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INTERNATIONAL REGULATORY UPDATE 15 – 19 AUGUST 2022

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ECB publishes statement on licensing of cryptoasset activities

The European Central Bank (ECB) has published a statement in its August Supervision Newsletter on the steps it is taking to harmonise the assessment of licensing requests for cryptoasset activities. The statement notes that, while there will shortly be a harmonised regulatory framework at both the EU level (under the proposed Markets in Cryptoassets Act (MiCA)) and international level (under the Basel Committee on Banking Supervision's proposed rules on the prudential treatment of banks' cryptoasset exposures), there is a risk of significant divergence between national approaches in the meantime.

The ECB therefore intends to apply the Capital Requirements Directive (CRD) criteria when assessing licensing requests covering cryptoasset activities and services and expects national competent authorities to do the same. A particular focus will be given to:

- whether the proposed activity matches the overall activity and risk profile of the institution;
- whether the institution's policies and procedures can sufficiently identify and assess risks specific to cryptoassets; and
- whether the institution meets the same general fit and proper criteria as are applicable in other licensing procedures, such as IT competence and appropriate risk experience.

The ECB also notes that it intends to publish horizontal analysis on its ongoing work within the Single Supervisory Mechanism (SSM) on banks' digital transformation, including the role of crypto-technologies, by the end of 2022.

CRR: EU Commission adopts RTS on residual risk add-on under alternative standardised approach for market risk

The EU Commission has adopted a Delegated Regulation containing regulatory technical standards (RTS) specifying exotic underlyings and the instruments bearing residual risks for the purposes of the calculation of own funds requirements for residual risks.

Under the Capital Requirements Regulation (CRR), firms using the alternative standardised approach (ASA) to market risk are required to calculate the residual risk add-on (RRAO). The RRAO is intended to provide simple and conservative capital treatment for any risks that are not covered by the other elements of the ASA. This means that instruments referencing an exotic underlying or instruments bearing other residual risks are subject to the RRAO treatment.

The RTS specify:

- what an exotic underlying is and that longevity risk, weather, natural disasters and future realised volatility should be considered as exotic underlyings;
- which instruments are instruments bearing residual risks; and
- risks that, in themselves, do not constitute residual risks.

The Delegated Regulation will enter into force on the twentieth day following that of its publication in the Official Journal.

PSD2: EU Commission adopts amending RTS on strong customer authentication as regards 90-day exemption for account access

The EU Commission has adopted a Delegated Regulation amending the RTS on strong customer authentication and common and secure open standards of communication laid down in Delegated Regulation (EU) 2018/389 as regards the 90-day exemption for account access.

In particular, the draft amending RTS:

- introduce into Commission Delegated Regulation 2018/389 a new mandatory exemption from the requirement to apply strong customer authentication (SCA). Under the exemption, account providers must not apply SCA when customers use an account information service provider to access their payment account information if certain conditions are met to ensure the safety and security of the payment service user's data. This

includes that data must be limited in scope, the account service payment service provider (ASPSP) has to apply SCA for the first access and periodically renew it, and the ASPSP may at any time decide to apply SCA if it has objectively justified and duly evidenced reasons for unauthorised or fraudulent access;

- limits the scope of application of the voluntary exemption in Article 10 of Commission Delegated Regulation (EU) 2018/389 to instances where the customer accesses the account information directly; and
- extends the timeline for the renewal of SCA from every 90 days to every 180 days where these exemptions apply.

ASPSPs that offer both a dedicated interface and a contingency mechanism are not required to implement the SCA exemption in the contingency mechanism, provided that they do not apply the SCA exemption in their direct customer channels.

ESMA proposes changes to EU regime for third country benchmarks

The European Securities and Markets Authority (ESMA) has published its response to the EU Commission's consultation on the regime applicable to the use of benchmarks administered in a third country.

ESMA's response comments on the functioning of the current regime and proposes improvements to the regulatory and supervisory framework as well as the EU benchmark labels. In particular, ESMA:

- proposes that the restrictions on the use of third country benchmarks should be removed following a risk-based approach while ensuring a level playing field between EU and third country administrators;
- supports the proposal to create a new category of 'strategic' benchmarks – this category would be the only category of benchmarks subject to mandatory restrictions of use, similar to the current rules; and
- argues that the introduction of an EU ESG benchmark label would be an extra supporting tool against greenwashing.

