CLIFFORD

CHANCE

Briefing note

International Regulatory Update

3 - 7 August 2015

IN THIS WEEK'S NEWS

- EMIR: EU Commission adopts Delegated Regulation on clearing obligation for interest rate swaps
- EU Commission reports on rules governing levels of application of banking prudential requirements
- EBA calls for evidence on SME lending and SME supporting factor
- EBA consults on exemption of third-country NFCs from own funds requirements for CVA risk
- CSDR: ESMA publishes technical advice
- PRA issues policy statement on depositor and dormant account protection
- PRA issues third policy statement on new PRA Rulebook
- CRD 4: Luxembourg implementing law enters into force
- PFSA publishes position regarding required level of deposit securing a financial instrument
- MPFA issues circular on offering approved pooled investment funds to non-MPF retail investors
- HKMA revises supervisory policy manual on Banking (Disclosure) Rules guidance
- MAS consults on proposed notice on liquidity coverage ratio and minimum liquid assets requirements for merchant banks
- OCC clarifies limits on physical commodity transactions by banks
- SEC adopts rules for registration of security-based swap entities
- Recent Clifford Chance briefings: ESMA advice on AIFMD passport; EU Securities Financing Transactions Regulation; and more. Follow this link to the briefings section.

Clifford Chance's International Regulatory Update is a weekly digest of significant regulatory developments, drawing on our daily content from our Alerter: Finance Industry service.

If you would like to continue to receive International Regulatory Update or would like to request a subscription for a colleague, please click here.

To request a subscription to our Alerter: Finance Industry service, please email Online Services.

If you would like to know more about the subjects covered in this publication or our services, please contact:

International Regulatory Group Contacts

Chris Bates +44 (0)20 7006 1041

Nick O'Neill +1 212 878 3119

Marc Benzler +49 69 7199 3304

Steven Gatti +1 202 912 5095

Mark Shipman + 852 2826 8992

Donna Wacker +852 2826 3478

International Regulatory Update Editor

Joachim Richter +44 (0)20 7006 2503

To email one of the above, please use firstname.lastname@cliffordchance.com

Clifford Chance LLP, 10 Upper Bank Street, London, E14 5JJ, UK
www.cliffordchance.com

EMIR: EU Commission adopts Delegated Regulation on clearing obligation for interest rate swaps

The EU Commission has adopted a draft Commission Delegated Regulation supplementing the European Market Infrastructure Regulation (EMIR) and setting out regulatory technical standards (RTS) on a clearing obligation for OTC interest rate derivative contracts to be cleared through a central counterparty. The draft Delegated Regulation covers interest rate swaps (IRS) denominated in the G4 currencies (EUR, GBP, JPY and USD) with specific features, including the index used as a reference for the derivative, maturity, and notional type. The classes covered are set out in an annex to the Delegated Regulation, but fall within four categories of contract:

- fixed-to-float IRS;
- float-to-float, or basis, swaps;
- forward rate agreements; and
- overnight index swaps.

The draft Delegated Regulation also sets out four different categories of counterparties for which different phase-in periods will apply, which will be between six months and three years after the entry into force of the final RTS. The Commission intends to provide a lead-in period for smaller market participants to provide them with extra time to comply. For funds, the Commission proposes that the threshold should be calculated at fund level, due to the segregated liability of funds. The draft Delegated Regulation sets a different phase-in period for intragroup transactions concluded between a counterparty established in a Member State and a counterparty established in a third country.

The draft Delegated Regulation will be subject to scrutiny by the EU Parliament and EU Council before publication in the Official Journal. Once finalised, the Commission Delegated Regulation will apply on the twentieth day after its publication in the Official Journal.

The RTS set out in the draft Delegated Regulation are based on proposals put forward by the European Securities and Markets Authority (ESMA) and form the first clearing obligation proposed by ESMA. The Commission has noted that it expects ESMA to propose obligations for other types of OTC derivates in the near future.

