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Briefing note

International Regulatory Update

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Capital Markets Union: EU Commission adopts mid-term review

The EU Commission has adopted a mid-term review of its 2015 Capital Markets Union action plan. The Commission notes that good progress has been made in implementing the action plan, with around two-thirds of the 33 actions delivered in 20 months.

The mid-term review follows up the initial action plan with nine new priority actions, including:

- strengthening the powers of the European Securities and Markets Authority (ESMA) to promote the effectiveness of consistent supervision across the EU and beyond;
- delivering a more proportionate regulatory environment for SME listing on public markets;
- reviewing the prudential treatment of investment firms;
- assessing the case for an EU licensing and passporting framework for fintech activities;
- presenting measures to support secondary markets for non-performing loans (NPLs) and exploring legislative initiatives to strengthen the ability of secured creditors to recover value from secured loans to corporates and entrepreneurs;
- ensuring follow-up to the recommendations of the High Level Expert Group on Sustainable Finance;
- facilitating the cross-border distribution and supervision of UCITS and alternative investment funds (AIFs);
- providing guidance on existing EU rules for the treatment of cross-border EU investments and an adequate framework for the amicable resolution of investment disputes; and
- proposing a comprehensive EU strategy to explore measures to support local and regional capital market development.

In addition, the Commission will advance its work on outstanding actions under the action plan. In particular, the Commission intends to put forward legislative proposals on:

- a Pan-European Personal Pension Product (PEPP) by the end of June 2017;
- conflict of laws rules for third party effects of transactions in securities and claims in the cross-border context in the fourth quarter of 2017; and
- an EU-framework for covered bonds in the first quarter of 2018.

The Commission is also taking forward its preparatory work on the following measures:

- amendments to the Delegated Regulation supplementing Solvency II in 2018 to review the prudential treatment of private equity and privately placed debt;
- a Recommendation on private placements in the fourth quarter of 2017;
- a Communication on a roadmap for removing barriers to post-trade market infrastructure (building on the recommendations of the EPTF – the European Post Trade Forum) in the fourth quarter of 2017;
- a Communication on corporate bond markets (building on the recommendations of the Expert Group on Corporate Bond Market Liquidity) in the fourth quarter of 2017; and
- a Code of Conduct to simplify withholding tax procedures, with a focus on refunds, by the end of 2017.

Criminalising money laundering: EU Council agrees on its position

The EU Council has agreed its position on the EU Commission's December 2016 proposal for a Directive to criminalise money laundering. The proposed Directive would establish minimum rules concerning the definition of criminal offences and sanctions related to money laundering, removal of obstacles to cross-border judicial

and police cooperation and bring EU rules into line with international obligations.

Discussions at the Council focused in particular on:

- the scope of the definition of a 'criminal activity' (Article 2(1)), where the Council compromise reaffirms that all categories of offences defined by the Council of Europe Warsaw Convention are covered as predicate offences, while references to existing EU legislation defining specific offences are also included to ensure that they are considered within the respective category. In addition, to address the threat of cybercrime, the Council agreed that this category should also be added to the definition of criminal activity;
- the introduction of a criminalisation obligation for self-laundering (Article 3(3)); and
- the link with the PIF directive, which provides specific rules for money laundering of property derived from PIF offences (Article 1(2)), where the Council has emphasised that Member States can transpose these rules through a single comprehensive framework on money laundering at national level.

The Council and the EU Parliament will enter into trilogue negotiations on the final text once the Parliament has decided on its position.

CRR and EMIR: Commission extends transitional period for own funds requirements for exposures to CCPs

A Commission Implementing Regulation (2017/954) extending the transitional periods related to own funds requirements for exposures to central counterparties (CCPs) under the Capital Requirements Regulation (CRR) and European Market Infrastructure Regulation (EMIR) has been published in the Official Journal.

Transitional periods under Article 497(2) of CRR and 89(5a) of EMIR had previously extended to 15 June 2017. The Commission deems a further extension of six months necessary in order to enable institutions established in the EU, or their subsidiaries established outside the EU, to avoid a significant increase in own funds requirements due to the lack of completion of the regulatory process for CCPs. As such, the transitional period is extended until 15 December 2017.

The Regulation entered into force on 10 June 2017.

