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Briefing note

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EBA publishes 2016 EU-wide stress test results

The European Banking Authority (EBA) has published the results of the 2016 EU-wide stress test of 51 banks. The objective of the stress test is to provide supervisors, banks and other market participants with a common analytical framework to consistently compare and assess the resilience of large EU banks to adverse economic developments.

The EBA reports that the EU banking sector has significantly shored up its capital base, leading to a starting point capital position for the stress test sample of 13.2% Common Equity Tier 1 (CET1) ratio at the end 2015, which is 200 basis points (bps) higher than the sample in 2014. The hypothetical scenario leads to a stressed impact of 380 bps on the CET1 capital ratio, bringing it across the sample to 9.4% at the end of 2018. The CET1 fully loaded ratio falls from 12.6% to 9.2%, while the aggregate leverage ratio decreases from 5.2% to 4.2% in the adverse scenario.

In the stress test the impact is driven by:

- credit risk losses of EUR-349 billion contributing -370 bps to the impact on the CET1 capital ratio;
- operational risk (EUR-105 billion or -110 bps) of which conduct risk losses contributed EUR-71 billion or -80 bps to the CET1 impact; and
- market risk across all portfolios including CCR (EUR-98billion or -100bps).

The EBA has concluded that the stress test results demonstrate resilience in the EU banking sector as a whole due to significant capital raising, although results for individual banks vary significantly.

The 2016 EU-wide stress test does not contain a pass fail threshold. The EBA intends for it to be used to support ongoing supervisory efforts to maintain the process of repair of the EU banking sector.

EBA reports on introducing EU leverage ratio

The EBA has published a report on introducing the leverage ratio (LR) in the EU, which sets out an impact assessment and details of the LR's calibration.

The EBA recommends a minimum LR in order to mitigate the risk of excessive leverage to be calibrated at a level of a 3%, which the EBA views as generally consistent with the objective of a backstop measure to supplement risk-based capital requirements. According to the report, the potential impact of introducing a 3% requirement on the provision of financing by credit institutions would be relatively moderate and there would be no strong effect on risk taking. The report does not give a strong indication of the different degrees of exposure to risk of excessive leverage (REL) across different types of credit institution but does identify that higher LR requirements may be warranted for global systemically important institutions (G-SIIs) due to a higher exposure to REL.

The EBA proposes to exempt central counterparties (CCPs) and central securities depositaries (CSDs) from the LR but the EBA has not identified arguments to exempt certain credit institutions on the basis of their limited size. The EBA has, however, identified that it will further explore reduced frequency and/or granularity of reporting requirements in future updates of the implementing technical standards (ITS) on LR reporting.

The report has been prepared to inform the work of the EU Commission on potential legislative proposals on LR.

EBA publishes list of resolution authorities

The EBA has published a list of designated resolution authorities under the Bank Recovery and Resolution Directive (BRRD). Resolution authorities are designated by each Member State to apply the resolution tools and resolution powers in order to ensure the orderly resolution of failing banks and investment firms. The list has been prepared on the basis of notifications received by the EBA.

EU Commission consults on EU macro-prudential framework

The EU Commission has launched a public consultation on the EU macro-prudential framework, which comprises two European Systemic Risk Board (ESRB) Regulations, the Capital Requirements Directive (CRD 4) and Regulation (CRR) and the Single Supervisory Mechanism (SSM) Regulation. The consultation is intended to review all five component pieces of legislation in order to identify and address any potential weaknesses, notably regarding the interplay of tools, procedures, and the institutional setting, in a comprehensive manner. The main objective is to ensure adequate alignment of the instruments and their activation procedures at the national level, especially with regard to the necessary interactions between competent and designated authorities, as well as the appropriate degree of coordination of national policies via the ESRB.

Among other things, the consultation seeks feedback from stakeholders on narrowing and refining the scope of existing macro-prudential instruments (such as capital buffers), making the rules more consistent with one another and examining the role and organisational structure of the ESRB and its relationship with the European Central Bank (ECB).

Comments on the consultation are due by 26 October 2016.

EMIR: EU Commission publishes addendum to draft RTS for margin requirements for uncleared OTC derivatives

The EU Commission has published an addendum setting out clarifications to the revised draft regulatory technical standards (RTS) for margin requirements for uncleared OTC derivatives. In particular, Article 36 has been redrafted to make clear the Commission's intention to have the first wave of initial margin requirements apply from one month after the date of entry into force of the RTS.

