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International Regulatory Update

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OTC derivatives and market infrastructures: ECON Committee sets out position on proposed regulation

The European Parliament's ECON Committee has voted on the European Commission's proposal for a regulation on OTC derivatives, central clearing parties (CCPs) and trade repositories. The ECON Committee approved the Commission's draft with amendments.

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As regards supervision, the Committee envisages a central role for ESMA, which will work closely with national supervisory authorities, be involved in authorising new CCPs to the market, and be allowed to carry out on-site inspections.

In relation to scope, the Committee rejected suggestions by some EU Member States that all derivatives should be governed by the regulation. Instead, MEPs want the rules to apply only to OTC derivatives, as proposed by the Commission. However, they want reporting obligations to apply to all derivatives in order to ensure that ESMA has a fuller picture.

As regards exemptions to the clearing obligation, pension schemes will be subject to a special regime, provided that the national capital requirements provide a guarantee similar to cleared contracts.

The Committee noted concerns about applying clearing obligations retroactively and voted to make clearing mandatory only from the moment the regulation enters into force. However, with regard to reporting obligations, the ECON Committee's position invites ESMA to assess how reporting retroactivity could be introduced if the information in question were essential to the supervisory authorities.

The Parliament's plenary session is scheduled to vote on the proposal in July 2011.

AIFM Directive: EU Council formally adopts text

The EU Council has given its final approval to the AIFM Directive. The adopted text is expected to be published in the Official Journal in June 2011. The Directive will enter into force on the 20th day following its publication in the Official Journal, and Member States will have two years to transpose its provisions into national law.

ESMA Chair outlines objectives of regulatory initiatives

ESMA Chair Steven Maijoor has given a speech on the common objectives of current regulatory initiatives in the financial services sector, and how ESMA intends to promote them.

Mr. Maijoor indicated that ESMA is currently preparing its technical advice to the European Commission on the AIFM Directive and intends to launch a consultation in July 2011. He noted that one of the key elements of the advice will be proposals to ensure the availability of information to investors, including information that will allow investors to better assess the risk profile of the fund. Mr. Maijoor also indicated that ESMA will be publishing its views on possible policy options on exchange traded funds (ETFs) in the next few months. He noted that, while the focus was initially on investor protection issues and possible additional disclosure, the scope of the work in this area has since been enlarged to cover ETFs' practices as regards collateral and securities lending.

In addition, Mr. Maijoor considered the consequences of regulatory changes for the organisation of ESMA. He argued that the mandates that are being introduced in new pieces of legislation for ESMA to draft technical standards imply a different role for ESMA in the legislative process, which should be reflected in the institutional framework for the negotiation of the proposals. He added that ESMA should have the possibility to provide its views earlier, in the negotiation phase, or at least to observe the negotiations, in order to ensure consistency between directives and regulations and any technical standards and advice that ESMA is expected to draft. Mr. Maijoor concluded his remarks by acknowledging that most of the future requirements will translate into higher costs for financial firms in the short term, but urged firms instead to consider the benefits that will be achieved through increased transparency and stability, and the ability to prevent future crises.

Credit rating agencies: ESMA issues two calls for evidence on draft regulatory technical standards

ESMA has issued two calls for evidence to facilitate the process of drafting regulatory technical standards on credit rating agencies to be adopted by the European Commission. The aim of these calls for evidence is for ESMA to gather information from credit rating agencies and other interested parties to assist it in preparing public consultation papers on draft regulatory technical standards and an analysis of the potential related costs and benefits.

In particular, ESMA has invited evidence to assist it in drafting regulatory technical standards on: (1) the content and format of the ratings data periodic reporting to be requested from credit rating agencies for the purposes of ongoing supervision; and (2) the assessment of compliance of credit rating agencies with Article 8.3 of the Credit Rating Agencies Regulation (1060/2009/EC).

Responses are due by 20 June 2011.