MiFID2: ITS on format and timing of weekly position reports published in Official Journal

A Commission Implementing Regulation (2017/953) laying down implementing technical standards (ITS) on the format and timing of position reports by investment firms and market operators of trading venues under MiFID2 has been published in the Official Journal.

In particular the ITS set out reporting deadlines for reports by market operators and investment firms showing the aggregate number of persons holding commodity derivative, emission allowance and derivative contracts and the total open position for each commodity derivative, emission allowance and derivative thereof which exceeds the thresholds specified in RTS 21 (Commission Delegated Regulation 2017/591).

The ITS will enter into force on 27 June 2017 and will apply from 3 January 2018.

MiFID2: ESMA updates Q&As on investor protection topics

The European Securities and Markets Authority (ESMA) has updated its questions and answers document (Q&A) on investor protection topics under MiFID2 and MiFIR.

The Q&A document includes fourteen new answers that are intended to clarify issues relating to:

- appropriateness;
- best execution;
- suitability;
- post-sale reporting;
- inducements;
- information on charges and costs; and
- underwriting and placement of a financial instrument.

ESMA intends to review its Q&As on a regular basis and update the document when new questions are received.

MiFID2: ESMA publishes product governance guidelines

ESMA has published final guidelines on product governance requirements for the manufacturers and distributors of financial products.

ESMA decided to develop the guidelines, which mainly address the target market assessment, in order to ensure that firms which manufacture and distribute financial instruments act in their clients' best interests during all stages of the life-cycle of products or services. They are intended to ensure a consistent and harmonised

implementation and application of the requirements under MiFID2. ESMA has made certain amendments following feedback received to its consultation on draft guidelines, including in relation to portfolio diversification.

ESMA will translate the final guidelines into the official EU languages, following which national competent authorities (NCAs) will have two months to confirm whether they comply or intend to comply with the guidelines.

Benchmarks: ESMA publishes framework for mandatory benchmarks contributions and draft RTS on cooperation agreements with third countries

ESMA has published a methodological framework to promote convergence in relation to the supervision of critical benchmarks. ESMA has also published final draft regulatory technical standards (RTS) on the minimum contents for cooperation arrangements between ESMA and NCAs in third countries that have been designated as equivalent under the Benchmarks Regulation.

ESMA has developed the framework to assist national competent authorities (NCAs) in their selection of supervised entities to be compelled to contribute input data to critical benchmarks should its representativeness become at risk. It applies to all Interbank Offered Rates (IBORs) and to the Euro OverNight Index Average (EONIA). The selection of the supervised entities shall be made on the basis of the size of a supervised entity's actual and potential participation in the market that the benchmark intends to measure, and the framework sets out criteria on how to measure this.

By publishing the framework, ESMA intends to minimise potential future divergences of supervisory practices and to prevent potential future disputes.

The final draft RTS published alongside the framework are intended to ensure convergence on cooperation arrangements entered into by EU NCAs and third country NCAs when they supervise administrators that apply for recognition in the EU. The draft RTS also aim to enhance the negotiation of the relevant arrangements and thereby allow for the use of third country benchmarks soon after an equivalence decision has been adopted.

CSDR: ESMA publishes official translations of guidelines on CSDs' access to CCPs and rules for participant default

ESMA has published the official translations of two sets of guidelines on the implementation of the Central Securities Depositories Regulation (CSDR) addressing central securities depositories' (CSDs') access to central counterparties (CCPs) and rules for participant default.

ESMA's guidelines on CSD access to CCP or trading venues' transaction feeds set out the conditions under which access could be refused, especially as this type of access is not covered under the Markets in Financial Instruments Regulation (MiFIR).

Under the CSDR, CSDs are left to define rules and procedures in order to address the insolvency of one or several of their participants. ESMA's guidelines on CSD participant default specify how such rules and procedures should be defined.

The guidelines will apply from 9 August 2017.

EBA publishes 2018 EU-wide stress test methodology for discussion

The European Banking Authority (EBA) has published its 2018 EU-wide stress test draft methodology and templates for discussion with the industry. The exercise will cover 70% of the EU banking sector and will assess EU banks' ability to meet relevant supervisory capital ratios during an adverse economic shock. The methodology covers all relevant risk areas and, for the first time, will incorporate IFRS 9 accounting standards. The results will inform the 2018 Supervisory Review and Evaluation Process (SREP), challenging banks' capital plans and leading to relevant supervisory outcomes. The exercise is also intended to provide enhanced transparency so that market participants can compare and assess the resilience of EU banks on a consistent basis. The list of institutions participating in the exercise has also been released.

