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Briefing note

# International Regulatory Update

## 11 - 15 April 2016

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**Data protection reform: EU Parliament approves final package**

The EU Parliament plenary session has adopted the EU data protection reform package, which comprises the General Data Protection Regulation (GDPR), setting out rules for individuals and businesses, and the Data Protection Directive relating to law enforcement.

The GDPR includes provisions on:

- a right to be forgotten;
- 'clear and affirmative consent' to the processing of private data;
- a right to transfer data to alternative service providers;
- the right to know when personal data has been hacked;
- clear and understandable explanations of privacy policies; and
- enforcement and penalty fines up to 4% of firms' total worldwide annual turnover.

The GDPR will enter into force 20 days after its publication in the Official Journal and will apply two years after this date.

The Directive includes provisions relating to data transfers across borders within the EU for police and criminal justice authorities and will set minimum standards for data processing for policing purposes within Member States. There will be a two year transposition period after publication in the Official Journal.

**Money market funds: EU Council Presidency publishes compromise proposal**

The EU Council Presidency has published a compromise text for the proposed regulation on money market funds (MMFs).

**CRR: EBA reports on securitisation, risk retention, due diligence and disclosure**

The European Banking Authority (EBA) has published a report reviewing the supervisory measures taken by competent authorities in 2014 to ensure compliance with securitisation risk retention, disclosure and due diligence requirements, in line with the mandate in Article 410(1) of the Capital Requirements Regulation (CRR). In the report the EBA identifies a number of general supervisory best practices to guide competent authorities in their supervisory assessments of compliance with the requirements.

The report found that most institutions are generally undertaking appropriate actions to comply with the requirements, with only ten cases of non-compliance with risk retention and due diligence reported since the rules were introduced in 2011.

The report also found that all of the EBA recommendations on enhancing regulation of risk retention, due diligence and disclosure rules, as set out in the December 2014 EBA opinion, have been taken on board in the proposals for a new EU securitisation framework issued by the Commission.

**EBA publishes opinion on due diligence measures for customers who are asylum seekers from high risk jurisdictions**

The EBA has published an opinion setting out measures credit and financial institutions can take to comply with EU Anti- Money Laundering and Counter-Terrorist Financing (AML/CFT) requirements when providing asylum seekers from higher-risk jurisdictions with access to basic financial products and services.

The opinion is addressed to competent authorities and promotes the development of a consistent approach to applying due diligence measures to customers who are asylum seekers from high-risk jurisdictions. The EBA highlights that providing asylum seekers with access to financial products and services is important and necessary, and should be accompanied with proportionate and effective anti money laundering and counter-terrorist financing control. The EBA suggests that money laundering and terrorist financing risks can in most cases be managed effectively by offering a limited range of services or setting up stricter monitoring controls, which will facilitate early intervention in the event of suspicion.

**ESMA publishes opinion on EU framework for loan origination by investment funds**

The European Securities and Markets Authority (ESMA) has published its opinion on a common European framework for loan origination by investment funds.

As part of its work on building a Capital Markets Union (CMU), the EU Commission asked ESMA to provide input on the key issues on which a consultation on the elements of a European framework on loan origination could focus.

Loan origination refers to investment funds providing credit, acting as a sole or primary lender, to borrowers such as SMEs. This represents an alternative form of market-based financing.

ESMA believes the elements presented in its opinion should ideally form part of a harmonised European framework, either through a legislative proposal or by way of an ESMA instrument supplementing the Alternative Investment Fund Managers Directive (AIFMD).

The Commission plans to issue a public consultation on the matter in Q2 2016.

**EMIR: ESMA publishes opinions on exemption from clearing obligation for certain Danish pension schemes**

ESMA has issued a set of opinions regarding the exemption of three Danish pension schemes from the obligation to centrally clear over-the-counter (OTC) derivative contracts under the European Market Infrastructure Regulation (EMIR).

