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Banking reform package: EU Council Presidency publishes compromise texts

The EU Council Presidency has published compromise texts on the legislative proposals forming the banking reform package.

The texts relate to the:

- proposed Regulation to amend the Capital Requirements Regulation (CRR 2);
- proposed Directive to amend the Bank Recovery and Resolution Directive (BRRD 2);
- proposed Regulation to amend the Single Resolution Mechanism Regulation (SRMR 2); and
- proposed Directive to amend the Capital Requirements Directive (CRD 5).

IOSCO consults on conflicts of interest during equity capital raising process

The International Organization of Securities Commissions (IOSCO) has published a consultation report proposing guidance to assist its members in addressing conflicts of interest and associated misconduct risks that may arise during the equity capital raising process.

The report requests feedback on proposed guidance concerning the key stages of the equity raising process where the role of intermediaries may give rise to conflicts of interest. The guidance proposes eight measures grouped together according to stages in the capital raising process. Specific conflicts of interest addressed include:

- conflicts of interest and pressure on analysts during the formative, pre-offering phase of a capital raising;
- conflicts of interest during the allocation of securities;
- conflicts of interest in the pricing of securities offerings; and
- conflicts of interest and conduct risks stemming from personal transactions by staff employed within firms managing a securities offering.

Comments are due by 4 April 2018.

Basel Committee reports on fintech implications for banks and supervisors

The Basel Committee on Banking Supervision (BCBS) has published a report on how technology-driven innovation in financial services may affect the banking industry and the activities of supervisors in the near to medium term.

The report draws on surveys with bank supervisors and comments received to the BCBS' consultation in August 2017. Following industry-wide scenario analysis, the report focuses on five potential future scenarios to describe the potential impact of fintech on banks:

- the better bank – modernisation and digitisation of incumbent players;
- the new bank – replacement of incumbents by challenger banks;
- the distributed bank – fragmentation of financial services among specialised fintech firms and incumbent banks;
- the relegated bank – incumbent banks become commoditised service providers and customer relationships are owned by new intermediaries; and
- the disintermediated bank – banks become irrelevant as customers interact directly with individual financial service providers.

The report focuses on three technological developments (big data, distributed ledger technology and cloud computing) and three fintech business models (innovative payment services, lending platforms and neo-banks).

The report suggests that the rapid adoption of enabling technologies and emergence of new business models pose various opportunities and risks to incumbent banks in almost all the banking industry scenarios considered. It also states that banking standards and supervisory expectations should be adaptive to new innovations, while maintaining appropriate prudential standards.

PRA sets out policy on Pillar 2 liquidity

The Prudential Regulation Authority (PRA) has published a policy statement (PS2/18) on liquidity under the Pillar 2 framework. The statement provides feedback to responses received to two PRA consultation papers, on Pillar 2 liquidity requirements (CP21/16) and the assessment of firms' Pillar 2 liquidity risk (CP13/17). The consultations proposed:

- using the methodologies consulted on in future PRA liquidity assessments;
- introducing a cashflow mismatch risk (CFMR) framework and associated reporting template; and
- setting survival guidance on the granular liquidity coverage requirement stress within the CFMR framework.

Following feedback on these proposals, the PRA's policy statement sets out the following:

- a final statement of policy on Pillar 2 liquidity;
- two updated supervisory statements 'The PRA's approach to supervising liquidity and funding risks' (SS24/15) and 'Guidelines for completing regulatory reports' (SS34/15);
- a final PRA110 template and reporting instructions; and
- a final amendment to the Reporting Part of the PRA Rulebook.

The statement of policy and amended SS24/15 and SS34/15 take effect from 23 February 2018. The PRA110 template and reporting instructions and the Reporting Part of the PRA Rulebook will take effect from 1 July 2019.

PRA consults on credit risk mitigation

The PRA has published a consultation paper (CP6/18) on its expectations regarding the eligibility of guarantees as unfunded credit protection under the CRR.