The 2018 EU-wide stress test will be carried out at the highest level of consolidation on a sample of 49 EU banks, 35 of which fall under the jurisdiction of the Single Supervisory Mechanism (SSM). No single capital threshold is defined for the exercise as banks will be assessed against relevant supervisory capital ratios under a static balance sheet and the results will be an input to the SREP, under which decisions are made on appropriate capital resources and forward looking capital plans.

For banks starting to report under IFRS 9 in 2018, the 2018 EU-wide stress test takes into account the impact of the implementation of IFRS 9 on 1 January 2018 both in terms of starting point and projections.

The final methodology will be published as the exercise is launched at the beginning of 2018, with the results to be published in mid-2018.

SSM: ECB consults on possible amendments to Regulation on supervisory fees

The European Central Bank (ECB) has launched a consultation on a review of the ECB Regulation on supervisory fees (Regulation (EU) No 1163/2014), which lays down all the rules and procedures governing the supervisory fee process within the Single Supervisory Mechanism (SSM). A review of the Regulation is provided for under Article 17 and the open consultation is intended to gather feedback from interested parties in order to assess possible improvements.

The review will focus on the methodology and criteria for calculating the annual supervisory fee to be levied on each supervised entity and group. Responses will provide the ECB with insights for preparing, if considered appropriate, a formal update to the Regulation. The outcome of the review is expected to be published in 2018.

Comments on the consultation are due by 20 July 2017.

Basel Committee revises guidelines on money laundering and financing of terrorism in correspondent banking

The Basel Committee on Banking Supervision (BCBS) has published revised guidelines for the management of risks related to money laundering and the financing of terrorism (ML/TF) in correspondent banking. The revisions, made to Annexes 2 ('Correspondent banking') and 4 ('General guide to account opening'), are in response to concerns that banks are withdrawing from correspondent banking to avoid these risks, which would, in turn, affect the ability to send and receive international payments.

The revisions are intended to ensure banks can conduct correspondent banking business with the best possible understanding of the applicable rules on countering ML/TF risks. The guidance sets out concrete regulatory and supervisory expectations and includes a list of risk indicators that correspondent banks should consider when assessing ML/TF risks associated with correspondent banking.

Consob and Bank of Italy consult on new regulation on reporting obligations of investment managers and investment funds

The Commissione Nazionale per le Società e la Borsa (Consob) and the Bank of Italy have launched a public consultation on proposals to amend Bank of Italy Circular No. 189/1993 and Consob Regulation No. 17297/2010, both of which set out reporting obligations applicable to, amongst others, investment managers and investment funds.

The main amendments to Bank of Italy Circular No. 189/1993 are:

- the introduction of new information details to be submitted as part of the reporting requirements applicable to the provision of portfolio management services;
- the elimination of some sections concerning operations of investment funds;
- the insertion of new subsections relating to the credit quality, residency and the economic sector of debtors in the ambit of the operations of closed-ended investment funds authorised to engage in the business of financing;
- the introduction of reporting requirements for SICAF (società di investimento a capitale fisso); and
- the introduction of reporting schemes for European venture capital funds (Euveca) and European social entrepreneurship funds (Eusef) similar to those established for close-ended investment funds.

The principal amendments to Consob Resolution No. 17297 are:

- the elimination of reporting requirements which are a duplication of those imposed by the Bank of Italy;
- the elimination of reporting requirements whose contents can be found in other databases or information available to the regulator;
- the elimination of reporting requirements applicable to private equity investment funds;
- amendments to reporting requirements applicable to the marketing of investment funds; and
- the extension of reporting requirements applicable to Italian investment funds managed by Italian managers to Italian investment funds managed by EU managers.

Comments need to be submitted to Bank of Italy/Consob by 1 August 2017.

Financial Supervision Amendment Act published in German Federal Gazette

The Financial Supervision Amendment Act (Finanzaufsichtsrechtergänzungsgesetz) has been published in the German Federal Gazette (Bundesgesetzblatt). The act sets out a package of measures addressed at banks to safeguard financial stability in the real estate sector. It confers new powers on

the German Federal Financial Supervisory Authority (BaFin), including to ensure certain minimum standards on the awarding of new loans, a limit on loans which are based on the value of the real estate property, and a time period requirement for when a real estate property loan has to be repaid.