Certain pension schemes were granted a transitional exemption from the clearing obligation under EMIR and now have to request an extension from their national competent authority. Before granting an exemption, the relevant competent authority needs the opinion of ESMA, drafted following consultation with the European Insurance and Occupational Pensions Authority (EIOPA).

This set of opinions covers three Danish based pension schemes where Finanstilsynet is the competent authority for securities markets.

**ISDA updates EMIR Classification Letter**

The International Swaps and Derivatives Association (ISDA) has published an updated version of its EMIR Classification Letter and accompanying guidance note. The letter enables counterparties to notify each other of their clearing status and other requirements under EMIR. The updated letter extends the clearing obligation for certain interest rate derivatives classes denominated in European Economic Area (EEA) currencies and certain credit default swap (CDS) index classes.

Key amendments in the updated letter include:

- aligning the definition of 'Category 1 entity' to that used in the published G-4 interest rate products regulatory technical standards (RTS); and
- providing for entities to make classifications in respect of the draft RTS for EEA rates and the RTS on CDS index classes.

The letter replicates a tool on ISDA Amend, the online service from ISDA and Markit that facilitates compliance with certain EMIR and other regulatory requirements, which will be expanded to cover the new classifications. Both the letter and the guidance note are available on ISDA's EMIR Documentation Initiative page.

**SEPA: EPC consults on instant credit transfer scheme**

The European Payments Council (EPC) has launched a consultation on the Single Euro Payments Area (SEPA) Instant Credit Transfer (SCT Inst) scheme. The proposed scheme aims to facilitate faster payments across the 34 countries which are within the scope of the current SEPA schemes. It applies to credit transfers made in euro, up to an initial maximum amount of EUR 15,000 per transaction, with the intention that the money will be available in the account of the payee within ten seconds on a 24/7/365 basis.

The EPC seeks comments on its SEPA instant credit transfer scheme rulebook (version 0.1) and the Maximum Amount for Instructions under the SCT Inst Rulebook (version 0.1), which have been published as part of the consultation. Comments are due by 10 July 2016. The finalised scheme rulebook will then be published in November 2016 and will be implemented in November 2017.

**Basel Committee publishes tenth progress report on adoption of Basel regulatory framework**

The Basel Committee on Banking Supervision (BCBS) has published an updated progress report on the adoption status of Basel III regulations for each BCBS member jurisdiction as of end-March 2016. The BCBS periodically monitors the adoption status of all Basel III standards, including the risk-based capital requirement, the requirements for systemically important banks (SIBs), and the liquidity coverage ratio (LCR).

As of March 2016, all 27 member jurisdictions have final risk-based capital rules, LCR regulations and capital conservation buffers in force. 24 jurisdictions have issued final rules for the countercyclical capital buffers and 23 have issued final or draft rules for their domestic SIBs framework. With regard to the global SIBs framework, all members that are home jurisdictions to G-SIBs have the final framework in force.

Member jurisdictions are now working on the implementation of other Basel III standards, including the leverage ratio and the net stable funding ratio (NSFR).

**Basel Committee consults on definitions and disclosure of non-performing exposures and forbearance**

The BCBS has launched a consultation on proposed definitions of non-performing exposures and forbearance. By defining these two terms the BCBS intends to assist efforts to develop a consistent standard for categorising problem loans and promote consistency in supervisory reporting and disclosures by banks.

The proposed definition of 'non-performing exposures' introduces criteria for categorising loans and debt securities that are centred on delinquency status (90 days past due) or the unlikeliness of repayment. It also clarifies the consideration of collateral in categorising assets as non-performing and the rules regarding the upgrading of an exposure from non-performing to performing. The definition also seeks to clarify the interaction between non-performing status and forbearance.

The proposed definition of 'forbearance' refers to concessions, such as a modification or refinancing of loans and debt securities that result from a borrower's financial difficulty. It permits forborne exposures to be categorised as performing or non-performing exposures and sets out criteria for when a forborne exposure can cease being identified as such. The definition also emphasises the need to ensure a borrower's soundness before the discontinuation.

