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INTERNATIONAL REGULATORY UPDATE 19 – 23 MARCH 2018

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MiFIR: ESMA issues opinion on treatment of packages under trading obligation for derivatives

The European Securities and Markets Authority (ESMA) has issued an opinion providing guidance on the treatment of packages under the trading obligation for derivatives. Package orders/transactions are composed of two or more financial instruments that are priced as a single unit, simultaneously executed, and where the execution of each component is contingent on the execution of all other components.

Article 28 of MiFIR introduced a requirement to trade derivatives that have been declared subject to the trading obligation in accordance with the procedure set out in Article 32 of MiFIR on regulated markets, multilateral trading facilities (MTFs), organised trading facilities (OTFs) or on equivalent third-country trading venues. During the development of draft RTS specifying the classes of derivatives subject to the trading obligation, ESMA decided that clarity was needed regarding the treatment of packages for the purposes of the trading obligation for derivatives.

The opinion clarifies the categories of packages for which the derivative components subject to the trading obligation are always required to be traded on a trading venue.

CRR: EBA reports on credit risk mitigation framework

The European Banking Authority (EBA) has published a report on the current Credit Risk Mitigation (CRM) framework set out in the Capital Requirements Regulation (CRR). The report is part of the EBA's roadmap on the Internal Ratings Based (IRB) approach, which also includes a review of supervisory practices, a harmonised definition of default and clarifications on modelling approaches to be used by institutions.

The report clarifies the application to the different credit risk approaches of the provisions currently laid down in the CRR regarding CRM. The report also highlights the limited guidance provided in the current CRR provisions on CRM under the Advanced-IRB (A-IRB) Approach.

The report also re-iterates the EBA's position regarding the three mandates for technical standards in the area of CRM identified in the CRR. These include:

- regulatory technical standards (RTS) on the recognition of conditional guarantees;
- RTS on liquid assets; and
- RTS on the internal models approach for master netting agreements.

The report states that these mandates only cover certain aspects of the regulatory framework and that fulfilling these three mandates, instead of undertaking an analysis of the overall CRM framework, would risk having disproportionate regulation with limited benefits.

FSB Chair sets out priorities to G20 Finance Ministers and Central Bank Governors

The Financial Stability Board (FSB) has published a letter from its Chair, Mark Carney, to G20 Finance Ministers and Central Bank Governors ahead of their meetings in Buenos Aires on 19-20 March.

The FSB's priorities are designed to reinforce the G20's objective of strong, sustainable and balanced growth through:

- vigilant monitoring to identify, assess and address new risks;
- disciplined completion of the G20's outstanding financial reform priorities;
- evaluating implemented policies to ensure the reform programme is efficient and effective, and addressing any unintended consequences; and
- optimising how the FSB works in order to maximise its effectiveness.

Basel Committee on Banking Supervision consults on minimum capital requirements for market risk

The Basel Committee on Banking Supervision (BCBS) has launched a consultation on revisions to the minimum capital requirements for market risk. The consultation aims to address issues that have been identified by the BCBS in monitoring the implementation and impact of the market risk standard issued in January 2016.

The proposed changes include:

- changes to the measurement of the standardised approach to enhance its risk sensitivity, including changes to FX risk;
- recalibration of standardised approach risk weights applicable to general interest rate risk, FX risk and equity risk;
- revisions to the assessment process to determine whether a bank's internal risk management models appropriately reflect the risks of individual trading desks;
- clarifications on the requirements for identification of risk factors that are eligible for internal modelling; and
- clarifications on the scope of exposures that are subject to market risk capital requirements.

The consultation also proposes a recalibration of the Basel II standardised approach for banks with less material market risk exposure.

Comments are due by 20 June 2018.

In addition, the BCBS has updated its frequently asked questions (FAQs) on market risk capital requirements. The FAQs address clarifications of the standardised approach, the internal models approach and the scope of application of the standard.

