entities, several breaches will be deemed to be a serious offence under the Securities Market Law, with fines that can reach 2% of own funds.

These amendments entered into force on 30 June 2014.

SAFE issues RMB/FX derivatives rules

The State Administration of Foreign Exchange (SAFE) has issued the 'Administrative Provisions for the Renminbi/Foreign Exchange Derivatives Products Business Offered to Clients by Banks', which apply to the RMB/FX forward, swap and options trading between banks and their clients (RMB/FX Derivatives Products). The provisions, which are intended to further promote the development of the derivatives market, will become effective on 1 August 2014.

Amongst other things, under the provisions:

- banks are only allowed to trade RMB/FX Derivatives Products with domestic entities or domestic individuals who have foreign exchange exposure during the approved overseas investment for hedging purposes;
- prior to conducting the RMB/FX Derivatives Products business, banks must obtain the license for foreign exchange spot purchase/sale business from SAFE, have sound derivatives trading systems (e.g. a risk management system, internal control system, etc.) and satisfy the qualifications for the financial derivatives products trading business from the China Banking Regulatory Commission;
- the terms of the RMB/FX Derivatives Products are subject to negotiation between banks and their clients;
- banks shall maintain client records and documents for no less than 5 years;
- banks may offer RMB/FX put options, RMB/FX call options or combination options to clients on the basis of common European options; and
- banks and domestic entities shall comply with the foreign exchange rules for entering into derivatives transactions in the offshore market.

The provisions are also applicable to the RMB/FX Derivatives Products business conducted by non-banking financial institutions.

Shanghai government amends foreign investment negative list in Shanghai FTZ

The Shanghai Municipal Government has issued the 'Special Administrative Measures on the Entry of Foreign Investment into the China (Shanghai) Pilot Free Trade Zone (Negative List) (2014 version)', which are intended to further relax the foreign investment restrictions in the China (Shanghai) Pilot Free Trade Zone.

In general, the 2014 negative list reduces the restrictive items from the negative list issued in 2013. Under the current regime, inbound investments by foreign investors in the Shanghai FTZ are generally allowed unless such investment is in a sector that is prohibited or restricted under the negative list. Amongst other things, under the new negative list:

- the number of total restrictive items is reduced from 190 to 139;

- foreign investment restrictions are relaxed in certain sectors such as manufacturing, entertainment, infrastructure, shipping services, etc.;
- regulatory treatment of foreign investments in the finance industry remains largely unchanged; and
- foreign investment remains restrictive in the telecommunication and internet services industries.

CBRC changes bank loan-to-deposit formula

The China Banking Regulatory Commission (CBRC) has issued the 'Circular on Adjustment of Loan-to-Deposit Ratio of Commercial Banks' (effective from 1 July 2014), which is intended to release more credit funds to support the real economy. Under the circular, although the 75% loan-to-deposit ratio should remain as it is, the way it is calculated will be adjusted as follows:

- the mandatory 75% loan-to-deposit ratio only applies to RMB business, and does not apply to foreign currency business or business with both RMB and foreign currencies (although CBRC will monitor their loan-to-deposit ratios as well);
- selected loans will be taken out of the calculation (e.g. loans to small businesses and agriculture, loans backed by bonds with at least one year of maturity, and loans backed by funding from international financial organisations and foreign governments) and rural banks can also take out loans funded by their largest shareholder and offered to farmers and small and micro businesses; and
- the scope of deposits is expanded to cover large negotiable certificates of deposit and, for a foreign invested bank in China, net deposit from its offshore parent with a term of more one year.

People's Bank of China further reforms foreign exchange rate mechanism

The People's Bank of China (PBoC) has issued a circular relating to the middle exchange rate of RMB in the inter-bank market and exchange rates offered by banks.

Amongst other things, the circular authorises the China Foreign Exchange Trade System (CFETS) to publish middle exchange rates of RMB against 10 foreign currencies in the inter-bank market at 9.15 am on each trading day. The rate of RMB/USD is determined based on the quotations of market makers before the market opens for trading and a weight determined by CFETS. Other middle exchange rates are cross rates based on the middle exchange rate of RMB/USD and the rates in the international markets, or the average quotation made by market makers in the inter-bank market.

The spot rate for RMB/USD tradings in the inter-bank market is allowed to fluctuate +2% based on the middle exchange rate, while the fluctuation range is ±3%, for RMB/EUR, RMB/JPY, RMB/HKD, RMB/GBP, RMB/AUD, RMB/CAD and RMB/NZD and ±5% for RMB/MYR and RMB/RUB.

Finally, the circular provides that banks may offer exchange rates to their customers based on market demands and their own pricing capability without being subject to regulatory restriction.

