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Briefing note

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- Recent Clifford Chance briefings: LIBOR reform and contractual continuity; Hong Kong consults on financial institution resolution regime; and more. Follow this link to the briefings section.

Short selling: European Court of Justice dismisses UK legal challenge

The European Court of Justice (ECJ) has delivered its judgment on the United Kingdom's legal challenge against the regulation on short selling and certain aspects of credit default swaps. The UK had asked the ECJ to annul Article 28 of the regulation, which empowers ESMA to prohibit or impose conditions on the entry by natural or legal persons into short sales or similar transactions, or to require such persons to notify or publicise such positions.

The UK had argued that Article 28 is unlawful on the basis that:

- it is contrary to the second principle established by the Court of Justice in Case 9/56 Meroni v High Authority, because:
  - the criteria as to when ESMA is required to take action under Article 28 entail a large measure of discretion;
  - ESMA is given a wide range of choices as to what measure or measures to impose, and what exceptions to specify, and these choices have very significant economic policy implications;
  - the factors which ESMA must take into account contain tests which are highly subjective;
  - ESMA is empowered to renew its measures without any limit on their overall duration; and
  - even if (contrary to the UK's submissions) Article 28 did not involve ESMA in making macroeconomic policy choices, ESMA nonetheless has a broad discretion as regards the application of policy to any particular case;
- Article 28 purports to empower ESMA to impose measures of general application which have the force of law, contrary to the Court's decision in Case 98/80 Giuseppe Romano v Institut national d'assurance maladie-invalidité;
- Article 28 purports to confer on ESMA a power to adopt non-legislative acts of general application, whereas in the light of Articles 290 and 291 of the Treaty on the Functioning of the European Union (TFEU), the Council has no authority under the Treaties to delegate such a power to a mere agency outside of these provisions; and
- if and to the extent that Article 28 were interpreted as empowering ESMA to take individual measures directed at natural or legal persons, it would be ultra vires Article 114 TFEU.

The ECJ has rejected the UK's arguments and dismissed the legal challenge, finding that ESMA's power to adopt emergency measures on the financial markets of the Member States in order to regulate or prohibit short selling is compatible with EU law and that, circumscribed by various conditions and criteria which limit that authority's discretion, the exercise of that power does not undermine the rules governing the delegation of powers laid down by the Treaty on the Functioning of the European Union.

SEPA: EU Council confirms deal with Parliament on extension of deadline for migration

The Permanent Representatives Committee has, on behalf of the EU Council, approved an agreement with the EU Parliament on a proposed regulation that postpones to 1 August 2014 the end-date in the euro area for the migration of domestic and intra-European credit transfers and direct debits in euros towards Single Euro Payments Area (SEPA) credit transfers and SEPA direct debits. The draft regulation, presented by the EU Commission on 9 January 2014, amends regulation 260/2012 on the migration to EU-wide credit transfers and direct debits, which had set a deadline of 1 February 2014. The postponement was proposed by the Commission for reasons of legal certainty and in order to avoid any discontinuity to the application of regulation 260/2012.

The EU Parliament is expected to vote accordingly in its plenary session in February 2014. The Council will subsequently formally approve the legislation without further discussion.

EU Commission adopts Delegated Regulation on calculation methods of capital adequacy requirements for financial conglomerates

The EU Commission has adopted a Delegated Regulation supplementing the Financial Conglomerates Directive and the Capital Requirements Regulation with regard to regulatory technical standards for the application of the calculation methods of capital adequacy requirements for financial conglomerates. The Delegated Regulation puts forward rules intended to ensure that institutions that are part of a financial conglomerate apply the appropriate calculation methods for the determination of required

capital at the level of the conglomerate. In particular, these rules are based on the following elements:

- elimination of multiple gearing;
- elimination of intra-group creation of own funds;
- transferability and availability of own funds; and
- coverage of deficit at financial conglomerate level having regard to definition of cross-sector capital.