Call for evidence on ratings data periodic reporting requirements for credit rating agencies
Call for evidence on the assessment of compliance of credit rating agencies with Article 8.3

Deposit guarantee schemes: ECON Committee votes on proposed changes

The European Parliament's ECON Committee has voted on the European Commission's July 2010 proposal to revise the Deposit Guarantee Schemes Directive. Amongst other things, the Committee voted to uphold the increased bank deposit protection limit of EUR 100,000, but to allow more room for the schemes to carry out preventive measures aimed at keeping a bank fully functional. Thus, whereas the Commission's proposal allowed one third of a scheme's funds to be used for this purpose, the Committee's position allows schemes to use nearly all their funds in this way, provided the members of the scheme are, together, considered by supervisors to be able to honour any payout obligations that may arise as well. A scheme must reach a target fund level of 1.5% of all deposits which it guarantees, but MEPs supported extending the Commission's proposed 10 year timeline for reaching this level to 15 years, arguing that this would allow EU banks to remain internationally competitive.

Similarly to the Commission proposal, MEPs supported a 'polluter pays' principle, whereby banks with greater risk profiles would be required to contribute more than banks with average risk. The Committee also voted for payouts of guaranteed savings to depositors within five working days rather than the seven days proposed by the Commission, although until the end of 2016 Member States may decide to apply a 20 working day payout deadline.

Commodity markets and raw materials: EU Council publishes conclusions

The EU Council (General Affairs) has issued conclusions welcoming the European Commission's February 2011 Communication which outlined its proposals on commodity markets and raw materials.

Amongst other things, the Council encouraged the Commission to come forward with proposals for better transparency and regulation on derivative commodity markets, within the framework of the revision of MiFID and the Market Abuse Directive and bearing in mind that the proposal for regulating OTC derivatives, central counterparties and trade repositories also has a bearing in this area.

The Council also stressed the need to improve the quality and availability of data on physical markets and derivatives markets, in particular OTC, to extend position reporting, and to give sufficient powers and tools to the respective supervisors to ensure a better coverage of physical and commodity derivatives markets, notably OTC, while preserving market liquidity.

MiFID: City of London reports on impact

The City of London has published a London Economics research report on the impact of MiFID in the context of global and national regulatory innovations. The objective of the study was to establish whether the findings concerning the impact of MiFID pre- and post-trade transparency requirements published in a similar London Economics report in 2010 apply generally across the EU or are UK-specific. The new report summarises the results of consultations with non-UK EU stakeholders that were undertaken and compares the findings to those from the consultation undertaken previously with UK stakeholders.

Financial sector taxation and bank levies: ECOFIN Council considers reports

The ECOFIN Council has published two reports, which it discussed at its meeting on 17 May 2011: (1) a report by the Council's Economic and Financial Committee providing a factual overview of financial levies and taxes in the Member States; and (2) an interim report from the EU Council Presidency on financial sector taxation, as discussed by the high level working party for tax issues.

The Economic and Financial Committee's report provides a factual overview of the introduction by Member States of systems of levies and taxes. It assesses short-term issues resulting from their implementation, in particular spill-over effects and the double charging of cross-border financial institutions. The report states that ten Member States have already introduced systems of levies and taxes, with four more currently in the process of doing so. The report also notes that most levies are being introduced with a certain flexibility towards an EU-wide solution at a later stage.

The report on financial sector taxation examines two options – a financial transactions tax and a financial activities tax. It stresses the importance of clarifying the purpose of such a tax, noting that it could be intended to serve as a source of revenue, a financial sector contribution to costs entailed by the financial crisis, a way of

curtailing risky financial activities or a means of heading off future financial crises. Finally, the report highlights the need to curtail the risk of relocation to financial centres outside the EU.

The ECOFIN Council invited the European Commission to present an impact assessment on various options of financial sector taxation before summer 2011.

Presidency Interim Report on Taxation of the Financial Sector
Draft Economic and Financial Committee report on financial levies and taxes

Basel III: IMF publishes working paper on bank behaviour

The IMF has published a working paper which investigates the impact of the new capital requirements introduced under the Basel III framework on bank lending rates and loan growth.