Basel Committee on Banking Supervision consults on Pillar 3 disclosure requirements

The BCBS has launched a consultation on the regulatory treatment of accounting provisions under Pillar 3 disclosure requirements. The consultation discusses a technical amendment to disclosure requirements for jurisdictions implementing an expected credit loss (ECL) accounting model and for those adopting transitional arrangements for the regulatory treatment of accounting provisions. The amendment is intended to provide disclosures that fully reflect any transitional effects for the impact of ECL accounting on regulatory capital. It also aims to provide further information on the allocation of accounting provisions in the regulatory categories of general and specific provisions for standardised exposures during the interim period.

Comments are due by 4 May 2018.

Brexit: UK and EU publish draft Withdrawal Agreement showing progress of negotiations following agreement on transition

HM Government and the EU Commission have both published the current text of the draft Withdrawal Agreement following EU-UK Article 50 negotiations in Brussels. The UK and EU reached agreement on a time-limited implementation or transition period during the negotiation round.

The colour-coded document indicates the areas where the text is:

- agreed at negotiators' level, and will only be subject to technical legal revisions in the coming weeks (highlighted green);
- agreed in terms of policy objectives but where drafting changes or clarifications are still required (highlighted yellow); and
- subject to ongoing negotiations (in white).

At a press conference following the negotiation round, the Secretary of State for Exiting the European Union, the Rt Hon David Davis MP, commented on the agreement reached on the transition. Among other things, the UK and EU have agreed that:

- international agreements which arise from the UK's membership of the EU will continue to apply during the period;
- a Joint Committee will be established to resolve concerns as they arise; and
- the agreement will be underpinned by a commitment from both sides to act in good faith.

The draft Withdrawal Agreement also sets out agreed chapters on citizens' rights and the financial settlement.

FCA consults on approach to supervision and enforcement

The Financial Conduct Authority (FCA) has published two approach documents on supervision and enforcement. The documents form part of the FCA's series of papers to set out its approach to regulation under the FCA Mission.

On supervision the FCA highlights that it is intelligence-driven and data-led, in order to take prompt and incisive action once harm has been identified. In particular, the document sets out the FCA's approach to:

- its role in ensuring fair and honest markets;
- why and how it prioritises supervision work; and
- the practicalities of supervision of regulated firms and individuals.

The paper on enforcement outlines how the FCA assesses harm, and how it uses its statutory powers to investigate and, where appropriate, take civil, criminal and/or disciplinary action where there has been contravention. The paper also notes that the FCA is currently reviewing its penalties policy and plans to consult on it later in 2018. The FCA also expects to review the whole of its Enforcement Guide for consultation in 2019.

Comments on the approach documents are due by 21 June 2018. The FCA intends to publish final versions of the papers later in 2018.

Fintech: FCA and ASIC sign enhanced cooperation agreement

The FCA and the Australian Securities and Investments Commission (ASIC) have signed an enhanced cooperation agreement to extend their existing agreement on cooperation and coordination on fintech innovation. This agreement forms part of the broader Fintech Bridge signed by the UK Chancellor of the Exchequer and the Australian Treasurer.

The FCA and ASIC have agreed to explore ways to quicken the licensing process in terms of the authorisation of innovative businesses that are already authorised in the other jurisdiction. Where a business is a participant in either authority's regulatory sandbox and would like to enter the other's, the FCA and ASIC will endeavour to facilitate that participation.

The FCA and ASIC will also look to:

- co-host fintech and regtech events;
- conduct joint policy work, research and experimentation;
- explore secondment opportunities; and
- raise topics or approaches of common interest at an international level to promote greater levels of international cooperation on financial innovation.

Fintech: HM Treasury publishes strategy

HM Treasury has published a policy paper on its strategy for the fintech sector. The policy paper sets out how the UK government plans to maintain and extend the UK's position in the fintech sector. It considers what further action can be taken to remove barriers to entry and growth faced by fintech firms in the UK and identifies areas of emerging opportunity offered by UK fintech.

In particular, the Fintech Sector Strategy includes:

- a Cryptoassets Task Force consisting of HM Treasury, the Bank of England (BoE), and the Financial Conduct Authority (FCA);

- robo-regulation pilot schemes to help new fintech firms, and the financial services industry more widely, comply with regulations, by building software which would automatically ensure they follow the rules;
- appointing three new Fintech Regional Envoys to ensure the benefits of fintech are felt across the UK;
- creating a set of industry standards which will enable fintech firms to partner with existing banks more easily;
- helping new, small fintech firms to provide complex financial services and thereby grow their businesses and reach new customers; and
- a Connect with Work programme developed by the government's Fintech Delivery Panel.