In addition, the act addresses legal uncertainties arising from the implementation of the Mortgage Credit Directive at the beginning of 2016, which has led to limited lending to young families and senior citizens.

BaFin publishes new draft ordinance on requirements for employees providing investment advice

The German Federal Financial Supervisory Authority (BaFin) has published a draft ordinance on the requirements for employees providing investment advice and on notification requirements (WpHG-Mitarbeiteranzeigeverordnung, WpHGMaAnzV) relating to the German Securities Trading Act (Wertpapierhandelsgesetz, WpHG), amending the currently applicable ordinance and implementing MiFID2 requirements.

The draft ordinance adopts the guidelines issued by ESMA for the assessment of knowledge and competence.

The draft ordinance is open for consultation until 19 June 2017.

BaFin publishes new draft ordinance on auditing of investment firms

BaFin has published a draft ordinance on the auditing of investment firms (Wertpapierdienstleistungs-Prüfungsverordnung, WpDPV) relating to the German Securities Trading Act (Wertpapierhandelsgesetz, WpHG), amending the currently applicable ordinance and implementing MiFID2 requirements.

The draft ordinance is open for consultation until 19 June 2017.

Luxembourg law implementing EU regulation establishing European account preservation order procedure published

The law of 17 May 2017 implementing Regulation (EU) 655/2014 of 15 May 2014 establishing a European account preservation order procedure to facilitate cross-border debt recovery in civil and commercial matters has been published in the Luxembourg official journal (Mémorial A).

The law amends the Luxembourg New Code of Civil Proceedings (Nouveau Code de Procédure Civile) by introducing a new Article 685-5, which provides for:

- the recognition and enforcement in Luxembourg of judicial decisions in civil and commercial matters issued by EU Member State courts in accordance with the Regulation; and
- the procedure to issue, revoke and modify a European account preservation order, as well as to limit or terminate the enforcement thereof, in Luxembourg.

The law further amends the law of 23 December 1998 establishing a financial sector supervisory commission (as amended). The Luxembourg financial sector supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), will be the authority competent to obtain account information, and banks established in Luxembourg will be required to disclose, upon request from the CSSF, whether the relevant debtor holds an account with them.

The law entered into force on 27 May 2017.

CSSF issues circulars on IT outsourcing to a cloud and use of cloud computing infrastructure

The CSSF has issued four circulars (17/654, 17/655, 17/656 and 17/657) supplementing and amending the IT outsourcing regulatory framework and introducing a dedicated regulatory regime for IT outsourcing relying on a cloud computing infrastructure. The circulars are applicable to credit institutions, investment firms and other professionals in the financial sector (PFS), as well as to payment and electronic money institutions.

CSSF circular 17/654 establishes the requirements regarding a new type of IT outsourcing – IT outsourcing relying on a cloud computing infrastructure. In particular, the circular provides guidance on the cloud computing service by, amongst other things, defining cloud computing, setting out the essential characteristics of the activity, and clarifying the service models offered by cloud computing service providers as well as the implementation models generally used. It further sets out the requirements in relation to IT outsourcing to a cloud computing infrastructure, including, but not limited to, requirements as regards operation of resources, governance, client notification and consent, CSSF notification and authorisation, risk management, business continuity, security of the systems, contractual provisions, control of the activities as well as audit rights.

CSSF circular 17/655 additionally updates and amends the provisions on the IT function and IT outsourcing provided for in CSSF circular 12/552 on the central administration, internal governance and risk management (as amended). In particular, it creates a new standby process allowing the relevant entity to be informed of security failures and requiring the implementation of a patches management procedure in relation to security failures. It further explicitly introduces the need-to-know and least-privilege principles into the general outsourcing requirements foreseen in circular 12/552.

CSSF circular 17/656, repealing and replacing CSSF circular 05/178, notably its Chapter 1 on outsourcing requirements, is aligned with circular 12/552. Chapter 2 of circular 17/656 further sets out the conditions support PFS and their potential foreign branches need to respect when making use of IT outsourcing (other than IT outsourcing relying on a cloud computing infrastructure).

Finally, CSSF circular 17/657 updates and amends CSSF circular 06/240 on administrative and accounting organisation, IT outsourcing and details regarding services provided under the status of support PFS (as amended), notably in relation to the entry into force of the new CSSF circular 17/654 on IT outsourcing relying on a cloud computing infrastructure.