EU Commission to consult European public on provisions in EU-US trade deal on investment and investor-state dispute settlement

EU Trade Commissioner Karel De Gucht has announced his decision to consult the public on the investment provisions of a future EU-US trade deal, known as the Transatlantic Trade and Investment Partnership. The Commission intends to publish a proposed EU text for the investment part of the talks, which will include sections on investment protection and on investor-to-state dispute settlement, in early March 2014. The draft text will be accompanied by explanations for non-experts. People across the EU will then have three months to comment. The EU-US negotiations for the Transatlantic Trade and Investment Partnership started in July 2013 and aim at removing trade barriers in a wide range of economic sectors to make it easier to buy and sell goods and services between the EU and the US. The third round of negotiations took place in Washington DC in December 2013 and the next round is scheduled for March 2014.

EMIR: ESMA publishes technical advice on procedural rules to impose fines on trade repositories

The European Securities and Markets Authority (ESMA) has published its final technical advice to the EU Commission on the future regulation on the procedural rules to impose fines and periodic penalty payments to trade repositories, which will be adopted by the Commission in the form of a delegated act under the European Market Infrastructure Regulation (EMIR). In order to deliver its advice, ESMA consulted market participants regarding the proposed procedural rules. ESMA has indicated that all of its major proposals were supported by the respondents to the consultation.

ESMA submitted its technical advice to the Commission on 20 December 2013.

Basel Committee consults on revised good practice principles for supervisory colleges

The Basel Committee on Banking Supervision has issued a consultative document on revised good practice principles for supervisory colleges. The original good practice principles on supervisory colleges were published in October 2010, and included a commitment to review the principles to take stock of any key lessons learned from their use. The consultative document updates the principles following a review of practical challenges in their implementation and possible areas of additional best practices.

The Committee intends to ensure that the principles remain fit for purpose and that they describe how high quality colleges typically function. The key changes include the following:

- Principle 1 now places greater emphasis on collaboration and information-sharing on an ongoing basis;
- Principle 2 provides greater clarity on the expectation to strike a balance between core college effectiveness and host involvement;
- Principles 3 includes the expectation that home and host supervisors will put in place appropriate mechanisms and sufficient resources for effective and timely information exchange;
- Principle 6 encourages home and host supervisors to agree on the types of feedback provided to banks and ensure consistency in how such feedback is provided;
- Principle 7 differentiates between banks that have established crisis management groups (CMGs), e.g. systemically important banks, and banks that do not have a CMG – for the former, guidance is provided on possible communication and coordination between the college and CMG on crisis preparedness; and
- alignment across the principles in terms of how macroprudential information is shared and utilised.

Comments are due by 18 April 2014.

Basel Committee sets out fundamental elements of banks' capital planning processes

The Basel Committee on Banking Supervision has published a paper entitled 'A Sound Capital Planning Process: Fundamental Elements', which sets out sound practices intended to foster an overall improvement in banks' capital planning practices.

Amongst other things, the paper:

- emphasises the importance of a formalised capital planning process that is administered through an effective governance structure;

- discusses the role of a capital policy in codifying guidelines that senior management will rely upon in making decisions about capital deployment or preservation, and also reiterates the importance of sufficient risk capture;
- highlights the benefits of incorporating forward-looking measures about potential capital needs into a bank's capital planning process; and
- summarises the need for a formal management process to consider and prioritise a range of actions that could be taken to preserve capital.

PRA and FCA consult on proposed management expenses levy limit for Financial Services Compensation Scheme

The Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) have published a joint consultation paper outlining the proposed management expenses levy limit (MELL) for the Financial Services Compensation Scheme (FSCS) for 2014/5. The MELL consulted on for 2014/15 is GBP 80 million.

The consultation closes on 17 February 2014.

PRA consults on proposed changes to Handbook

The PRA has published a consultation paper (CP2/14) setting out proposed changes to rules and policy material contained in the PRA Handbook. CP2/14 is the first in a series of planned consultations over two years, aimed at reshaping the Handbook material inherited from the Financial Services Authority (FSA) to create a rulebook containing PRA rules only.