The PRA is proposing amendments to its supervisory statement (SS17/13) on credit risk mitigation (CRM) that seek to provide clarity and further guidance on the eligibility criteria for the recognition of guarantees. Key expectations, which would extend to any contract or other documented obligation purporting to be a guarantee for the purpose of achieving unfunded credit protection, include:

- that the guarantee is, at a minimum, legally enforceable under the firm's governing law and in the jurisdiction where the guarantor is incorporated, and the practical ease of enforcement be considered;
- that an independent legal opinion consider the eligibility criteria;
- that firms ensure a guarantee is incontrovertible by considering its terms, the remedies available and whether the guarantor could, in practice, successfully seek to reduce or be released from liability; and
- that firms review existing agreements to ensure they do not contain clauses that will render a guarantee ineligible.

The PRA also sets out its interpretation of the timeliness requirement and the exclusion of certain types of payments and limited coverage. It also briefly notes the potential treatment of ineligible guarantees as additional capital under Pillar 2.

Feedback is sought on these proposed changes, as well as the nature of firms' existing guarantee arrangements for CRM, the impact of the proposals on existing CRM practices and any other issues.

The consultation closes on 16 May 2018.

Financial Services and Markets Act 2000 (Benchmarks) (Amendment) Regulations 2018 published

The Financial Services and Markets Act 2000 (Benchmarks) (Amendment) Regulations 2018 (SI 2018/204) have been laid before Parliament.

The regulations amend regulation 61 of the Financial Services and Markets Act 2000 (Benchmarks) Regulations 2018 (SI 2018/135), which makes transitional provision in respect of existing benchmark administrators, not currently regulated under the Financial Services and Markets Act 2000, who were administering benchmarks on or before 30 June 2016. The transitional provision in SI 2018/135 applies to existing benchmark administrators only in respect of benchmarks administered on or before 30 June 2016 and the purpose of the amendment in SI 2018/204 is to apply the transitional provision both to such benchmarks and to benchmarks administered after that date and during the transitional period in regulation 61.

The regulations came into force on 26 February 2018, before SI 2018/135 comes into force. This is to ensure that SI 2018/135 comes into force as amended by this instrument.

FCA publishes Dear CEO Letter on quality of prudential regulatory returns

The Financial Conduct Authority (FCA) has written a Dear CEO letter on the quality of prudential regulatory returns, noting that a significant number of firms submit returns that contain inaccurate and incomplete data. Common issues identified by the FCA include:

- failure to complete the underlying templates within the COREP submissions and inconsistent completion of COREP returns;
- failure to submit certain returns, such as the FINREP return;
- incorrect calculation of the total sum of risk exposures across various risk categories;
- reporting using incorrect units; and
- not reporting cumulatively (on a year-to-date basis) on the FSA002 income statement.

The FCA therefore requests that IFPRU investment firms and BIPRU firms review their regulatory reporting practices to ensure that they are fit for purpose, comply with the relevant reporting provisions and produce materially accurate data. From 1 October 2018, the FCA intends to review a sample of firms' returns and will consider next steps if it finds that firms are continuing to submit inaccurate, incomplete and/or poor quality data.

Treasury Committee launches digital currencies inquiry

The House of Commons Treasury Committee has launched an inquiry into digital currencies and distributed ledger technology (DLT).

The inquiry aims to investigate the role of digital currencies in the UK, including the opportunities and risks that digital currencies may bring to consumers, businesses, and the Government.

It intends to examine the potential impact of distributed ledger technology on financial institutions, including the central bank and financial infrastructure. It also intends to scrutinise the regulatory response to digital currencies from the Government, the Financial Conduct Authority (FCA), and the Bank of England, and how regulation could be balanced to provide adequate protection for consumers and businesses without stifling innovation.

Fintech: FCA consults on global sandbox

The FCA has launched a consultation on the creation of a global fintech sandbox.

The FCA's current sandbox only allows firms to conduct tests in the UK, while many aspects of fintech and financial markets are global. A global sandbox could potentially allow firms to conduct tests in different jurisdictions at the same time and allow regulators to work together and identify and solve common cross-border regulatory problems, through tests.