Amongst other things, the paper suggests that large banks will on average need to increase their equity-to-asset ratio by 1.3 percentage points under the Basel III framework and that this will lead large banks to increase their lending rates by 16 basis points, causing loan growth to decline by 1.3% in the long run. The paper also anticipates that banks' responses to the new regulations will vary considerably from one advanced economy to another (e.g. a relatively large impact on loan growth in Japan and Denmark and a relatively lower impact in the US), depending on cross-country variations in banks' net cost of raising equity and the elasticity of loan demand with respect to changes in loan rates.

ISDA publishes discussion paper on clearing issues

ISDA has published a paper on the economics of central clearing which discusses the purposes and function of, and the issues associated with, central clearing of OTC derivatives. The paper concludes that central counterparty clearing facilities (CCPs) can successfully reduce and reallocate counterparty risk through rigorous preparation for, and management of, member defaults.

On the subject of risk, the paper notes that CCPs can create systemic risk and argues that it is imperative that they have strong and conservative risk management and sufficient financial resources to withstand stressed markets, and that CCPs require close supervision by regulators. In addition, it observes that CCPs' margin policies can pose risks to the efficient functioning of the financial system. The paper warns that mandatory clearing of OTC derivatives will lead to a large amount of liquidity being tied up as margin at CCPs and that increases in margin requirements by CCPs during a crisis could be destabilizing. The paper recommends that CCPs should generally align control, governance and membership requirements with the interests of participants that absorb their risks and share their losses.

Retail structured products: Joint Associations Committee publishes combined principles

The Joint Association Committee (JAC), which comprises, amongst others, ISDA, ICMA and AFME, has re-released its set of principles for managing the provider-distributor relationship in retail structured products and the principles for managing the distributor-individual investor relationship, originally published in July 2007 and July 2008 respectively.

The JAC notes that, although they were originally published before the financial crisis, the principles address many of the same issues as those sought to be addressed by recent regulatory initiatives in a number of jurisdictions to improve investor protection. As a result, the JAC believes that now is an appropriate time to re-release the principles in order to both encourage their usage and help inform the current debate.

FSA consults on proposed guidance on supervisory formula method and significant risk transfer

The FSA has published proposed guidance setting out its expectations for firms using the supervisory formula method to calculate risk-weighted exposure amounts for unrated securitisation positions. The FSA has concerns that firms' use of the supervisory formula method undermines the significant risk transfer requirement with the reduction in risk-weighted exposure amounts due to the use of the supervisory formula method being disproportionate to the credit risk transferred. The FSA has indicated that, for firms to comply with the significant risk transfer test, it will generally expect them to obtain a public rating on retained tranches to apply the ratings based approach instead of using the supervisory formula method.

Comments are due by 22 June 2011.

FSA issues guidance on cooperation between insolvency practitioners and clearing houses in default situations

The FSA has published non-binding guidance on the cooperation between recognised bodies providing central counterparty services and insolvency practitioners to assist in the management of member defaults by recognised bodies. The guidance is intended to facilitate a closer understanding of the regime in Part VII of the Companies Act 1989 and the management of the respective responsibilities of recognised bodies and insolvency practitioners in a default situation.

CSSF clarifies new license requirement for non-EU/EEA professionals

The Commission de Surveillance du Secteur Financier (CSSF) has published its May 2011 newsletter, which clarifies the new licensing requirement for non-EU/EEA entities introduced by the law of 28 April 2011. Under the new law, which entered into force on 9 May 2011, these entities must be in possession of a Luxembourg license, not only if they have a Luxembourg branch but also if they come to Luxembourg occasionally or temporarily, notably to receive deposits or other repayable funds, or to provide any other service within the scope of the law of 5 April 1993 on the financial sector in Luxembourg. The CSSF has indicated that the requirement of 'coming to Luxembourg' has to be understood as 'moving in person' by one or more agents of the non-EU/EEA entity to Luxembourg.

