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Briefing note

International Regulatory Update

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IN THIS WEEK'S NEWS

- ESMA issues opinion on asset segregation and applying depositary delegation rules to CSDs
- Financial conglomerates: EU Commission carries out analysis of regulatory framework
- ESAs consult on credit assessments of ECAIs
- EBA publishes draft technical standards on authorisation of credit institutions
- EMIR: ESMA and Securities and Exchange Board of India sign MoU on CCPs
- HM Treasury publishes final draft regulations for insurance linked securities
- PSD2: HMT publishes consultation outcome on implementation
- FCA publishes findings from suspended property fund review
- FCA sets out scope of investment platforms market study
- MiFID2: FCA publishes forms for passporting notifications
- BoE announces direct access to RTGS accounts for non-bank PSPs
- PSD2 implementing law published in German Federal Gazette
- CNMV issues press release on calibration of circuit breakers and publication of trading halts under MiFID2
- Decree on improving development of bond issues published in France
- SFC and FCA sign MOU on enhanced supervision of cross-border regulated entities
- ASIC consults on new client money reporting rules
- Recent Clifford Chance briefings: Second circuit reverses LIBOR convictions; Conduit jurisdiction of the DIFC courts; Brexit; and more. Follow this link to the briefings section.

ESMA issues opinion on asset segregation and applying depositary delegation rules to CSDs

The European Securities and Markets Authority (ESMA) has published an opinion to the EU Commission, Council and the Parliament setting out possible clarifications of

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legislative provisions under the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive. The suggested clarifications relate to the asset segregation requirements in case of safe-keeping duties by the appointed depositary of a fund (UCITS or alternative investment fund (AIF)) and the application of depositary delegation rules to central securities depositaries (CSDs).

In its opinion, ESMA suggests a regime which ensures:

- assets are clearly identifiable as belonging to the AIF/UCITS, consistent with any reuse (where permitted); and
- investors receive adequately robust protection by avoiding the ownership of the assets being called into question in case of the insolvency of any of the entities in the custody chain.

ESMA concludes that only minimum EU-wide segregation requirements should be prescribed, leaving room for stricter requirements or different account structures if national laws in specific Member States make them necessary.

Financial conglomerates: EU Commission carries out analysis of regulatory framework

The EU Commission has prepared a staff working document setting out an analysis of Directive 2002/87/EU on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (FICOD) and the FICOD amending Directive (2011/89/EU), as well as regulatory technical standards (RTS) that support the application of the FICOD rules. In particular, the paper draws conclusions on the continued fitness of FICOD in achieving its objectives and assesses whether FICOD remains fit for purpose.

FICOD sets out specific provisions for groups identified as financial conglomerates, including rules relating to capital adequacy, reporting on intragroup transactions and governance requirements at the level of the financial conglomerate. The analysis considers each of the main areas covered in FICOD:

- scope;
- capital;
- governance;
- intragroup transactions and risk concentration; and
- supervision and enforcement.

FICOD was included under the Commission's REFIT programme in the Commission Work Programme, but the evidence gathered has not been sufficient to support a full evaluation. Overall, the Commission's analysis highlights that FICOD remains a useful supervisory tool. The Commission views it as important to keep in place a framework for the supervision of mixed-activity financial groups and believes that, in general, FICOD has functioned well. The framework under FICOD functions to capture group risks and gives supervisors oversight over cross-sector groups, and the Commission has identified that in some instances certain gaps and inconsistencies are addressed by supervisors in the application of the FICOD framework and therefore do not fundamentally undermine the effectiveness of the framework.

ESAs consult on credit assessments of ECAIs

The European Supervisory Authorities (ESAs), comprising the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and European Securities and Markets Authority (ESMA), have published consultation papers on the Implementing Regulations on the mapping of credit assessments of External Credit Assessment Institutions (ECAIs) for credit risk under the Capital Requirements Regulation (CRR) and the Solvency II Directive (Solvency II). The consultations address the recent recognition of five new credit rating agencies (CRAs) and the deregistration of one CRA.