The circulars are applicable as of 17 May 2017.

AMF issues recommendations on provision of future performance simulations to investors

Following a public consultation on the provision of future performance simulations to investors which closed in January 2017 and recent amendments to its General Regulation, the Autorité des marchés financiers (AMF) has published a set of recommendations (DOC-2017-07) aimed at standardising the applicable rules and good practices among the professionals concerned.

The recommendations are intended to:

- remind investment services providers, asset management companies, financial Investment advisers and crowdfunding investment providers of what is required by the regulations and how they should be interpreted;
- propose a standard warning aimed at investors regarding future performance simulators; and
- define good and bad practices regarding technical aspects to designing future performance simulations.

Indonesian and Philippine financial regulators sign letter of intent on banking integration and regulatory co-operation

Indonesia's Financial Services Authority, Otoritas Jasa Keuangan (OJK), and the Philippine's central bank, Bangko Sentral ng Pilipinas (BSP), have signed a letter of intent as an initial step towards a bilateral agreement on the implementation of the ASEAN Banking Integration Framework (ABIF).

The letter of intent outlines an agreement between the OJK and the BSP to start drafting a bilateral agreement, under the ABIF, that is expected to provide, among other things, greater access and operational flexibility for Philippine and Indonesian Qualified ASEAN Banks operating in each other's jurisdictions, based on the equal reciprocity principle, and regulatory cooperation.

The letter of intent represents a major step toward achieving greater banking and financial integration between Indonesia and the Philippines, as well as within the wider AEC. In 2016, the OJK signed its first letter of intent with the Bank of Thailand, and a bilateral agreement with Bank Negara Malaysia.

MAS consults on proposals to facilitate provision of digital advisory services

The Monetary Authority of Singapore (MAS) has published a consultation paper on proposals to facilitate the provision of digital advisory services in Singapore. The proposals are intended to support innovation in financial services by recognising the unique characteristics of and risks posed by digital platforms.

The consultation sets out the MAS' expectations of the board and senior management of digital advisers to address the risks posed by the provision of digital advisory services, and covers governance and supervision of algorithms. The MAS is seeking feedback on the minimum standard of care that digital advisers should exercise.

The consultation also sets out the MAS' proposed changes to legislation to facilitate the provision of digital advisory services in Singapore. In particular, the consultation touches on the areas of suitability of advice, portfolio management, and execution of investment transactions, as well as the licensing and regulatory requirements, and available exemptions, under the Securities and Futures Act and/or the Financial Advisers Act in this regard. Some of the issues apply to both digital advisers as well as conventional capital markets intermediaries.

Comments on the consultation are due by 7 July 2017.

MAS responds to feedback on draft regulations on regulatory framework for unlisted margined derivatives offered to retail investors

The MAS has published its response to the feedback it received on its March 2014 consultation on draft regulations to enhance the regulatory framework for unlisted margined derivatives offered to retail investors. Amongst other things, the MAS has confirmed that:

- it will proceed with the proposed amendments to require retail customers' moneys to be deposited in trust accounts with MAS-licensed banks in Singapore. In the event a capital market services (CMS) licence holder is unable to hold retail customers' moneys denominated in a particular foreign currency with MAS-licensed banks in Singapore, MAS expects the CMS licence holder to hold an equivalent amount with MAS-licensed banks in Singapore. Where the CMS licence holders have to convert the foreign currency amount to Singapore Dollars, the CMS licence holders should disclose to customers the conversion rate, conversion costs, and the party bearing the costs;
- gold should be included as acceptable collateral;
- in respect of the regulatory carve-out for banks and merchant banks which was removed by the Securities and Futures (Amendment) Act 2017, and the removal of which will result in banks and merchant banks dealing in OTC derivatives contracts where the underlying is foreign exchange, or spot foreign exchange for the purpose of leveraged foreign exchange (LFX) contracts, to be considered as conducting the regulated activity of dealing in capital markets products under the SFA, the MAS will provide a two-year transitional period for banks, merchant banks and their representatives currently conducting LFX trading to submit the relevant notifications and comply with the business conduct requirements;
- for requirements under the draft regulations, it will provide a transitional period of twelve months from the date on which the amendments are effected (T date, which is estimated to be early 2018) for all the proposed requirements, except the following:
  - the base capital requirement of SGD 5 million for CMS licence holders dealing in unlisted derivatives with retail customers will take effect on T date, i.e. there will be no transitional period; and
  - for the requirement to maintain separate trust accounts for retail customers' transactions in listed and unlisted products, the MAS will provide a transitional period of 18 months from T date.

