FINANCIAL SERVICES REGULATION
Exchange – International Newsletter

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DLA PIPER

INTRODUCTION

WELCOME

DLA Piper's Financial Services International Regulatory team welcomes you to the twenty-fifth edition of 'Exchange – International' – an international newsletter designed to keep you informed of regulatory developments in the financial services sector.

This issue includes INTERNATIONAL updates, as well as contributions from EUROPE, AUSTRALIA, AUSTRIA, ITALY, the MIDDLE EAST, the NETHERLANDS, the UK and the USA.

Our aim is to assist you in providing an overview of developments outside your own jurisdiction which may be of interest to you. In each issue we will also focus on a topic of wider international interest. In this edition, "In Focus" looks at the consultation paper released by ESMA in December 2014, which contained its technical advice and its draft regulatory and technical standards for MiFID II.

In addition, the Italian section focusses on the new legislation implemented by the Italian Securities and Exchange Authority (Consob), which will have significant implications for the selling of complex financial products to retail consumers. The UK section reports on the differing approaches of market participants to the proposed ring-fencing legislation and the record fines issued to five banks in light of the foreign exchange benchmark manipulation scandal.

In Austria, we consider the Austrian Supreme Court judgement regarding banks' liabilities for mis-directed money transfers and the requirement to reconcile the account name with the account number. The Netherlands section outlines the protection afforded by the new the Financial Markets Amendment Act 2016, which documents a number of steps to protect derivatives investors in the event of the bankruptcy of an intermediary. In Australia, we look forward to a new stage of payments systems' regulation, through which credit card issuers in Australia will no longer require authorisation by APRA in order to carrying on banking business.

Please click on the links below to access updates for the relevant jurisdictions.

Your feedback is important to us. If you have any comments or suggestions for future issues, we would be very glad to hear from you.

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CONTENTS

INTERNATIONAL

REPORTS

FSB REPORT ON STRUCTURAL BANKING REFORMS

On 27 October 2014, the Financial Stability Board (**FSB**) produced a report to G20 Leaders on structural banking reforms and the effect that inconsistencies in cross-border implementation are having on global financial stability.

The report noted that major structural banking changes that have been implemented in a number of jurisdictions (including in those jurisdictions in which most of the globally systemically important banks (**G-SIBs**) are currently hosted and operating). These changes, brought about in light of the lessons learned from the 2008 financial crisis, have been designed to separate ‘core’ banking activities (including retail and payment activities) with ‘riskier’ capital market and investment banking activities, in order to reduce the risk burden on depositors and the individual governments who may be tasked with bailing them out; and the risks posed to the stability of the broader financial system. Most of these changes have been implemented through functional separation of retail and investment banking divisions, through regulatory mechanisms including prohibition, ring-fencing, subsidiarisation or geographic separation.

The report findings state that banking reform in the US, UK, EU and other places has been generally justified by authorities on the basis of reducing systemic risk and ending implicit guarantees for ‘Too Big To Fail’ institutions. The intention has been to provide greater clarity and certainty in the event of troubled G-SIBs requiring resolution. Although generally supported by other jurisdictions, there have been concerns highlighted in a number of areas, including complications in cross-border resolution; decreased liquidity in financial markets; reduced capital market flows; and regulatory arbitrage (where firms shop to pick and choose their regulatory jurisdictions to suit business objectives).

The report noted that whilst there have not been any observed cases of materially adverse impacts resulting from the changes, the new regulations and rules have yet to be fully adopted and implemented, and the effects on global financial stability will only become apparent once many of the regulatory changes have been published and come into effect.

As a result of this, the FSB has indicated it will continue to monitor the situation. The FSB, together with the International Monetary Fund (**IMF**) and the Organisation for Economic Cooperation and Development (**OECD**), will present an update on structural banking reforms and associated cross-border implications in 2016. To supplement this update, the report notes that the Basel Committee on Banking Supervision (**BCBS**) will be reporting in late 2015 on the range of mechanisms used by national governments for dealing with cross-border branches and subsidiaries; which will also coincide with the OECD assessment of the cross-jurisdictional consistency of capital and liquidity requirements.