FSA publishes draft regulations on OTC derivatives electronic trading facilities

The Financial Services Agency (FSA) has published draft regulations on OTC derivatives electronic trading facilities and the mandatory use of electronic trading facilities. The draft regulations consist of proposed amendments to the Cabinet Order, Cabinet Office Ordinance and Guidelines (which set out detailed rules to implement the Financial Instruments and Exchange Act (FIEA)). The draft regulations are intended to implement amendments to the FIEA that were passed by the Diet on 6 September 2012, which introduced and outlined a new regime for OTC derivatives electronic trading facilities and the mandatory use of electronic trading facilities. Public comments are due by 31 July 2014 and, once finalised, the new regulations will become effective on 1 September 2015.

The draft regulations set out requirements which an operator of an electronic trading facility needs to satisfy, including minimum capital, internal rules, books and records and publication of information on transactions. The draft regulations also provide for procedures to apply to the FSA for permission, which must be obtained before a foreign electronic trading facility can engage in business in Japan.

In general, Financial Instruments Business Operators (i.e. securities houses, investment managers and investment advisors, FIBOs) and Registered Financial Institutions (i.e. banks and other financial institutions, RFIs) will be required to use electronic trading facilities when they enter into certain OTC derivatives transactions. According to the draft regulations, such transactions will be limited to certain types of interest rate swaps (yet to be specified by the FSA) that are denominated in JPY.

The draft regulations propose to exempt FIBOs and RFIs from mandatory use of electronic trading facilities if any of the following conditions are met:

- the transaction is booked in a trust account;
- the transaction is a certain intra-group transaction;
- one party is not a Type I FIBO (i.e. securities house), a bank which is an RFI, DBJ, Shoko Chukin Bank, Shinkin Central Bank, or Nochu Bank; or
- the average outstanding notional amount (limited to OTC derivatives transactions that are subject to mandatory clearing or reporting and excluding transactions booked in trust accounts) of one party is less than JPY 6 trillion.

MAS responds to feedback on proposed amendments to notices on prevention of money laundering and countering financing of terrorism

The Monetary Authority of Singapore (MAS) has published its responses to the feedback it received in relation to its 2 June 2014 consultation paper on proposed amendments to the MAS Notices on Prevention of Money Laundering and Countering the Financing of Terrorism (AML/CFT Notices). The proposed amendments were intended to clarify financial institutions' obligations under the AML/CFT Notices in relation to the Personal Data Protection Act (PDPA).

Amongst other things, the MAS has confirmed that:

- the approach to granting both access and correction rights (in relation to personal data provided to financial institutions) to customers should generally be aligned with the PDPA;
- if a customer has granted power of attorney to a representative, banks can grant access and correction rights to the representative, in accordance with the AML/CFT Notices;
- the definition of 'connected parties' will include company directors, partners and natural persons with executive authority, as the case may be, in a company, partnership or a body corporate or incorporate – the definition will be further refined in a subsequent consultation on comprehensive amendments to the AML/CFT Notices; and
- for the purposes of meeting the AML/CFT requirements, financial institutions may, whether directly or through a third party, collect, use and disclose personal data without customer consent, as per existing practice.

The related MAS Notice 626 (Amendment) 2014 came into effect on 1 July 2014.

The MAS has revised the following notices on prevention of money laundering and countering the financing of terrorism, effective immediately:

- MAS Notice 3001: Prevention of Money Laundering and Countering the Financing of Terrorism – Holders of Money-Changer's Licence and Remittance Licence;
- MAS Notice 824: Prevention of Money Laundering and Countering the Financing of Terrorism – Finance Companies;
- MAS Notice FAA-N06: Prevention of Money Laundering and Countering the Financing of Terrorism – Financial Advisers;
- MAS Notice SFA04-N02: Prevention of Money Laundering and Countering the Financing of Terrorism – Capital Markets Intermediaries; and
- MAS Notice 314: Prevention of Money Laundering and Countering the Financing of Terrorism – Life Insurers.

RECENT CLIFFORD CHANCE BRIEFINGS

Shadow directors and facility agreements

There have been several recent cases in which financial institutions have been accused of acting as shadow directors of companies which have been declared insolvent. The judgment handed down on 3 June 2014 by Madrid Commercial Court No. 5 (insolvency of Mag Import S.L.) helps to focus this debate.

This briefing comments on the threat of shadow directorship, case law on shadow directors and the treatment of shadow directorship in the recent judgment.

http://www.cliffordchance.com/briefings/2014/07/shadow_directorsandfacilityagreements.html

Court of Appeal accepts frustration in 'Sand Ban' case appeal

The Singapore Court of Appeal has overturned a High Court decision and ruled that a 'Sand Ban' by Indonesian authorities frustrated supply contracts.

This briefing discusses the Court of Appeal's ruling in Alliance Concrete Singapore Pte Ltd v Sato Kogyo (S) Pte Ltd [2014] SGCA 35.

http://www.cliffordchance.com/briefings/2014/07/court_of_appeal_acceptsfrustrationinsandban.html