The updated Implementing Regulations provide a specified approach to establish the correspondence, or mapping, between credit ratings and the credit quality steps defined in the CRR and Solvency II. The mappings for the other 25 ECAIs covered in the Implementing Regulations remain unchanged. The ESAs have also published individual draft mapping reports illustrating how the methodology was applied to produce the five additional mappings.

Comments are due by 18 September 2017.

EBA publishes draft technical standards on authorisation of credit institutions

The EBA has published a final report setting out draft RTS and implementing technical standards (ITS) on information requirements for the authorisation of credit institutions under the Capital Requirements Directive (CRD 4). The EBA encourages the Commission to adopt the RTS and ITS at the earliest possible opportunity to support the consistent, efficient and rigorous assessment of any applications for authorisation submitted by entities seeking to relocate in the context of Brexit.

The draft RTS include:

- a comprehensive list of information to be provided in an application by undertakings seeking to obtain the authorisation referred to in Article 8(1) of CRD 4;
- requirements applicable to the proposed shareholders and members with qualifying holdings of the applicant credit institution; and
- details of obstacles that could prevent the effective exercise of supervisory functions, including examples.

The draft ITS set out a form to be used by undertakings seeking to obtain authorisation, as well as relevant procedures and requirements relating to the submission of such applications and the approach to be taken in respect of incomplete applications.

EMIR: ESMA and Securities and Exchange Board of India sign MoU on CCPs

ESMA has signed a memorandum of understanding (MoU) on central counterparties (CCPs) with the Securities and Exchange Board of India (SEBI). The MoU establishes cooperation arrangements regarding CCPs which are established and authorised or recognised in India, and which have applied for legal recognition under the European Market Infrastructure Regulation (EMIR). The MoU is effective as of 21 June 2017.

HM Treasury publishes final draft regulations for insurance linked securities

HM Treasury has published draft regulations introducing a new regulatory and tax regime for insurance linked securities (ILS).

The new ILS framework is set out in two draft regulations. The draft Risk Transformation Regulations 2017 introduce a new regulated activity of insurance risk transformation and a new corporate structure for multi-arrangement insurance special purpose vehicles (mISPVs). The draft Risk Transformation (Tax) Regulations 2017 set out the taxation of ISPVs. The regulations also set out the approach that is to be taken by the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) to ISPV authorisation and supervision.

The draft regulations are accompanied by the government's response to the November 2016 consultation on a new ILS framework, which sets out the final approach to the tax and regulation of ILS vehicles in the UK.

The final draft regulations have been published so that the insurance and reinsurance industry can prepare for the new framework coming into force in autumn 2017. The regulations will be laid before Parliament after summer recess.

PSD2: HMT publishes consultation outcome on implementation

HM Treasury has published its response to the consultation on the implementation of the recast Payment Services Directive (PSD2), which was launched on 9 February 2017. The document summarises the responses received and indicates where the final policy has been adjusted to take respondents' views into account.

Alongside the consultation response the Government has laid the statutory instrument before Parliament. Additionally, HMT and the Financial Conduct Authority (FCA) have jointly published a statement setting out their expectations for the third party access provisions in PSD2.

PSD2 is due to be transposed and apply from 13 January 2018.

FCA publishes findings from suspended property fund review

The Financial Conduct Authority (FCA) has published the findings of its review into fund suspensions and pricing adjustments following the vote to leave the EU.

Following the UK's vote in June 2016, some daily-dealt property funds, and subsequently a number of unit-linked funds, had to suspend dealing in units and/or apply pricing adjustments temporarily because assets could not be realised quickly enough to meet redemption demand and due to the lack of certainty of property values.

The FCA takes the view that the current regulatory regime goes some way to addressing the potential for unfair treatment of customers as a result of fund suspensions and pricing adjustments. However, the FCA still wanted to review how it had worked in practice in the period following the referendum and whether there were lessons that the FCA should learn to help it improve its response to any similar future market events.

