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## **CLOs: ESMA publishes report on rating practices and challenges**

The European Securities and Markets Authority (ESMA) has published a [report](#) on EU credit ratings of collateralised loan obligations (CLOs). The report provides an overview of CLO rating practices and identifies medium-term risks and supervisory concerns for the asset class, including amongst others concerns relating to the following:

- credit rating agencies (CRAs)' internal organisation;
- their interactions with CLO issuers;
- dependence on rating models and data provided by third parties and other operational risks; and
- commercial influence on the rating process.

## **EU Commission consults on AML/CFT action plan**

The EU Commission has published for [consultation](#) a proposed anti-money laundering/counter terrorist financing (AML/CFT) action plan, which sets out measures the Commission intends to take over the next twelve months to better enforce, supervise and coordinate the EU's rules on combating money laundering and terrorist financing. The plan contains six proposed pillars:

- continued close monitoring of the implementation of relevant EU rules by Member States;
- harmonisation of rules (the Commission intends to propose a more harmonised set of rules in the first quarter of 2021);
- consistent supervision across Member States, including through the establishment of an EU-level supervisor;
- the establishment of an EU mechanism to help further support and coordinate the work of Member States' financial intelligence units;
- the enforcement of EU-level criminal law provisions and information exchange (including guidance on exchange through public-private partnerships); and
- continued work on a global level, including protecting the Single Market from third countries with deficient AML/CFT regimes.

Comments on the consultation are due by 29 July 2020.

As part of the final pillar of the proposed action plan the EU Commission has published a new [methodology](#) for identifying high-risk third countries under the Anti-Money Laundering Directive (AMLDD). The new methodology is intended to be more transparent and to facilitate greater engagement with, and involvement of, the third countries in the efforts to reduce money laundering and terrorist financing. It has been published alongside an [updated list](#) of high-risk third countries, which the Commission has revised to better align it with the lists published by the Financial Action Task Force.

## **EBA publishes inquiry into dividend arbitrage trading schemes**

The European Banking Authority (EBA) has published a [report](#) on its inquiry into dividend arbitrage trading schemes. The inquiry showed that national authorities do not share the same understanding of dividend arbitrage trading schemes due to the differences in Member States' domestic tax law. According to the EBA, facilitating or handling proceeds from tax crimes undermines the integrity of the EU's financial system. It has therefore set out its expectations of credit institutions and national authorities and announced a [10-point action plan](#) for 2020/21 to enhance the future framework of prudential and AML requirements covering such trading schemes.

Under the current regulatory framework, the EBA expects credit institutions and national authorities to:

- take a comprehensive view of the risks highlighted by dividend arbitrage trading cases, looking at the adequacy of financial institutions' internal controls and governance as well as AML/CFT systems and controls; and
- consider the exchange of information between prudential and AML authorities when performing reviews of institutions' internal controls and governance and other activities.

The EBA aims to strengthen its prudential guidelines on internal governance, its guidelines on the assessment of the suitability of members of the management body and key function holders, and its guidelines on the supervisory review and evaluation process. It also aims to monitor how prudential colleges will follow up on the cum-ex related guidance and amend its guidelines on AML.

The EBA will then carry out a second formal inquiry into the actions taken to supervise compliance with the amended requirements.

## **Credit risk: PRA publishes policy statement on probability of default and loss given default estimation**

The Prudential Regulation Authority (PRA) has published a [policy statement](#) (PS11/20) setting out:

- feedback to the responses it received on its consultation paper (CP21/19) entitled 'Credit risk: Probability of Default and Loss Given Default estimation'. CP21/19 set out proposals to implement the EBA's regulatory products relating to estimation of Probability of Default (PD) and Loss Given Default (LGD); and
- in an appendix, the PRA's final policy in an [updated supervisory statement](#) (SS11/13) entitled 'Internal Ratings Based (IRB) approaches'.

The EBA's set of regulatory products, known as a roadmap, are intended to reduce unwarranted variability across banks in internal ratings based (IRB) risk-weighted assets (RWAs) for credit risk.

The PRA notes that it has made several changes to the draft policy in CP21/19, including amongst others:

- extending the implementation deadlines for the EBA roadmap and the mortgage hybrid approach;
- amending the approach to discounting cured exposures;

- accepting temporary divergence between accounting impairment models and approved IRB models for defaulted exposures; and
- clarifying the use of Sterling Overnight Index Average (SONIA), including for defaults that occurred before the first date SONIA is available from the Bank of England.

The policy will take effect from 1 January 2022. The policy statement sets out further information on implementation dates for the EBA roadmap.

### **Brexit: UK Government publishes letter on equivalence**

The UK Government has published a [letter](#) dated 23 April 2020 from John Glen, Economic Secretary to the Treasury (HMT), to the House of Commons European Scrutiny Committee on the UK Government's position on equivalence in financial services.