To enable the concerned entities to comply with this new license requirement, the CSSF has invited them to send a notification to the CSSF as soon as possible, indicating their identity and the activities envisaged or carried out by them in Luxembourg. Based on the notifications received, the CSSF may publish more details relating to the licensing proceedings and conditions.

SFC consults on legislation to implement short position reporting

The Securities and Futures Commission (SFC) has issued a consultation paper on the proposed subsidiary legislation that will give effect to the short position reporting regime announced in the 'Consultation Conclusions on Increasing Short Position Transparency' dated 2 March 2010. Under the reporting regime, a short position that hits the threshold of 0.02% of the issued share capital of a listed company or a market value of HKD 30 million, whichever is lower, has to be reported to the SFC on a weekly basis. In general, the party who beneficially owns the short position will be responsible for the reporting.

The SFC has indicated that the reporting requirement will only apply to the constituent stocks of the Hang Seng Index, the Hang Seng China Enterprises Index and other financial stocks specified by the SFC, and may be tightened to increase transparency and monitoring in contingency situations. The SFC will also provide an electronic reporting facility and a template for reporting. Aggregated short positions of each stock will be published, on an anonymous basis, a week after the SFC's receipt of the reports.

Comments on the proposed legislation are due by 30 June 2011.

OTC forex derivatives: RBI amends guidelines

The Reserve Bank of India (RBI) has issued amendments to its guidelines on OTC foreign exchange derivatives and overseas hedging of commodity prices and freight risks, which were issued on 28 December 2010. In particular, the amendments revise the eligibility criteria for users of cost reduction structures. Under the revised eligibility criteria, listed companies and their subsidiaries/joint ventures/associates that have a common treasury and consolidated balance sheet or unlisted companies with a minimum net worth of INR 200 Crore can undertake cost reduction structures subject to conditions.

The RBI has indicated that the revised eligibility criteria will also be applicable to users of OTC option strategies involving a simultaneous purchase and sale of options for overseas commodity hedging.

OCC consults on proposed rule implementing transfer of functions from Office of Thrift Supervision

The Office of the Comptroller of the Currency (OCC) has issued a notice of proposed rulemaking implementing several provisions of the Dodd-Frank Act, including the transfer of functions from the Office of Thrift Supervision and changes to national bank preemption and the OCC's visitorial authority. The Dodd-Frank Act mandates that the OCC assume responsibility for the ongoing examination, supervision, and regulation of Federal savings associations as of 21 July 2011.

Amongst other things, the OCC is proposing to amend the regulations governing its organization and functions, the availability and release of information, and post-employment restrictions for senior examiners, as well as to

amend its assessment fee rule to include Federal savings associations, in order to facilitate the transfer of certain functions of the Office of Thrift Supervision to the OCC pursuant to Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition, the OCC is proposing amendments to its rules pertaining to change in control of credit card banks and trust banks to implement section 603 of the Act, deposit-taking by uninsured Federal branches to implement section 335 of the Act, and its preemption and visitorial powers rules, subpart D, to implement various other sections of the Act.

Comments are due by 27 June 2011.

RECENT CLIFFORD CHANCE BRIEFINGS

Bank resolution regimes – comparative analysis

Regulators continue to work on developing more effective tools for resolving failed banks and other systemically important financial institutions. The aim is to put an end to the idea that any institution is 'too big to fail' and so can depend on taxpayer support to avoid insolvency.