Comments to the consultation close on 15 July 2016.

**Bank of England to become administrator of SONIA interest rate benchmark**

The Bank of England (BoE) will become the administrator of the Sterling Overnight Index Average (SONIA) interest rate benchmark on 25 April 2016.

As administrator, the BoE will have overall responsibility for the SONIA benchmark and will provide oversight and governance. The Wholesale Markets Brokers' Association (WMBA) will continue to calculate and publish SONIA, but on behalf of the BoE.

The BoE intends to reform SONIA by broadening the range of transactions underpinning SONIA to include bilaterally negotiated and brokered transactions, with the aim of making it more resilient. Additionally, when the BoE's new money market data collection is fully established, it is intended that this will be used as the data source for SONIA. It is anticipated that SONIA will transition to the new basis in Q2 2017.

The BoE aims to publish a consultation on its plans to reform the SONIA benchmark in late summer 2016.

**FCA and PRA consult on enforcement decision-making processes**

The Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) have published a joint consultation paper on strengthening the transparency and effectiveness of the FCA's and PRA's enforcement decision-making processes.

This follows recommendations made by HM Treasury in its 'Review of enforcement decision-making at the financial services regulators' (Enforcement Review) and Andrew Green QC's 'Report into the FSA's enforcement actions following the failure of HBOS' (Green Report).

The consultation paper looks at implementing the recommendations from the Enforcement Review and Green Report and covers:

- referral decision-making;
- cooperation between the regulators in enforcement investigation; and
- the subject's understanding and representations in joint enforcement investigations.

The FCA also proposes to amend the Enforcement Guide and the Decision Procedure and Penalties Manual to provide a framework and incentives for partly contested cases.

The PRA intends to consult separately on the recommendations dealing with settlement and contested decision-making, once the Bank of England and Financial Services Bill has passed through Parliament. The PRA also plans to publish more detail about its enforcement process.

Comments on the joint consultation are due by 14 July 2016.

**FCA reports on thematic review on funds meeting investors' expectations**

The FCA has published the findings of its thematic review (TR16/3) that looked at whether UK authorised investment funds and segregated mandates are operated in line with investors' expectations as set by marketing and disclosure material, and investment mandates.

The FCA found that fund management firms are generally meeting expectations and complying with their responsibilities towards investors. However, the review did find examples of unclear product descriptions and inadequate governance or oversight. Some examples include:

- clarity of product descriptions – the FCA found that some funds' key investor information documents (KIIDs) did not have clear descriptions of how they were managed;
- providing adequate oversight and governance – the review found there was a risk that firms do not provide the same level of attention to customers' interests when a fund ceases to be actively marketed; and
- ensuring appropriate distribution – more funds needed to review the distribution of their funds by third parties to ensure their products were not mis-sold.

The FCA has asked all firms to consider the findings in the paper and review their arrangements accordingly, and will follow up on the work through individual feedback to firms and routine supervision.

**FCA publishes interim report on its investment banking market study and a discussion paper on the IPO process**

The Financial Conduct Authority (FCA) has published the interim conclusions of its investment and corporate banking market study (MS15/1.2).

The study has found some areas where improvements could be made to encourage competition, including concerns that:

- the widespread use of contractual clauses in client engagement letters can exacerbate pressure to award transactional business to a lending bank or corporate broker, restricting future choice of supplier;
- the 'blackout' period in the UK Initial Public Offering (IPO) process between publication of research by syndicate banks and the circulation of the 'pathfinder' prospectus means that these are made available too late to be used by buy-side investors, non-syndicate banks' analysts and independent research providers;
- allocations of shares in IPOs are skewed towards buy-side investors from whom banks derive greater revenues from other business lines, potentially shutting out other investors; and
- league tables can be misleading because some banks carry out loss-making transactions purely to generate a higher position in league tables.

