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INTERNATIONAL REGULATORY UPDATE 13 – 17 AUGUST 2018

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Benchmarks: Respondents to ECB consultation support ESTER as EONIA replacement

The European Central Bank's (ECB's) working group on euro risk-free rates has published a summary of responses to its consultation on candidate euro risk-free rates to replace the Euro OverNight Index Average (EONIA).

The consultation asked for feedback on the working group's assessment of the advantages and disadvantages of three candidate euro risk-free rates. According to the feedback received:

- 88% of respondents viewed the euro short-term rate (ESTER) as the most appropriate future euro risk-free rate, predominantly on the grounds of its unsecured nature, compilation methodology and low volatility, as well as the fact that the ECB is the administrator;

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If you would like to know more about the subjects covered in this publication or our services, please contact:

International Regulatory Group Contacts

Chris Bates +44 (0)20 7006 1041

Gareth Old +1 212 878 8539

Marc Benzler +49 69 7199 3304

Steven Gatti +1 202 912 5095

Paul Landless +65 6410 2235

Mark Shipman + 852 2826 8992

Donna Wacker +852 2826 3478

International Regulatory Update Editor

Joachim Richter +44 (0)20 7006 2503

To email one of the above, please use firstname.lastname @cliffordchance.com

Clifford Chance LLP,
10 Upper Bank Street,
London, E14 5JJ, UK
www.cliffordchance.com

- respondents generally concurred with the working group's conclusion that ESTER is the most reliable and robust, and the most appropriate, unsecured candidate for the euro risk-free rate; and
- respondents largely shared the conclusion of the working group that the GC Pooling Deferred Funding Rate and the RepoFunds Rate are the most reliable and robust secured candidate rates.

The working group plans to make its recommendation on the new euro risk-free rate in autumn 2018.

ECON Committee publishes draft report on proposed crowdfunding regulation

The EU Parliament Committee on Economic and Monetary Affairs (ECON) has published its draft report on the proposal for a regulation on European Crowdfunding Service Providers (ECSPs) for Business.

The EU Commission is seeking to enable crowdfunding platforms to offer their services throughout Europe and to unlock early stage financing for businesses through its proposal for a Crowdfunding Regulation and its proposal to amend MiFID2. The proposal for a Crowdfunding Regulation is the first deliverable of the EU Commission's Action Plan on how to harness the opportunities presented by technology-enabled innovation in financial services (fintech).

Overall, the draft report welcomes the EU Commission's proposal, but recommends a number of changes to improve the proposed regulation, particularly concerning:

- the threshold for crowdfunding offers that fall under the scope of the CSPs;
- the responsibility of national competent authorities (NCAs);
- the differentiation between simple and complex crowdfunding structures;
- the expansion of scope to initial coin offerings; and
- the level playing field towards third-country crowdfunding platforms.

Luxembourg bill on inactive accounts, inactive safe-deposit boxes and unclaimed insurance payments published

A new bill on inactive accounts, inactive safe-deposit boxes and unclaimed insurance payments has been lodged with the Luxembourg Parliament.

The aim of the bill is to define a specific legal framework in relation to inactive accounts, inactive safe-deposit boxes and unclaimed insurance payments. The bill is inspired by the regimes that exist in France and Belgium.

The proposed legal framework is intended to:

- improve the customers' and beneficiaries' position by facilitating the search for their accounts, safe-deposit boxes and insurance contracts; and
- provide clarity and legal certainty to banks and insurance companies by specifying their obligations.

The bill also reinforces the legal framework fighting against money laundering and terrorism financing (ML/TF) as inactive accounts potentially bear a higher ML/TF risk.

To prevent the situation of inactive accounts or safe-deposit boxes and of unclaimed insurance payments, the bill imposes on banks and insurance companies an obligation to contact their costumers on a regular basis, inform them of the consequences of inactivity, and, if needed, to carry out additional research in order to find the customer or beneficiary.

If the attempts to contact the customer or beneficiary have not been successful, the bank or insurance company must transfer the relevant assets to the Consignment Office (Caisse de consignation). In the case of safe-deposit boxes, the Consignment Office must preserve them for 50 years. For any other asset, the customer or beneficiary has 30 years to contact the Consignment Office.

In order to simplify the research by customers and beneficiaries (as successors thereof), the bill also foresees the establishment of a centralised electronic register for any asset that is transferred to the Consignment Office. The register can be consulted by the relevant persons who can demonstrate their right to the assets transferred to the Consignment Office (including, as the case may be, heirs and other successors).