The FCA proposes that the global sandbox could focus on:

- inviting applicants to address pre-identified challenges, such as developing innovative solutions to anti-money laundering compliance and payment services that seek to transfer money cross-border;
- supporting specific firms with cross border ambitions across any sector; and
- seeking to address policy and regulatory challenges.

One option is that the global sandbox is initially set up as an international college of regulators who have their own innovation or sandbox models. Firms already working with those regulators would get access to multiple regulators. It would also mean that regulators could collectively share and learn from each other on new innovative business models.

Although the FCA has set out one view on how a global sandbox could be developed, it remains interested in other ideas and welcomes input on any and all aspects of moving towards a global sandbox.

Comments are due by 2 March 2018.

FCA issues call for input on use of technology to achieve smarter regulatory reporting

The FCA has issued a call for input on using technology to achieve smarter regulatory reporting.

In November 2017, the FCA and the Bank of England held a 'TechSprint' (a meeting of financial services providers, technology companies and subject matter experts) to examine how technology could be used to make it easier for firms to meet their regulatory reporting requirements and to improve the quality of information the firms provide. From this meeting, participants developed a 'proof of concept', which is intended to make regulatory reporting requirements machine-readable and executable. This would allow firms to map the reporting requirements directly to the data that they hold, therefore creating the potential for automated, straight-through processing of regulatory returns.

The call for input sets out the development of the 'proof of concept' and requests feedback on how the FCA could improve this process and, more generally, on the broader issues surrounding the role technology can play in regulatory reporting.

Comments are due by 20 June 2018 and the FCA intends to publish a feedback statement summarising the views received and the proposed next steps in Summer 2018.

FCA and CFTC sign fintech cooperation arrangement

The FCA and the Commodity Futures Trading Commission (CFTC) have signed a cooperation arrangement that commits the regulators to collaborating and supporting innovative firms through each other's financial technology initiatives (FCA Innovate and LabCFTC).

The cooperation arrangement focuses on information sharing regarding fintech market trends and developments. It also facilitates referrals of fintech companies interested in entering the others' market, and sharing information and insight derived from each authority's relevant sandbox, proof of concept, or innovation competitions.

The cooperation arrangement aims to facilitate responsible fintech innovation and ensure international collaboration on emerging regulatory best practices.

AMF concludes that offer of cryptocurrency derivatives requires authorisation and advertising such offers via electronic means is prohibited

Following an analysis of the legal categorisation of cryptocurrency derivatives, the Autorité des Marchés Financiers (AMF) has reached the conclusion that platforms which offer these products must comply with the authorisation and business conduct rules, and that these products must not be advertised via electronic means.

Over the past few months, the cryptocurrency boom has encouraged several online trading platforms to offer binary options, CFDs or Forex contracts with an end-of-day maturity (rolling spot forex), where the underlying is a cryptocurrency. Such contracts allow investors to bet on a cryptocurrency's rise or fall without holding the underlying.

The AMF has carried out a legal analysis of cryptocurrency derivatives. The AMF's process of reasoning is twofold: on the one hand, to determine the legal categorisation of the notion of a 'derivative' in the context of cryptocurrency derivatives and, on the other, to consider whether a cryptocurrency could legally be regarded as an eligible underlying. The notion of a 'derivative' is not defined in EU legislation as such. Within the MiFID framework, EU lawmakers only set out a list of derivatives (such as options, futures, swaps or forwards), followed by a list of eligible underlyings.

The AMF has concluded that a cash-settled cryptocurrency contract may qualify as a derivative, irrespective of the legal categorisation of a cryptocurrency.

As a result, online platforms which offer cryptocurrency derivatives fall within the scope of MiFID2 and must therefore comply with the authorisation, conduct of business rules, and the EMIR trade reporting obligation to a trade repository. In particular, these products are subject to the provisions of the Sapin 2 law, and notably the ban of advertisements for certain financial contracts.

AMF publishes position paper on review of European Supervisory Authorities

The AMF has published a position paper on the review of the European Supervisory Authorities (ESAs). In September 2017, the EU Commission published a legislative proposal to review the ESAs, to enhance their powers and to improve their governance and funding. The AMF supports the proposed reform and the Commission's objective of creating a stronger and more integrated European financial supervision for the Capital Markets Union.

