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Briefing note

International Regulatory Update

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Credit rating agencies: EU Commission reports on state of market and alternatives

The EU Commission has published a final report on the feasibility of alternatives to credit ratings and the state of the credit rating market. The report:

- analyses references to external credit ratings in EU legislation and in private contracts among parties in financial markets and assesses potential alternatives to external credit ratings that are currently being used in the EU;
- assesses the impact and effectiveness of the measures in the Credit Rating Agencies Regulation (CRA 3) concerning competition in the credit rating industry;
- evaluates the impact of CRA 3 on governance and internal procedures of CRAs, in particular the prevention of conflict of interests and the use of alternative remuneration models;
- analyses the provisions relating to Structured Finance Instruments (SFIs) and their potential extension to other asset classes; and
- considers the feasibility of the establishment of an EU CRA for the assessment of sovereign debt and an EU credit rating foundation for all other credit ratings.

EMIR: EU Commission adopts RTS on minimum details of data to be reported to trade repositories

The EU Commission has adopted a Delegated Regulation with regard to regulatory technical standards (RTS) on the minimum details of the data to be reported to trade repositories (TRs). The Regulation amends earlier RTS specifying the details and type of reports required under Article 9(5) of the European Market Infrastructure Regulation (EMIR), reflecting recent developments and experience gained in the area of trade reporting.

The revised RTS aim to:

- clarify data fields, their description or both;
- adapt existing fields to the reporting logic prescribed in existing Q&As or to reflect specific ways of populating them; and
- introduce new fields and values to reflect market practice or other necessary regulatory requirements.

The Regulation will enter into force on the twentieth day following that of its publication in the Official Journal, and will apply from the first day of the ninth month after its date of entry into force.

CRD 4: EBA advises EU Commission on prudential requirements for investment firms

The European Banking Authority (EBA) has delivered its technical advice to the EU Commission on the criteria to identify the class of investment firms for which the prudential regime laid down in the Capital Requirements Directive (CRD 4) and Regulation (CRR) is applicable and the rules which should apply to them.

The EBA recommends:

- that the investment firms subject to the full CRR and CRD should be those identified as global systemically important institutions (G-SIIs) or other systemically important institutions (O-SIIs) in accordance with the current regulatory framework;
- that the suitability of the OSII guidelines for the purpose of identifying the investment firms that should be subject to the full CRR and CRD is revised after the new prudential framework for investment firms is completed; and
- postponing any specific regulatory change related to investment firms at this stage and starting the review of specific provisions once the CRR review has reached a more advanced stage, assuming that the only investment firms subject to the full CRD and CRR are those identified by the EBA in its recommendation.

The EBA's response to the remainder of the Commission's call for advice will be published separately before 30 June 2017.

Basel Committee publishes eleventh progress report on adoption of Basel regulatory framework

The Basel Committee on Banking Supervision (BCBS) has published an updated progress report on the adoption status of Basel III regulations for each BCBS member jurisdiction as of end-September 2016. The BCBS periodically monitors the adoption status of all Basel III standards, including the risk-based capital requirement, the requirements for systemically important banks (SIBs), and the liquidity coverage ratio (LCR).

As of September 2016, all 27 member jurisdictions have final risk-based capital rules, LCR regulations and capital conservation buffers in force. 26 jurisdictions have issued final rules for the countercyclical capital buffers and 25 have issued final or draft rules for their domestic SIBs framework. With regard to the global SIBs framework, all members that are home jurisdictions to G-SIBs have the final framework in force. 18 member jurisdictions have also issued final or draft rules on margin requirements for non-centrally cleared derivatives.

Member jurisdictions are now working on the implementation of other Basel III standards, including the leverage ratio and the net stable funding ratio (NSFR).

FSB publishes methodology for assessment of bank resolution regimes and implementation of Key Attributes

The Financial Stability Board (FSB) has published a methodology for assessing the implementation of its Key Attributes of Effective Resolution Regimes for Financial Institutions in the banking sector.

This follows a consultation in August 2013. The final methodology was developed using the feedback received, the experience of field tests and by collaborating with relevant standard-setting bodies, the International Monetary Fund (IMF) and the World Bank.

The methodology sets out essential criteria to guide the assessment of the compliance of a jurisdiction's bank resolution frameworks with the FSB's Key Attributes. The aim of the methodology is to promote consistent assessments across jurisdictions and to provide guidance to jurisdictions when adopting or reforming bank resolution regimes to implement the Key Attributes.

The FSB intends to continue to monitor the implementation of the Key Attributes.

