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Briefing note

International Regulatory Update

30 January – 03 February 2017

IN THIS WEEK'S NEWS

- ESMA publishes framework for 2017 CCP stress test
- ESMA reports on supervision of credit rating agencies, trade repositories and third country CCPs
- EMIR: ESMA writes to EU Commission on sanctioning powers
- EMIR: ESMA consults on guidelines on transfer of data between trade repositories
- Transparency Directive: ESMA publishes guide on major holding notifications
- UCITS: ESMA issues opinion on share classes
- CRD 4: RTS for benchmarking portfolio assessment standards and assessment sharing procedures published in Official Journal
- FSB consults on draft guidance on CCP resolution and resolution planning
- Brexit: Government publishes White Paper
- PSD 2: HMT consults on UK implementation
- FCA and PRA publish changes to enforcement decision-making processes
- Ring-fencing: PRA publishes policy statement on reporting and residual matters
- German Federal Government submits draft law amending financial supervision laws to give BaFin additional powers to address potential threats to financial stability
- MiFID2: German Federal Government submits second draft implementing law
- BaFin and Deutsche Bundesbank revise supervision guideline
- Polish Finance Ministry publishes draft ordinance on higher risk weighting for exposures secured by mortgages on immoveable property
- Polish Financial Supervision Authority sets out position on prohibition of lenders remunerating credit intermediaries under draft Act on Consumer Credit and Supervision over Mortgage Loan Intermediaries and Agents
- HKMA issues new supervisory policy manual on margin and risk mitigation standards for non-centrally cleared OTC derivatives

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- HKMA announces countercyclical capital buffer for Hong Kong
- NDRC specifies governmental approval regime for foreign-invested projects
- Bank of Korea and Bank Negara Malaysia renew bilateral swap arrangement
- CFTC staff grants temporary no-action relief to swap dealers complying with EU uncleared swap margin requirements
- Recent Clifford Chance briefings: Unilateral option clauses; FCA enforcement; and more. Follow this link to the briefings section.

ESMA publishes framework for 2017 CCP stress test

The European Securities and Markets Authority (ESMA) has published the framework for its 2017 EU stress test exercise on central counterparties (CCPs). Under the European Market Infrastructure Regulation (EMIR), ESMA is required to coordinate EU-wide assessments of the resilience of CCPs to adverse market developments.

ESMA conducted its first CCP stress test in April 2016, focusing on the counterparty credit risk that EU CCPs would face because of simultaneous clearing member defaults and market price shocks. The 2017 exercise will also include liquidity stress as part of its evaluation of CCP resilience.

CCPs will provide the data for the stress test in March 2017, which will then be validated in Q2 2017. ESMA will finalise the data analysis by Q3, with the results of the exercise being published in Q4 2017.

ESMA reports on supervision of credit rating agencies, trade repositories and third country CCPs

ESMA has published its annual report and supervision work programmes setting out its main areas of supervisory focus for credit rating agencies (CRAs), trade repositories (TRs), and third country CCPs in the EU. The report also details the actions ESMA has taken in 2016 in carrying out its supervisory role.

The report highlights priorities including:

- strategy and governance, particularly in light of the UK exiting the EU;
- the quality, internal controls and risk assessment for CRAs;
- data quality and availability, technology trends and internal control at TRs; and
- pending requests by third country CCPs for recognition and the finalisation of a risk framework to identify priorities for recognised third country CCPs.

EMIR: ESMA writes to EU Commission on sanctioning powers

ESMA has written to the EU Commission to request that it consider issues related to ESMA's supervisory and sanctioning powers under EMIR in the context of the current EMIR review. The letter also emphasises similar aspects related to credit rating agencies that ESMA believes would benefit from a joint analysis.

ESMA recommends that amendments be made to EMIR and the CRA Regulation and proposes that the Commission considers further harmonisation of the supervisory and enforcement frameworks applicable to trade repositories and CRAs.

EMIR: ESMA consults on guidelines on transfer of data between trade repositories

ESMA has published for consultation its draft guidelines on the transfer of data between trade repositories (TRs) authorised in the EU under EMIR. The six authorised TRs within the EU are required to maintain records of derivative transactions for at least ten years following the termination of the relevant contracts.

The need to transfer data to another TR may arise for different reasons. The draft guidelines address separately the situations where the transfer is due to a withdrawal of registration of the TR from the cases in which the transfer is done on a voluntary basis and under normal market conditions.