The letter seeks to provide clarity on the Government's position on equivalence in financial services under the future UK-EU economic partnership, including:

- agreeing provisions to stabilise unilateral decisions under existing third country equivalence frameworks through regulatory cooperation and structured processes for the withdrawal of equivalence decisions;
- seeking equivalence across all the current equivalence regimes under EU law; and
- ensuring that both the UK and EU have recognised each other's equivalence regimes at the end of the transition period on 31 December 2020.

The letter also discusses the requirements for 'assurance' from CCP supervisors under EMIR 2.2 and its interaction with 'comparable compliance'. While noting that the interpretation is not yet clearly established, the letter also seeks to make the small clarification that 'assurance' does not necessarily require comprehensive commitments on enforcement from a third country.

Finally, in response to a question on whether the forthcoming Financial Services Bill will contain clauses allowing HMT to implement EU financial services legislation post-transition, the letter notes that details on the content of the Bill will be set out in due course.

### **Brexit: Draft bill authorising French Government to adopt emergency measures published**

A [draft bill](#) has been introduced to the French Parliament which, among other things, authorises the French Government to adopt emergency legislation in the form of ordinances for a period of 30 months from the publication of the law. These provisions would enable the Government to adapt to Brexit uncertainties following the end of the transition period, notably as regards:

- the conditions for continuing performing insurance contracts;
- the management of collective investments and equity savings plans; and
- the treatment of British nationals residing in France as well as of UK companies operating in France.

The draft bill is being discussed in the National Assembly.

## **CSDR: BaFin applies ESMA guidelines on standardised procedures and messaging protocols**

In April 2020, ESMA published the German version of its [guidelines](#) on standardised procedures and messaging protocols under Article 6 paragraph 2 of the Central Securities Depositories Regulation (CSDR). The German Federal Financial Services Supervisory Authority (BaFin) has now confirmed that it will apply these guidelines in its supervisory practice.

The guidelines specify the requirements under Article 6 paragraph 2 of the CSDR and Article 2 of Delegated Regulation (EU) 2018/1229. According to these regulations, investment firms should take measures to limit the number of failed settlements. For this purpose, investment firms should enter into agreements with professional clients to ensure that they have all the information necessary for smooth settlement at the time when the transaction is to take place. The guidelines provide specific details on the structure of the exchange of information.

## **Bank of Italy issues communication on information required for assessment of acquisition of a qualifying holding in a CCP**

Pursuant to article 79-sexies, paragraph 6 of the Consolidated Law on Finance (Testo Unico sulla Finanza), the Bank of Italy and CONSOB have [adopted](#) Annex I of the joint guidelines on the prudential assessment of acquisitions and increases of qualifying holdings in the financial sector issued by the European Supervisory Authorities on 20 December 2016 as the list of minimum information that is necessary to carry out the assessment provided for in Article 32 of the European Market Infrastructure Regulation (EMIR) with respect to a proposed acquisition of a qualifying holding in a central counterparty. This list of information provides an exhaustive framework for the assessment, harmonised at EU level as a result of the ESA guidelines.

## **CONSOB issues recommendation on arrangements for ex post reporting obligations of costs and charges related to provision of investment and ancillary services**

Following its February 2020 consultation, CONSOB has [adopted](#) a recommendation on the arrangements for the ex post reporting obligations of costs and charges related to the provision of investment and ancillary services. This initiative is part of the regulatory framework implementing MiFID2 and the related Delegated Acts, which requires intermediaries to provide greater disclosure and transparency on costs and charges connected with the performance of investment and ancillary services, in order to allow investors to make an informed assessment of investments made.

## **CSSF issues circular on Luxembourg laws implementing AMLD5**

The Luxembourg financial sector supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), has issued [circular 20/742](#) dated 4 May 2020 on the entry into force of the law of 25 March 2020 amending the law of 12 November 2004 on the fight against money laundering and terrorist financing ([AML/CTF Law](#)) and the law of 25 March 2020 establishing a central electronic data retrieval system concerning IBAN accounts and safe-deposit boxes ([Central Electronic Data Law](#)).

The circular is intended to draw the attention of professionals subject to AML/CTF supervision by the CSSF and falling within the scope of the AML/CTF Law to the major changes that the new laws bring to the AML/CTF system applicable to the Luxembourg financial sector.