Overall, the FCA found that the use of suspensions, deferrals and other liquidity management tools were effective in preventing market uncertainty escalating, but that the quality of liquidity monitoring and management varies between funds. The FCA recommends that funds take external events into account as part of their planning in order to deal with potential liquidity risks.

In its statement the FCA sets out findings for authorised fund managers, depositaries, platform providers and other sectors.

The FCA will consider the findings of the review alongside responses to its February 2017 discussion paper on illiquid assets and open-ended investment funds. The FCA's response to the discussion paper, including whether the current regulatory regime may need to be revised, will be summarised in a feedback statement in due course.

FCA sets out scope of investment platforms market study

The FCA has published the terms of reference for its investment platforms market study. The study will aim to diagnose whether competition between investment platforms is working well for consumers.

The FCA expects its analysis to cover:

- platforms and other firms that offer access to retail investment products through an online portal, likely to include financial advisers, wealth managers and distributors;
- retail investors who access retail investment products through an online portal;
- intermediaries, including financial advisers and wealth managers who use intermediated platforms to access different retail investment providers on behalf of their clients;
- product and wrapper providers who use platforms to distribute their products;
- technology providers to whom platforms outsource services, and;
- fund ratings and data providers whose information platforms use and distribute.

The market study follows on from the FCA's asset management market final report, published in June 2017, which highlighted a number of potential competition issues in the platforms sector.

Feedback on the topics proposed by the FCA is due by 8 September 2017. The FCA plans to set out preliminary conclusions in an interim report by Summer 2018.

MiFID2: FCA publishes forms for passporting notifications

The FCA has published a new webpage on passporting under MiFID2 and certain forms to be used for applications.

The forms relate to firms giving notice of their intention to:

- establish a branch or change branch particulars in another EEA state;
- provide cross border services and activities in another EEA state;
- provide arrangements to facilitate the access to a multilateral trading facility (MTF) or an organised trading facility (OTF) from another EEA state; and
- use a tied agent established in another EEA state or amend the details of a tied agent established in another EEA state.

Alongside the forms, the FCA has provided details of the timetable for submissions. Among other things, cross-border service passport notifications should be submitted by 2 December 2017. Establishment passport notifications should be submitted as early as possible after the MiFID2 passporting gateway opens on 31 July 2017 because MiFID2 grants home competent authorities three months to assess notifications, followed by a maximum two months before the passport becomes effective.

BoE announces direct access to RTGS accounts for non-bank PSPs

The Bank of England (BoE) has announced the extension of direct access to the Real-Time Gross Settlement (RTGS) system to non-bank payment service providers (PSPs), alongside publication of a revised settlement account policy that includes non-bank PSPs.

Non-bank PSPs will be eligible to apply for a settlement account in the RTGS system and apply for direct access to the UK's sterling payment systems that settle in sterling central bank money, including Faster Payments, Bacs, CHAPS, LINK, Visa and, once live, a new digital cheque imaging system. The changes are intended to enable non-bank PSPs to compete on a more level playing field with banks and offer a wide range of payment services. Before non-bank PSPs can open a settlement account, they will be required to demonstrate compliance with a new risk management framework, which the BoE has been working on with the Financial Conduct Authority (FCA), HM Treasury (HMT), HM Revenue & Customs (HMRC), the Payment Systems Regulator (PSR) and payment system operators. A number of legislative changes are also required and, as such, the BoE expects the first non-bank PSPs to join RTGS during 2018.

The BoE, FCA and payment systems operators have published a guide setting out more detail on the requirements and application process, which is intended to help firms interested in exploring direct access to UK payment systems and RTGS.

PSD2 implementing law published in German Federal Gazette

The German law to implement the revised Payment Services Directive (PSD2) has been published in the German Federal Gazette (Bundesgesetzblatt).