The Luxembourg financial sector supervisory authority (Commission de Surveillance du Secteur Financier), the Luxembourg insurance sector supervisory authority (Commissariat aux Assurances), and the Consignment Office are in charge of supervising, applying, and enforcing the new provisions.

The lodging of the bill with the Parliament constitutes the start of the legislative procedure.

Central Bank and BRSA of Turkey take measures to ease financial markets

The Central Bank has introduced a series of measures intended to support financial stability and sustain the effective functioning of markets.

In particular, as regards TRY liquidity management:

- in the framework of intraday and overnight standing facilities, the Central Bank will provide all the liquidity banks need;
- discount rates for collateral against TRY transactions will be revised based on type and maturity to provide banks with flexibility in their collateral management;
- collateral FX deposit limits for TRY transactions of banks are raised to EUR 20 billion from EUR 7.2 billion;
- as indicated in the Monetary and Exchange Rate Policy Text for 2018, when deemed necessary, in addition to one-week repo auctions traditional repo auctions or deposit selling auctions may be held with maturities no longer than 91 days;
- for days with relatively higher funding needs, more than one repo auction may be conducted with maturities between 6 and 10 days; and
- to provide flexibility in banks' collateral management, upon the request of banks, a portion of or the entire amount of the winning bids in one-week repo auctions will be allowed to be used in deposit transactions instead of repo transactions at the Central Bank Interbank Money Market with the same interest rate and maturity.

As regards FX liquidity management:

- banks will be able to borrow FX deposits in one-month maturity in addition to one-week maturity;
- the Central Bank will resume its intermediary function in the FX deposit market, so that banks will be able to borrow from and lend to each other in the FX deposit market as per the rules set by the Implementation Instructions on the Foreign Exchange and Banknotes Markets;
- banks' current foreign exchange deposit limits of around USD 50 billion may be increased and utilisation conditions may be improved if deemed necessary; and
- banks will continue to purchase foreign banknotes from the Central Bank via FX transactions within their pre-determined limits at the Foreign Exchange and Banknotes Markets.

The Central Bank also intends closely to monitor market depth and price formation, and take all necessary measures to maintain financial stability. Further, the Central Bank has reduced TRY reserve requirement ratios by 250 basis points for all maturities and reserve requirement ratios for non-core FX liabilities by 400 basis points for up to (and including) 1-year, up to (and including) 2-year and up to (and including) 3-year maturities and accordingly the reserve requirement ratios have become 20%, 15% and 10% respectively.

In addition, the maximum average maintenance facility for FX liabilities has been raised to 8% and from now on EUR can be used (along with USD) for the maintenance against TRY reserves under the reserve options mechanism.

The Banking Regulation and Supervision Agency (BRSA) also announced that the total notional principle amount of banks' currency swaps and other similar products (spot + forward FX transactions) with foreign counterparties where at the initial date local banks pay TRY and receive FX should not exceed 50% of a bank's regulatory capital. In this regard, unless the current excess is eliminated, no further transactions of these types could be executed and maturing transactions should not be renewed.

The BRSA has since tightened these measures by decreasing the above rate from 50% to 25%. Accordingly, the total notional principle amount of banks' currency swaps and other similar products (spot + forward FX transactions) with foreign counterparties where at the initial date local banks pay TRY and receive FX should not exceed 25% of the bank's regulatory capital. This ratio should be calculated daily on a consolidated and individual basis.

BRSA facilitates loan restructurings

The BRSA has amended the Regulation on Credit Classification and Provisioning Rules and Procedures in a bid to expedite restructurings. Through the amendment, the BRSA has allowed loans in the second group (loans and other receivables under close monitoring) to be treated as first group loans (loans of a standard nature and other receivables). It has also relaxed the conditions required to be met for loans to remain in the first group.

Banks are required to classify their loans and receivables in one of the five groups outlined in the Regulation. These groups differ from each other in terms of the performance of the loans. With the amendment, the monitoring period of the loans in the second group is reduced from 1 year to 3 months and the condition requiring the payment of at least 10% of interest and

principal of the loans has been revoked. However, the other two conditions, which are that (i) interest and principal payments should not be delayed by more than 30 days and (ii) the conditions for restructuring (i.e. financial difficulty) should not exist, would still be applicable to the loans in the second group. Furthermore, only banks who have adopted Turkish Financial Reporting Standard 9 (similar to IFRS 9) can benefit from this amendment.