SAFE publishes Q&A on overall macro-prudential management of cross-border financing

The State Administration of Foreign Exchange (SAFE) has published its Policy Q&As No.1 on the Overall Macro-prudential Management of Cross-border Financing, providing clarifications to the Circular of the People's Bank of China (PBoC) on Matters regarding the Overall Macro-prudential Management of Cross-border Financing (Circular No. 9), in particular in relation to three aspects: (i) the transitional arrangement for foreign-invested enterprises (FIEs); (ii) the calculation of foreign debt size; and (iii) the management of foreign debt registration, account and currency exchange.

Among other things, the Q&As clarify that:

- FIEs may choose between the existing model and the model under Circular No. 9 during the one-year transitional period, by submitting a written filing report to the local SAFE when handling their first contract filing procedure with SAFE after the issuance of the Q&As. Other special types of FIEs, including foreign-invested leasing companies and holding companies, may continue to adopt the current model to borrow foreign debts under the SAFE Circular on Distributing the Administrative Measures for Registration of Foreign Debts (SAFE Circular [2013] No. 19), if not choosing to apply the new model under Circular No. 9;
- as to foreign debt arising from the borrower's performance of its payment obligation under 'Wai Bao Nei Dai', this shall be calculated into the risk-weighted cross-border financing balance under Circular No. 9 of the borrower. No extra quota, including the additional amount equal to the borrower's audited net assets by the end of last year under the SAFE Circular on Promulgation of the Provisions of the Administration of Foreign Exchange for Cross-border Guarantee (SAFE [2014] No. 29), will be available to the borrower;
- those foreign debts subject to the approval by other authorities (such as the National Development and Reform Commission) on a transaction-by-transaction basis, may also go through the contract filing procedures at SAFE based on the approved amount, which will be calculated into the balance;
- those cross-border financing businesses which are not taken into account when calculating the balance, such

as indebtedness incurred under cash-pooling arrangements, Panda bond proceeds used for onshore subsidiaries and RMB trade financing, shall also be subject to the applicable registration requirements of SAFE; and

- the use of proceeds from cross-border financing under Circular No.9 by enterprises shall comply with relevant requirements set out in the SAFE Circular on Reforming and Regulating Policies on the Control over Foreign Exchange Settlement of Capital Accounts (SAFE Circular [2016] No. 16); for RMB foreign debts, the PBoC Circular on Clarifying the Operating Rules for RMB Settlement Business of Foreign Direct Investment (PBoC Circular [2012] No. 165) is also applicable.

SFC issues circular to licensed corporations on responsible officers and substantial shareholders

The Securities and Futures Commission (SFC) has issued a circular to licensed corporations on responsible officers and substantial shareholders.

In recent years, the SFC has observed an increasing number of persons with no prior experience in the securities industry seeking to set up or acquire licensed corporations in Hong Kong. It notes that in some cases, large premiums were paid by new substantial shareholders acquiring licensed corporations that have little or no business. The SFC has indicated that it is also aware of reports of a 'market price' for hiring a responsible officer who does not participate in the firm's management or operations. Accordingly, the circular reminds the industry that licences are granted to corporations and individuals to enable them to carry on a business in a regulated activity. The SFC may revoke the licences of corporations and individuals that do not genuinely carry on a business in a regulated activity. The circular emphasises that a licensed corporation's responsible officers should have sufficient authority to supervise the business of regulated activity in the licensed corporation. The SFC reminds licensed corporations and applicants that it is not acceptable to hire responsible officers in name only, where those responsible officers in reality do not participate in the supervision of the licensed corporation's business, or they lack sufficient authority to do so.

When the SFC considers an application for approval to become a substantial shareholder of a licensed corporation, it will scrutinise the proposed arrangement particularly closely if the licensed corporation appears to be dormant. The circular states that this is because there may be a concern that the new substantial shareholder is seeking to avoid the normal assessment and vetting process involved in a new licensed corporation application. The SFC may enquire into a proposed substantial shareholder's source of funding and financial strength. The SFC will also assess any potential changes to the licensed corporation's business plan and senior management following a change of ownership. The circular stresses that substantial shareholders should be aware that the SFC expects a licensed corporation's board of directors and senior management to be composed of individuals with an appropriate range of skills and experience to understand and run the corporation's activities.