ESMA's draft guidelines establish high-level principles that would need to be followed by the TR participants, reporting entities, counterparties, and CCPs on the one hand, and the TRs on the other.

ESMA plans to consider the feedback it receives to this consultation in Q1 2017 and expects to publish a final report of the guidelines by end Q2 2017/beginning Q3 2017.

Comments to the consultation close 31 March 2017.

Transparency Directive: ESMA publishes guide on major holding notifications

ESMA has published a practical guide to national rules across the European Economic Area (EEA) on major holdings notifications under the Transparency Directive. The guide aims to help market participants navigate the different requirements on investors to notify issuers when

they acquire or dispose of shares admitted to trading, resulting in their total voting rights crossing certain set thresholds.

The first part of the guide contains a fact sheet for each EEA country (with the exception of Lichtenstein) setting out the national requirements in relation to notification of major holdings along with links to the relevant websites. The second part presents information on rules and practices in a series of tables, enabling market participants to compare rules across different jurisdictions.

The guide will be updated on an ad hoc basis, based on changes to national rules and practices.

UCITS: ESMA issues opinion on share classes

ESMA has issued an opinion on common principles for setting up share classes in undertakings for collective investment in transferable securities (UCITS) funds.

Under the UCITS Directive, UCITS can offer different share classes to investors, but the Directive does not prescribe whether and to what extent share classes of a given UCITS can differ from one another.

ESMA has identified four high-level principles that should be followed when setting up different share classes:

- common investment objective – share classes of the same fund should have a common investment objective reflected by a common pool of assets;
- non-contagion – UCITS management companies should implement appropriate procedures to minimise the risk that features specific to one share class could have a potentially adverse impact on other share classes of the same fund;
- pre-determination – all features of the share class should be pre-determined before the fund is set up; and
- transparency – differences between share classes of the same fund should be disclosed to investors when they have a choice between two or more classes.

ESMA recommends that share classes established prior to the opinion which do not comply with these principles should be allowed to continue in order to mitigate the impact on investors. Such share classes should be closed to new investors within six months of the publication of the opinion, and for additional investment by existing investors within 18 months of publication.

CRD 4: RTS for benchmarking portfolio assessment standards and assessment sharing procedures published in Official Journal

Delegated Regulation (EU) 2017/180 with regard to regulatory technical standards (RTS) for benchmarking portfolio assessment standards and assessment sharing procedures under the Capital Requirements Directive (CRD 4) has been published in the Official Journal. Article 78 of CRD 4 requires that competent authorities assess the consistency and comparability in risk-weighted assets (RWA) produced by institutions' internal modelling approaches (except for operational risk) for which competent authorities have granted permission to be used for capital purposes.

The RTS specify the procedures for sharing the assessments between competent authorities and with the European Banking Authority (EBA) and the standards for the assessment by competent authorities of the internal approaches applied to calculating own funds for market, the internal model method (IMM), credit valuation adjustment (CVA), and credit risk.

The Delegated Regulation will enter into force on 23 February 2017.

FSB consults on draft guidance on CCP resolution and resolution planning

The Financial Stability Board (FSB) has launched a consultation on draft guidance on resolution and resolution planning for central counterparties (CCPs).

In August 2016 the FSB issued a discussion note on essential aspects of CCP resolution planning. Based on responses to the note, the FSB has developed a proposal for guidance to assist authorities and jurisdictions in implementing effective resolution regimes and developing credible resolution strategies and plans for CCPs.

Amongst other things, the consultation seeks comments on:

- the overall objectives of CCP resolution and resolution planning;
- the powers that resolution authorities should have to maintain the continuity of critical CCP functions, return the CCP to a matched book and address default and non-default losses;
- the potential indicators of circumstances that could lead to a determination to trigger resolution; and
- steps authorities should take for CCP resolution planning including assessing resolvability and

considerations about the formation of crisis management groups for systemically important CCPs.

Comments to the consultation close 13 March 2017.

Brexit: Government publishes White Paper

The Department for Exiting the European Union has published a White Paper on Brexit. The structure of the paper mirrors the twelve principles set out by the Prime Minister in her speech at Lancaster House on 17 January 2017 and it sets out the basis of HM Government's priorities as well as the broad strategy to build a new partnership with the EU, including a free trade agreement and customs agreement.