Amongst other things, the consultation paper sets out:

- the PRA's proposal to replace the six Principles for Business inherited from the FSA with the Fundamental Rules;
- proposed changes to the rules on the PRA's information gathering powers on its own initiative;
- proposed changes to the rules on the use of the power in section 166 (Reports by skilled persons) and section 166A (Appointment of skilled person to collect and update information) of FSMA;
- the PRA's intention to update its statement of policy on the exercise of the financial stability information power; and
- the PRA's plan to move the table on the application of the Handbook to incoming EEA firms in SUP 13 Annex 1 to the PRA website.

CP2/14 also addresses the recommendation by the Parliamentary Commission on Banking Standards (PCBS) that the Principles should be amended to include a requirement that a bank must operate in accordance with the safety and soundness of the firm and that directors' responsibilities to shareholders are to be interpreted in the light of this requirement.

The consultation closes on 21 March 2014.

Bill to implement CRD 4 package submitted to Dutch Parliament

The Dutch government has submitted to Parliament a bill which, once enacted, would implement the CRD 4 package in Dutch law. Besides implementing the capital requirements of the CRD 4 package and providing for supervisory tools of the Dutch Central Bank (DCB), the legislative proposal provides for, amongst other things, the possibility of a temporary ban against a member of a bank or investment firm's management body or any other natural person who is held responsible for breaches of prudential requirements, from exercising functions in such firms or in group companies. Such a ban would have a maximum term of one year, subject to a possible extension of another year.

Furthermore, the bill includes the CRD 4's provisions on the corporate governance of banks and investment firms, including:

- the bonus cap of 100% applicable to employees whose professional activities have a material impact on the firm's risk profile (which may be increased to 200% if shareholders give their consent); and
- the 'living will' of banks, i.e. banks and investment firms shall put in place recovery plans for the restoration of their financial situation following a significant deterioration and the DCB shall put in place appropriate resolution plans setting out options for the orderly resolution of relevant institutions in the case of failure.

In relation to the new bonus cap requirements, the Dutch government intends to decrease the cap further to 20% of fixed salary. A draft legislative proposal including strict remuneration rules for the entire financial sector was published for consultation in November 2013. These stricter rules would, if adopted, apply from 1 January 2015.

FINMA consults on amendments to its circular on liquidity of banks

In the context of the proposed revision of the Liquidity Ordinance to introduce a short-term liquidity coverage ratio based on the Basel III minimum standard in 2015, the Swiss Financial Market Supervisory Authority (FINMA) has launched a consultation on a revision of its Circular 2013/6 'Liquidity – banks'.

Amongst other things, the proposed revision includes:

- requiring banks to have a minimum level of high quality assets as a liquidity reserve and to demonstrate that they can survive a significant stress scenario lasting for one month;
- introducing a phrased implementation of the short-term liquidity coverage ratio for all banks (apart from systemically important banks) starting in 2015; and
- introducing structural measures and net stable funding ratios in 2018 to supplement quantitative liquidity standards.

The consultation period ends on 28 March 2014.

Swiss National Bank proposes to increase countercyclical capital buffer

Following consultation with FINMA, the Swiss National Bank (SNB) has proposed to the Federal Council to increase the sectoral countercyclical capital buffer (CCB) from 1% to 2% of risk-weighted positions secured by residential property situated in Switzerland. The proposed increase in the level of the sectoral CCB is expected to result in a further rise in the capital requirements for mortgage loans on residential property in Switzerland.

The proposed deadline for compliance with the increased CCB requirements is 30 June 2014.

Chinese authorities issue administrative measures on blocking assets in relation to terrorist activities

The People's Bank of China (PBOC), the Ministry of Public Security (MPS) and the Ministry of State Security (MSS) have jointly issued administrative measures to further clarify the procedures and requirements for blocking assets in relation to terrorist activities, which became effective as of 10 January 2014.

