CLIFFORD

CHANCE

INTERNATIONAL REGULATORY UPDATE 26 – 30 AUGUST 2019

- **EBA publishes reports on asset encumbrance and funding plans**
- **BaFin adapts administrative practice for recognition of Common Equity Tier 1 instruments**
- **Luxembourg law implementing Shareholder Rights Directive 2 published**
- **CSSF warns financial sector professionals about practice to avoid when outsourcing on cloud computing infrastructure**
- **National Clearing House and Polish Financial Supervision Authority agree on strategic cooperation to support financial innovation and use of distributed ledger technology**
- **FINMA issues guidance on combating money laundering on the blockchain**
- **Swiss National Bank publishes survey results on digitalisation and fintech at Swiss banks**
- **APRA strengthens rules to combat contagion risk within banking groups**
- **HKMA completes review of liquidity facilities framework for banks**
- **HKMA provides update on requirements relating to opening of accounts**
- **HKMA issues revised guidelines on credit risk management for personal lending business**
- **SFC issues circular to licensed corporations on managing liquidity risk of funds**
- **Recent Clifford Chance briefings: public procurement and more. Follow this link to the briefings section**

Clifford Chance's International Regulatory Update is a weekly digest of significant regulatory developments, drawing on our daily content from our Alerter: Finance Industry service.

To request a subscription to our Alerter: Finance Industry service, please email Online Services.

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

EBA publishes reports on asset encumbrance and funding plans

The European Banking Authority (EBA) has published two reports on EU banks' asset encumbrance and funding plans for 2019 to 2021. The reports are intended to assist EU supervisors in their assessment of the sustainability of banks' main sources of funding.

The report on funding plans analyses balance sheet forecasting and other

data submitted by 160 banks from all EU jurisdictions. Key findings include:

- total assets are projected to grow by 6.1% on average, mainly driven by loans to households and non-financial corporates;
- banks intend to increase client deposits and issue more debt instruments (in particular, unsecured debt);
- the spread between interest rates for client deposits and for loans to clients is expected to increase slightly or decline less severely than in previous years; and
- the cost of issuing debt securities is expected to increase.

The report on asset encumbrances found that the overall weighted average asset encumbrance ratio was stable and did not change from December 2017 to December 2018. Repo financing remains the most important source of asset encumbrance in the EU, increasing from a 27% share to 30% in December 2018. In comparison, the share of covered bonds and central bank funding as sources of asset encumbrance decreased slightly from last year.

BaFin adapts administrative practice for recognition of Common Equity Tier 1 instruments

The German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) has adapted its administrative practice for classifying capital instruments as Common Equity Tier 1 instruments in accordance with Article 26(3) of the Capital Requirements Regulation (CRR). This is due to changes in the CRR.

In addition to the known application procedure under the first subparagraph of Article 26(3) CRR, institutions can now also notify subsequent issuances pursuant to the second subparagraph of Article 26(3) CRR. This is subject to the condition that the institution has already been granted permission under the first subparagraph of Article 26(3) CRR not more than three years ago and that the instrument issued by way of the capital increase is the same type of instrument.

A letter published by BaFin sets out which documents are to be submitted in each procedure and which declarations are to be made.

Luxembourg law implementing Shareholder Rights Directive 2 published

The Luxembourg law of 1 August 2019 modifying the Luxembourg law of 24 May 2011 on the exercise of certain rights of shareholders in listed companies (SHR Law) and transposing the Shareholder Rights Directive (EU) 2017/828 (SHRD 2), which amends Directive 2007/36/EC with regard to the encouragement of long-term shareholder engagement, has been published in the Mémorial A.

The main objective of the SHRD 2 and the new law is to improve the long-term viability of European companies and create a more attractive environment for shareholders. The law introduces new chapters into the SHR Law to implement the above measures into the Luxembourg legal environment.

The amendments that are introduced by the law are mainly relevant for Luxembourg companies the securities of which are admitted to trading on an

EU regulated market (within the meaning of Directive 2014/65/EU) and to their shareholders and intermediaries providing services to them.

The new legal regime imposed by the law has to be read together with the EU Commission Implementing Regulation 2018/1212, dated 3 September 2018, which contains a prescriptive list of obligations for both issuers and intermediaries.

CSSF warns financial sector professionals about practice to avoid when outsourcing on cloud computing infrastructure

The Luxembourg financial sector supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), has issued a press release to warn financial sector professionals about the requirement to restrict the continued access of resellers of cloud computing services to their outsourcing projects.

The CSSF notes that when professionals of the financial sector use cloud computing solutions for outsourcing projects, resellers commonly retain access to the client interface even after completing its initial configuration. The CSSF considers that this practice must be avoided as it generates unauthorised access to a financial sector professional's cloud computing resources and creates an increased risk for the financial sector, particularly where resellers with access to the cloud computing resources of several clients are exposed to cyber-attacks.