The treatment of loans in the second group as first group loans would allow banks to maintain less reserves for these loans and accordingly their capital adequacy ratio will increase, and they will have greater flexibility.

As mentioned above, the amendment also eases the conditions required to be met for loans to remain in the first group. The Regulation requires that any loans which have been subject to restructuring, including loans in the first group, are classified as being in the second group. The amendment stipulates that the change of conditions of contract and/or partial or full refinance of a loan in the first group will not be regarded as a restructuring, provided that the borrower is not in financial difficulty. Accordingly, banks are no longer required to treat these loans as being in the second group and therefore these loan may still be classified as first group loans.

Overall, banks now have the ability to treat certain loans as being in the first group, which will allow more room for restructuring and provide certain capital relief to banks.

SFC consults on proposed guidelines for securities margin financing activities

The Securities and Futures Commission (SFC) has launched a public consultation on proposed guidelines to clarify, codify and standardise the risk management practices for securities margin financing (SMF). The proposed guidelines provide qualitative guidance as well as quantitative benchmarks for margin lending policies and key risk controls to prevent SMF brokers from expanding margin loans beyond their financial capability.

Key proposals include requiring SMF brokers to put in place prudent controls to prevent excessive leverage and over concentration both in terms of securities collateral and individual margin clients. Brokers would also be required to set and enforce specific policies for margin calls and conduct stress tests at least monthly. In addition, the proposed guidelines set out clearer guidance for haircuts for securities acceptable as collateral.

Comments on the consultation are due by 18 October 2018.

HKEX consults on proposed changes to review structure for listing committee decisions

The Stock Exchange of Hong Kong Limited (SEHK), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEX), has launched a public consultation on its proposed changes to the review structure in relation to Listing Committee (LC) decisions. The proposed changes are intended to enhance governance within the SEHK's structure for reviewing LC decisions and promote transparency, accountability and consistency in decision-making.

The review structure consultation is the separate consultation as mentioned in the joint consultation conclusions on 'Proposed Enhancements to the SEHK's Decision-Making and Governance Structure for Listing Regulation' published

by the SEHK and the Securities and Futures Commission (SFC) in September 2017.

In particular, the SEHK proposes to:

- revise the current two-level review structure for decisions of material significance made by the LC so that those decisions will be subject to only one level of review and discontinue the Listing Appeals Committee (LAC);
- establish a new independent review committee (new Review Committee) consisting entirely of outside market participants with no current LC members or representatives of the SFC or HKEX to replace the Listing (Review) Committee and the Listing (Disciplinary Review) Committee; and
- enhance the transparency and accountability of the SEHK's decision-making process - decisions of the new Review Committee for non-disciplinary matters will be routinely published.

In addition, as stated in the joint conclusions, the proposal to codify paragraph 10.6 of the memorandum of understanding governing listing matters between the SFC and the SEHK dated 28 January 2003 (as supplemented by the first addendum dated 9 March 2018) will be adopted with the reference to the LAC deleted. The consultation paper provides details regarding provisions for the SFC's power to request a consideration or review of any matter, including a decision of the LC by the new Review Committee.

Comments on the consultation paper are due by 12 October 2018.

HKMA announces mystery shopping programme in respect of sale of investment and insurance products

The Hong Kong Monetary Authority (HKMA) has announced that it will institute a mystery shopping programme (MSP) on authorised institutions' selling practices in respect of investment products and insurance products. The MSP, which is expected to commence shortly, is intended to ascertain the practices of authorised institutions in customer risk profiling, financial needs analysis (as applicable to life insurance products), suitability of recommendations, and product and risk disclosure.

The HKMA has engaged a service provider to undertake the MSP. Any industry-wide issues and good practices identified through the MSP will be shared with the industry as appropriate.

APRA proposes changes to improve transparency, comparability and flexibility of ADI capital framework

The Australian Prudential Regulation Authority (APRA) has released for consultation a discussion paper on potential approaches to improve transparency, comparability and flexibility of the authorised deposit-taking institution (ADI) capital framework. The proposed approaches are intended to focus on amending disclosure requirements and the way in which ADIs would be required to calculate and report capital ratios, without altering the quantum and risk sensitivity of capital requirements.