ESMA emphasises that, while the EU Benchmarks Regulation (BMR) covers a wide range of benchmarks used in the EU, so far very few jurisdictions have followed a similar regulatory approach regarding the provision and use of benchmarks. ESMA notes that the wide scope of the BMR would therefore lead to the undesirable outcome of limited availability of third country benchmarks to EU investors as opposed to their non-EU peers.

The EU Commission intends to prepare a report with recommendations on the effectiveness of the BMR to the EU Parliament and Council.

FCA encourages market participants to continue transition of LIBOR-linked bonds

The Financial Conduct Authority (FCA) has published a statement encouraging issuers of LIBOR-linked bonds (or those that may have a future LIBOR-linked dependency) issued under English or other non-US laws which make consent solicitation practicable to schedule consent solicitation processes for conversion to fair alternative rates. The FCA has emphasised that responsibility for initiating this process lies with the bond issuer.

The statement also encourages holders of bonds without robust fallbacks or another mechanism to remove reliance on LIBOR to engage with the relevant issuer(s) or their agent(s) and request that they initiate these conversion processes.

The FCA has also reminded issuers that the publication of synthetic yen LIBOR will cease at the end of 2022 and that it is consulting (CP22/11) on a proposal to cease the requirement to continue publication of the 1- and 6-month synthetic sterling LIBOR settings at the end of March 2023.

The USD LIBOR panel ends at the end of June 2023. The FCA reminds issuers that USD LIBOR bonds issued under English and other non-US law will not benefit from US legislation converting these to risk-free rates (RFRs) at the end of June 2023.

While the FCA is also consulting (CP22/11) on market participants' outstanding USD LIBOR exposure to help it consider whether to use its powers to require continued publication on a temporary and synthetic basis of the 1-, 3- and 6- month USD LIBOR settings after end-June 2023, it has warned market participants not to rely on such publication. The FCA notes that, if it does require publication of any synthetic USD LIBOR rates, this will be for a temporary period only. For longer-maturity bonds conversion through consent solicitation or other arrangements will be necessary.

BaFin publishes new circular on additional liquidity outflows for other products and services

The German Federal Financial Supervisory Authority (BaFin) has published its new Circular 07/2022 relating to additional liquidity outflows for other products and services pursuant to Article 23 of Commission Delegated Regulation (EU) 2015/61 (LCR DR). The circular applies to institutions under BaFin's direct supervision (LSIs).

The new circular, which replaces the previous Circular 12/2021, specifies the materiality criteria for the annual reporting of liquidity outflows required under Article 23 (2) LCR DR. In addition, BaFin has made a few changes to the content that arose from the need for clarification in practice.

By way of the new materiality criteria, BaFin intends to ensure that only those institutions submit an annual report for which the categories of products and services set out in Article 23 (1) (a) to (h) LCR DR are in fact relevant. The circular is intended to ease the regulatory burden on institutions, as many will in future be exempt from the annual reporting. At the same time, BaFin hopes to receive more targeted data from the institutions.

The new circular will enter into force with effect from its publication, so that the specified materiality criteria will apply immediately (i.e. for the reporting date 30 September 2022). The changes made in section 5 (Definition of the products and services according to Article 23 (1) LCR DR and determination of the respective outflow rates) compared to the previous circular will only apply as of 31 March 2023.

MAS publishes information paper on operational risk management specifically in relation to third-party arrangements

The Monetary Authority of Singapore (MAS) has published an information paper on operational risk management with a focus on management of third-party arrangements.

The information paper is based on a thematic inspection of the operational risk management (ORM) standards and practices of selected banks over 2020 and 2021 and primarily sets out good practices relating to third party risk management that the MAS expects to see in banks. All banks are expected to benchmark their practices against the information paper and take steps to address any gaps in a risk-appropriate manner, while non-bank financial institutions (FIs) are encouraged to adopt the recommended practices where relevant and appropriate to the materiality of the risks posed by their third-party arrangements.

