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MiFID2: EU Commission signals intention to amend ESMA's draft amendment to RTS 1

The EU Commission's Directorate-General for Financial Stability, Financial Services and Capital Markets Union has published a communication to the Commission on the intention to endorse the draft amendments to regulatory technical standards 1 (RTS 1) under MiFID2, which were drafted by the European Securities and Markets Authority (ESMA). Annexed to the communication, which is dated 10 August 2018, is a draft letter to Steven Maijoor, ESMA Chair, setting out the changes requested by the Commission.

The draft RTS 1 amendment submitted by ESMA seeks to introduce transparency requirements for trading venues and investment firms in respect of shares, depository receipts, exchange-traded funds, certificates and other similar financial instruments. The Commission proposes to endorse ESMA's draft once changes, made in respect of the issues summarised below, are introduced:

- the co-legislators did not provide that quotes of systematic internalisers would need to respect tick size increments. Technical standards cannot be employed to achieve this result;
- there is evidence that not applying tick sizes to shares and depositary receipts risks negative repercussions on the liquidity in those two asset classes and quoting prices outside the tick size increments might also hinder the efficient valuation and pricing of shares and depositary receipts. As efficient price formation is an important feature underpinning the introduction of tick size increments, systematic internalisers quoting prices for shares and depositary receipts below the standard market size should respect tick size increments in order to accurately reflect prevailing market conditions; and
- confining the proposed amendments to shares and depositary receipts addresses concerns about efficient price formation while remaining in line with the legislative intent not to introduce a general obligation that all quotes by systematic internalisers have to respect the tick size increments.

SFTR: ESMA publishes opinion rejecting Commission proposals to amend technical standards on reporting

ESMA has published an opinion in response to the EU Commission's proposed amendments to the draft technical standards on reporting under the Securities Financing Transactions Regulation (SFTR), which relate to provisions on the use of legal entity identifiers (LEI) for branches and unique transaction identifiers (UTI) for reporting to trade repositories. Overall, ESMA has declined to amend the draft technical standards following the Commission's letter dated 24 July 2018.

ESMA takes the view that the Commission's proposals would:

- hinder the possibility to take into account international developments and reporting standards agreed at global level;
- deviate from and create inconsistency with the currently applicable EMIR reporting standards;

- not provide certainty, clarity, predictability and consistency, which is essential for the market and public authorities in relation to reporting standards; and
- result in a significantly extended timeline for the introduction of global standards in the EU.

ESMA has issued its opinion under the ESMA Regulation, which requires it to adopt a formal opinion on proposed amendments to its draft technical standards by the EU Commission within a six-week period.

CRR: ECB consults on risk-type-specific chapters of guide to internal models

The European Central Bank (ECB) has launched a consultation on the credit risk, market risk and counterparty credit risk chapters of its guide to internal models. Under the Capital Requirements Regulation (CRR), the ECB is required to grant permission to use internal models for credit risk, counterparty credit risk and market risk where the requirements set out in the corresponding chapters of the CRR are met by the institutions concerned. The ECB's guide to internal models is intended to provide transparency on how the ECB understands those rules and how it intends to apply them.

The ECB published a first version of the guide on 28 February 2017. The ECB has updated the guide in line with the targeted review on internal models (TRIM) and, as such, launched a consultation on the general topics chapter in March 2018 and is now consulting on the risk-type-specific chapters.

Comments on the consultation are due by 7 November 2018.

ESAs report on automation in financial advice

The Joint Committee of the European Supervisory Authorities (ESAs), which comprise the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and ESMA, has published a report on the results of the monitoring exercise on automation in financial advice. The ESAs launched the exercise, which analysed the evolution of automatic in financial advice in the securities, banking and insurance sectors over the past two years through a survey of national competent authorities (NCAs), following publication of a discussion paper in 2015 and report in 2016.

Overall, the ESAs found that:

- the risks and benefits already identified in the previous reports were largely confirmed by the analysis;
- automation in financial advice is slowly growing but remains limited; and
- services being offered are largely through partnerships between established financial intermediaries rather than by pure fintech firms.

The ESAs take the view that the limited growth of automation of financial advice and lack of materialisation of identified risks means there is no need to take immediate action. A new monitoring exercise will be carried out if or when the development of the market and market risks warrant such work.

Brexit: SIs under the EU (Withdrawal) Act for 3 - 7 August 2018

HM Government published new draft statutory instruments (SIs) under the EU (Withdrawal) Act 2018 last week.

The draft EEA Passport Rights (Amendment, etc., and Transitional Provisions) (EU Exit) Regulations 2018, which amend the Bank of England Act 1998 and Financial Services and Markets Act 2000, among others, have been laid before Parliament.