The CSSF therefore requires financial sector professionals to restrict access to the client interface to the resource operator only, and to withdraw the reseller's access after completion of the initial configuration of the client interface.

National Clearing House and Polish Financial Supervision Authority agree on strategic cooperation to support financial innovation and use of distributed ledger technology

The National Clearing House and the Office of the Polish Financial Supervision Authority have signed an agreement on strategic cooperation concerning the development of the Polish fintech infrastructure and supporting innovation in the financial markets. Within the sandbox environment, the NCH and the Office of the PFSA will implement, among other things, projects concerning the use of distributed ledger technology (blockchain).

Under the agreement, the NCH and the Office of the PFSA will provide substantive and technological support for, among other things, projects involving the implementation of innovative solutions in the regulatory and supervisory areas. The NCH and PFSA's common objective is to increase the dynamics of the development of the Polish fintech ecosystem.

FINMA issues guidance on combating money laundering on the blockchain

The Swiss Financial Market Supervisory Authority (FINMA) has published guidance on how it applies Swiss anti-money laundering rules to financial services providers supervised by FINMA in the area of blockchain technology. In its guidance, FINMA provides information about its technology-neutral

application of the regulation to payment transactions on the blockchain as follows:

- institutions supervised by FINMA are only permitted to send cryptocurrencies or other tokens to external wallets belonging to their own customers whose identity has already been verified and are only allowed to receive cryptocurrencies or tokens from such customers;
- FINMA-supervised institutions are thus not permitted to receive tokens from customers of other institutions or to send tokens to such customers;
- this practice applies as long as information about the sender and recipient cannot be transmitted reliably in the respective payment system; and
- unlike the FATF standard, this established practice applies in Switzerland without an exception for unregulated wallets.

Swiss National Bank publishes survey results on digitalisation and fintech at Swiss banks

The Swiss National Bank has published the results of a survey on digitalisation and fintech at Swiss banks conducted in the fourth quarter of 2018. The exercise – part of ongoing monitoring by the SNB in the context of its statutory mandate – focused on financial stability considerations. The aim was to gain a representative picture of how digitalisation and fintech are influencing banks operating in the deposits and lending business.

Overall, the results indicate that the banks expect a strong level of digitalisation in financial intermediation. They view this mainly as a source of opportunities, particularly with regard to cutting costs and improving service quality. However, they also highlight challenges, in particular from increasing competition, both with other banks and with new market participants such as bigtechs and digital banks. Against this backdrop, the banks are seeking to achieve ambitious digital maturity targets and are investing in their own innovations or acquiring innovative solutions from specialised firms such as fintechs. However, digitalisation strategies and the corresponding objectives vary depending on the size of the financial institution.

APRA strengthens rules to combat contagion risk within banking groups

The Australian Prudential Regulation Authority (APRA) has published the responses to the feedback it received on its July 2018 public consultation on the proposed revisions to the related entities framework for authorised deposit-taking institutions (ADIs), and released the final revised version of the prudential standard titled 'APS 222: Associations with Related Entities' (APS 222) to combat contagion risk within banking groups.

Responding to the consultation, APRA confirmed that the prudential standard APS 222 will be updated to include:

- a broader definition of 'related entities' that includes board directors and substantial shareholders;
- revised limits on the extent to which ADIs can be exposed to related entities;
- minimum requirements for ADIs to assess contagion risk; and

- removing the eligibility of ADIs' overseas subsidiaries to be regulated under APRA's extended licensed entity framework.

Additionally, APRA will require ADIs to regularly assess and report on their exposure to step-in risk – the likelihood that they may need to 'step in' to support an entity to which they are not directly related.

The revised prudential standard (APS 222) is effective from 1 January 2021.

Further, based on the feedback received, APRA has released the following standards:

- the final revised version of the reporting standard titled 'ARS 222.0: Exposures to Related Entities' (ARS 222.0), which is intended to set out requirements for the provision of information to APRA relating to an ADI's exposures to related entities; and
- a new reporting standard titled 'ARS 222.2: Exposures to Related Entities – Step-in Risk' (ARS 222.2), which is intended to set out requirements for the provision of information to APRA relating to an ADI's exposures to step-in risk entities.

The revised reporting standard (ARS 222.0) and the new reporting standard (ARS 222.2) will be applicable to reporting periods ending on or after 1 January 2021.

HKMA completes review of liquidity facilities framework for banks

The Hong Kong Monetary Authority (HKMA) has announced that it has completed a review of its liquidity facilities framework for the provision of Hong Kong dollar liquidity to banks. The updated liquidity facilities framework takes forward the key recommendation of the Financial Stability Board's 2018 Peer Review of Hong Kong.