The MAS has observed that banks have generally established frameworks and processes to provide oversight of operational risk, but implementation effectiveness needs improvement. With respect to third-party risk management, banks were found to have more established frameworks and processes to manage outsourcing arrangements compared to non-outsourcing arrangements.

Amongst other things, the MAS expects FIs to:

- establish a proper governance structure and framework to facilitate effective and adequate management attention on and oversight of operational risk and outsourcing arrangements;
- have a clearly defined operational risk appetite, supported by relevant indicators and thresholds, to articulate the nature, level and types of operational risk that they are willing to assume;
- establish a clear definition of operational risk and common operational risk taxonomy for consistent risk identification, assessment, and management across business units and the three lines of defence (LoDs);
- institute regular and comprehensive reports on analyses of operational risk profiles, assessments of material operational risk events or incidents (OREs), as well as areas of risk concerns and trends, to facilitate oversight of the operational risk landscape;
- maintain a comprehensive ORE dataset that contains consistent and standardised risk event information, including root causes, to facilitate trend analyses and identification of potential risk hotspots;
- specify clear requirements, and provide comprehensive guidance, on the due diligence and risk assessment processes for the onboarding of new outsourcing arrangements and periodic reviews of existing ones; and
- ensure that staff appointed for managing outsourcing arrangements are sufficiently trained and have the necessary seniority and competencies to discharge their responsibilities.

APRA publishes final reporting standards on updated capital framework for banks

The Australian Prudential Regulation Authority (APRA) has published final reporting standards to support the updated capital adequacy and credit risk capital requirements for authorised deposit-taking institutions (ADIs).

The publication accompanies the new bank capital framework, which is designed to embed strong levels of capital and align Australian standards with the internationally agreed Basel III requirements. It responds to the consultation released in April 2022 on APRA's proposed new reporting standards for capital adequacy and credit risk capital (Reporting Standard ARS 110.0 Capital Adequacy', 'Reporting Standard ARS 112.0 Capital Adequacy: Standardised approach to credit risk' (ARS 112.0), and 'Reporting Standard ARS 113.0 Capital adequacy: Internal ratings-based approach to credit risk' (ARS 113.0)), as well as consequential and other minor updates to the following ADI reporting standards (primarily as a result of APRA's ADI capital reforms):

- Reporting Standard ARS 180.0 - Counterparty Credit Risk;
- Reporting Standard ARS 221.0 - Large Exposures; and
- Reporting Standard ARS 223.0 - Residential Mortgage Lending.

Based on the feedback received to its April 2022 consultation, APRA has indicated that it is committed to meeting the 1 January 2023 implementation date, to complete the prudential reforms and provide ADIs with certainty for planning. To maximise the time available for entities' development of reporting solutions, APRA has included a copy of the publicly visible taxonomy with its response and will be making the collection available in the APRA Connect external test environment in early September 2022. APRA will also hold information sessions to provide more information regarding the submission of returns.

Federal Reserve Board issues guidance on cryptoasset-related activities

The Board of Governors of the Federal Reserve System (FRB) has issued supervisory letter SR 22-6 / CA 22-6 outlining steps Board-supervised banks should take prior to engaging in cryptoasset-related activities. These include assessing whether such activities are legally permissible and determining whether any regulatory filings are required. In addition, the supervisory letter states that a supervised banking organization should notify its lead supervisory contact at the Federal Reserve prior to engaging in crypto-asset-related activities. The letter emphasizes the importance of having adequate systems, risk management and controls in place to conduct cryptoasset-related activities in a safe and sound manner and consistent with applicable law prior to commencing such activities.

RECENT CLIFFORD CHANCE BRIEFINGS

Semiconductors – increasing governmental and regulatory scrutiny

Semiconductors are essential for many aspects of our lives – work, communication, energy production, healthcare and travel – as well as national

security systems and military hardware. A global shortage of semiconductors and increasing protectionism means that the industry is of major strategic and geopolitical importance to governments.

This briefing paper discusses the increasing regulation, what it means for M&A and some of the challenges that lie ahead.

https://www.cliffordchance.com/briefings/2022/08/semiconductors---increasing-governmental-and-regulatory-scrutiny.html

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