Prospectuses: ECON Committee publishes report on proposed regulation

The EU Parliament Committee on Economic and Monetary Affairs (ECON) has published its report, dated 19 July 2016, on the proposal for a regulation on the prospectus to be published when securities are offered to the public or admitted to trading. The report has been tabled for first reading at the Parliament's plenary session on 13 September 2016.

BRRD: AFME publishes Article 55 model clause package

The Association for Financial Markets in Europe (AFME) has published a model clause package for the contractual recognition of bail-in under Article 55 of the Bank Recovery and Resolution Directive (BRRD).

The package is intended to support cross-border effectiveness of resolution and contains model contractual terms that market participants can use to comply with the requirements of Article 55 when issuing debt instruments and certain other contracts governed by the law of a jurisdiction outside the EU. The package is intended to be used as a starting point for negotiation and users of the package must satisfy themselves as to the regulatory and other implications of its use.

Alongside the model clauses, AFME has highlighted its continued concerns with the scope of Article 55 and has published a press release setting out its view that Article 55 should be amended to align it with the Financial Stability Board (FSB) Principles for Cross-border Effectiveness of Resolution Actions in order to provide a clearer scope of liabilities.

IOSCO consults on liquidity of secondary corporate bond markets

The International Organization of Securities Commissions (IOSCO) has published a consultation report on the liquidity of the secondary corporate bond markets. The report states that there is no substantial evidence that liquidity in secondary corporate bond markets has deteriorated markedly from historic norms and that there is no reliable evidence that regulatory reforms have caused a substantial decline in market liquidity.

Furthermore, the report highlights significant changes to the characteristics and structure of secondary corporate bond markets, including changing dealer inventory levels, increased use of technology and electronic trading venues, and changes in the role of participants and execution models (i.e., dealers shifting from a principal model to an agency model).

Comments are due by 30 September 2016.

FCA publishes policy statement on Payment Accounts Regulations 2015

The Financial Conduct Authority (FCA) has published its final policy statement (PS16/20) on Handbook changes and finalised guidance relating to the Payment Accounts Regulations 2015 (PARs), which implement the Payment Accounts Directive (2014/92/EU – PAD) in the UK.

The policy statement sets out feedback received to the FCA's consultation, which was launched in March 2016, its response and the final Handbook changes and finalised guidance. Overall, respondents to the consultation broadly agreed with the FCA's approach. Among other things, the policy statement sets out:

- guidance on the definition of a 'payment account';
- guidance on packaged accounts;
- regulatory reporting requirements in relation to switching and basic bank accounts; and
- details of the FCA's powers of enforcement under the PARs.

Provisions of the PARs on packaged accounts, switching and basic bank accounts enter into force on 18 September 2016 and the Handbook changes and non-Handbook guidance come into effect on the same day.

PRA invites firms to apply for temporary modification of leverage ratio rules

The Prudential Regulation Authority (PRA) has published a statement inviting firms to apply for a temporary modification of the leverage ratio part of the PRA Rulebook.

This is in response to the Financial Policy Committee's (FPC's) recommendation that when the PRA is applying its rules on the leverage ratio it should consider allowing firms to exclude from the calculation of the total exposure measure the assets constituting claims on central banks, where they are matched by deposits accepted by the firm that are denominated in the same currency and of identical or longer maturity.

The PRA is implementing the FPC's recommendation and is offering a rule modification direction in relation to the definition of the total exposure measure of the leverage ratio framework, and firms are able to apply with immediate effect.

The FPC intends to recalibrate the leverage ratio to reflect the exclusion of central bank claims as part of its planned review of the leverage ratio framework in 2017.

Dutch Ministry of Finance consults on tighter requirements for entities offering investment objects or investment bonds

The Dutch Ministry of Finance has issued for consultation a draft legislative proposal which, once adopted in final form, would amend the Financial Supervision Act. The proposal aims to increase the protection of investors in investment objects and investment bonds and to deter fraudulent suppliers from the market.

Investment objects include, for instance, investments in teak plantations, cottages or whiskey. Investors are typically entitled to a portion of the proceeds of the teak plantation trees, the cottage or the bottles of whiskey. Investment bonds are bonds the proceeds of which are used for collective investment, and where subsequently the proceeds of the collective investment are used for paying interest on the bonds as well as redemption amounts.

The underlying principle of the proposal is to treat managers of investment objects and investment bonds on the same footing as managers of collective investment funds. This is to be achieved by tightening the rules for offerings of investment objects and by introducing a new regime for offerings of investment bonds. In particular, the proposal introduces a licensing requirement for the managers of investment objects or investment bonds. Such managers will be subject to the same prudential and conduct of business rules as managers of collective investment funds. This means that no investment objects or investment bonds may be offered in the Netherlands if the manager of the relevant assets does not possess a Dutch license.