On the amendment of the AML/CTF Law, the CSSF stresses in particular the changes in the following areas:

- new and amended definitions (e.g. virtual asset, virtual asset service providers, financial institution, beneficial owner);
- scope of the AML/CTF requirements and in-scope professionals (e.g. tied agent, payment and e-money institution agents, virtual asset service providers, real estate agents);
- broader CSSF supervision perimeter;
- new obligations in the context of the risk assessment;
- adaptation of the customer due diligence requirements (e.g. identification/verification via electronic identification means, prohibition of keeping anonymous safe-deposit boxes);
- clarification of adequate internal management requirements (e.g. allocation of sufficient resources to the internal audit function, additional requirements in terms of group-wide policies and procedures);
- strengthening of the protection for certain individuals reporting suspicions of ML/TF; and
- reinforcing of the supervisory powers of the supervisory authorities and self-regulatory bodies as well as of the cooperation between authorities.

With respect to the Central Electronic Data Law, the CSSF emphasises the introduction of:

- new registration requirements for virtual asset service providers and fiduciary and company service providers; and
- a new central electronic data retrieval system, allowing for the identification, in real time, of any natural or legal person holding or controlling payment accounts, bank accounts identified by an IBAN number and safe-deposit boxes in Luxembourg. The CSSF has announced the release of a separate circular dedicated to this specific aspect.

Finally, the CSSF notes that the new laws have implemented only certain provisions of AMLD5.

### **CSSF issues regulation on setting of countercyclical buffer rate**

The CSSF, has issued a new [regulation](#) (20-01) on the setting of the countercyclical buffer rate for the second quarter of 2020. The regulation was published in the Luxembourg official journal (Mémorial A) on 23 April 2020. The regulation follows the Luxembourg Systemic Risk Committee's recommendation of 12 March 2020 (CRS/2020/001) and maintains the countercyclical buffer rate for relevant exposures located in Luxembourg at 0.5% for the second quarter of 2020. The new rate will apply as of 1 January 2021.

The regulation entered into force on 23 April 2020.

## **Polish Financial Supervision Authority sets out position on robo-advisory services**

The Polish Financial Supervision Authority (PFSA) has [presented](#) its draft position regarding robo-advisory services, which is intended to ensure the uniform implementation of robo-advisory services by interested financial institutions, while taking into consideration the appropriate protection of customers, particularly non-professional investors. The draft position addresses the most important issues related to robo-advisory services which should be taken into account in the activity of the supervised entity. It concerns the entire process, starting from the stage of the designing of the service up to its implementation in practice and monitoring of existing solutions.

The draft has been sent for consultations to sector organisations (Chamber of Brokerage Houses, Polish Bank Association, Fund and Asset Management Chamber), which are to end on 29 May 2020.

## **PBoC and SAFE issue new FX regulations for QFII/RQFII to remove investment quota restriction**

The People's Bank of China (PBoC) and the State Administration of Foreign Exchange (SAFE) have released the '[Provisions](#) on Cash Management for Domestic Securities and Futures Investment by Foreign Institutional Investors', which officially remove the investment quota restriction and streamline the cash management requirements under the regimes for qualified foreign institutional investors (QFII) and Renminbi qualified foreign institutional investors (RQFII).

The key points of the Provisions are as follows:

- qualified foreign investors will no longer need to apply for an investment quota from SAFE for investments in China. Instead, they only need to complete a business registration with SAFE through their main custodian;
- under the consolidated regime, each qualified foreign investor can appoint multiple domestic custodians (and select one as its main custodian) and freely choose the currencies and timing of remittance into China; and
- the procedures for repatriating profits are simplified. Qualified foreign investors are only required to provide a letter of undertaking to pay the applicable tax in full, instead of the current regime which requires a special audit report and tax clearance/filing certificates. However, the special audit report and tax clearance/filing certificates are still required before a qualified foreign investor can fully liquidate its entire portfolio and repatriate all amounts out of China.

The Provisions will take effect on 6 June 2020 and are expected further to simplify the regulation of qualified foreign investors from a currency control perspective.

## **Regulation amending Stamp Duty Ordinance to lower transaction costs for primary market ETF activities gazetted**

The Hong Kong Government has gazetted the [Stamp Duty Ordinance](#) (Amendment of Schedule 8) Regulation 2020 to implement an initiative in its 2020-21 Budget relating to the reduction of the transaction costs of exchange

traded funds (ETFs) listed in Hong Kong. The Regulation is intended to amend Schedule 8 to the Stamp Duty Ordinance to lower transaction costs for primary market ETF activities by waiving the stamp duty on stock transfers involving the activities of ETF market makers in the course of allotting and redeeming ETF units listed in Hong Kong.

The Regulation will be tabled before the Legislative Council for negative vetting on 20 May 2020 and will come into effect on 1 August 2020.

### **HKMA consults on implementation of mandatory reference checking scheme to address ‘rolling bad apples’ phenomenon**

The Hong Kong Monetary Authority (HKMA) has launched a public [consultation](#) on its implementation of the mandatory reference checking (MRC) scheme to address the ‘rolling bad apples’ phenomenon, taking into account initial comments from the banking industry.