FCA publishes final report on investment and corporate banking market study

The Financial Conduct Authority (FCA) has published the final report on its market study into investment and corporate banking (MS15/1.3), which focussed on primary market activities, comprising equity capital markets, debt capital markets and M&A services, in the UK. The FCA has identified that while many clients, particularly large corporate clients, feel that the universal banking model of cross-selling and cross-subsidisation from lending and corporate broking services to primary market services works well for them, there are some practices that could have a negative impact on competition, particularly for smaller clients.

The FCA published its interim findings in April 2016 for consultation, which were generally supportive of the analysis. Overall, the FCA considers that neither feedback received nor further work carried out requires any change to its findings or proposals set out in the interim report. As such, the FCA is taking forward the following remedies:

- industry guidelines to improve the presentation of league tables to end misrepresentation in pitches to clients;
- reducing incentives for loss-making trades that generate higher league table positions;
- a supervisory programme for IPO allocations, which the FCA expects to consult on in winter 2016/17; and
- banning the use of contractual clauses in engagement letters and contracts that restrict competition without being clearly beneficial to clients, which the FCA has launched a consultation on (CP16/31).

The consultation proposes to prohibit the use of 'right of first refusal' and 'right to act' clauses for all agreements entered into after the commencement date of the new rules. However, the rules would not prohibit future services restrictions in bridging loans.

Comments on the contractual clauses consultation are due by 16 December 2016.

German Federal Government proposes draft law to amend German Insolvency Code to protect contractual netting agreements

Following the decision of the German Federal Court of Justice (Bundesgerichtshof) of 9 June 2016 on the invalidity of netting agreements deviating from section 104 of the German Insolvency Code, the German Federal Government (Bundesregierung) has proposed a draft law to amend section 104 of the German Insolvency Code. The draft law is intended to clarify the scope of section 104 to ensure the enforceability of the contractual close-out netting agreement in insolvency proceedings.

The law shall enter into force retroactively from 10 June 2016.

BaFin publishes updated information on transitional period regarding new video identification process

Having suspended its Circular 4/16 (GW) on video identification procedures until the end of the year on 11 July 2016, the German Federal Financial Supervisory Authority, the Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), has now announced that the Circular will be further suspended until a new Circular is published in 2017. The Circular 1/2014 – suspicious transaction report in accordance with sections 11, 14 of the GwG shall apply instead until the coming into force of the new Circular in the second quarter of 2017. The suspension is intended to avoid the need for adjustments to new standards to be made twice within a short period of time.

Polish Financial Supervision Authority consults on draft amendments to Recommendation H on internal control system in banks

The Polish Financial Supervision Authority (PFSA) has published draft amendments to Recommendation H on the internal control system in banks for public consultation.

The amendments to Recommendation H are aimed at ensuring that the PFSA's expectations with regard to good practices concerning the internal control system in banks are in line with the provisions of law that came into force following the amendment to the Act – Banking Law and the Act on the Functioning of Cooperative Banks and their Association and on Associating Banks. Furthermore, the draft Recommendation takes into account regulations set out in the draft Ordinance of the Minister of Finance on the Risk Management System and System of Internal Control of the Remuneration Policy and Detailed Method of Estimating Internal Capital.

The draft Recommendation is also aimed at ensuring that the good practices concerning internal control systems are in line with the market standards in force.

New secured money market with CCP service established in Turkey

Under the IFM Project, the Undersecretariat of Treasury, the Central Bank of the Republic of Turkey, Borsa Istanbul A.Ş. and Istanbul Takas ve Saklama Bankası A.Ş. (Takasbank) have been cooperatively conducting studies for almost a year to establish a secured money market for the development of the capital markets, to encourage the private sector to take long term loans in domestic currency, and a healthier management of interest risk by banks..

Following amendments made in April 2016 to Article 78 of the Capital Market Law (Law No. 6362) which covers the central counterparty (CCP) service, the Borsa Istanbul Directive has now been announced. According to the Borsa Istanbul Directive, which has been approved by the Capital Markets Board, the secured money market will be under Borsa Istanbul and Takasbank will be the CCP. In the new market, banks and intermediary institutions which are members of Borsa Istanbul will execute secured transactions with no counterparty risk. The new money market, which is seen as an important step for the development of Turkish financial markets due to its potential to attract international investors, became operational on 14 October 2016.

The introduction of the new market is intended to encourage long term transactions, such as 3-month or 6-month transactions, instead of the current overnight transactions. It is also expected that the interest rates originated under such transactions will be taken as reference for the issuance of capital market instruments. The reference interest rates are expected to be at the level of global standards.

MAS responds to feedback on proposed amendments to MAS Notice 637 to implement revisions to Basel III capital framework

The Monetary Authority of Singapore (MAS) has published its responses to the feedback it received on its October 2015 consultation paper on proposed amendments to MAS Notice 637 on Risk Based Capital Adequacy Requirements for Banks Incorporated in Singapore (MAS Notice 637) to implement revisions to the Basel III capital framework.