Among other things, the paper highlights the importance of a smooth, mutually beneficial exit from the EU through a phased process of implementation of new arrangements, including on immigration, customs, co-operation on criminal and civil justice matters and regulatory and legal frameworks for business. The paper identifies that the length of phase-in periods may differ in different areas. The White Paper also confirms that the Government intends to publish a separate White Paper on the Great Repeal Bill. The Government also intends to bring forward separate legislation on customs and immigration.

PSD 2: HMT consults on UK implementation

HM Treasury (HMT) has launched a consultation on the implementation of the recast Payment Services Directive (PSD 2). The Government is required to implement PSD 2 by 13 January 2018 and the consultation seeks feedback from stakeholders on its proposals to transpose the legislation through accompanying draft implementing legislation.

The consultation paper highlights that the Government's default approach for implementing EU legislation is copy-out, but for PSD 2 the Government intends to build on the existing Payment Services Regulations (PSRs), including derogations exercised in the implementation of PSD 1, in order to ensure continuity and consistency and, as far as possible, a tailored approach for the UK payments market. Annex B of the consultation includes the draft Payment Services Regulations 2017, through which the Government intends to implement PSD 2, using copy-out as far as possible. The draft Regulations will revoke and replace the existing Payment Services Regulations 2009 (SI 2009/209), an approach the Government considers likely to make the UK legislation easier to use. The Government intends to finalise and lay the final implementing legislation in Parliament in early 2017 to provide firms with the longest possible lead-in time to adjust to any changes required.

Comments are due by 16 March 2017.

FCA and PRA publish changes to enforcement decision-making processes

The Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) have published a joint policy statement on the issues arising from their consultation paper, 'Proposed implementation of the Enforcement Review and the Green Report' (CP 16/10). The statement sets out the FCA and PRA's response to the comments received on the consultation and the changes they will make to their enforcement polices and processes in order to enhance transparency and effectiveness of the decision-making processes.

Responses were predominantly supportive of the FCA and PRA's proposed changes, which followed 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). Amendments will therefore be, or have already been, made to the FCA Handbook relating to the following areas:

- the decision-making process on whether to refer an issue to Enforcement and Markets Oversight or the Regulatory Action Division for investigation;
- providing more information to investigation subjects about why they have been referred for investigation and regularly updating them throughout the investigation;
- ensuring effective levels of dialogue between Enforcement and Supervision during an investigation; and
- producing more detailed guidance on the process for joint FCA/PRA investigations.

The FCA is also introducing two new processes:

- for 'partly contested cases', in which subjects of investigations can agree to certain elements of their cases and contest other elements; and
- to allow those under investigation to proceed more directly and quickly to the Upper Tribunal;

The proposals which have not already been put into practice will be implemented by amendments to the FCA's Decision Procedure and Penalties manual (DEPP) and the Enforcement Guide (EG). These primarily came into effect

on 31 January 2017. The introduction of partly contested cases and the abolition of Stage 2 and 3 discounts to penalties in settlement will come into effect on 1 March 2017.

Ring-fencing: PRA publishes policy statement on reporting and residual matters

The PRA has published its policy statement (PS3/17) on reporting and residual matters relating to the implementation of ring-fencing. The policy statement sets out feedback to its consultation (CP25/16) published on 7 July 2016 and Chapter 5 of its occasional consultation (CP36/16) published on 11 October 2016, which related to consequential changes to the PRA's ring-fencing regime as a result of HM Treasury amendments to the ring-fencing secondary legislation.

The policy statement sets out minor changes and clarifications made to the rules as a result of feedback received, but the PRA has not made any significant changes to its proposals. The final rules and supporting documents that implement the proposals, which comprise several updated supervisory statements and an updated Statement of Policy, are available as appendices.

The policy statement is relevant to banking groups that will be required by the Financial Services and Markets Act 2000 (FSMA) as amended by the Financial Services (Banking Reform) Act 2013 to ring-fence core activities, including both those which currently have core deposits in excess of GBP 25 billion and those groups which expect to exceed this threshold by 1 January 2019.