Based on these findings, the FCA proposes measures designed to ensure that competition takes place on the merits by reducing artificial incumbency advantages, improving clients' ability to appoint banks that best suits their needs, ensuring that conflicts are properly managed, and improving the IPO process.

Following the interim report, the FCA has published a discussion paper (DP16/3) suggesting improvements to the way in which information is provided to investors during the initial IPO process. The proposed IPO process models involve:

- a requirement to delay the release of any research by analysts at banks connected to the IPO until after the prospectus is published; and
- a requirement to invite analysts from unconnected banks and independent research providers to any meetings with management.

The proposed IPO reform is intended to ensure more diverse and independent information is available earlier in the IPO process.

Comments on DP16/3 are due by 13 July 2016.

**DNB maintains countercyclical capital buffer at 0%**

The Dutch Central Bank (DNB) has announced that it is maintaining the countercyclical capital buffer for banks at 0%.

The countercyclical capital buffer (CCyB) is a macroprudential instrument that aims to protect banks against systemic risks resulting from excessive credit growth. It is a variable add-on to the minimum capital requirements, and can be increased to 2.5% of risk-weighted assets or higher, should the circumstances dictate. If risks are abating, the CCyB may be reduced. If risks materialise, e.g. in a crisis, the CCyB may be released at once so that banks can absorb losses without constraining credit supply.

From 2016 onwards, the DNB will publish the CCyB rate on a quarterly basis. Banks must apply the add-on to their exposures to Dutch counterparties. CCyB decisions are in principle internationally recognised, which means that foreign banks must apply the add-on set by the DNB to their Dutch exposures.

In December 2015, the DNB decided to set the Dutch CCyB at an initial level of 0%. An important consideration was the moderate development of indicators such as credit growth and prices of real estate.

According to the DNB, this situation has not changed significantly. Therefore, the DNB does not see any reasons to activate the CCyB for the Netherlands, and the CCyB rate is maintained at 0%.

**CSSF issues circular on forthcoming collection of 2016 ex-ante contributions to Luxembourg Deposit Guarantee Fund**

The Luxembourg financial sector supervisory authority, the Commission de Surveillance du Secteur Financier (CSSF), has issued a circular (16/01) providing information on the collection of the 2016 ex-ante contributions to the Luxembourg Deposit Guarantee Fund (FGDL) pursuant to Article 166(2) of the law of 18 December 2015 on the failure of credit institutions and of certain investment firms (2015 Law).

The circular is addressed to all credit institutions incorporated under Luxembourg law, to the Luxembourg branches of non-EU credit institutions and to the Entreprise des Postes et Télécommunications.

Pursuant to Article 166 of the 2015 Law, all credit institutions that are members of the FGDL have to pay the contributions referred to in Article 179 of the 2015 Law into accounts of the FGDL with the Luxembourg Central Bank to meet the financial resources target levels of the FGDL.

The CSSF, in its capacity as Depositor and Investor Protection Council (CPDI) and as competent authority, has adopted and approved the methodology for calculating the contributions in accordance with Article 179 of the 2015 Law and the relevant EBA Guidelines (EBA/GL/2015/10). The calculation method is set out in Annex 1 to the circular.

The corresponding individual invoices for the forthcoming collection of the 2016 contribution will be sent to credit institutions by the FGDL. The 2016 contributions will amount to one third of the target level that the FGDL is allowed to collect by 2018. The invoices are payable via bank transfer within two weeks.

**HKMA issues revised supervisory policy manual on supervisory review process**

The Hong Kong Monetary Authority (HKMA) has issued a revised version of the supervisory policy manual (SPM) module on the supervisory review process. The revised SPM module contains updated text relating to the implementation of the Basel III capital buffers. In particular, the explanation of the interaction between the Pillar 2 capital requirements derived from the Pillar 2 supervisory review process, and the Pillar 1 buffer level prescribed under the Banking (Capital) Rules, has been refined.