BENCHMARKS UNDER CLOSE REGULATORY SCRUTINY

In the wake of recent scandals, there has been a renewed regulatory focus on benchmarks and their regulation. The international response to the various benchmark scandals and the concerns arising out of them has been driven by the International Organisation of Securities Commissions (**IOSCO**)’s publication of the Principles for Financial Benchmarks in 2013. In summary, these principles were designed to improve the reliability of benchmarks by addressing:

- The governance of benchmark administrators;
- The quality of the data submitted; and
- Accountability mechanisms for benchmark administrators and submitters.

The FSB published its final report on foreign exchange benchmarks on 30 September 2014, which highlighted a number of recommendations for reforming key FX benchmarks, particularly focussing on the WM/Reuters 4pm London Fix (**WM/R 4pm London Fix**). The focus of the paper was to improve not only the structure of the fixes, but also measures to improve the conduct of participants within the market.

The recommendations centred on a number of key aspects of the benchmark process, including calculation methodologies; banks' risk and conflict management infrastructure; and greater regulatory and market scrutiny of participants before, during and after a fix. The paper also endorsed the recommendations of the September 2014 IOSCO review specifically of the WM/R 4pm London Fix.

The FSB report noted that "based on discussions with the relevant market sectors, the [FSB] believes that all the recommendations above can and will be accepted and implemented by the market groups concerned".

Europe has also responded to the global benchmark regulatory push. In December, the Commission issued its latest compromise proposal for its Regulation on the indices and benchmarks in financial instruments and financial contracts. The proposed regulation is still working its way through the European Parliament and the Council of the EU, and is not expected to be in force until 2016.

The regulation proposes regulating a significantly wider array of benchmarks than had previously been considered. 'Critical benchmarks' which would require supervision and regular viability assessments, would be defined as those indices used to reference the amount payable under a financial instrument, which are used as a reference for at least €500 billion of financial instruments, and for whom the majority of the contributors to the benchmark are supervised entities.

There will be requirements on national competent authorities to notify ESMA of the use of benchmarks; requirements for benchmark administrators to be authorised and have strict policies on governance, oversight and accountability; and requirements for contributors to comply with a legally binding code of conduct.

The UK, which has direct supervision over a number of the major benchmarks, including LIBOR and the WM/R 4pm London Fix, has also proposed introducing domestic legislation to ensure transparency and restore integrity to the fixes. The Fair and Efficient Markets Review (**FEMR**), set up by the Chancellor George Osbourne in June 2014, produced its preliminary findings into the additional financial benchmarks to be brought under regulatory scope.

The report recommended bringing seven new benchmarks under UK regulation, on top of LIBOR, which is already regulated. These were:

1. SONIA – Sterling Overnight Index Average;
2. RONIA – Repurchase Overnight Index Average;
3. WM/Reuters 4pm London Fix;
4. ISDAFIX – a benchmark for annual swap rates for swap transactions;
5. London Gold Fixing;
6. LBMA Silver Price; and
7. ICE Brent – the benchmark for crude oil.

In December 2014, the UK Government accepted the findings of FEMR's review, and has committed to implementing regulation on the seven named financial benchmarks. Alongside its response paper, the government also produced an impact assessment and draft statutory instrument.

It is expected that further regulatory developments will be seen over the course of the next year, as regulators both nationally and internationally strive to rebuild the integrity of benchmark indices.

EUROPE

ESMA ADVISES EU INSTITUTIONS AND NATIONAL COMPETENT AUTHORITIES ON REGULATING CROWDFUNDING

In December 2014, the European Securities and Markets Authority (**ESMA**) published an opinion on investment-based crowdfunding, along with issuing an advice note to EU policymakers.