ELTIF Regulation: Legislative Decree on implementation published

Legislative Decree no. 233 of 16 December 2017, which sets out rules intended to implement, and adjust Italian national legislation to, the provisions of the European Long-Term Investment Fund (ELTIF) Regulation, has been published in the Italian Official Gazette no. 36 of the 13 February 2018.

The decree will come into force on 28 February 2018.

Initial coin offerings: FINMA publishes guidelines

The Swiss Financial Market Supervisory Authority (FINMA) has published new guidelines regarding the supervisory and regulatory framework for initial coin offerings (ICOs). The guidelines supplement the earlier FINMA Guidance 04/2017 and provide further guidance on the submission of enquiries regarding ICOs and the categorisation of tokens.

In relation to token categories, FINMA has clarified that it will focus on the economic function and purpose and transferability of the token. Whether anti-money laundering (AML) and securities regulations apply to ICOs will depend on whether the tokens are classified as securities. FINMA has clarified that:

- payment tokens are not treated as securities – for ICOs where the token is intended to function as a means of payment and can already be transferred, FINMA will require compliance with AML requirements;
- utility tokens are not treated as securities if their sole purpose is to confer digital access rights to an application or service and if the token can be used in this way at the point of issue; and
- asset tokens are regarded as securities – therefore securities law requirements and civil law requirements under the Swiss Code of Obligations will apply to the trading of such tokens.

FINMA may publish a circular in the future to provide further guidance.

Subsidiary legislation to adjust scope of products regulated under OTC derivatives regime gazetted

The Hong Kong Government has gazetted the Securities and Futures (Stock Markets, Futures Markets and Clearing Houses) (Amendment) Notice 2018 and the Securities and Futures (OTC Derivative Products) Notice to adjust the scope of products regulated under the over-the-counter (OTC) derivatives regulatory regime in Hong Kong.

The two notices are intended to exclude the following products from the scope of OTC derivative products regulated under the Securities and Futures Ordinance (SFO):

- products traded on and cleared through additional markets and clearing houses prescribed; and
- delta one warrants, a certain type of call warrant with a strike price set at zero or close to zero.

The exclusion of these products from the regime is intended to help reduce compliance costs, as the excluded products are not typically regarded as OTC derivatives.

The two pieces of subsidiary legislation will be tabled before the Legislative Council for negative vetting on 28 February 2018. The government plans to put the subsidiary legislation into operation on 27 April 2018.

FSC to introduce comprehensive supervisory framework for financial conglomerates

The Financial Services Commission (FSC) has outlined a plan to introduce a comprehensive supervisory framework for financial conglomerates. The plan is intended to set out key policy tasks and principles for the supervision of financial conglomerates.

The key aspects of the framework include:

- the scope of application – the scheme will be applicable to any group of companies with financial affiliates of KRW 5 trillion or more in assets in at least two sectors of banking, insurance or securities;
- realignment of supervisory framework – a consultative body will be created to clarify responsibilities and facilitate coordination in group-wide supervision;

- reporting and disclosure requirements – a financial conglomerate under comprehensive supervision will be required to report its group-wide capital adequacy and aggregate risk management to the supervisory authorities on a regular basis and disclose the information to the public;
- comprehensive risk management system – a head of financial conglomerate will be identified as a representative company to take responsibilities for group-wide risk management;
- comprehensive assessment of capital adequacy – a financial conglomerate's capital adequacy will be assessed on a group-wide basis to limit excessive leverage;
- management of intra-group transactions, risk concentration, etc. – financial conglomerates will be subject to group-wide stress testing to assess the impact of risk contagion on financial affiliates in the event of a crisis, and they will be required to have a contingency plan for financial affiliates;
- assessment of contagion risks from non-financial activities – the FSC will develop and test an assessment program by the end of 2018 to evaluate the size and possibility of risk contagion in a financial conglomerate; and
- 'firewall' between financial and non-financial affiliates – the FSC will strengthen the 'firewall' measures between financial and non-financial affiliates to prevent a conflict of interests in governance, intra-group transactions and ownership structures.