Amongst other things, the measures state that:

- financial institutions and certain non-financial institutions that are subject to anti-money laundering obligations under the PRC Anti-money Laundering Law (AML institutions) are strictly required to block assets in relation to the list of terrorist organisations and terrorists and relevant blocking decisions as published by the MPS (terrorist-related assets);
- once terrorist-related assets are blocked, AML institutions shall submit written reports to the MPS, MSS and PBOC regarding the amount, ownership, location and trading information of the terrorist-related assets and notify the relevant customers of the reasons for blocking their assets in a timely manner; and
- AML institutions shall assist with the investigations of the MPS, MSS and PBOC in accordance with the applicable laws and provide relevant information regarding the terrorist-related assets.

SFC issues circular on risks associated with virtual commodities

The Securities and Futures Commission (SFC) has issued a circular to remind licensed corporations and associated entities to take all reasonable measures to ensure proper safeguards exist to mitigate the money laundering and terrorist financing risks associated with virtual commodities.

The circular notes that, under the Guideline on Anti-Money Laundering and Counter-Terrorist Financing, services that inherently provide more anonymity present higher money laundering and terrorist financing risks. Where relevant to their business, licensed corporations and associated entities are advised to guard against the money laundering and terrorist financing risks associated with potential or existing customers that are operators of schemes related to virtual commodities.

Licensed corporations and associated entities are advised to take into account the money laundering and terrorist financing risks associated with virtual commodities including, where relevant, whether the customer that is a virtual commodity scheme operator has established and implemented effective controls against money laundering and terrorist financing involving the virtual commodities. Where a high money laundering and terrorist financing risk situation is identified as a result of this assessment, licensed corporations and associated entities are advised to take additional measures, as provided in the Guideline on Anti-Money Laundering and Counter-Terrorist Financing.

The SFC has also reminded licensed corporations and associated entities of their statutory obligations to make a report to the Joint Financial Intelligence Unit if customer due diligence and ongoing monitoring reveal any

suspicious activity related to money laundering and terrorist financing on a customer account.

FSC announces plan to improve security of derivatives transactions

The Financial Services Commission (FSC), Financial Supervisory Services (FSS), Korea Exchange (KRX) and Korea Financial Investment Association (KOFIA) have jointly announced a plan to improve the security of derivatives transactions. The plan is intended to prevent accidents of huge losses caused by erroneous orders as well as to reduce settlement risks and excessive price fluctuation in derivatives trading.

The key measures under the plan include:

- strengthening securities firms' internal controls – the FSC will encourage securities firms to voluntarily reinforce their internal control standards to prevent excessive orders that exceed the limit bid or limit offer, and the FSS and the KRX will also strengthen their oversight on such trading;
- introducing price banding limits – considering the limitations exposed by current safety mechanisms in responding to excessive price fluctuations, the FSC plans to introduce price banding limits on futures and options trading. Upon implementation, investors will only be allowed to place orders of futures and options transaction within a certain range of the latest trade price during market hours; and
- improving remedies for erroneous orders – currently, derivatives prices could only be corrected when the two respective parties of the transaction reach an agreement, but the KRX will be given direct authority to cancel orders if a transaction is deemed to pose threats to the security of trading settlement. For those who erroneously place orders, punitive commission will be charged.

The FSC has indicated that the plan will be implemented within the first half of 2014 after revising related regulations. Detailed measures will be finalised based on discussions with related experts from the industry.

FSC forms task force to develop measures for customer data protection

The FSC has formed a task force to respond to the recent leakage of personal information of certain credit card holders. Headed by the FSC, the task force held its first meeting on 17 January 2014 to discuss how to prevent the consequences of the incident from spreading and to identify measures to prevent the re-occurrence of such incidents.

Amongst other things, the task force will seek to:

- overhaul the current private information protection system;
- devise a plan to strengthen financial institutions' responsibility on data protection;
- reinforce punitive actions regarding customer information protection;
- regulate the use of leaked data in promoting financial products;
- announce a financial customer data protection plan to each financial company;
- inspect all financial institutions and distribute self-inspection check lists;
- set best practices on customer data protection;
- strengthen management of outsourced service companies; and
- establish an internal information technology (IT) control system and strengthen IT system security.