HM Treasury also published the draft Electronic Money, Payment Services and Payment Systems (Amendment and Transitional Provisions) (EU Exit) Regulations 2018 and draft Credit Transfers and Direct Debits in Euro (Amendment) (EU Exit) Regulations 2018. These SIs will make amendments to the Payment Services Regulations (PSRs), Electronic Money Regulations (EMRs) and retained EU law related to the SEPA Regulation, to ensure that they continue to operate effectively in the UK once the UK has left the EU. The draft instruments are still in development and are intended to provide Parliament and stakeholders with further details on HM Treasury's approach to onshoring financial services legislation. The drafting approach, and other technical aspects of the proposal, may change before the final instrument is laid before Parliament. HM Treasury intends to lay these SIs before Parliament in the autumn.

Rules governing central counterparties, central securities depositories and central depository services published in Italian Official Gazette

On 13 August 2018, the Bank of Italy and the Commissione Nazionale per le Società e la Borsa (Consob) issued a joint regulation on post-trading, introducing new rules governing central counterparties, central securities depositories and central depository services. This new regulation replaces the previous regulation dated 22 February 2008.

Following the entry into force of the European Market Infrastructure Regulation (EMIR) and the Central Securities Depositories Regulation (CSDR), Italy's primary legislation on post-trading, set out in Legislative Decree No. 58/1998 (the Italian Financial Act), was given a comprehensive review. It was therefore necessary to adjust Italy's secondary legislation as well, to bring it in line with the relevant European regulations. The main new feature of these rules is the revision of the reporting requirements to the supervisory authorities, which will only affect central counterparties and central securities depositories.

The joint regulation may be subject to a further, more extensive review covering the activities of intermediaries authorised to maintain securities accounts, once the Italian legislation has been updated to reflect the changes introduced by Directive (EU) 2017/828 amending Directive 2007/36/EC (Shareholders' Rights Directive).

CSSF issues circular on organisational arrangements of depositaries of Luxembourg non-UCITS funds

The Luxembourg financial sector supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), has issued a circular (18/697) concerning the organisational arrangements of depositaries of Luxembourg investment funds other than those subject to the UCITS depositary regime (Non-UCITS), including but not limited to Luxembourg Full Scope AIFs (i.e. alternative investment funds (AIFs) managed by an authorised and fully licensed alternative investment fund manager (AIFM)).

To a large extent, Circular 18/697 mirrors the structure of Circular 16/644 concerning the depositary regime of Luxembourg UCITS. However, certain requirements of Circular 18/697 differ from those of Circular 16/644 to take into account the specifics of the type and legal regime of the relevant Non-UCITS funds concerned.

Circular 18/697 provides for common clarifications in relation to the governance and internal organisation of credit institutions, investment firms and certain other financial sector professionals (namely the depositary of assets other than financial instruments) acting as depositaries of Non-UCITS funds regardless of their legal regime. It also provides additional details regarding the application file and information to be submitted to the CSSF, in order for a credit institution, an investment firm or another financial sector professional to be - and remain - approved by the CSSF as a depositary of a Non-UCITS fund. In this respect, entities already approved as a UCITS' or AIF's depositary on 1 January 2019 will not be required to submit a new application file to the CSSF but will have to comply with the provisions of Circular 18/697.

In addition, Circular 18/697 contains specific provisions applicable only to depositaries of Non-UCITS funds qualifying as Full Scope AIFs. These provisions mainly concern the internal procedures and policies to be put in place by the AIFs' depositaries (namely in terms of conflict of interests, internal control mechanisms and escalation procedures). It also clarifies the scope of the safekeeping obligation of AIFs' depositaries (including specific measures to be taken depending on, among other things, the type of AIFs' assets safekept) and the asset segregation obligation to be complied with throughout the entire delegation chain of AIFs' depositaries (i.e. for the assets held by the depositary, by the first delegate and by any other delegates further down the custody chain).

Circular 18/697 will enter into force on 1 January 2019 and will repeal Chapter E of IML Circular 91/75 (which is, to a large extent, incorporated in Circular 18/697 with regard to Non-UCITS regulated investment funds other than Full-Scope AIFs). Circular 18/697 also amends Circular 16/644 to make it applicable, as from 1 January 2019, to Part II UCIs that are allowed to market their units to retail investors in Luxembourg (irrespective of whether these Part II UCIs qualify as Full Scope AIFs or not).

Draft Act amending certain Acts to strengthen supervision and protection of investors in Polish financial market adopted

The Council of Ministers has adopted the draft Act amending certain Acts in order to strengthen the supervision and protection of investors in the financial market, the objective of which is to strengthen the coordination of the state's policy regarding the financial market and the early identification of risks connected with its functioning.