Fintech Committee established by Italian authorities

The Ministry of Economy and Finance has established a new Fintech Committee (Comitato di Coordinamento per il Fintech) in collaboration with the Bank of Italy, Consob (the Italian securities regulator), IVASS (the Italian insurance regulator), AGCM (the Italian anti-trust authority), the Italian data protection authority, the Digital Agency for Italy and the Italian tax authority. A memorandum of understanding has been entered into by these authorities.

The main intention of the Committee is to give full implementation to the EU Commission's Fintech Action Plan, which encourages Member States' own initiatives to ensure high levels of consumer protection, stability and competition with regard to new financial technologies.

Bank of Italy consults on new supervisory regulations on banks' investments in real estate assets

The Bank of Italy has launched a public consultation concerning new supervisory provisions intended to regulate banks' investments in real estate assets and on acquisitions of real estate assets for the purposes of collecting receivables. These provisions will be included in Bank of Italy Circular No. 285 of 17 December 2013 and will replace the provisions set out in Bank of Italy Circular no. 229/1999.

Comments are due by 18 May 2018.

PFSA issues opinion on provision of intermediary services in relation to disposal and repurchase of units in collective investment undertakings by banking sector entities

In relation to the passing of the Act Amending the Act on Trading in Financial Instruments and Certain Other Acts, which is intended, in particular, to implement the provisions of MiFID2 into Polish law, the Polish Financial Supervision Authority (PFSA) has issued an opinion on the provision of intermediary services in relation to the disposal and repurchase of units in collective investment undertakings by entities from the banking sector.

Bank of Spain maintains countercyclical capital buffer at 0%

The Bank of Spain (Banco de España) has decided to maintain at 0% the value of the countercyclical capital buffer (CCB) applicable to credit exposures in Spain in the second quarter of 2018.

This measure has been adopted pursuant to the powers granted to the Bank of Spain by Law 10/2014 on the regulation, supervision and solvency of credit institutions, and by Royal Decree 84/2015 and Bank of Spain Circular 2/2016 implementing that law.

According to the Bank of Spain, the analysis of the indicators warning of emerging systemic risk associated with excessive credit growth currently advises against setting the CCB above 0%. Other central indicators considered together support not activating the CCB for the moment.

Dutch bank creditor hierarchy legislative proposal published

The Dutch Ministry of Finance has submitted to the House of Representatives (Tweede Kamer) of the Netherlands its legislative proposal amending the ranking of certain unsecured debt instruments in insolvency proceedings, which implements the EU Directive (2014/59/EU) amending Article 108 of the Bank Recovery and Resolution Directive (BRRD). The legislative proposal amends the Dutch Bankruptcy Act.

The proposal introduces a layer of senior non-preferred (SNP) unsubordinated debt into Dutch law that ranks above subordinated debt but below other senior unsubordinated liabilities in insolvency. As such, the additional layer of SNP debt gives banks a statutory option to comply with the subordination requirement under the total loss-absorbing capacity (TLAC) standard and the minimum requirement for own funds and eligible liabilities (MREL).

The proposal is currently under review by the standing committee on finance (vaste commissie voor Financiën). Once approved by the House of Representatives, the proposal will be submitted to the Senate (Eerste Kamer) for final approval.

FINMA sets out expectations on implementing stay regulation for financial contracts

The Swiss Financial Market Supervisory Authority (FINMA) has issued FINMA Guidance 01/2018 'Implementation of the requirement for amending financial contracts (Art. 12 para. 2bis BO in conjunction with Arts. 56 and 61a BIO-FINMA)'.

Under Article 12 para. 2bis of the Banking Ordinance (BO) in conjunction with Article 56 Banking Insolvency Ordinance of FINMA (BIO-FINMA), banks may agree new financial contracts or amendments to existing financial contracts which are governed by foreign law or a foreign jurisdiction only if the counterparty recognises a stay on termination of contracts by FINMA.

This requirement must be met as of 1 April 2018 (Phase 1) for contracts with domestic and foreign banks and securities dealers and as of 1 October 2018 (Phase 2) for contracts with other counterparties.