In particular, the discussion paper outlines two general approaches designed to aid ADIs in representing and communicating their capital strength:

- under one approach, ADIs would continue using existing definitions of capital and risk-weighted assets, but APRA would develop a methodology

allowing them to improve the credibility and robustness of internationally comparable capital ratio disclosures; or

- under a second approach, APRA would change the way ADIs calculate capital ratios to instead use more internationally harmonised definitions of capital and risk-weighted assets - to maintain the strength and risk-sensitivity of the capital framework, there would need to be corresponding increases in minimum ratio and/or capital buffer requirements.

APRA has indicated that it is open to considering the approaches independently or in combination, or indeed retaining its current methodology, and is seeking industry feedback on whether the benefits of the suggested approaches outweigh the regulatory burden and associated increase in complexity.

In addition, the discussion paper proposes measures to make the capital framework more flexible in times of stress, including by increasing the size of regulatory capital buffers relative to minimum regulatory capital requirements.

Comments on the discussion paper are due by 2 November 2018.

RECENT CLIFFORD CHANCE BRIEFINGS

The New Legal Landscape for Cross-Border Investment in the United States - What Investors in Europe and Asia Need to Know

As part of President Trump's continuing trade policies and the US government's efforts to restrict foreign control of US national security and infrastructure assets - with particular attention to China - President Trump has signed legislation imposing significant new restrictions on inbound investment into the United States. While the final version of the legislation, entitled the Foreign Investment Risk Review Modernization Act (FIRRMA), did not go as far as earlier drafts considered by Congress or some of the statements made by legislators, it does intensify the foreign investment review process run by the Committee on Foreign Investment in the United States (CFIUS) in important ways.

This briefing discusses the final version of the legislation.

https://www.cliffordchance.com/briefings/2018/08/the_new_legal_landscapefor cross-borde.html

Pros and Cons of the OCC's New Fintech Charter

On 31 July 2018 the Office of the Comptroller of the Currency (the OCC) announced that it will begin to accept special purpose national bank charter applications from financial technology (FinTech) companies. Concurrently, the OCC published a Policy Statement on Financial Technology Companies' Eligibility to Apply for National Bank Charters and Comptroller's Licensing Manual Supplement: Considering Charter Applications from Financial Technology Companies. The OCC special purpose national bank charter for FinTech companies may be attractive to FinTech companies that provide or intend to provide technology-enabled lending and/or payment services.

This briefing outlines the pros and cons of the OCC FinTech Charter, along with certain other observations and considerations of an alternative to that charter.

https://www.cliffordchance.com/briefings/2018/08/pros_and_cons_oftheoccsnewfintechcharter.html

Treasury Issues Report Regarding Nonbank Financials, Fintech, and Innovation - Residential Mortgage Lending

The US Department of the Treasury has released a fourth report in its series on the core principles for regulating the US financial system. This report, entitled 'A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation', analyses and provides recommendations for the regulation of nonbank financial companies, the fintech sector and other forms of financial market innovation through the lens of the core principles. Thematically, the report primarily addresses the following two core principles:

- making regulation efficient, effective, and appropriately tailored; and
- enabling American companies to be competitive with foreign firms in domestic and foreign markets.

Clifford Chance has prepared a briefing paper discussing the Treasury's recommendations regarding residential mortgage lending. Specifically, the report highlighted several areas of potential improvement for the residential mortgage industry, including adapting to the increase in non-bank participation, addressing regulatory challenges which discourage market participation or otherwise hinder the industry, and encouraging the adoption of available technological improvements.

https://www.cliffordchance.com/briefings/2018/08/treasury_issues_reportregardingnonban0.html

A Fintech Regulatory Sandbox - The Treasury's Modest Proposal

This briefing discusses the Treasury's 'regulatory sandbox' proposal in its report 'A Financial System That Creates Economic Opportunities: Nonbank Financials, Fintech, and Innovation'.

Although short on specifics, the report affirms the Treasury's commitment in principle to the establishment of a regulatory sandbox for innovative fintech companies, in coordination with other federal and state regulators; and even goes so far as to recommend that if voluntary efforts to persuade state regulators to join are unavailing, Congress should legislatively override such resistance through federal preemption.

https://www.cliffordchance.com/briefings/2018/08/treasury_issues_reportregardingnonban.html

The Insider Information Law - Now It Is Serious

On 3 August 2018 numerous amendments to Federal Law No. 224-FZ On Combating Unlawful Use of Insider Information and Market Manipulation were published. The amendments will take effect on 1 May 2019.

This briefing summarises some of the key amendments that will have a game changing impact on the market.

https://www.cliffordchance.com/briefings/2018/08/the_insider_informationlawnowitisseriou0.html

C L I F F O R D

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Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

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