Investment-based crowdfunding, as distinct from other forms of crowdfunding, is based on project owners pitching their ideas to, typically, non-professional clients in return for an equity stake in the project. In issuing its opinion and advice, ESMA recognises that the development of crowdfunding is a comparatively new trend and was not on the forefront of the minds of EU legislators during the drafting of existing legislation, and therefore it had been necessary to adapt the existing EU regulation to this new area. ESMA's view is that this has left the potential for legislative gaps, which may require addressing.

In its Opinion, addressed to national competent authorities, ESMA states that the EU rules which apply to crowdfunding platforms will depend on, to a large extent, the business model used. The 'typical' investment-based crowdfunding platform, which involves a reception and transmission of orders, would have a capital requirement of €50,000 or appropriate equivalent insurance under the Markets in Financial Instruments Directive (**MiFID**). ESMA highlighted that gathering "expressions of interest" would likely be sufficient to amount to this requirement.

The Opinion noted that a crowdfunding platform could encounter difficulties when it came to passporting its permissions. In order to achieve the widest possible audience, it is likely that crowdfunding platforms would require an EU passport. Therefore, those Member States who have developed regimes which allow for lower capital requirements under MiFID Article 3 could prevent a crowdfunding platform having access to a passport. ESMA also noted that there could be weaknesses in investor protection as a result of disapplying MiFID capital requirements, although these could be mitigated using national legislation or regulation. Similarly, those business models structured to avoid the requirements under the Prospectus Directive could encounter similar issues.

ESMA also considered that investment-based crowdfunding could, in cases where the project amounted to a collective investment scheme, need to be considered against the requirements of the Alternative Investment Fund Managers Directive (**AIFMD**), European Venture Capital Funds Regulation and European Social Entrepreneurship Funds Regulation.

The Advice note, addressed to the EU institutions, urged policymakers to consider a number of areas surrounding the regulatory framework for crowdfunding platforms. In particular, ESMA stated that legislators should consider the thresholds in MiFID and the Prospectus Directive. ESMA highlighted that one option would be to develop a specific crowdfunding regime which would regulate those platforms operating outside the existing MiFID framework.

Commenting on the announcement, Steven Maijoor, Chair of ESMA, announced "ESMA's aim is to enable crowdfunding to reach its potential as a source of finance, while ensuring that risks to users of crowdfunding platforms are identified and addressed in a proportionate and convergent way across the EU."

"We believe that there are benefits both for investors as well as for platforms by operating inside rather than outside the regulated space."

EC GUIDANCE ON PRACTICAL APPLICATION OF RUSSIAN SANCTIONS

The European Commission has issued guidance on implementing a number of aspects of the July 2014 sanctions (and subsequent extensions in September and December) against Russia.

The guidance takes the form of twenty-six questions and answers, which clarify the European Commission's stance on what activities would be considered a breach of the

sanctions. The focus on the paper is to make clear whether certain activities in relation to financial services and bond markets would be permissible.

The questions cover a range of topics, including:

- Financial assistance;
- Trade finance;
- Emergency funding;
- Other loans; and
- Capital markets.

The guidance states that the sanctions had been selectively targeted by the EU to weaken Russian State-owned financial institutions; reduce the potential for arms transfers to Russia; and prevent the transfer of certain sensitive technologies. When considering how to apply these sanctions, firms should pay attention, not only to the strict legal parameters outlined in the regulations, but also to these overriding objectives.

MLD4 AND WTR MOVE CLOSER TO ADOPTION FOLLOWING POLITICAL AGREEMENT

In December 2014, the Presidency of the Council of the European Union has announced that political agreement has been reached between itself and the European Parliament on the Anti-Money Laundering Directive 4 (**MLD 4**) and the revised Wire Transfer Regulation (**Revised WTR**). The first text of the legislation was published in February 2015.

The MLD 4 proposal builds on the Financial Action Task Force (**FATF**) Recommendations published in February 2013, and has been subject to extensive negotiation between the Presidency and Parliament for almost two years. The press release has described the provisions of MLD 4 as going "well beyond" international standards and marking a "considerable step forward in the fight against money laundering and terrorist financing".