Taking the feedback to the consultation into consideration, the MAS has revised MAS Notice 637 to implement requirements for Singapore incorporated banks that are consistent with the following final standards issued by the Basel Committee on Banking Supervision:

- capital requirements for banks' equity investments in funds;
- the standardised approach for measuring counterparty credit risk exposures;
- capital requirements for bank exposures to central counterparties; and
- revised pillar 3 disclosure requirements.

The amendments are intended to enhance the risk capture of banks' equity exposures and counterparty credit risk exposures. According to the MAS, the revised Pillar 3 disclosure requirements will improve the comparability and consistency of disclosures and enable market participants to better assess a bank's capital adequacy. Revisions have also been made to align the regulatory capital treatment for investments in unconsolidated major stake entities that are not financial institutions and private equity and venture capital investments with the treatment of significant investments in commercial entities under the Basel capital framework.

The amendments will take effect from 1 January 2017. For the amendments related to the Standardised Approach for Measuring Counterparty Credit Risk Exposures (SA-CCR), and Capital Requirements for Bank Exposures to Central Counterparties (CCPs), transitional arrangements are

provided to allow more time for implementation. For Pillar 3 disclosure requirements, the disclosures required under the revised framework will be for the reporting periods ending on or immediately after 1 January 2017 for the majority of disclosure templates and 1 January 2018 for the remaining templates.

SAT consults public on rules on tax due diligence regarding non-residents' financial accounts

The State Administration of Taxation (SAT) has issued a draft of the 'Administrative Measures on Due Diligence for Tax-related Information of Non-residents' Financial Accounts', along with a Q&A document. Once finalised and promulgated, the draft Measures are intended to implement the OECD standard for automatic exchange of financial account information.

The draft Measures contain detailed rules on:

- due diligence procedures for existing as well as newly opened financial accounts;
- the financial institutions and financial accounts which are exempted from due diligence;
- the scope of information to be collected and reported by financial institutions; and
- penalties for non-compliant financial institutions and account owners.

The draft Measures also specify the following schedule:

- from 1 January 2017, due diligence should be carried out for newly opened accounts of individuals and institutions;
- before 31 December 2017, due diligence on existing accounts of high-net-worth individuals should be completed;
- before 31 December 2018, due diligence on existing accounts of other individuals and all existing accounts of institutions should be completed.

The draft Measures will be open to public comments until 28 October 2016.

HKMA issues circular on total loss-absorbing capacity holdings standard

The Hong Kong Monetary Authority (HKMA) has issued a circular to authorised institutions on the total loss-absorbing capacity (TLAC) holdings standard issued by the Basel Committee on Banking Supervision (BCBS) on 12 October 2016.

The new standard amends the text of the Basel III standard relating to the definition of capital to specify the regulatory capital treatment for banks' holdings of TLAC instruments issued by global systemically important banks (G-SIBs). It will apply to both G-SIBs and non-G-SIBs with the aim of reducing contagion risk within the financial system if an issuing G-SIB were to fail.

The main elements of the prescribed regulatory capital treatment include the following:

- deduction – a bank's holdings of TLAC instruments, and instruments ranking pari passu with subordinated forms of TLAC instruments, that are not already included as regulatory capital of the issuing G-SIB, must be deducted from the investing bank's Tier 2 capital;
- exemption thresholds – in addition to permitting non-regulatory capital TLAC holdings to be included within the existing 10% threshold for 'insignificant' investments in regulatory capital, another 5% threshold applicable only to non-regulatory capital TLAC holdings will be made available. G-SIBs which hold other G-SIBs' TLAC instruments are subject to additional conditions in applying the 5% threshold, including that the holdings must be booked in the trading book; and
- capital buffers – G-SIBs must take into account the TLAC requirement when calculating their regulatory capital buffers. Common Equity Tier 1 capital that is being used to meet the TLAC requirement cannot be used to meet the regulatory capital buffers.

The standard is scheduled to take effect at the same time as the minimum TLAC requirements for G-SIBs become effective according to Section 21 of the TLAC Term Sheet published in November 2015 by the Financial Stability Board (i.e. 1 January 2019, but later for those whose headquarters are in emerging market economies). The HKMA intends to implement the revised treatment in accordance with the BCBS timetable through appropriate amendments to the Banking (Capital) Rules and relevant supervisory guidance, and will consult the industry on its implementation proposals in due course. In the meantime, authorised institutions are advised to study the revised standard issued by the BCBS and to prepare for any system changes that may be necessary for its implementation in Hong Kong.