This briefing compares key aspects of the UK, German and US bank resolution regimes (including the orderly liquidation authority under the Dodd-Frank Act) with the proposals published by the European Commission for new EU resolution tools for banks and significant investment firms. It also compares certain aspects of the Commission's proposed debt write-down ('bail-in') resolution tool with the requirements published by the Basel Committee on loss absorbency at the point of non-viability.

http://www.cliffordchance.com/publicationviews/publications/2011/05/bank_resolution_regimes-comparativeanalysis.html

European contract law – draft code published

The European Commission wants a European contract law. As part of its long march towards this nirvana, it has published and asked for comments on a 'feasibility study' (i.e. a draft contract code). This is the first time that the Commission has officially opened up the content, as opposed to the concept, of its code to scrutiny. The draft code covers primarily the sale of goods and services, involving both business to consumer and business to business contracts, but if the current draft is eventually pushed into law, it will form the foundation for the Commission's inexorable expansion into other areas. The draft code should, therefore, concern everyone. Judged against precepts of freedom of contract and certainty, the draft code is wanting.

http://www.cliffordchance.com/publicationviews/publications/2011/05/european_contractlawdraftcodepublished.html

New EU decision-making landscape – delegated acts & implementing acts

The Lisbon Treaty introduced two new articles that allow the EU Member States and European Parliament to delegate power to the European Commission to adopt delegated acts and implementing acts. For the financial services and insurance sectors, these acts introduce an additional layer of complexity to the EU legislative landscape.

This briefing paper explains when these acts are called for, how they are adopted and how they fit into the new European financial supervisory structure.

http://www.cliffordchance.com/publicationviews/publications/2011/05/new_eu_decision-makinglandscapedelegatedact.html

EU Transparency Register: new rules on lobbying in the European Parliament and Commission

On 11 May 2011, the European Parliament voted to set up a joint register of lobbyists that would combine the existing registers of the Parliament and the European Commission. The Council has for the moment decided not to participate.

This briefing provides an in-depth review and considers the next steps.

http://www.cliffordchance.com/publicationviews/publications/2011/05/eu_transparency_registernewrulesonlobbyin.html

India permits foreign investment in limited liability partnerships

The Indian government has now permitted foreign direct investment in Indian limited liability partnerships involved in certain kinds of business activities and subject to strict guidelines. These guidelines do not clarify whether there are any restrictions on the price at which a foreign partner may purchase interest in an Indian LLP or sell such interest to an Indian resident.

This briefing provides an overview of the terms and conditions issued by the Indian government for permitting foreign direct investment in an Indian LLP.

http://www.cliffordchance.com/publicationviews/publications/2011/05/india_permits_foreigninvestmentinlimite.html

US Regulatory Update – SEC issues final whistleblower rules

On 25 May 2011, the SEC, by a divided vote of 3-2, adopted final rules implementing the controversial whistleblower provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Dodd-Frank Act amended the Securities Exchange Act of 1934 to add Section 21F, which requires the SEC to pay whistleblowers awards (subject to limitations and conditions) of 10% to 30% of any sanctions collected when they voluntarily provide the SEC with original information about a violation of the US securities laws that leads to a successful SEC enforcement action resulting in sanctions exceeding USD 1 million. The final rules define eligibility for an award and set forth the procedures whistleblowers must follow to be eligible for an award.

This briefing discusses the final rules, which create significant incentives for whistleblowers to report suspected securities law violations to the SEC and usher in a new era of increased regulatory risk for companies. Significantly, the rules do not require the whistleblower first to report the matter to the company's internal compliance apparatus. The rules place a premium on prevention, and indirectly incentivize companies to voluntarily disclose issues earlier and more often.

http://www.cliffordchance.com/publicationviews/publications/2011/05/us_regulatory_updatesecissuesfina.html

New US sanctions against PDVSA

The US Department of State has imposed sanctions on Petróleos de Venezuela S.A. (PDVSA) under the Iran Sanctions Act, as amended by the Comprehensive Iran Sanctions, Accountability and Divestment Act of 2010 (CISADA). Although State has now imposed CISADA sanctions on a total of nine firms, the only target of any financial or economic significance to the US and world economy is PDVSA.

This briefing discusses the new sanctions.

http://www.cliffordchance.com/publicationviews/publications/2011/05/new_us_sanctionsagainstpdvsa.html

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