German Federal Government submits draft law amending financial supervision laws to give BaFin additional powers to address potential threats to financial stability

The German Federal Government has submitted a draft law supplementing several financial supervision laws (including the German Banking Act (KWG), the German Insurance Supervisory Act (VAG) and the German Capital Investment Code (KAGB)), giving the German Federal Financial Supervisory Authority (BaFin) additional powers in the event of threats to the stability of the financial system and amending the provisions implementing the Mortgage Credit Directive 2014/17/EU.

BaFin is empowered to take necessary measures to avoid possible risks to the stability of the financial system due to real-estate bubbles. Amongst other things, BaFin may impose minimum lending standards for new loans.

MiFID2: German Federal Government submits second draft implementing law

Following the proposal made by the German Federal Ministry of Finance on 30 September 2016, the German Federal Government has submitted a second draft law implementing the Markets in Financial Instruments Directive 2014/65/EU (MiFID2) (Zweites Finanzmarktnovellierungsgesetz).

Amongst other things, the draft law amends the German Securities Trading Act (WpHG), the German Banking Act (KWG), the German Stock Exchange Act (BörsG) and the German Capital Investment Code (KAGB). Important consequences are the extension of the list of administrative offences and increase of fines, tightening of the regulatory framework for algorithmic trading and in particular high-frequency trading, and the creation of additional powers for the German Federal Financial Supervisory Authority (BaFin). New provisions provide for the monitoring of position limits of commodity derivatives and the supervision of data delivery services.

BaFin and Deutsche Bundesbank revise supervision guideline

The German Federal Financial Supervisory Authority (BaFin) and the German Central Bank (Deutsche Bundesbank) have revised the guideline on the ongoing monitoring of credit and financial services institutions by the Deutsche Bundesbank (Aufsichtsrichtlinie). The guideline deals with the distribution of tasks between BaFin and the Deutsche Bundesbank with regard to the ongoing supervision of institutions pursuant to section 7 of the German Banking Act (KWG).

The revision was necessary to reflect the requirements imposed by the Single Supervisory Mechanism (SSM), which provides for direct supervision of significant institutions by the European Central Bank (ECB).

Polish Finance Ministry publishes draft ordinance on higher risk weighting for exposures secured by mortgages on immoveable property

The Finance Ministry has published a new draft ordinance which imposes higher risk weighting on banks for foreign currency mortgage loans.

The draft stipulates that:

- exposures secured by a mortgage on a residential property as referred to in Article 125 para. 1 subpara. a of the Capital Requirements Regulation (CRR), and

where the amount of the capital or interest instalment is dependent on exchange rate changes of a currency or currencies other than the debtor's revenue currency, shall be given a risk weight of 150%; and

- exposures secured by a mortgage on offices or other commercial premises as referred to in Article 126 para. 1 subpara. a of the CRR located in the Republic of Poland shall be given a risk weight of 100%.

The draft has been submitted for inter-ministerial consultations.

Polish Financial Supervision Authority sets out position on prohibition of lenders remunerating credit intermediaries under draft Act on Consumer Credit and Supervision over Mortgage Loan Intermediaries and Agents

The Polish Financial Supervision Authority (KNF) has presented its position on the prohibition of the remuneration of credit intermediaries by lenders stipulated in the draft Act on Consumer Credit and Supervision over Mortgage Loan Intermediaries and Agents.

The KNF, having participated in the work on this draft Act from the beginning, recommends introducing a prohibition of remunerating credit intermediaries and presents the underlying motives for this, considering this issue as significant for the balanced development of the mortgage loan market.

HKMA issues new supervisory policy manual on margin and risk mitigation standards for non-centrally cleared OTC derivatives

The Hong Kong Monetary Authority (HKMA) has issued a new supervisory policy manual (SPM) module on margin and risk mitigation standards for non-centrally cleared over-the-counter (OTC) derivatives. The final draft form of the new SPM module was shared with authorised institutions on 30 December 2016.

The new module sets out the minimum standards that the HKMA expects authorised institutions to adopt in respect of margin and other risk mitigation standards for non-centrally cleared OTC derivatives transactions.

As noted in the HKMA letters issued in December 2016, the phase-in of initial margin requirements for phase one institutions, and variation margin requirements for all covered entities will start from 1 March 2017, subject to a six-month transitional period.

HKMA announces countercyclical capital buffer for Hong Kong

The Hong Kong Monetary Authority (HKMA) has announced that the countercyclical capital buffer (CCyB) for Hong Kong will increase to 1.875% with effect from 1 January 2018, from the current 1.25%. The increase is consistent with the Basel III phase-in arrangements for the CCyB.