Comments are invited by 14 October 2016.

CNMV issues communication regarding ESMA's warning about CFDs, binary options and other speculative products

The Spanish Securities Market Commission (CNMV) has published a communication in connection with the European Securities and Markets Authority's (ESMA's) warning, circulated on 25 July 2016, regarding the marketing of contracts for difference (CFDs), binary options and other speculative products to retail clients. The reason for this communication is the increase in the marketing of these kinds of products through aggressive marketing methods and the number of complaints from investors who have suffered significant losses when trading these products.

ESMA has warned that these products carry a very high level of risk as they are not standardised and the specific features of the products can be different from one provider to another, including for example in relation to the terms, conditions and costs involved. Furthermore, it has been observed that these products are also being offered by unauthorised and unregulated entities which further adds to the risk of investor detriment.

The CNMV shares ESMA's concerns around the trading of these products and wishes to warn investors about the risks of CFDs, binary options and other speculative products. Additionally, it has highlighted its lack of competence to supervise the investment firms that commercialise this kind of product using the European passport and without an establishment in Spain.

Chancellery of the President presents draft of 'Act on FX Denominated/Indexed Loans'

The draft Act on the Reimbursement of Certain Payments Under Facility and Loan Agreements has been presented at a press conference with the participation of the Secretary of State in the Chancellery of the President and the president of the National Bank of Poland.

The Act concerns agreements for a facility or a loan denominated in/indexed to foreign currencies for which security was established in the form of a mortgage over real property.

Under the Act:

- consumers are to be reimbursed for inflated currency spreads by means of a decrease in the principal amount of the facility to be repaid (in the case of active facilities) or in the form of a payment (in the case of facilities under expired agreements);
- a threshold as to the amount will be introduced – PLN 350,000 – which will be the amount of the principal of the facility with respect to which a consumer will be able to apply for a decrease in the principal or for a refund of overpayment; and
- there will be voluntary conversion of facilities into PLN – the banks will have one year to restructure them.

The Act may have a significant impact on the Polish banking sector.

HKMA revises supervisory policy manual on liquidity risk management

The Hong Kong Monetary Authority (HKMA) has issued a supervisory policy manual (SPM) module entitled 'Regulatory Framework for Supervision of Liquidity Risk', which is a revised version of an existing module on 'Liquidity Risk Management'. The revised module seeks to provide an overview of the statutory liquidity requirements and the HKMA's approach to assessing compliance with the Banking (Liquidity) Rules by authorised institutions.

The revised module provides:

- an outline of the HKMA's approach to supervising authorised institutions' liquidity risk;
- an overview of the statutory requirements in respect of the liquidity coverage ratio (LCR) and the liquidity maintenance ratio (LMR), possible supervisory responses to liquidity events, and the setting by authorised institutions of internal targets above the statutory minimum required level of LCR or LMR;
- an explanation of the approach and criteria adopted by the HKMA for the designation of category 1 institutions which are subject to the LCR requirements, whilst other authorised institutions (category 2 institutions) are subject to the LMR requirements;
- guidance on the LCR and LMR requirements, including the methodologies to determine the amounts of 'high quality liquidity assets' and 'total net cash outflows' under the LCR (for category 1 institutions) or 'liquefiable assets' and 'qualifying liabilities (after deductions)' under the LMR (for category 2 institutions); and
- guidance on the disclosure of liquidity information by authorised institutions, as required under the Banking (Disclosure) Rules.

According to the HKMA, the provisions in the revised module are predominantly a collation of the requirements, standards and expectations set out in the HKMA's previous circulars and frequently asked questions (FAQs) on the subject and authorised institutions should already be meeting them. Otherwise an AI should align its internal processes more closely with the provisions within two months of the issuance of the module.

Enforcement Decree of Korean Act on Corporate Governance of Financial Companies takes effect

The Financial Supervisory Service (FSS) has announced that the State Council has approved the newly proposed Enforcement Decree of the Act on Corporate Governance of Financial Companies. The enforcement decree seeks to promote sound and transparent corporate governance of financial firms by setting high standards for board members and the largest shareholder, governance structure, and accountability.