Furthermore, with reference to the sound practices identified in 'A Sound Capital Planning Process: Fundamental Elements' issued by the Basel Committee on Banking Supervision (BCBS) in January 2014, some new provisions relating to authorised institutions' capital planning have been incorporated into the SPM module. These relate primarily to the responsibilities of the board and senior management, and the integration of capital planning with the overall capital adequacy assessment process. The revision also aligns some of the provisions in the module with those in other SPM modules and supervisory requirements.

**HKEX publishes guidance letter for issuers subject to rumours or market commentaries**

The Stock Exchange of Hong Kong Limited (SEHK), a wholly owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEX), has published a guidance letter for listed issuers subject to rumours or market commentaries with allegations of fraud, material accounting or corporate governance irregularities (together, allegations) that may require a halt of trading in their securities.

The guidance letter outlines a revised SEHK approach that allows issuers that are subject to allegations and have applied for a trading halt to resume trading in their securities if they can address such allegations with a clarification announcement (e.g. a denial of allegations). The guidance letter also sets out the issuers' obligations in handling allegations. If, in the view of the SEHK, there is or there is likely to be a false or disorderly market in the issuer's securities as a result of the allegations, the issuer must make a clarification announcement informing the market about its position regarding each allegation promptly or apply for a trading halt. If trading is halted, the issuer must ensure trading resumes as soon as practicable following publication of a clarification announcement.

The SEHK would not normally pre-vet the clarification announcement and, save for exceptional circumstances, would expect securities trading to resume following its publication. The SEHK may thereafter follow up with the issuer on any further disclosures, reviews or investigations it considers necessary on matters that have arisen out of the allegations.

**SFC issues circular in relation to reporting of OTC derivatives transactions to HKMA trade repository**

The Securities and Futures Commission (SFC) has issued a circular to licensed corporations in relation to the reporting of over-the-counter (OTC) derivatives transactions to the HKMA trade repository.

The circular reminds licensed corporations of the announcement made by the HKMA for the second round of training and simulation tests to be conducted in the second half of 2016. The first round of training and simulation tests was scheduled to be conducted in the first half of 2016. The training and simulation tests are intended to help regulated entities prepare for the commencement of the mandatory reporting obligation under the new OTC derivatives regulatory regime.

Licensed corporations which have activities that may be subject to the mandatory reporting obligation are advised to sign up for the reporting service of the HKMA's OTC derivatives trade repository (HKTR) and complete the simulation test as early as possible. However, those who have already signed up and completed a simulation test before are not required to do so again.

The HKMA has also announced the billing arrangements for the reporting services provided by the HKTR, which will take effect on 1 May 2016. HKTR members are advised to complete the relevant preparations mentioned in the announcement before the above effective date.

**Government Accountability Office issues report on regulators' evaluations of large banking institutions' resolution plans**

The US Government Accountability Office (GAO) has published a report concerning regulation by the Federal Reserve and the Federal Deposit Insurance Corporation of large banking institution plans for orderly resolution (so-called living wills) that big banks are required to file in accordance with the Dodd-Frank Act. In 2011, the regulators issued a rule requiring such companies to annually file a resolution plan. If they jointly find a plan is not credible, the company could be subjected to more stringent requirements.

The GAO, an independent, nonpartisan congressional agency, was asked to review the regulators' programs for assessing resolution plans. Its newly released report examines each regulator's review processes, the progress made in assessing plans, and stakeholder views on the usefulness of the plans.

In the report, the GAO has recommended, among other things, that the relevant regulatory agencies should publicly disclose more information about how they decide whether to accept a bank's resolution plan.

## RECENT CLIFFORD CHANCE BRIEFINGS

**Brexit – assessing the impact on asset managers**

On 23 June 2016, the UK will decide in a referendum whether to remain in or to leave the European Union. Should the UK vote in favour of leaving, so-called Brexit, the UK Government will initiate a procedure leading to the UK's withdrawal from the EU and, ultimately, to the establishment of a new relationship with its former EU partners.