Of particular note in the announcement was the introduction of a new requirement that Member States keep and maintain a register of beneficial ownership, in many ways similar to domestic regulation announced by the UK in October 2013. The MLD 4 register will be available to competent authorities, intelligence authorities, obliged entities and persons able to demonstrate a legitimate interest in the field. It has been separately announced that the phrase "legitimate interest" will extend to investigative journalists and other concerned citizens, who will be able to access information such as names, dates of birth, nationalities, residency and details of the nature of ownership.

There are also proposals to tighten controls on suspicious transactions for banks, auditors, lawyers real estate agents and casinos; as well as proposals for the EU to conduct supranational AML risk assessments; supervise cross-border payment institutions; and enhance the ability of intelligence agencies to share information and collaborate in investigations.

The Revised WTR is designed to aid in the tracing of money transferred within the European Union. There is also the prospect of more "innovative" sanctions to ensure compliance with the regulation.

The final proposals will need to be ratified by EU Member States' ambassadors (COREPER) and a number of committees before it can be put to a final vote in the European Parliament. The final vote is expected to take place sometime in H2 2015.

EDPS ADVISES REGULATORS OF FINANCIAL SERVICES ABOUT DATA PROTECTION CONSIDERATIONS

The European Data Protection Supervisor (**EDPS**), the European supervisory authority in charge of protecting personal data and privacy, has released a set of guidelines for considering data protection when developing EU financial services regulation, in order to ensure that EU institutions integrate data protection principles at the heart of financial services legislation.

The guidelines are designed to act as part of the policy toolkit for EU institutions to ensure that the rights to both privacy and protection of personal data, as enshrined in the Charter of the EU, are protected when new financial services policies and legislation are being produced.

The report summarises the nature of the privacy and data protection rights granted under the EU Charter and subsequent legislation, and describes ten analytical steps that should be considered when anticipating new legislation. The steps range from identifying the information to be processed; the legal purpose and basis for processing; the parties who will have access to the information; and any guarantees necessary to protect the individual's rights.

The guidelines proceed to address the practical steps needed to apply this methodology in a financial services regulatory context, for example when drawing up sanctions, whistleblowing schemes and requesting data from telecommunications providers.

Looking forward, the EDPS has emphasised its commitment to proactively engaging in consultation at all stages of the EU policymaking and legislative process, both formally and informally. The EDPS has also stated that it will, if necessary, issue public comments on implementing measures by EU supervisory authorities, where its view is not sought beforehand.

The EDPS has indicated it will take on board any feedback to its guidelines and has stated its intention to review the effectiveness of the guidelines no later than 2019.

NEW AUTHORITY FOR ECB INTERVENTION IN EU GOVERNMENT BOND MARKET

On 14 January 2015, the Court of Justice's Advocate-General Cruz Villalón (**AG**) issued his opinion in the case of Gauweiler and Others v Deutscher Bundestag (Case C-62/14) regarding the legality of the European Central Bank (**ECB**) directly intervening in the EU bond market, prior to the adoption of the quantitative easing (**QE**) programme adopted on 22 January 2015.

The €1.1 trillion QE programme, which was announced on 22 January 2015 by ECB President Mario Draghi in light of the deflationary pressure within Eurozone markets, will be implemented by the ECB directly buying euro-denominated, investment-grade securities on the secondary market.

The Gauweiler case was brought to the German Federal Constitutional Court by a number of German politicians and academics, in order to challenge the ECB's announcement of its institution of an Outright Market Transactions (**OMT**) programme in September 2012 at the height of concerns about the viability of the Eurozone.

The AG's opinion supports the ECB's actions while imposing certain obligations on the ECB when it engages in an OMT programme. The opinion states that prior to implementing an OMT programme the ECB must give a proper account of the reasons for adopting the programme identifying clearly and precisely the extraordinary circumstances which justify implementing such a programme. It also indicates that the ECB must ensure the programme retains its character as a "monetary" rather than "economic" measure and that, in order to do so, it must refrain from any direct involvement in the financial assistance programme that applies to the EU Member State concerned (i.e. any state whose bonds are being purchased).