Some of the key provisions include the following:

- disqualification criteria for officers who pose a conflict of interest, which are currently applicable only to banks and financial holding companies, are to be extended to other financial firms. Rules restricting outside directors from concurrently holding positions outside the company are also to be tightened;
- the board of directors of financial firms with assets greater than KRW 5 trillion must comprise at least three outside directors. The chairperson of the board must be an outside director. A succession plan for the chief executive officer is compulsory;
- performance-based pay is compulsory for officers and employees of financial firms with assets greater than KRW 5 trillion. A portion of the performance-based pay for company officers must be deferred for at least three years; and
- the fit and proper assessment for the largest shareholder of a financial institution taking place every two years is to be applied to insurance companies, financial investment services providers, and consumer finance companies in addition to banks.

The enforcement decree is effective from 1 August 2016 (with a three-month delay for some provisions on governance, internal controls, and risk management).

Indonesia's and Malaysia's financial regulators sign bilateral agreement on regulatory co-operation and banking integration

Indonesia's Financial Services Authority, Otoritas Jasa Keuangan (OJK), and Malaysia's central bank, Bank Negara Malaysia (BNM), have signed a bilateral agreement under the ASEAN Banking Integration Framework (ABIF).

The agreement, which seeks to operationalise the earlier Heads of Agreement in 2014, will provide greater access and operational flexibility for Malaysian and Indonesian Qualified ASEAN Banks operating in each other's jurisdictions, based on the equal reciprocity principle. As an illustration, Indonesia and Malaysia will each allow, among other matters, three banking groups to be established and have businesses in the respective markets.

The commitments in the agreement form part of the ASEAN Framework Agreement on Services.

Following the official launch of ABIF and establishment of the ASEAN Economic Community (AEC) in 2015, the agreement represents a major step toward achieving greater banking and financial integration between Indonesia and Malaysia and within the wider AEC.

METI and MAFF finalise amended regulations to require certain dealers to include OTC commodity derivatives for margin calculation

Under the margin regulations in the Financial Instruments and Exchange Act of Japan (FIEA) which will become effective on 1 September 2016, a covered entity may, at its discretion, include certain out-of-scope products (including non-centrally cleared OTC commodity derivatives) for the purpose of calculating variation margin (VM) and/or initial margin (IM) provided that such inclusion is made on a continuous basis so as to avoid arbitrary inclusion.

However, the Ministry of Economy, Trade and Industry of Japan (METI) and the Ministry of Agriculture, Forestry and Fisheries of Japan (MAFF) have now finalised the amended regulations and guidelines under the Commodity Derivatives Act of Japan (CDA). In response to the public consultation, METI and MAFF have indicated that a Specified OTC Commodities Derivatives Business Operator (tokutei tentou shouhin derivatives torihiki gyousha) under the CDA, which is also a covered entity under the FIEA, is required to include non-centrally cleared OTC commodity derivatives for the purpose of calculating VM and IM and file a notice to the METI and/or the MAFF.

The amended regulations and guidelines will become effective on 1 September 2016.

Federal agencies finalize rule exempting certain commercial and financial end users from initial and variation margin requirements

The Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, and the Farm Credit Administration have announced a final rule excluding certain commercial and financial end users from margin requirements for certain swaps not cleared through a clearinghouse. The rule is the same as the interim final rule previously adopted by the regulators.

Under the final rule, the agencies exempt from its margin requirements the non-cleared swaps of commercial end users, small banks, savings associations, Farm Credit System institutions, and credit unions with USD 10 billion or less in total assets. In addition, the non-cleared swaps of certain treasury sectors, certain financial cooperatives, and captive finance companies are also exempted from the agencies' margin requirements. In all circumstances, the non-cleared swaps must hedge or mitigate commercial risk of these counterparties and satisfy the rule's requirements for an exemption from mandatory clearing.

The final rule administers a law passed by the US Congress in January 2015.

CLIFFORD CHANCE BRIEFINGS

The landscape after Brexit

In the aftermath of the UK's decision to leave the European Union, shockwaves continue to reverberate across both the financial markets and the political landscape. At our recent Conversations event, Lord Jay of Ewelme, former British ambassador to France and former head of the Foreign and Commonwealth Office, joined Clifford Chance experts to discuss the legal and commercial realities of the UK moving towards Brexit.

This briefing paper summarises their conversation.

https://www.cliffordchance.com/briefings/2016/08/the_landscape_afterbrexit.html

New Argentine Public-Private Partnership Regime Expected Soon – Another Step In The Right Direction

In June 2015, Argentine President Mauricio Macri sent a public-private partnership (PPP) bill to Congress, which was designed in consultation with local business chambers and multilateral entities, and has also drawn support from various members of the legal and financial community.

This briefing paper analyses the PPP bill and looks at the aspects that could be improved.

https://www.cliffordchance.com/briefings/2016/08/new_argentine_public-privatepartnershipregim.html