Among other things, the draft Act provides for the introduction of the obligatory dematerialisation of corporate bonds, investment certificates issued by closed-ended investment funds and debentures, regardless of whether or not they were offered to the public or are to be admitted to trading on any trading venue. The above financial instruments are to be subject to obligatory registration in the depository of securities maintained by the Central Securities Depository of Poland (KDPW).

Moreover, the draft Act introduces changes regarding the composition and manner of financing of the Polish Financial Supervision Authority (PFSA). It also sets out the legal framework for the exchange of information between the PFSA, its members and other bodies, i.e. the Internal Security Agency, the Central Anti-Corruption Bureau, the National Revenue Administration, the Police and the Office of Competition and Consumer Protection.

Central Bank of Turkey to set up FX swap market

Following the recent announcement by the Capital Markets Board of Turkey and Borsa Istanbul (Istanbul Stock Exchange) on the introduction of centralised swap markets and the Banking Regulation and Supervision Agency's recent decision subjecting the FX swap transactions to be entered into by Turkish banks with foreign counterparties to certain thresholds, the Turkish Central Bank has announced that it plans to set up an FX swap market.

Accordingly, the Central Bank has announced that transactions will be conducted via quotation method with banks authorised in the FX and banknotes markets within their pre-determined limits.

The Central Bank hopes these measures will increase the efficiency in Turkish lira and foreign exchange liquidity management as well as its control over the swap markets.

SFC shares findings of licensed corporation's AML/CFT measures and controls inspection

The Securities and Futures Commission (SFC) has issued a circular to licensed corporations and associated entities to share with them its inspection and review findings of their anti-money laundering/counter financing of terrorism (AML/CFT) measures and controls. The circular highlights a number of deficiencies in regulatory standards expected from licensed corporations with regard to AML/CFT measures and controls and shares some good practices for improving their AML/CFT measures and controls.

The SFC reminds licensed corporations and associated entities to take all reasonable measures to mitigate money laundering and terrorist financing risks as well as to put in place proper safeguards to ensure compliance with the customer due diligence and record-keeping requirements under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance. The SFC has advised licensed corporations and associated entities to critically review their internal AML/CFT policies, procedures and controls and take immediate action to rectify any deficiencies or inadequacies in light of the circular.

The SFC has also encouraged licensed corporations and associated entities to consider any applicable good practices in devising their AML/CFT measures and controls.

MAS and Dubai Financial Services Authority sign agreement on fintech cooperation

The Monetary Authority of Singapore (MAS) and the Dubai Financial Services Authority (DFSA) have signed a fintech cooperation agreement that allows referrals of innovative businesses between the two authorities. The agreement is intended to reflect the commitment of both authorities to support the continuous development of fintech and innovation to deliver new and enhanced financial services to manage risks better, reduce costs, and increase efficiency.

The agreement centres on a referral mechanism which will enable the authorities to refer fintech companies to each other, as well as facilitate the sharing of information on financial sector innovation in their respective markets.

In addition, both authorities have agreed to work on joint innovation projects on the application of key technologies such as digital and mobile payments, blockchain and distributed ledgers, big data, and Application Programming Interfaces.

The agreement builds on the relationship between the MAS and DFSA, who entered into a memorandum of understanding in 2008 which fosters supervisory cooperation in banking, insurance and capital markets and facilitates the exchange of information between the two authorities.

MAS responds to feedback received on proposed revisions to large exposures framework for Singapore-incorporated banks

The MAS has published its responses to the feedback it received on its January 2018 public consultation on proposed revisions to the large exposures framework (LEF) for Singapore-incorporated banks.

In its responses, the MAS has clarified its proposals as follows:

- there will be no change to the proposed tightening of the large exposures limit (LEL) to 25% of Tier 1 capital;
- all exposures to banks will be subject to the LEL (including exposures arising from nosto and vostro accounts), except for intraday interbank exposures which are exempted for up to 2 days (if they fail to settle within the day) but thereafter will be subject to the LEL;
- banks have discretion to design internal limits for their exposures to systemically important financial institutions (SIFIs). While breaches of these limits will not be regulatory breaches, banks are expected to institute proper risk management systems and controls to manage their exposures and to ensure that their exposures to SIFIs comply with the LEL;
- the MAS will require aggregation based on economic interdependence between all counterparties regardless of the size and will require banks to identify any single counterparty whose exposures exceed 5% of Tier 1 capital, in line with the Basel large exposures framework;
- exposures to counterparties directly controlled by, or directly economically interdependent on, a central government or central bank will not be required to be aggregated with exposures to the same central government or central bank but can be treated as separate entity;