Within the updated framework, a new resolution facility has been introduced to provide for the scenario in which resolution powers under the Financial Institutions (Resolution) Ordinance (FIRO) are exercised by the HKMA as the resolution authority. A number of refinements have also been made to various established arrangements, so as to foster a better understanding of the different ways that liquidity may be made available to banks by the HKMA.

The updated liquidity facilities framework takes immediate effect and supersedes the 'Policy Statement on the Role of the Hong Kong Monetary Authority as Lender of Last Resort' issued in March 2009.

HKMA provides update on requirements relating to opening of accounts

Following the circular issued by the Securities and Futures Commission (SFC) to intermediaries on 28 June 2019 in relation to amendments to Paragraph 5.1 of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, the HKMA has issued a circular to all registered institutions to update its guidance on requirements relating to the opening of accounts. The latest HKMA guidance supersedes the circular dated 24 August 2018 on clarifications on remote investment account opening.

The new guidance reminds intermediaries that they should take all reasonable steps to establish the true and full identity of each of their clients. Where an

account opening procedure other than a face-to-face approach is used, it should be one that satisfactorily ensures the identity of the client.

The HKMA has confirmed that if a registered institution has established the true and full identity of a client when opening a bank account irrespective of using face-to-face approach or non-face-to-face approach, the registered institution will not be required to verify the client's identity again when opening an investment account for the client.

HKMA issues revised guidelines on credit risk management for personal lending business

The HKMA has revised its guidelines on credit risk management for personal lending business to provide greater flexibility to authorised institutions in the use of new credit risk management tools powered by financial technology.

The guidelines, originally issued in May 2018, allow authorised institutions to carve out a small portion of their personal lending portfolio as a 'New Personal-Lending Portfolio' (NPP) and apply innovative credit analytic tools built on financial technology such as big data analysis to assess and approve credit applications.

Several authorised institutions have since rolled out new retail credit products following the guidelines and the HKMA notes that this business has been operating smoothly. The HKMA therefore considers that it is no longer necessary to set an across-the-board limit applicable to all authorised institutions on such lending (i.e. 10% of an authorised institution's capital base). Instead, the HKMA expects authorised institutions intending to develop this business to set a limit of their own, which should be commensurate with their risk appetite and risk management capability.

Authorised institutions that intend to develop NPP business are expected to discuss their plan with the HKMA.

SFC issues circular to licensed corporations on managing liquidity risk of funds

The SFC has issued a circular to licensed corporations to highlight deficiencies or inadequacies noted in fund managers' liquidity risk management practices.

The SFC surveyed selected licensed fund managers which manage SFC-authorised funds (authorised fund managers) to understand their liquidity risk management processes and conducted inspections on some of these fund managers to assess their compliance with the SFC's circular on liquidity risk management (July 2016) and implementation of the enhanced requirements under the Fund Manager Code of Conduct. The SFC found inadequacies or deficiencies on the part of some authorised fund managers in maintaining proper liquidity risk management systems and controls in the following areas:

- overall liquidity risk management framework;
- assessments of liquidity profiles of fund assets and liabilities;
- stress testing;
- governance structure for risk management;
- risk management reports; and

- documentation.

The circular also reminds fund managers that, at times of significant changes in the markets in which their funds invest, they should perform more frequent and enhanced liquidity stress testing to assess the potential impact on liquidity as well as the adequacy of their action plans and liquidity risk management tools. The SFC advises fund managers to have in place appropriate action plans regarding how they would meet the fund's liquidity needs should any of the stress scenarios materialise.

The SFC has indicated that, where appropriate, it will provide further guidance to fund managers to assist them in enhancing their systems and controls and will not hesitate to take action against fund managers which fail to comply with the regulatory requirements or meet expected standards.

RECENT CLIFFORD CHANCE BRIEFINGS

Debarment – Asia Pacific raises the bar on public procurement

Debarment regimes exclude companies from public procurement opportunities following conviction for specified offences. This briefing paper examines the global trend towards the strengthening of these regimes and how this is likely to affect companies in the Asia Pacific.

https://www.cliffordchance.com/briefings/2019/08/debarment_asia_pacificraisesthebaronpubli.html

A recent Hong Kong court reminder to non-executive directors regarding their duty to enquire and investigate in the face of red flags

The recent Hong Kong judgment of Moulin Global Eyecare Holdings Limited (in liquidation) v Olivia Lee Sin Mei [2019] HKCFI 1715 reminds non-executive directors (NEDs), in particular those with a professional background, of their duty to exercise care and skill in performing their roles, and the potential consequences they may face if they fail to do so. This is in line with existing English and Australian case law on duties of NEDs.

This briefing paper discusses the judgment.

https://www.cliffordchance.com/briefings/2019/08/a_recent_hong_kongcourtremindert.html

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

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

© Clifford Chance 2019

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.