In particular, the law provides that:

- payment initiation service providers require a payment service licence from the German Federal Financial Supervisory Authority (BaFin);
- payees shall not request charges for the use of payment instruments for which interchange fees are regulated under Chapter II of Regulation (EU) 2015/751 and for payment services to which Regulation (EU) No 260/2012 applies; and
- strong customer authentication is required where the payer (i) accesses its payment account online; (ii) initiates an electronic payment transaction; or (iii) carries out any action through a remote channel which may imply a risk of payment fraud or other abuses.

The law will enter into force on 13 January 2018.

CNMV issues press release on calibration of circuit breakers and publication of trading halts under MiFID2

The Spanish National Securities Market Commission (Comisión Nacional del Mercado de Valores) (CNMV) has issued a press release regarding the European Securities and Markets Authority's (ESMA's) guidelines on the calibration of circuit breakers and publication of trading halts under MiFID2.

The guidelines clarify the provisions of Article 48(5) of MiFID2. They are not restricted to a specific type of circuit breaker and apply indistinctly to all mechanisms that trading venues could potentially put in place in accordance with Article 48(5) of MiFID2. The main purpose of the guidelines is to develop common standards to be taken into consideration by trading venues for the calibration of their circuit breakers and, more generally, to ensure consistent application of the provisions of Article 48(5) of MiFID2. The CNMV has agreed to inform ESMA of its intention to comply with the guidelines and will incorporate them in its supervisory practices.

The guidelines will be applicable from 3 January 2018, the same date on which MiFID2 begins to apply.

Decree on improving development of bond issues published in France

In the context of the modernisation of the French law on bond issuances, Decree no. 2017-1165 of 12 July 2017, implementing Ordinance no. 2017-970 of 10 May 2017, has been published in the French Journal Official.

The Decree further specifies the relevant changes in the provisions of the French commercial code and French financial and monetary code regarding the requirements for the proper information of bondholders alongside increased free contractual relationships with their issuer. It specifies the following conditions of form and notice, if not provided by the terms and conditions of the issue agreement, for:

- appointing or replacing the representatives of the bondholders' group (known as 'la masse');
- calling general meetings of bondholders;
- disregarding the lack of approval by the general meeting of bondholders when the board of directors, executive board or managers of the debtor company decide to carry out changes regarding the form of the company or secured bond issues not benefiting the 'masse';
- authorising the representatives of the 'masse' to release security interests granted to the bondholders subject to the decision of the general meeting of bondholders to proceed in this way; and
- offering on-demand redemption of the bondholders' securities when applicable.

The Decree sets at:

- one year the maximum holding time of debt securities or bonds that do not give access to capital, acquired or being held by issuers (i.e. credit institutions, investment firms and financing companies) for the purpose of improving their liquidity. This is reduced to a maximum of 60 calendar days for debt securities acquired by issuers for the purpose of placing them;
- up to 10% of the issued negotiable debt securities the percentage an issuer can acquire and hold subject to informing the Banque de France; and
- EUR 100,000 or more as (i) the amount for bonds with a nominal value authorising the parties to freely negotiate the issue contracts without the 'masse' provisions, and (ii) the minimum subscription or purchase amount per investor and transaction for bonds placed with professional investors, while issues intended to be offered to the public remain subject to the framework set out in the French commercial code.

The Decree entered into force on 15 July 2017, the day following that of its publication.

SFC and FCA sign MOU on enhanced supervision of cross-border regulated entities

The Hong Kong Securities and Futures Commission (SFC) and UK Financial Conduct Authority (FCA) have signed a memorandum of understanding (MOU) to provide for consultation, cooperation and exchange of information in connection with the supervision and oversight of regulated entities that operate on a cross-border basis in Hong Kong and the United Kingdom.

The MOU, which covers financial market participants and other entities that are regulated by the SFC or the FCA, enables the SFC and the FCA to cooperate with each other in the interest of fulfilling their respective regulatory mandates.