EU Commission reports on rules governing levels of application of banking prudential requirements

The EU Commission has reported to the EU Parliament and the EU Council on the rules governing the levels of application of banking prudential requirements.

The supervision of a banking group which is composed of several credit institutions or investment firms is carried out at two levels – the level of the entire banking group and the level of each institution of the group. According to this principle of dual-level supervision, the banking prudential rules set out in the Capital Requirements Regulation (CRR) and Directive (CRD 4) shall apply at both individual and consolidated levels. However, this principle is subject to a number of exceptions.

The Commission's report assesses the appropriateness of the rules governing the level of application of the CRR/CRD 4 prudential requirements, in particular the exemption regime.

EBA calls for evidence on SME lending and SME supporting factor

The European Banking Authority (EBA) has issued a call for evidence on small and medium enterprises (SMEs) and the SME supporting factor, a capital reduction factor for loans to SMEs introduced in the CRR to allow credit institutions to enhance lending to SMEs.

The EBA has invited stakeholders to provide their input and evidence to support its ongoing analysis of bank lending to SMEs and the impact of the SME supporting factor.

Comments are due by 1 October 2015. The EBA's final report, which will inform the EU Commission's own report on the impact of own funds requirements on lending to SMEs, is expected to be published in Q1 2016.

EBA consults on exemption of third-country NFCs from own funds requirements for CVA risk

The EBA has launched a consultation on draft regulatory technical standards (RTS) on the exemption of transactions with non-financial counterparties (NFCs) established in the third country from the own funds requirement for credit valuation adjustment (CVA) risk under the CRR. The CRR excludes from own funds requirements for CVA risk an institution's transactions with NFCs regardless of whether they are established in the EU or a third country, where those transactions do not exceed the clearing threshold set out in the European Markets Infrastructure Regulation (EMIR). The draft RTS specify the procedures for excluding third country NFC transactions and acknowledge that in some instances it may be disproportionate to require a third country NFC to compute the EMIR clearing threshold at the inception of each trade. As such, the draft RTS set out two options:

- institutions will be required to meet the requirements of the RTS at trade inception; or
- introduction of a quarterly frequency for institution's due diligence requirements.

The draft RTS also specify that institutions should be responsible for:

- identifying all NFCs that would be considered NFCs if established in the EU and calculate their own funds requirements for CVA risk accordingly; and
- ensuring third country NFCs calculate, and do not exceed, the EMIR clearing threshold.

Comments on the consultation are due by 5 November 2015.

CSDR: ESMA publishes technical advice

The European Securities and Markets Authority (ESMA) has published its final report on technical advice relating to the possible content of delegated acts required under the Central Securities Depositories Regulation (CSDR – Regulation No 909/2014). The technical advice relates to two provisions on:

- penalties for settlement fails, relating to the obligation to settle instructions on the intended settlement date; and
- the substantial importance of a central securities depository (CSD), relating to notary services, central maintenance services and settlement services.

The final report also notes that it may be necessary to establish a mechanism for the collection, processing and aggregation of data necessary for the calculation of indicators and that ESMA is analysing the most appropriate way to establish such a mechanism.

PRA issues policy statement on depositor and dormant account protection

The Prudential Regulation Authority (PRA) has published a policy statement (PS18/15) setting out new rules intended to ensure depositors who may experience a decrease in the level of protection following the change to the Financial Services Compensation Scheme (FSCS) deposit protection limit are given the opportunity to adjust to the new limit, without incurring any penalty or loss of interest. The level of deposit protection will change from the current GBP 85,000 to GBP 75,000 after 31 December 2015.

Depositors protected by the FSCS who are contractually tied into products with balances above GBP 75,000 (either currently or at product maturity) will be able to request to withdraw funds between the old and new limits without penalty, charge or loss of interest. Depositors will be able to request withdrawals until 31 December 2015. Firms are not required to action requests until 1 October 2015 but will need to return funds to depositors within two months of the request or by 31 January 2016 – whichever is earlier. Firms cannot require depositors to close an entire account unless the funds are placed into a new product with similar terms. The rules also clarify that depositors should not lose interest accrued at the time of withdrawal on the amount withdrawn or the remaining amount.