The FSC requires all financial institution to submit their customer data protection plan to the task force at the end of January 2014. The task force will develop a final plan to better protect personal information of customers held by financial firms in February 2014. The FSC plans to revise the Protection of Credit Information Act, Electronic Financial Transaction Act and other related acts, starting from March 2014.

DFSA publishes sixth issue of Markets Brief on ongoing market disclosure

The Dubai Financial Services Authority (DFSA) has published Markets Brief Issue No. 6, January 2014 – Ongoing Market Disclosure. This issue sets out the DFSA's policy on ongoing market disclosure requirements in relation to dividends and other distributions by reporting entities, and connected persons' disclosures.

Amongst other things, it states that in the case of debentures, where there is any degree of discretion in periodic distribution payments or their dates, or if the rate calculation is based on a variable or floating rate, then additional market disclosure via a Regulatory Announcement Service will be required when a decision is taken regarding a distribution or a rate calculation is made (in accordance with Markets Rule 4.1 of Appendix 2).

The DFSA also notes that a number of issues have arisen regarding compliance with the DFSA's Connected Persons Rules. Markets Brief Issue No. 6 reiterates the triggers for disclosures to the DFSA and to the market (through Regulatory Announcement Services) in the case of changes to Connected Persons and the means by which such disclosures should be made.

RECENT CLIFFORD CHANCE BRIEFINGS

Developments in US and EU Sanctions Compliance

On 20 January 2014, a six month partial suspension of US and EU sanctions in relation to Iran came into effect. This briefing summarises the key issues, as well as other developments of interest affecting the US and EU sanctions compliance in recent months.

http://www.cliffordchance.com/publicationviews/publications/2014/01/developments_in_usandeusanctionscompliance.html

ICMA consults on sovereign bonds

The International Capital Market Association (ICMA) is consulting on the appropriate form of collective action clauses and pari passu provisions for sovereign bonds. Both proposals raise important issues, particularly in the context of sovereign debt restructuring. Collective action clauses can facilitate debt restructuring while, as shown by the ongoing litigation against Argentina, pari passu clauses can hinder the process. But how should the desire of a sovereign to ease the path to a debt restructuring be weighed against the entitlement of bondholders to be paid? How should the rights of the holders of different bonds be balanced? How can the risk of triggering an accelerated exit be avoided? How much say should creditors have in determining the depth and/or shape of any restructuring? How can creditor coordination be enhanced? ICMA's consultation offers bondholders the chance to have their say.

This briefing discusses the key points of the consultation.

http://www.cliffordchance.com/publicationviews/publications/2014/01/icma_consults_onsovereignbonds.html

LIBOR reform and contractual continuity – issues for the financial markets

LIBOR is used as a benchmark in a vast number of contracts globally. Market participants are questioning what will happen to their contracts if the way in which LIBOR is calculated is changed. Although the outcome will depend on the precise terms of the contract, the circumstances in which it was entered into and what happens to LIBOR, the English courts will be well aware of the wider importance to the financial markets of any decision they make and should strive to ensure as little disruption to the financial markets as possible. They have a number of tools at their disposal to achieve continuity (notably contractual interpretation and implication of terms) and will also rely to the extent possible, on any contractual interest rate fall-back provisions.

This briefing discusses LIBOR reform and its effect on contractual continuity.

http://www.cliffordchance.com/publicationviews/publications/2014/01/libor_reform_andcontractualcontinuityissue.html

Corporate Update January 2014

Clifford Chance has produced the January 2014 edition of its bi-annual Corporate Update, which provides a round-up of developments in company law and corporate finance regulation over the last six months and looks ahead to forthcoming legislative and regulatory changes.

As previous editions of Corporate Update and our recently published 2014 AGM Update have included features on the new requirements for reporting directors' remuneration, we take a breather from the detail of that particular initiative and look instead at BIS' proposals to require UK companies to identify the beneficial owners of their shares. These plans are not without controversy and include the maintaining of a register of this information, which BIS intend should be open to the public, which will place an additional burden on companies.