The Basel III regulatory framework provides for the CCyB to be phased in over a period of 3 years (from 2016 to 2018) and to become fully effective on 1 January 2019. Under the phase-in arrangement, the maximum CCyB under Basel III has been scheduled to begin at 0.625% of banks' risk-weighted assets on 1 January 2016 and increase each subsequent year by an additional 0.625% to reach its final maximum of 2.5% on 1 January 2019. This means that for 2018 the maximum CCyB under the Basel III phase-in arrangement is 1.875%.

NDRC specifies governmental approval regime for foreign-invested projects

The National Development and Reform Commission (NDRC) has issued the 'Circular on Implementing the Administration of Foreign-invested Projects under the Catalogue of Investment Projects Subject to Governmental Approval (2016)', which is intended to further promote the filing regime for foreign-invested projects and attract more foreign investment. The circular clarifies the approval and filing requirements on foreign-invested projects, stating amongst other things that:

- if the total investment amount of a foreign-invested project falling into the category of restricted projects under the Catalogue of Industries for Guiding Foreign Investment (2015) (Restricted Foreign-invested Projects) is no less than USD 300 million (including subsequent capital increases), the prior approval of the central NDRC is required, and if the total investment amount of a Restricted Foreign-invested Project is no less than USD 2 billion (including subsequent capital increase), a separate prior filing with the State Council is also required;
- if the total investment amount of a Restricted Foreign-invested Project is less than USD 300 million (including subsequent capital increase), the prior approval of the provincial government is required;
- approval procedures for foreign-invested projects, which are not covered under the preceding paragraphs but fall under the industries set out in Articles 1 to 10 of

the Catalogue of Investment Projects Subject to Governmental Approval (2016) (such as the sector of energy, transportation), shall be handled in accordance with Articles 1 to 10 accordingly; and

- foreign-invested projects which are not covered under the preceding paragraphs and are not explicitly prohibited in accordance with the Catalogue of Industries for Guiding Foreign Investment (2015) are only subject to the filing procedures of the local NDRC.

Bank of Korea and Bank Negara Malaysia renew bilateral swap arrangement

The Bank of Korea and Bank Negara Malaysia have entered into an agreement to renew the bilateral KRW/MYR swap arrangement. The size of the arrangement is maintained at 5 trillion KRW/15 billion MYR, the same amount which was decided under the initial arrangement established on 20 October 2013. The swap arrangement is for a period of three years and can be extended by mutual agreement between the two central banks.

The arrangement is intended to promote greater use of local currencies in settlement of trade and further strengthen the financial cooperation between the two countries.

CFTC staff grants temporary no-action relief to swap dealers complying with EU uncleared swap margin requirements

The staff of the CFTC's Division of Swap Dealer and Intermediary Oversight has issued temporary no-action relief to permit swap dealers complying with EU uncleared swap margin requirements to comply with those EU requirements in lieu of certain CFTC margin requirements that are eligible for substituted compliance. This no-action relief is effective from 4 February 2017 – when many swap dealers must begin to comply with EU margin requirements – until 8 May 2017.

Pursuant to the substituted compliance framework established in the CFTC's Cross-Border Margin Rule, the CFTC has been analyzing the EU Commission's request that the CFTC determine that EU margin requirements provide a sufficient basis for an affirmative finding of comparability. Pending such a determination, this relief gives swap dealers who would otherwise also be subject to both EU margin requirements and the CFTC's margin requirements certainty about their compliance obligations.

The CFTC's margin requirements apply only to swap dealers and major swap participants that are not subject to oversight by a prudential regulator.

RECENT CLIFFORD CHANCE BRIEFINGS

Impact of EU-US bilateral agreement on insurance and reinsurance prudential measures

On 13 January 2017, the European Commission published a statement made jointly with the Office of the United States Trade Representative announcing that the EU and the US have negotiated a bilateral agreement on prudential measures regarding insurance and reinsurance. The Commission also published the text of the agreement.

The Agreement has been welcomed by many trade associations and reinsurers since it calls for an end to collateral and local presence requirements for EU and US reinsurers, which have long been an issue for reinsurers operating internationally.