PRA issues third policy statement on new PRA Rulebook

The PRA has published a policy statement (PS19/15) setting out final rules and supervisory statements following on from CP17/15 – The PRA Rulebook: Part 3. PS19/15 is the third in a series of publications that will redraft the Handbook inherited from the Financial Services Authority (FSA) to create the PRA Rulebook.

PS19/15 sets out final rules on:

- passporting;
- regulatory reporting; and
- reverse stress testing.

It also sets out final supervisory statements that relate to:

- aggregation of holdings for the purpose of the prudential assessment of controllers;
- the internal capital adequacy assessment process (ICAAP) and the supervisory review and evaluation process (SREP);
- guidelines for completing regulatory reports (entering into force on 1 January 2016); and
- internal governance.

The PRA is planning to launch the new PRA Rulebook online in 2015.

CRD 4: Luxembourg implementing law enters into force

The Law of 23 July 2015 implementing, amongst others, Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (CRD 4 Law) has been published in the Luxembourg Official Journal (Mémorial A).

CRD 4 Law entered into force and is applicable from 4 August 2015.

PFSA publishes position regarding required level of deposit securing a financial instrument

The Polish Financial Supervision Authority (PFSA) has published a position regarding new regulations in light of which investment firms acting upon the orders of retail clients to purchase or dispose of derivatives that are not cleared through a CCP will need to require such retail clients to provide a security deposit in an amount not lower than 1% of the nominal value of the financial instrument.

In its position, the PFSA notes that the new regulations exclusively concern specific kinds of financial instruments (i.e. derivatives) and that therefore, in interpreting these regulations, one must take into account the specificity of trade in this category of instruments. In addition, the PFSA notes that while introducing the new legislation, the legislator has clearly differentiated between the requirement to hold a specified value of a security deposit and the action of executing investment decisions made by the client. Consequently, the requirement to hold the deposit mentioned above is to apply to three actual situations, that is, to the submission by a retail client of:

- an order for purchase of a financial instrument; or
- an order for disposal of a financial instrument; or
- an order for purchase and disposal of a financial instrument, and such sequence of actions by the client should refer to that specific financial instrument and apply if the investment firm allows such solution in its contractual terms for the provision of such brokerage service.

MPFA issues circular on offering approved pooled investment funds to non-MPF retail investors

The Mandatory Provident Fund Schemes Authority (MPFA) has issued a circular to all trustees, sponsors or investment managers of approved pooled investment funds (APIFs), noting their increasing interest in offering existing or new APIF fund classes to non-mandatory provident fund (MPF) retail investors.

The circular highlights to MPF trustees and investment managers who intend to utilise existing APIFs for distribution to non-MPF retail investors the potential differences in investment objectives and horizon amongst different groups of fund holders and noting that APIFs were originally established with the objective of serving the retirement needs of MPF members. Moreover, the circular advises MPF trustees and investment managers to be aware of any compliance, operational and risk management issues that may arise when new non-MPF retail classes are open to the retail market, which may attract sudden inflow or outflow of funds and have a significant impact on the net asset value of the APIFs.

The circular requires MPF trustees to be satisfied that sufficient controls are in place to safeguard MPF members against potential volatility and dilution risks, and ensure fair treatment and allocation of liabilities amongst different fund classes, whether arising out of fees and expenses or obligations to indemnify against losses incurred. In particular, MPF trustees are advised to ensure fees and charges incurred, or liabilities due to a particular fund class, are borne by that particular class only.

HKMA revises supervisory policy manual on Banking (Disclosure) Rules guidance

The Hong Kong Monetary Authority (HKMA) has issued a revised version of the supervisory policy manual (SPM) on its guidelines regarding the application of the Banking (Disclosure) Rules.