SFC issues circular on reporting of OTC derivatives transactions

The SFC has issued a circular to licensed corporations announcing that phase two of the mandatory reporting of over-the-counter (OTC) derivatives transactions will commence on 1 July 2017. The reporting covers transactions in all five major asset classes (interest rate, foreign exchange, equity, credit and commodity) of OTC derivatives products, as well as the reporting of valuation information.

The circular reminds licensed corporations that will be subject to phase two reporting obligations to have their reporting systems and relevant operations ready before 1 July 2017. Licensed corporations that will be subject to mandatory reporting must sign up for the reporting service of the Hong Kong Trade Repository (HKTR) and complete a scenario test and a product specific test before they will be accepted for reporting. Those who have already signed up and completed a scenario test under phase one mandatory reporting are also required to complete a product specific test in order to be accepted by the HKTR for reporting additional OTC derivatives products under phase two reporting. Licensed corporations that will need to report under phase two reporting but have not signed up for HKTR's reporting services, or have not enrolled in simulation tests, are advised to contact HKTR immediately.

The circular also emphasises that licensed corporations must make sure that their reporting agents, if any, meet all technical requirements specified by the HKTR, and they must also test the trade submission process with their agents and file the declaration form on the readiness of reporting via their agents before these agents can be accepted for reporting on their behalf.

The SFC has advised licensed corporations that encounter or foresee any technical difficulties in complying with phase two reporting obligations to contact it immediately.

RECENT CLIFFORD CHANCE BRIEFINGS

Thoughts on the recently published ECB guidance on leveraged transactions

On 16 May 2017, the European Central Bank (ECB) published its finalised guidance on leveraged transactions, which will apply to banks supervised by the ECB under the Single Supervisory Mechanism (SSM). This guidance aims to harmonise the definition of leveraged transactions and ensure sound and consistent risk management practices. It enters into force six months after publication, on 16 November 2017.

This briefing paper discusses the guidance.

https://www.cliffordchance.com/briefings/2017/06/thoughts_on_the_recentlypublishedecbguidanc0.html

Withholding Tax Revolution? The effect of the BEPS multilateral convention on cross-border debt and equity investments

68 countries signed the BEPS multilateral convention on Wednesday 7 June. Its effect is to amend the hundreds of double tax treaties between those countries to introduce new anti-avoidance rules. After years of uncertainty we finally know which countries are opting for which variant of the proposed rules, and therefore which investments are likely to be adversely affected.

This briefing paper summarises the impact of the new rules on cross-border debt and equity investment and – in particular – withholding tax.

https://www.cliffordchance.com/briefings/2017/06/withholding_tax_revolutiontheeffectofth.html

A slice of MFN with that incremental loan

In recent trends, borrowers have been negotiating expansive exceptions to most favored nation (MFN) clauses for incremental loans in order to optimize flexibility and minimize costs for future financings. The ever-lasting issuers' market has emboldened borrowers and developed the precedent for a growing list of MFN exceptions.

Against this backdrop, lenders recognize that incremental facilities provide a borrower with quick access to liquidity that can be utilized for value-maximizing or liability-managing purposes (such as acquisitions or refinancings) that may benefit the ultimate recoveries of such lenders. In addition, an incremental facility may provide a future investment opportunity for existing lenders hungry for paper in a market with little net new money. Notwithstanding such benefits, lenders remain sensitive to the threat that any new incremental debt carrying higher pricing may pose to the price of their existing paper. Incremental loans with steeper interest rates are analogous to the release of new car models and the resultant devaluation of previous editions. As a result, lenders typically negotiate for MFN clauses that require an automatic increase in pricing of the existing loans so that they remain at all times within a prescribed margin (typically 50 basis points) of any new incremental loans. Such MFN clauses, at their core, protect the value and tradability of the original debt in the secondary market.

Nonetheless, with ever expanding bargaining leverage, borrowers are negotiating creative ways to minimize MFN and related incremental loan protections. This briefing paper discusses some of the key MFN exceptions borrowers have been pursuing in recent periods.

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