This briefing paper highlights the key areas of the Agreement and considers its potential effect on third country (re)insurers, including those in Solvency II equivalent jurisdictions and, following the Brexit referendum result, looks at the potential impact for (re)insurers based in the UK.

https://www.cliffordchance.com/briefings/2017/01/impact_of_eu-us_bilateralagreementoninsuranc.html

Unilateral Option Clauses – 2017 Survey

Dispute resolution clauses providing for arbitration but giving one party the exclusive right to elect to refer a particular dispute to litigation before the courts – also known as 'unilateral option clauses' – have remained a common feature in many transaction documents since we carried out our last survey in 2014.

Following recent decisions in France and Singapore – and in light of the result of the United Kingdom's referendum of 23 June 2016 on its membership of the European Union – the time is right to re-visit the topic to see if such unilateral option clauses remain 'fit for purpose'. Clifford Chance has therefore refreshed and expanded its survey as to their effectiveness. The survey now covers over 60 jurisdictions, 21 of which are included for the first time (including 14 African jurisdictions).

https://www.cliffordchance.com/briefings/2017/01/unilateral_optionclauses-2017survey.html

FCA Enforcement – More Options for Resolution

On 1 February 2017 the FCA announced significant changes to the enforcement decision making process which

are likely to impact all enforcement cases, including those currently underway.

This briefing paper discusses the changes to the FCA's enforcement process.

https://www.cliffordchance.com/briefings/2017/02/fca_enforcement_moreoptionsforresolution.html

CFTC gives guidance on cooperation

On 19 January 2017, the US Commodity Futures Trading Commission issued an Enforcement Advisory describing the factors that will be considered to evaluate the cooperation provided by companies that are the subject of CFTC investigations and / or enforcement actions. The CFTC can, in its discretion, reduce penalties to be imposed for violations based upon its determination of a company's level of cooperation. The Cooperation Advisory emphasizes a company's proactive steps in response to an investigation, including encouraging personnel to cooperate with CFTC, identifying potential wrongdoers from within the company and from other organizations, devoting staff and resources to an investigation, and providing both documents and helpful explanations of market operations to CFTC. The Cooperation Advisory also suggests that CFTC will no longer treat joint-defense agreements as a negative factor per se, but will be critical of gratuitous sharing of potentially relevant documents. Finally, it suggests that CFTC may now be more interested in company policies, controls and culture, including both those that existed at the time of any misconduct, and those that the company enacts remedially.

This briefing paper discusses the Cooperation Advisory.

https://www.cliffordchance.com/briefings/2017/01/cftc_gives_guidanceoncooperation.html

Favorable Trend for Plaintiffs in Data Breach Class Actions – Circuits Differ on Whether Free Credit Monitoring Supports Standing

Enterprises responding to a data breach must be careful in crafting customer notifications and remedial measures, especially the provision of free credit monitoring services, due to these actions' potential impact on standing for class action plaintiffs. The 6th and 7th Circuits have found that post-breach mitigating actions like the provision of free credit monitoring services may constitute an admission of injury sufficient to give rise to standing. This trend, however, was criticized in the 3rd Circuit's recent opinion in In Re Horizon Healthcare Services, Inc. Data Breach Litigation. Nonetheless, in this uncertain environment companies should be mindful of the potential impact of certain remedial measures on subsequent class actions.

This briefing paper discusses recent standing opinions.

https://www.cliffordchance.com/briefings/2017/01/favorable_trend_forplaintiffsindatabreac.html

Progress on the liberalisation of the Saudi equity market

The Saudi Stock Exchange (Tadawul) has published, for public consultation, draft rules and regulations in relation to the move from the T+0 to the T+2 cycle for settlement of securities transactions.

In our May 2016 briefing paper (please see the link below), we spoke about initiatives announced by the Saudi Capital Market Authority (CMA), which is the Saudi capital markets regulator, to stimulate the development of, and increase foreign participation in, the Tadawul by introducing the T+2 cycle for settlement of securities transactions, and regulations permitting securities lending and covered short selling of Tadawul-listed securities. On 9 January 2017, the Tadawul took an important step towards the implementation of these initiatives by issuing a number of publications, which are available on the Tadawul website.

This briefing paper aims to provide a succinct overview of these regulatory changes and invites our clients to participate in the public consultation process.

https://www.cliffordchance.com/briefings/2017/01/progress_on_the_liberalisationofthesaud.html

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

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