The revised module provides additional guidance on the amendments made to the Banking (Disclosure) Rules in connection with the implementation of the Basel III standard in Hong Kong. These include disclosure requirements on the composition of capital, capital ratios and capital buffers, as well as the liquidity coverage ratio. In addition, the revised module updates earlier guidance to align with recent changes made to the local prudential reporting regimes relating to Mainland China activities and international claims.

MAS consults on proposed notice on liquidity coverage ratio and minimum liquid assets requirements for merchant banks

The Monetary Authority of Singapore (MAS) has published a consultation paper on the proposed notice on liquidity coverage ratio (LCR) and minimum liquid assets (MLA) requirements for merchant banks.

The MAS had issued two consultation papers on Local Implementation of Basel III Liquidity Rules in August 2013 and August 2014. The responses to the consultation feedback described revisions to the liquidity regulatory framework in Singapore, including the implementation of the LCR rules in Singapore and a revision of the MLA rules. Another key revision to the framework was the expansion of the scope of liquidity requirements, such that merchant banks will be subject to the same liquidity requirements as banks from 1 January 2016.

The revised framework for banks was implemented through the new MAS Notice 649 published in November 2014. MAS Notice 1XXX, which prescribes equivalent requirements for merchant banks in Singapore, and the corresponding reporting forms, are appended in Annexes A and B of the consultation paper respectively.

Comments on the draft Notice and reporting forms attached at the Annexes are due by 4 September 2015.

OCC clarifies limits on physical commodity transactions by banks

The Office of the Comptroller of the Currency (OCC) has published Bulletin 2015-35, which contains guidance clarifying limits on physical commodity transactions by banks and supplements Banking Circular 277 (BC-277) on risk management of financial derivatives published in 1993.

Bulletin 2015-35 sets out the OCC's expectations regarding the extent to which national banks and federal branches or agencies of a foreign bank may make or take delivery of a physical commodity to hedge commodity derivatives transactions. The bulletin includes calculation guidance for determining whether physical hedging activities are a nominal portion of risk management activities and clarifies that the OCC will consider physical hedging positions to be nominal only when:

- a bank's commodity position is no more than 5 percent of the notional value of the bank's derivatives that are in the same particular commodity; and
- they allow for physical settlement within 30 days.

The bulletin is also intended to remind banks that the OCC requires institutions seeking to engage in commodity derivatives to submit a plan describing their intended engagement and obtain a written statement from the OCC confirming no objection to the plan.

SEC adopts rules for registration of security-based swap entities

The US Securities and Exchange Commission (SEC) has established a registration process for security-based swap dealers (SBS dealers). Under the new rules, SBS dealers will be required to submit a form containing information about business activities, structure, and background, as well as information about control affiliates. At the time of registration, a senior officer of the dealer will be required to certify that he or she has reasonably determined that the dealer has developed and implemented written policies and procedures reasonably designed to prevent violations of US federal securities laws. This new registration process will also require a second, separate certification by a Chief Compliance Officer that no statutorily disqualified persons are involved in effecting the dealer's security-based swap transactions. The SEC has also adopted an equivalent registration process for major security-based swap participants. Registered non-US entities will be required to appoint a US agent for service of process and their books and records will be subject to SEC inspection.

The SEC has also proposed a rule of practice that would provide a waiver application process to permit certain statutorily disqualified associated persons to continue engaging in security-based swap transactions.

Compliance with the SBS dealers registration regime will be required once the business conduct, financial responsibility and recordkeeping rule for registered security-based swap entities has been implemented and finalisation of the proposed rule of practice.

RECENT CLIFFORD CHANCE BRIEFINGS

ESMA issues advice on extending AIFMD marketing passport

The AIFMD (Alternative Investment Fund Managers Directive) marketing passport could be extended to some non-EU managers and funds marketing to professional investors in the EU. Such is the advice from ESMA in relation to the application of the AIFMD passport to non-EU Alternative Investment Fund Managers (AIFMs) and Alternative Investment Funds (AIFs).