The consultation is intended to establish a common protocol for reference checking to help enhance the disclosure of the employment history of prospective employees to cover conduct specific information before an authorised institution considers establishing an employment relationship with a prospective employee.

Under the consultation, the HKMA proposes a framework for the MRC scheme to be adopted by authorised institutions on the employment of specified positions within the banking sector, in order to avoid ‘rolling bad apples’ and to minimise possible harm to bank consumers and risks to the banking sector. The HKMA has indicated that the MRC scheme will adopt a proportionate approach and be confined to specific categories of employees of authorised institutions whose conduct and integrity are more important and where the need to address ‘rolling bad apples’ is of relatively higher priority.

Comments on the consultation are due by 7 August 2020.

### **HKMA issues circular on common assessment framework for green and sustainable banking**

The HKMA has issued a [circular](#) to update authorised institutions regarding developments in its promotion of green and sustainable banking. In its previous circulars dated [7 May 2019](#) and [28 June 2019](#) the HKMA stated that a key part of its Phase I measures to promote green and sustainable banking is to develop a common framework to assess the ‘greenness baseline’ of individual authorised institutions. In view of this, the HKMA has developed a [self-assessment framework](#) with the support of a working group consisting of 22 authorised institutions and incorporated comments received from the industry.

The self-assessment framework is intended to facilitate authorised institutions in reviewing readiness and preparedness in addressing climate and environmental risks, help authorised institutions formulate strategies and approaches, and inform the design of supervisory expectations and requirements under Phase II of the HKMA’s three-phased approach. The framework will collect information about the stage of development with respect to climate risks and environmental risks under six key elements, including (i) governance, (ii) corporate planning and tools, (iii) risk management process,

(iv) business policies, products and services, (v) performance and resources, and (vi) disclosure and communication.

The HKMA has indicated that, currently, it intends to implement the assessment for around 50 authorised institutions based predominantly on their asset sizes and business activities. Moreover, the selected authorised institutions will have 12 weeks to complete this initial round of assessment, taking into account the COVID-19 situation. Authorised institutions not covered in this round of the exercise have also been encouraged to reflect on their readiness and preparedness in addressing climate and environmental risks.

### **Hong Kong Quality Assurance Agency launches green finance certification scheme – ESG fund**

The Hong Kong Quality Assurance Agency (HKQAA) has [announced](#) the launch of its ‘Green Finance Certification Scheme – ESG Fund’ to provide third-party conformity assessments on the environmental, social and governance (ESG) fund and further promote ESG initiatives with a view to directing capital flows towards green and sustainable uses.

The green finance certification scheme for ESG funds is an extension of the HKQAA’s certification service for green funds launched in September 2019. It has been developed in response to the Securities and Futures Commission’s (SFC’s) Strategic Framework for Green Finance and the rising demand from investors to promote clarity among ESG funds, with reference to international principles and guidance, including the United Nations Principles for Responsible Investment (UNPRI).

The Hong Kong Government has indicated that it will continue to support the certification scheme and encourage more local, Mainland China and overseas entities to make use of the scheme and Hong Kong’s capital markets for ESG investments and financing.

### **CFTC requests comments on proposed rule concerning swap clearing requirement exemptions**

The Commodity Futures Trading Commission (CFTC) has published a [proposed rule](#) in the Federal Register concerning amendments to the regulations governing which swaps are exempt from the clearing requirement set out in the Commodity Exchange Act (CEA). The proposed amendments would address the treatment of swaps entered into by certain central banks, sovereign entities, and international financial institutions. The CFTC is also issuing a supplemental notice of proposed rulemaking to further propose amendments to exempt from required clearing swaps entered into by certain bank holding companies, savings and loan holding companies, and community development financial institutions. In addition, the CFTC is proposing to publish a compliance schedule setting out all the past compliance dates for the 2012 and 2016 swap clearing requirement regulations and to make certain other, non-substantive technical amendments to the relevant part of its regulations. Comments are requested on or before 13 July 2020.

## **RECENT CLIFFORD CHANCE BRIEFING**

### **The EBA publishes its report on the creation of an STS Framework for synthetic securitisations**

The EBA has published its report on the feasibility of extending the STS Securitisation Framework to synthetic securitisations. In the report, the EBA has proposed a set of criteria for synthetic STS securitisation – limited to balance sheet synthetic securitisations – and indicated how originators could benefit from a more favourable regulatory capital treatment for such transactions. It has, however, left it up to the European Commission to decide whether to proceed with such differentiated treatment.

This briefing discusses the key issues arising from the report.

<https://www.cliffordchance.com/briefings/2020/05/the-eba-publishes-its-report-on-the-creation-of-an-sts-framework.html>

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