However, the AG's opinion also makes it clear that the ECB must have a broad discretion when framing and implementing the EU's monetary policy, and the courts must exercise a considerable degree of caution when reviewing the ECB's activity, because the courts lack the expertise and experience which the ECB has with regard to monetary policy.

In his conclusion, the AG stated that the OMT programme would be compatible with the EU founding treaties, provided that:

- "The ECB refrains from any direct involvement in the financial assistance programmes to which the OMT programme is linked;
- The ECB complies strictly with the obligation to state reasons and with the requirements deriving from the principle of proportionality; and
- The timing of its implementation is such as to permit the actual formation of a market price in respect of the government bonds."

The AG's opinion is not the decision of the European Court of Justice (**ECJ**), however the ECJ decision will typically follow the opinion of the AG, even if it modifies some aspects. The ECJ Decision is expected to follow shortly.

HÖKMARK REPORT PROPOSES AMENDMENTS TO BANKING STRUCTURAL REFORM REGULATION

On 7 January, Rapporteur of the European Parliament's Economic and Monetary Affairs Committee (**ECON**), Gunnar Hökmark MEP, published a draft report proposing a number of major amendments to the EU's regulation on structural reform in the banking sector proposal.

The focus of the report was on protecting tax-payers and depositors, and therefore the report proposes that structural separation decisions should be considered in the light of the ability to resolve the institution and the risks it poses to financial stability. The report proposed that requiring structural separation of banks should only be one part of a broader range of powers available to the regulator, including imposing particular capital requirements and should not be mandatory.

The report aims to resolve some of the derogation issues which have plagued the progress of the bill. Although the report removes the option for derogating the structural separation requirements required by Article 21, there are amendments to Article 9 which would mean that a credit institution could not be forced to separate if it did not deal in investments as principal or hold trading assets. Furthermore, even if those activities were carried out, the entity could still avoid the prospect of separation if it was separately capitalised, had independent management and possessed its own decision making capacity. This approach would act as some relief to large UK banks, whose domestic ring-fencing proposal under the Vickers Report, could have forced UK banks to 'double separate' under domestic and EU requirements. Under this new proposal, as a result of UK ring-fenced banks not being permitted to deal in the above mentioned regulated activities, the possibility of double separation would be less likely.

There are also proposals for publishing two separate balance sheets for the banking book and trading book, even if these activities are not structurally separated. The report further proposes broadening the definition of proprietary trading to include elements of intentionality, and additional flexibility for using different types of derivatives, including OTC derivatives, to manage risk.

The Hökmark Report was published shortly after the Italian Presidency of the Council of the European Union published a progress report on the banking structural reform proposals, in anticipation of the EU Presidency being passed onto Latvia in the first half of 2015. The recommendations of the Hökmark Report were submitted to ECON on 21 January and the contents are likely to change to some degree before the Parliament defines its position. There will be further discussion on banking structural reform by the Parliament and the Council during the first half of 2015, with the new Latvian Presidency having indicated that it wishes to devote significant resources to the issue.

HM TREASURY DROPS BONUS CAP LEGAL CHALLENGE

Chancellor of the Exchequer of the UK, George Osborne, has officially withdrawn the UK's challenge to the Credit Risk Directive IV (2013/36/EU) (**CRD IV**) bonus cap proposals following a letter to Mark Carney, Chair of the FSB and Governor of the Bank of England, in which Mr Osborne stated the appeal had "minimal prospects for success".

A number of provisions in CRD IV implemented a limit on variable remuneration, including bonus payments, that were payable to certain "material risk takers" within an organisation. The regulation also requires a number of disclosures regarding the salaries of such individuals.

The UK launched its challenge in February 2014 on a number of grounds, including stating that the proposed measures had inadequate Treaty legal basis; were disproportionate; and failed to comply with the principles of subsidiarity, legal certainty and data protection.