ASIC consults on new client money reporting rules

The Australian Securities and Investments Commission (ASIC) has released a consultation paper proposing to make new client money reporting rules for Australian financial services (AFS) licensees that hold 'derivative retail client money' within the meaning of the Corporations Act.

These rules will impose record keeping, reconciliation and reporting requirements on AFS licensees that hold derivative retail client money. ASIC is proposing that the client money rules should apply to all derivative retail client money received by an AFS licensee, unless the client money relates to a derivative that is traded on a fully licensed domestic market, such as the ASX 24.

The new proposals follow the passage of bills – the Treasury Laws Amendment (2016 Measures No. 1) Bill 2016 and the Corporations Amendment (Client Money) Regulations 2017 – which will prevent AFS licensees from withdrawing client money provided by retail derivative clients, and using it for the wide range of purposes currently permitted under the Corporations Act, including as the AFS licensee's own working capital.

The reforms also give ASIC the power to make new client money reporting rules to ensure greater transparency in relation to an AFS licensee's receipt and use of derivative retail client money.

RECENT CLIFFORD CHANCE BRIEFINGS

Brexit – ESMA signals tougher stance on UK Asset Manager relocation to the EU

On 13 July 2017, ESMA published three opinions setting out sector-specific principles aimed at supporting supervisory convergence in the context of requests from UK financial institutions seeking to relocate to the EU27. The opinions relate to investment management, investment firms and secondary markets and follow on from the general, cross-sectoral opinion published by ESMA in May 2017, on which we briefed earlier.

The opinion on Investment Management covers UCITS and AIFMD structures, and delegation to MiFID investment firms. Most of the content is not surprising and what we already know about regulators' considerations when an asset manager is establishing in their jurisdiction, but it does indicate a change of tone from ESMA in respect of Brexit relocations, particularly in relation to substance requirements on delegation. The underlying message is that ESMA is requiring EU regulators to be tough on proposed relocations and, in particular, any proposals to delegate functions back to the UK.

Non-EU asset managers with EU fund structures (e.g. U.S. managers acting as delegates to EU management companies) should also follow this development, as the ESMA opinion and the EU regulatory reaction to it are relevant not only to UK managers looking to relocate to the EU, but also to non-EU managers who are part of EU fund structures.

This briefing paper discusses the opinion.

https://www.cliffordchance.com/briefings/2017/07/brexit_esma_signalstougherstanceonukasse.html

Brexit – European Union (Withdrawal) Bill and the Devolution Dimension

The Scottish and Welsh devolved administrations have said that they will refuse their consent to the Government's Repeal Bill. Refusal would be a political gambit rather than a legal one, but no less significant for that. But the Bill, or something like it, must be passed if the UK's legal system is to function after Brexit. Politics, even of devolution, must not be allowed to block critical measures.

This briefing paper discusses the Bill and the politics of devolution around it.

https://www.cliffordchance.com/briefings/2017/07/brexit_european_unionwithdrawalbillandth.html

FCA consults on new premium listing category for sovereign controlled companies

On 13 July 2017, the FCA published a consultation paper, CP 17/21, on the creation of a new listing category for companies controlled by a shareholder that is a sovereign country. The FCA is consulting on the addition of a new additional category of premium listing for such companies whereby all the existing investor protections applicable to the existing premium listings will apply, subject to two specific modifications.

This briefing paper discusses the proposal.

https://www.cliffordchance.com/briefings/2017/07/fca_consults_on_newpremiumlistingcategoryfo.html

Labour's proposed UK financial transaction tax – What it means for investors, institutions and businesses

The Labour Party has announced a plan to expand the existing UK stamp duty into a broader financial transaction tax.

Stamp duty currently applies in practice only to UK equities. Labour's proposed tax would cover all equities and debt securities, if there is either a UK issuer or a UK party to a trade. It would also apply to credit and equity derivatives with a UK counterparty.