The FSC has indicated that it will publish best practice guidelines for the comprehensive supervision of financial conglomerates in March 2018. Under the guidelines, a trial of the comprehensive supervisory scheme will be launched in the second half of 2018. Regulatory details will be finalised by the end of 2018. The FSC intends to submit a draft bill for comprehensive supervision to the National Assembly by the end of 2018, with the aim of phasing in the new supervisory framework in 2019.

MAS consults on draft regulations for mandatory trading of derivatives contracts

The Monetary Authority of Singapore (MAS) has launched a public consultation on draft regulations to operationalise the proposed new Part VIC of the Securities and Futures Act (SFA) on mandatory trading of over-the-counter (OTC) derivatives on organised markets. The move is one of the key reforms recommended by the G20 and Financial Stability Board and is intended to improve market transparency.

Amongst other things, the consultation paper seeks feedback on the following proposals:

- for the trading obligation to apply to interest rate swaps (IRS) with certain contract specifications and which are denominated in US Dollar, Euro and Pound Sterling;
- for the trading obligation to apply to banks that exceed a threshold of SGD 20 billion gross notional outstanding of OTC derivatives contracts booked in Singapore for each of the last four quarters;
- to exempt public bodies, including all central banks, governments and international multilateral organisations from the trading obligation;

- for the trading obligation to apply to banks (as described above) where the IRS (as described above) are traded in Singapore by both counterparties;
- to exempt intra-group transactions from the trading obligation; and
- to implement the amendments to the SFA and issue the regulations in Q3 2018. MAS proposes to allow appropriate time for market participants to make arrangements to access organised markets to meet the trading obligations. To that end, the MAS is seeking feedback on the trading facilities that market participants may access, or intend to access, for the trading of US Dollar, Euro and Pound Sterling IRS, as well as any other considerations and timing concerns that may affect market participants' ability to access trading facilities for the trading of such products.

The MAS has also stated that it proposes to subject IRS with certain contract specifications and which are denominated in Euro and Pound Sterling to clearing obligations.

Comments on the consultation paper are due by 23 March 2018.

SEC publishes guidance on preparing disclosures concerning cybersecurity risks and incidents

The US Securities and Exchange Commission (SEC) has published interpretive guidance concerning public companies' disclosure obligations with respect to cybersecurity risk and incidents. The guidance also addresses the application of disclosure controls and procedures, insider trading prohibitions, and selective disclosure prohibitions in the cybersecurity context.

RECENT CLIFFORD CHANCE BRIEFINGS

Indirect clearing – Part VII amended just in time for 3 January indirect clearing changes

Amidst the mass of legislation before Parliament at the end of 2017 and a pre-MiFID 2 rush, one technical legislative amendment was passed with particular relevance to the legal certainty of the financial market clearing infrastructure in the UK.

This briefing paper discusses the effect of the Companies Act 1989 (Financial Markets and Insolvency) (Amendment) Regulations 2017 (SI 2017 No. 1247), which amended Part VII of the Companies Act 1989 to extend protection from insolvency challenge under English law to certain indirect clearing arrangements.

https://www.cliffordchance.com/briefings/2018/02/indirect_clearingpartviiamendedjustintim.html

Supreme Court provides much-needed clarity to Dodd-Frank Act whistleblower status

On 21 February 2018, the US Supreme Court ruled that individuals who make internal disclosures of alleged unlawful activity – as opposed to those who report wrongdoing to the Securities Exchange Commission (SEC) – are not protected as 'whistleblowers' under the Dodd Frank Act, overturning the Ninth Circuit's holding in Somers v Digital Realty Trust Inc and resolving a hotly contested circuit split.

This briefing discusses the Supreme Court's decision, and comments on the much-needed clarity for businesses, which now have clear guidelines regarding who qualifies for 'whistleblower' protection.

https://www.cliffordchance.com/briefings/2018/02/supreme_court_providesmuch-neededclarityt.html

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