This briefing paper assesses the potential impact of Brexit on fund and asset managers, including in respect of UCITs, AIFs and portfolio managers.

http://www.cliffordchance.com/briefings/2016/04/brexit_assessingtheimpactonassetmanagers.html

**UK election law – how are businesses restricted during the EU referendum campaign?**

The UK is holding a referendum on whether it should remain in or leave the EU on 23 June 2016. UK election law applies from 15 April to regulate what individuals and companies can do and say about the referendum.

This briefing paper summarises the law, and asks what it means in practice for business in the run up to the referendum.

http://www.cliffordchance.com/briefings/2016/04/uk_election_law_howarebusinessesrestricte.html

**How Soft is Your Soft Call?**

Call protections are designed to protect lenders' yield in the event of a repayment of debt before maturity. Depending on their scope and limitations, call protections are often characterized as 'hard' or 'soft'. 'Soft call' provisions, which are common in institutional syndicated credits, typically require payment of a one percent premium upon the 'refinancing' or 'repricing' of the loan within a certain period after closing that reduces the lenders' effective yield. 'Hard call' provisions, in contrast, which are common in riskier credits, typically require payment of a one to-three percent premium without discriminating as to the nature and effect of the subject prepayment. While designed to ensure that lenders receive the benefit of their bargained-for economic return, the actual reach of soft call provisions varies widely from one transaction to the next. In the current volatile leveraged loan environment, lenders should pay more attention to the terms and application of prepayment premiums, as widening margins make it more likely that sponsors and borrowers will be looking for the earliest opportunities to refinance into less expensive loans.

This briefing paper:

- explores the key features that characterize soft call provisions;
- differentiates soft call provisions from prepayment premiums in second lien leveraged loans;
- identifies certain enforceability issues that parties should consider when drafting and negotiating these provisions; and
- concludes with some final thoughts and market data regarding the effectiveness of call protections.

http://www.cliffordchance.com/briefings/2016/04/how_soft_is_yoursoftcall.html

**US Department of Labor Finalizes Fiduciary Rule**

On 6 April 2016, the US Department of Labor (DOL) issued its long-awaited final regulation re-defining what it means to be an 'investment advice fiduciary' under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code. The final rules significantly expand the class of advisers and the scope of investment advice that are subject to fiduciary standards and impose the same fiduciary standards on advisers to individual retirement accounts (IRAs) that have long applied to plans covered by ERISA.

The DOL also finalized certain prohibited transaction exemptions which allow investment advisers to receive compensation for providing investment advice under arrangements which would otherwise be prohibited due to certain conflict of interest rules. Most notably, these exemptions include the so-called 'Best Interest Contract Exemption' (BIC Exemption) which provides relief from the prohibited transaction rules where a fiduciary concludes that the investment advice is in the best interest of the plan or individual retirement account (and satisfies certain additional requirements).

This briefing paper provides a summary of the significant changes between the final rules and the final BIC Exemption and the proposed regulations and exemptions that were issued by the DOL last April.

http://www.cliffordchance.com/briefings/2016/04/u_s_department_oflaborfinalizesfiduciaryrule.html

**Devaluation of Russian Currency as a Ground for Rent review?**

On 29 March 2016 the Ninth Arbitrazh Appellate Court (case No. A40- 83845/2015) reversed the earlier decision of the Moscow City Arbitrazh Court which took the unprecedented step of introducing a currency band of RUB 30- 42 per USD 1 for rent amounts under an office lease agreement. The band was introduced in the middle of a ten-year lease entered into between two commercial parties (the VimpelCom Case).

This briefing paper discusses the decision.

http://www.cliffordchance.com/briefings/2016/04/devaluation_of_russiancurrencyasagroundfo.html

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