FINMA notes that, in practice, amending the relevant contracts has proven to be a much more time-consuming task than had originally been assumed by the industry. In the absence of an amendment to a contract, it would be possible to comply with the new requirements by putting in place a trade stop. However, FINMA acknowledges that industry reports of the number of counterparties currently affected by trade stops of this kind indicate that such trade stops could significantly impact the Swiss financial centre.

FINMA has now clarified in its guidance that it is acceptable for banks to delay putting in place trade stops for a maximum of nine months after the expiration of the applicable implementation deadline where consent from the counterparty has not been obtained. However, banks should take appropriate measures to make the necessary amendments to relevant contracts as soon as possible.

HKMA announces launch of enhanced competency framework for anti-money laundering and counter-financing of terrorism

The Hong Kong Monetary Authority (HKMA) has issued a circular to announce the launch of the professional level of its enhanced competency framework (ECF) for anti-money laundering and counter-financing of terrorism (AML/CFT) on 3 April 2018. The ECF sets out the competency standards for AML/CFT practitioners in the Hong Kong banking industry. Further to the December 2016 launch of the core level targeting entry-level staff, the HKMA in collaboration with the banking sector has developed the professional level for more experienced practitioners. The Hong Kong Institute of Bankers (HKIB) is the administrator of the ECF.

The HKMA has also updated its guide to the ECF, which provides details of the application of the framework.

As the Supervisory Policy Manual module CG-6 ‘Competence and Ethnical Behaviour’ emphasises the importance of ensuring continuing competence of staff members, the HKMA encourages authorised institutions to adopt the ECF as a benchmark for enhancing the level of professional competence of banking practitioners responsible for AML/CFT compliance roles. Apart from supporting their staff to attend training and examinations that meet the ECF benchmark, authorised institutions are also advised to keep records of the relevant training and qualification of their staff and to provide them with the necessary assistance in relation to the applications for grandfathering, exemption and certification, and fulfilment of on-going continuing professional development training under the ECF. In its supervisory process, the HKMA will take into account the progress of implementation of the ECF by authorised institutions and their efforts in enhancing staff competence and on-going development.

JPX and TSE introduce artificial intelligence for market surveillance operations

The Japan Exchange Regulation (JPX-R) and the Tokyo Stock Exchange (TSE) have introduced artificial intelligence (AI) technology for market surveillance operations to detect market misconduct.

The deployed AI technology is intended to enable surveillance personnel to finish preliminary investigations more quickly and focus on detailed investigations. While the final decision on conducting such investigations will continue to be made by surveillance personnel, this initiative aims to facilitate more in-depth and detailed investigations and to improve their market monitoring functions, thereby protecting the fairness and credibility of the TSE market.

Japanese FSA approves second experimental deal under FinTech Experiment Hub

The Japanese Financial Services Agency (JFSA) has been providing a framework FinTech Experiment Hub (FE Hub) since September 2017, which allows fintech venture companies and financial institutions to test fintech related new business, whereby the JFSA will provide a support team for clearance and compliance solutions and clarify any ambiguity and the interpretation and application of regulations when such companies provide the tested services to the public in the future.

On 16 March 2018, as a second deal under the FE Hub, the JFSA approved the commencement of experiments by Dai Nippon Printing Co., Ltd. and The Nishi-Nippon City Bank, Ltd. regarding a know your customer (KYC) procedure using facial recognition technology which makes it possible to issue bank cards immediately. In Japan, one of the competent authorities regarding KYC and other anti-money laundering regulations is the National Police Agency (NPA) and the NPA will also be involved in the test under the FE Hub.

The first case treated under the FE Hub also related to the KYC process, and involved the testing of a shared KYC process among member financial institutions which allows a member financial institution to use the record or history of past KYC processes conducted by other member financial institutions. It was approved by the JFSA on November 2017 and the test is scheduled to continue until March 2018.

FSC to strengthen corporate governance rules for financial companies

The Financial Services Commission (FSC) has announced its plan to amend the Act on Corporate Governance of Financial Companies and its subordinate regulations to strengthen corporate governance rules for financial companies.