CLIFFORD CHANCE BRIEFINGS

UK FCA publishes final report of investment and corporate banking market study

The Financial Conduct Authority (FCA) has found that, while many clients feel well served by primary capital

market services, a targeted package of remedies is required to encourage competition, particularly for smaller clients. The FCA is also continuing to look at how the IPO process can be improved. The market study was launched in May 2015 following the FCA's review of competition in the wholesale sector in 2014.

The study covered debt and equity capital markets, mergers and acquisitions, and acquisition financing (primary market) services carried out in the UK. Links with related services such as corporate lending and broking, and ancillary services, were also in scope.

This briefing paper discusses the final report.

https://www.cliffordchance.com/briefings/2016/10/uk_fca_publishesfinalreportofinvestmentan.html

Transactional certainty triumphs

English commercial law is not paternal. It expects contracting parties to look after their own interests. There are principles about undue influence and unconscionable bargains but, as a recent case shows, the threshold to invoke them successfully is high, even where derivatives are involved. Commercial certainty requires that deals be upheld, not frustrated.

This briefing paper discusses the case.

https://www.cliffordchance.com/briefings/2016/10/transactional_certaintytriumphs.html

New arbitration centre opens in Riyadh

The Saudi Centre for Commercial Arbitration has opened in Riyadh, Saudi Arabia, and aims to be the leading regional centre for alternative dispute resolution by 2030.

The Saudi Arabian Arbitration Law was established by Royal Decree No M/34, dated 24/5/1433H (corresponding to 16 April 2012G) and overhauled the regulatory framework for arbitration in the Kingdom. At the time, the Arbitration Law was welcomed as providing a potential alternative to conventional court proceedings, which can prove time-consuming and costly. However, Saudi Arabia lacked an effective institutional framework under which the new Arbitration Law could be implemented.

This briefing paper discusses the new arbitration centre.

https://www.cliffordchance.com/briefings/2016/10/new_arbitration_centreopensinriyadh.html

IRS Limits 'Earnings Stripping' by Multinational Corporate Groups

On 13 October 2016, the Treasury and the IRS issued regulations that make it harder for a non-US parent company with US subsidiaries to use intercompany debt to strip taxable earnings out of those subsidiaries.

The new rules are the final version of a significantly broader proposal that the Treasury and the IRS made in April 2016. That proposal would have applied in a range of cases where a US company (or even a non-US company that had a US branch or that was affiliated with a US company) issued debt to a related lender. The proposed rules would have denied a tax deduction for interest expense on such debt, and would have unfavorably altered the US tax treatment of the debt in other ways as well.

The April proposal was meant to hit inversions, and other tax planning perceived as abusive, but was widely viewed as overreaching. Companies across a range of industries and members of Congress of both parties complained that the proposed rules would have imposed harmful tax consequences for taxpayers in cases not involving any type of aggressive tax planning, and would have created big administrative burdens for taxpayers. Treasury indicated it received almost 30,000 written comments.

The final rules have a narrower focus. They will apply largely – though not exclusively – to corporate groups with a non-US parent and US subsidiaries. The rules will limit such a group's ability to use intercompany loans to the US subsidiaries, as a means of stripping taxable earnings out of the US into lower-tax jurisdictions. The new rules will need to be taken into account when structuring most future acquisitions of US businesses by non-US buyers.

This briefing paper discuss the new rules.

https://www.cliffordchance.com/briefings/2016/10/irs_limits_earningsstrippingbymultinationa.html

DOJ Issues New Guidance on Reduced Penalties for Voluntary Disclosure of Export Control and Sanctions Violations

The Department of Justice (DOJ) has issued new guidance regarding the availability of reduced penalties for voluntary self-disclosure, full cooperation, and timely remediation of export control and trade sanctions violations. Along with the Foreign Corrupt Practices Act (FCPA) 'pilot program' and the Yates Memorandum, this guidance continues the DOJ's recent trend of incentivizing self-disclosure of corporate crime and raising the bar for cooperation credit.

The guidance provides that qualifying entities will be eligible for non-prosecution agreements (NPAs), reduced monetary penalties, and the absence of a corporate monitor. To be eligible for such benefits, however, corporations must comply with the DOJ's stringent definitions of 'voluntary disclosure,' 'full cooperation,' and 'timely and appropriate remediation,' which include specific requirements regarding the timing and content of the disclosure, placing the burden for making disclosures of wilful violations to the DOJ on the reporting companies, the identification and production of documents and witnesses from outside the United States, and the implementation of an effective compliance program.

This briefing paper discusses the guidance.

https://www.cliffordchance.com/briefings/2016/10/doj_issues_new_guidanceonreducedpenaltiesfo.html

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