Many elements of the proposal are currently unclear, however there are in our view significant flaws in its design. In particular, it suffers from 'cascade' effects which will greatly increase the effective rate, and these costs will inevitably be borne by pension funds, investment funds and other end users. It will also, despite the claims of its designer, create a strong incentive for funds, investors and traders to migrate from the UK.

This briefing paper discusses the proposed tax.

https://www.cliffordchance.com/briefings/2017/07/labour_s_proposedukfinancialtransactiontax.html

Corporate Update July 2017

Clifford Chance has produced the July 2017 edition of its bi-annual Corporate Update, which provides a round-up of developments in company law and corporate finance regulation over the last six months and looks ahead to forthcoming legislative and regulatory changes.

https://www.cliffordchance.com/briefings/2017/07/corporate_updatejuly2017.html

The decline of the conduit jurisdiction of the DIFC courts

A Judicial Tribunal was established last year pursuant to Dubai Decree No. 19 of 2016 to determine conflicts of jurisdiction between the DIFC Courts and the onshore Dubai Courts. The Tribunal has jurisdiction to determine conflicts of jurisdiction where the DIFC Courts and the Dubai Courts have both:

- not abandoned hearing the case;
- abandoned hearing the case; or
- rendered conflicting judgments on the case.

This briefing paper discusses the decisions of the Tribunal to date and the implications of these decisions for the conduit jurisdiction of the DIFC Courts to enforce foreign and domestic arbitral awards and foreign judgments. In short, the effectiveness of that jurisdiction appears to be on the decline. However, there are steps that can be taken by the parties to ensure that their disputes continue to be heard by the DIFC Courts, which are also examined in this briefing.

https://www.cliffordchance.com/briefings/2017/07/the_decline_of_theconduitjurisdictionofth.html

Second Circuit agrees with the DC Circuit in sharply limiting judicial review over DPAs

In its 12 July 2017 decision in United States v HSBC Bank USA, N.A., the US Court of Appeals for the Second Circuit in New York sharply limited the scope of judicial review and supervision over deferred prosecution agreements (DPAs). In doing so, the Second Circuit agreed with the 5 April 2016 opinion of the US Court of Appeals for the District of Columbia Circuit in United States v Fokker Services B.V., which was the first Circuit Court decision to strictly limit the scope of judicial review of DPAs. Fokker was the first appellate decision to hold that, because of constitutional separation of powers, a US district court may not refuse to approve a DPA because it disagreed with the merits of the DOJ's charging decisions or the terms of the DPA. As the second appellate decision on this issue, the HSBC opinion extends the reasoning in Fokker beyond the context of initial court approval of a DPA, and clarifies the very limited scope of judicial supervision over a DPA while it remains pending on the court's docket.

This briefing paper discusses the decision.

https://www.cliffordchance.com/briefings/2017/07/united_states_secondcircuitcourtofappeal.html

Second circuit reverses LIBOR convictions – holds prosecutor's use of testimony lawfully compelled by foreign sovereign violated fifth amendment

On 19 July 2017, the United States Court of Appeals for the Second Circuit overturned the criminal convictions of two former traders sentenced to jail in connection with the years-long, multi-jurisdictional investigation into LIBOR manipulations. In United States v. Allen, the Second Circuit held that the Fifth Amendment right against self-incrimination prohibits prosecutors from using a defendant's compelled testimony against him at trial, even if the testimony was lawfully compelled by a foreign sovereign under normal protocols in that jurisdiction. The court also clarified that when the government's evidence is challenged as having been derived from compelled testimony, prosecutors bear a heavy burden in proving that the evidence was wholly derived from a legitimate, non-compelled source. The Allen decision, which undoes the first individual convictions secured by the US Department of Justice (DOJ) in connection with the LIBOR investigations, will meaningfully impact the DOJ's interactions with foreign regulators conducting parallel investigations, and is required reading for any practitioner representing individuals and entities in the increasingly active world of cross-border investigations.

This briefing paper discusses the decision.

https://www.cliffordchance.com/briefings/2017/07/second_circuit_reversesliborconvictionshold.html