The plan focuses on the following four areas:

- **fitness and propriety of major shareholders** – the FSC will tighten the 'fit-and-proper' test for the largest shareholders of a financial company to verify whether those actually controlling the company are eligible to own a financial company;
- **transparency in chief executive officer (CEO) nomination** – to enhance transparency in the nomination of their CEO, financial companies will be required to strengthen their criteria and procedure for screening candidates, evaluate a pool of CEO candidates on a periodic basis, and report the results to shareholders;
- **effectiveness in compliance and internal controls** – full-time auditors and audit committee members will be restricted from serving for more than a certain period of time (e.g. six years) at the same company. To make sure audit committee members concentrate on their duty, they will be prohibited from holding concurrent positions in any sub-committee within the board of directors. Further, to strengthen internal controls and compliance with risk management, financial companies' executives and employees including the CEO, compliance officer and risk management officer will be held accountable for poor compliance; and

- **public disclosure of remuneration schemes** – financial companies' remuneration schemes will come under greater scrutiny by shareholders and financial consumers to prove whether their executives and employees deliver performance and values that correspond to their remuneration. Further, financial companies will be required to disclose the remuneration of executives and employees that exceeds certain thresholds.

The FSC has indicated that it will submit its proposal for amendments to the Act on Corporate Governance of Financial Companies to the National Assembly within the first half of 2018.

FSC proposes amendments to Financial Investment Services and Capital Markets Act

The FSC has proposed amendments to the Financial Investment Services and Capital Markets Act. The proposed amendments are intended to relax certain investment restrictions on private equity funds, reduce the compliance burden for collective investment scheme (CIS) operators, and help investors make informed decisions.

The key proposals include the following:

- CIS operators may deliver fund account statements to investors every six months instead of every three months;
- the classes of securities not open to investment by private equity funds will be limited to equity securities with voting rights so that private equity funds may invest in convertible preferred stocks and redeemable convertible preferred stocks; and
- for enhanced investor protection, CIS operators will be required to file disclosures on remuneration for investment managers and their performance to investors.

Comments on the proposed amendments are due by 18 April 2018.

FSC proposes amendments to Enforcement Decree of Financial Investment Services and Capital Markets Act

The FSC has proposed amendments to the Enforcement Decree of the Financial Investment Services and Capital Markets Act (FSCMA). The proposed amendments are intended to encourage financing for startups and small and medium-sized enterprises through crowdfunding, and strengthen registration rules for investment advisors for enhanced investor protection.

The key proposals include the following:

- crowdfunding will be subject to the relevant provisions under the FSCMA and open to businesses other than financial firms, insurance providers, real estate businesses, and entertainment establishments; and
- the minimum capital requirements for companies offering investment advisory and discretionary investment services will be determined at the end of each month instead of the end of the year. The length of the period during which compliance with the minimum capital requirement is recognised will be shortened from one year to six months.

Comments on the proposed amendments are due by 18 April 2018.

New US Executive Order prohibits US persons dealing in Venezuelan virtual currency

President Trump has issued an Executive Order effective 19 March 2018 prohibiting the involvement of US persons and the US financial system in all 'transactions related to, provision of financing for, and other dealings in […] any digital currency, digital coin or digital token' issued by, for or on behalf of the Venezuelan government after 8 January 2018. The President has issued the Executive Order in response to attempts by the Maduro government to circumvent US financial sanctions issued in August 2017 against the Government of Venezuela and Petróleos de Venezuela by issuing a digital currency. The US Treasury Department's Office of Foreign Assets Control (OFAC) has released new FAQs related to the Executive Order confirming that US persons are prohibited from engaging in transactions related to Venezuelan 'Petros', 'Petro-Gold' and any other digital currency issued by the Government of Venezuela absent a specific license from OFAC.

OFAC has also issued a set of FAQs on virtual currency generally, which, among other things, provides guidance that US persons are required to block virtual currency that is the property of OFAC Specially Designated Nationals (SDNs) and entities owned 50% or more directly or indirectly by SDNs.

RECENT CLIFFORD CHANCE BRIEFINGS

Unintended targets — the surprising breadth of the proposed new EU digital services tax

The European Commission has published a proposal for a new pan-EU Digital Services Tax (DST). The proposal would apply a 3% tax on the gross revenues of a wide range of businesses.