On the regulatory front, we consider the FCA's plans to press ahead with the introduction of new Listing Rules to require a written agreement to be put in place between a listed company and its controlling shareholders (30% or more) to ensure that the listed company can act independently of any such shareholders. These plans have now been largely finalised and are expected to be in force by autumn 2014.

Among other items, we also review the new powers granted to the FCA in October 2013 which enable it to publish information about enforcement action against individuals or firms, including their identity, at an earlier stage than was previously the case and, crucially, before the person in question has had an opportunity to formally challenge the case against them.

http://www.cliffordchance.com/publicationviews/publications/2014/01/corporate_update-january2014.html

It's in the trees! It's coming! – The new Senior Managers and Certification Regimes receive Royal Assent

The close of 2013 saw proposed changes to the way individuals in the banking sector are supervised move a step closer as the Financial Services (Banking Reform) Bill completed its eventful parliamentary journey.

The Bill received royal assent on 18 December and became the Financial Services (Banking Reform) Act. Amongst the important changes to the regulatory landscape for banks and certain investment firms will be the introduction of new 'Senior Managers' and 'Certification' regimes, which will bring a wider range of individuals than ever before within the ambit of a stricter supervisory regime.

Although the legislative process has been completed, the majority of the Act has yet to come into force (including the new criminal offence). Many aspects of the new Senior Managers and Certification regimes have been left to be determined by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) through their rule making powers. They propose to consult during the course of 2014, with the new regimes expected to come into force during 2015.

This briefing discusses the new regimes and their impact.

http://www.cliffordchance.com/publicationviews/publications/2014/01/it_s_in_the_treesitscoming-thenewsenio.html

Claw-back and revision of bonuses – new rules per 1 January 2014

Directors' bonuses can be revised if they are unreasonably high and can be clawed back if they are awarded on the basis of incorrect information. Furthermore, a new rule states that if the value of the shares held by directors increases as a result of a public offer, the difference in value will be deducted from their remuneration. Any such revision, claw-back or deduction, has to be reported in the explanatory notes to the annual accounts.

This briefing elaborates on these new rules.

http://www.cliffordchance.com/publicationviews/publications/2014/01/claw-back_and_revisionofbonusesnewrulespe.html

Putting the records straight

New information gathering powers and record keeping requirements apply to certain DIFC registered and recognised companies from 15 December 2013.

Changes to the DIFC Companies Law of 2009 which came into force on 15 December 2013 change the accounting record keeping requirements of both DIFC companies and foreign 'Recognised Companies' operating in the DIFC and extend information gathering powers to the DIFC Companies Registrar.

Amendments have also been made to the General Partnerships Law of 2009, the Limited Partnership Law of 2006 and the Limited Liability Partnership Law of 2004 to introduce equivalent accounting record keeping requirements for the types of entities governed by these rules.

This briefing highlights the key changes that the amendments have introduced, which include:

- a reduction in the minimum time period for maintaining accounting records;
- an additional requirement to maintain underlying documents in respect of recorded transactions;
- the extension of record keeping requirements and information gathering powers to foreign 'Recognised Companies' operating in the DIFC; and
- broad powers for the DIFC Companies Registrar to obtain any information from a DIFC Company or a Recognised Company considered desirable in order to fulfil any of its purposes.

http://www.cliffordchance.com/publicationviews/publications/2014/01/putting_the_recordsstraight.html

Too big to fail? Hong Kong consults on financial institution resolution regime, but it is just the start…

Resolution regimes, and their stablemate, regulatory capital, are hot news. Hong Kong has joined the party, with the launch on 7 January of a three month consultation process on the establishment of a resolution regime for financial institutions. The proposals in the 141 page consultation paper seek to put in place an argument for Hong Kong to have a resolution regime encompassing all the key attributes required by the Financial Stability Board to be implemented in its member jurisdictions, including Hong Kong. Overall the general framework proposed in the paper is familiar but, perhaps inevitably, the complexity of the underlying issues means that many of the most thorny

have been parked for the second stage of consultation later this year.

This briefing discusses the proposals.

http://www.cliffordchance.com/publicationviews/publications/2014/01/too_big_to_fail_hongkongconsultsonfinancia.html