This briefing paper discusses the extension of the AIFMD marketing passport.

http://www.cliffordchance.com/briefings/2015/08/esma_issues_adviceonextendingaifmdmarketin.html

EU Securities Financing Transactions Regulation – New rules on rights of reuse of collateral

The recently agreed EU regulation on securities financing transactions (SFTR) also imposes new rules on rights of reuse of collateral. In particular, the rules will require counterparties to provide new disclosures to the collateral provider if they receive financial instruments as collateral with a right of use or under title transfer arrangements. These rules are likely to take effect in mid-2016, will have retroactive effect in relation to existing collateral arrangements and will apply extra-territorially to non-EU counterparties receiving collateral from persons in the EU.

This briefing paper discusses the reuse of financial instruments received under a collateral arrangement under the SFTR.

http://www.cliffordchance.com/briefings/2015/08/eu_regulation_onsecuritiesfinancin.html

Luxembourg Legal Update – July 2015

The latest edition of our Luxembourg Legal Update offers a 360° view on recent legal developments in Luxembourg. The newsletter provides a compact summary and guidance on the new legal issues which could impact your business, particularly in relation to banking, finance, capital markets, corporate, litigation, employment, funds, investment management and tax law.

http://www.cliffordchance.com/briefings/2015/07/luxembourg_legalupdate-july2015.html

Single sided reporting for OTC derivatives in Australia – when does it apply?

In December 2014 the Australian Government announced its intention to introduce a single sided reporting regime for the benefit of phase 3B entities as part of its de-regulatory policy initiative. At the end of May 2015, the Government released for industry comment the Corporations Amendment (Central Clearing and Single-Sided Reporting) Regulation 2015 to, amongst other things, implement the single sided reporting exemption. The Regulations are scheduled to commence on 1 October 2015 in so far as it relates to single-sided reporting. The Regulations are still in draft form.

This briefing paper discusses the Regulations.

http://www.cliffordchance.com/briefings/2015/08/single_sided_reportingforotcderivativesi.html

OTC derivative reporting in Australia – what you need to know

Under Part 7.5A of the Corporation Act 2001 the Australian Securities & Investment Commission (ASIC) has the power to make rules with regards to trade reporting, central clearing and platform trading in respect of those classes of derivatives determined by the Minster. The Minister made such a determination in May 2013 and ASIC published the ASIC Derivative Transaction Rules (Reporting) 2013 in July 2013 as amended in February 2015.

This briefing paper discusses the rules.

http://www.cliffordchance.com/briefings/2015/08/otc_derivative_reportinginaustraliawhatyo.html

Proposed Treasury Regulations Would Affect Management Fee Waiver Arrangements

The US Treasury Department and the Internal Revenue Service (IRS) recently released proposed regulations that, if enacted, would set forth guidelines for determining whether certain partnership allocations should be recharacterized as payments for services. The preamble to the proposed regulations also announced that the IRS intends to limit the application of certain guidance under which grants of partnership profits interests are not treated as taxable events to the recipient of the partnership interest, or the partnership.

The proposed regulations would apply to all arrangements under which a service provider performs services that benefit a partnership, and receive a related direct or indirect allocation and distribution from the partnership. However, the proposed regulations focus particularly on arrangements whereby an investment fund manager receives a partnership profits interest in lieu of receiving management fees.

The proposed regulations set out various factors for determining whether allocations and distributions in lieu of waived management fees will be recharacterized as compensation, and include various examples. The primary factor in the determination will be whether the partnership profits interest granted to the service provider reflects significant entrepreneurial risk relative to the overall entrepreneurial risk of the partnership, and the proposed regulations provide indicia that create a rebuttable presumption the partnership interest lacks significant entrepreneurial risk.

This briefing paper discusses the proposed regulations.

http://www.cliffordchance.com/briefings/2015/07/proposed_treasuryregulationswouldaffec.html