The intended target is primarily the large US digital businesses, but the scope of the tax is surprising. Many large digital businesses would not be subject to the DST, but many more traditional businesses would be, both B2B and B2C.

In particular, all internet advertising sales by large businesses would be subject to the DST — and the broad scope of the DST charge on 'multilateral interfaces' means that it may also apply to many financial services.

This briefing paper summarises the new proposal and its impact on business. It also identifies a potentially serious impact of the DST on the privacy of internet users.

https://www.cliffordchance.com/briefings/2018/03/unintended-targets--the-surprising-breadth-of-the-proposed-new-e.html

UK nationalisation – the law and the cost

Nationalisation is on the agenda in the UK. The Labour Party says that, if it wins the next general election, it will nationalise the railways, water and energy companies, the Royal Mail and possibly private finance initiative (PFI) companies.

Nationalisation for less than full market value will, almost inevitably, trigger compensation claims by investors. The investors likely to have the best chance of launching a successful claim are those based in a jurisdiction that is party to an investment treaty with the UK, including, for example, China, Hong

Kong and Singapore. Investors who do not benefit from investment treaty protection, including UK investors, would have a potential claim under the Human Rights Act 1998 and/or the European Convention on Human Rights, but these claims are likely to face greater challenges. However, UK and other investors may benefit collaterally by virtue of another investor bringing a successful investment treaty claim. The UK Government may not want to pay higher compensation to a foreign investor than to a UK pension fund. Hence the final result may be that there is little practical choice but to offer the higher value to all.

This briefing paper considers how, as a legal matter, nationalisation would work, and the legal constraints that may limit a Government's ability to nationalise for less than full market value.

https://www.cliffordchance.com/briefings/2018/03/uk_nationalisationthelawandthecost.html

FCA sets out its approach to enforcement

In April 2017, the FCA published its Mission and committed to giving further details about how it proposes to regulate firms and individuals in the financial services sector. On 21 March 2018, it published a consultation paper setting out its approach to enforcement (alongside a separate paper detailing its approach to supervision).

This briefing paper sets out the key take-away points from the FCA's enforcement approach document.

https://www.cliffordchance.com/briefings/2018/03/fca_sets_out_itsapproachtoenforcement.html

Germany proposes harsher penalties for corporates

The long-awaited coalition agreement in Germany may have important implications for the law on corporate penalties. Under current proposals, the maximum amount of pecuniary penalties which may be imposed will increase to 10% of a corporate's revenue. The plans also include incentives to cooperate with authorities and new rules in relation to internal investigations.

No single party secured a majority in the German parliamentary election in September 2017, leading to the formation of a coalition between the Christian-Democratic Union (CDU), Christian-Social Union in Bavaria (CSU) and the Social-Democratic Party (SPD). The coalition partners presented their coalition contract on 7 February 2018. Amongst the important features of this contract are proposals for comprehensive reform of the law on the penalties which may be imposed on corporates (in particular in relation to criminal misconduct committed by employees) and separate new regulations governing the judiciary.

This briefing paper reviews the proposals and their implications for companies.

https://www.cliffordchance.com/briefings/2018/03/germany_proposesharsherpenaltiesforcorporates.html

Mexico passes groundbreaking FinTech Act

On 1 March 2018, the Mexican Congress passed the Financial Institutions Act (Ley para Regular las Instituciones de Tecnología Financiera) (the FinTech Act) for, among others, the regulation of FinTech firms and crypto-currency transactions.

The FinTech Act was designed on the principles of financial inclusion, customer protection and competition, and also takes into account anti-money laundering and terrorist financing (AML/CFT) risks associated with these new products and services. The FinTech Act primarily regulates two types of FinTech firms or platforms: (i) crowdfunding companies, which serve as platforms to connect entrepreneurs with investors and fund new ventures on an equity-base, debt-base and royalty-base and (ii) e-money companies, which will render, through digital means, electronic payment services of 'fiat currency' or 'crypto-currencies.'

This briefing paper discusses the act.

https://www.cliffordchance.com/briefings/2018/03/mexico_passes_groundbreakingfintechact.html