- a bank can disaggregate counterparties on an exceptional basis if they do not meet all the conditions in Appendix 2 of MAS Notice 639, provided the bank assesses that there are sufficient corporate governance safeguards and ring-fencing measures and can justify and document this assessment clearly;
- the substantial exposures limit will be removed;
- the LEL will apply to short-term trade finance exposures arising from credit risk mitigation instruments, overnight repurchase and reverse repurchase transactions and temporary breaches of the LEL from trading book exposures, but will broaden the existing exemptions to include exposures to foreign central governments or central banks of a sovereign country that are denominated in a foreign currency relative to the domestic currency and where the sovereign country is rated at least 'AA-' for foreign currency external credit assessment and will remove the exemption criteria based on the funding currency of exposures to foreign central governments, foreign central banks and 0% risk-weighted foreign public-sector entities; and
- the MAS is undertaking a review to consider the effect of netting agreements relating to on-balance sheet assets and liabilities under the risk-based capital framework.

Banks will be required to submit the regulatory reporting schedules no later than the 14th of the second month following the end of each semi-annual period, and to commence semi-annual reporting for positions as at 31 December 2019. The implementation date of the revisions to the LEF will be extended to 30 September 2019.

MAS consults on measures to strengthen cyber resilience of financial institutions

The MAS has published a consultation paper on its proposed requirements for financial institutions (FIs) in Singapore to implement essential cyber security measures to protect their IT systems.

FIs will be required to implement the following six cyber security measures:

- address system security flaws in a timely manner;
- establish and implement robust security for systems;
- deploy security devices to secure system connections;
- install anti-virus software to mitigate the risk of malware infection;
- restrict the use of system administrator accounts that can modify system configurations; and
- strengthen user authentication for system administrator accounts on critical systems.

The proposed requirements are already part of the existing MAS Technology Risk Management Guidelines and the MAS intends to elevate them into legally binding requirements intended to help FIs strengthen their cyber resilience and guard against cyber-attacks.

The MAS is seeking comments on, amongst other things:

- the list of entities licensed, approved, registered or regulated by the MAS that will be required to implement the proposed requirements;
- the definitions to be used in the notice which will be published by the MAS;
- whether there are any other security controls and processes which should be included in the list; and
- whether the transition period of 12 months from the date of issuance of the notice is adequate for FIs to implement the frameworks, processes and controls to comply with the proposed requirements.

Comments on the consultation paper are due by 5 October 2018.

ASIC updates guidance for trustees of wholesale equity schemes

The Australian Securities and Investments Commission (ASIC) has released updated Regulatory Guide 192 Licensing: Wholesale equity schemes (RG 192), following its March 2017 public consultation on proposals to either remake or repeal Class Order on Wholesale equity schemes: Licensing relief for trustees.

The updates to the guidance are intended to reflect:

- the changes made to the relief provided in the ASIC Corporations (Wholesale Equity Scheme Trustees) Instrument 2017/849 to trustees of wholesale equity schemes that are operated by a manager holding an Australian financial services (AFS) licence; and
- the amendments made to the financial requirements that may apply to these managers in the ASIC Corporations (Amendment and Repeal) Instrument 2017/848.

RECENT CLIFFORD CHANCE BRIEFINGS

BITs – still value for money

The judgment of the Court of Justice of the European Union in Slovak Republic v Achmea BV cast doubt over the utility of intra-EU BITs as a means of protecting European investors' rights when investing in other EU Member States. The utility of BITs that are not between EU Member States, however, remains undiminished. Continued threats of politically-motivated expropriations, when coupled with this post-Achmea legal uncertainty, highlight the need to consider investment protection and structuring concerns carefully and well in advance of any investment being made.

This briefing outlines the issues and provides a quick refresher for investors.

https://www.cliffordchance.com/briefings/2018/08/bits_-_still_valueformoney-august2018.html

EU financial services horizon scanner, September 2018

The financial services horizon scanner provides a high level overview of ongoing and expected EU legislative initiatives that are likely to impact firms providing financial services in the EU.

Prepared as of September 2018, the horizon scanner sets out projected timelines for the finalisation and implementation of relevant requirements, covering approximately the next 18 months to two years.

https://www.cliffordchance.com/briefings/2018/01/eu_financial_serviceshorizonscanner.html

Privilege and ENRC – Two things we now know, and two we still don't

The Court of Appeal has clarified some important and controversial aspects of privilege, in particular that legal proceedings can be reasonably in contemplation at a far earlier stage than the prosecuting authorities might like. But, despite pointing the law in the right direction, the Court of Appeal has left other fundamental issues for the Supreme Court to sort out, most notably who within a corporation is the lawyer's client.

This briefing discusses the judgment.

https://www.cliffordchance.com/briefings/2018/09/privilege_and_enrctwothingswenowknowan.html

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