However, in November 2014, a non-binding opinion by Advocate General Nilo Jääskinen issued to the ECJ stated that the grounds for challenge should be rejected. In his reasoning, Mr Jääskinen stated that the limits imposed by CRD IV, including a limit on variable remuneration of 100% of fixed remuneration (which can be increased to 200% with shareholder consent) did not amount to a bonus cap or pay fixing, because it did not fix the level of fixed remuneration. It was also noted that creating a unified risk management framework "could not have been better achieved by measures taken at the national level". Although the ECJ is not required to follow the opinion of the Advocate General, in practice the ECJ often accepts the Advocate General's findings or makes only minor amendments.

In the letter to Mark Carney dated 20 November 2014, published on the government website, George Osborne stated that although he was "increasingly concerned by recent developments that appear to be driving up fixed compensation in the banking industry… it now looks clear there are minimal prospects for success with our legal challenge so we will no longer pursue it. But that should not stop us from pursuing our objective on ensuring a system of remuneration that encourages responsibility instead of undermining it".

As a result of withdrawing the application, the UK will be required to pay the costs incurred by the European Parliament and the Council of the EU in defending the case.

EUROPEAN COMMISSION FINES BANKS €95 MILLION FOR COLLUSION

On 21 October, the European Commission announced two sets of fines totalling almost €95 million on a number of major international banks found to have colluded on aspects of the Swiss Franc derivatives market.

The first set of fines were given to UBS, JP Morgan and Credit Suisse for a total of over €33.3 million, as a result of their collusion in fixing prices in the "bid-ask" market. The banks were found to have fixed the bid-ask spreads on a number of products to third parties, but maintained narrower spreads for trades between one another. The aim of this price fixing was found to have been to prevent other market participants from competing on the same terms. There would have also been a fine for RBS, however they were given a 100% reduction resulting from immunity granted for revealing the existence of the cartel. The fines also included a 30% discount for UBS and a 25% discount for JP Morgan for their cooperation under the notice.

The second 'set' of fines involved an illegal cartel between RBS and JP Morgan to influence the Swiss franc LIBOR benchmark interest rate, in contravention of EU antitrust rules. The manipulation involved traders discussing rates of LIBOR submissions, along with respective trading positions and intended prices. Again, RBS received 100% reduction in their fine, as a result of immunity granted for revealing the existence of the cartel, which helped the bank avoid a potential fine of €110 million. JP Morgan received a leniency discount of 40% for their cooperation with the investigation, but were still fined over €60 million.

The 2006 Leniency Notice, published by the Commission, entitles the entity which reveals the existence of a cartel to the Commission to justify full immunity, under certain conditions. This has proved highly controversial, in allowing certain organisations to seemingly escape prosecution for breaches of EU law. The Commission, however, has argued it has been effective in encouraging firms to report on cartels and cooperate with the investigation.

AUSTRALIA

PAYMENTS SYSTEM REGULATION CHANGES TAKE EFFECT

From 1 January 2015, the Access Regime in Australia has been reformed so that credit card issuing and credit card acquiring services in Australia no longer require an entity to be authorised by the Australian Prudential Regulatory Authority (**APRA**) to carry on banking business.

Background

A complex framework for regulating payments operates in Australia with relevant provisions contained in numerous laws, regulations and instruments administered by several regulators including ASIC, APRA, AUSTRAC and the Payments System Board.

Australia is one of the most highly banked nations in the world, with an estimated 99 per cent of people over the age of 15 having an account with a formal financial institution, as well as 79 per cent having a debit card and 64 per cent a credit card. Australians have also been quick to embrace mobile and electronic payments systems.

Rapidly changing technology has brought new entrants into the market, increasing competition amongst payment providers and schemes and new methods of payment. The recent Financial Services Inquiry final report, published in December 2014, shows the diversity of the existing payments systems and highlights the issues facing law makers in seeking to maintain regulatory neutrality between the varying payment methods.

Reforms to the Access Regime

Prior to the reforms, Australian law required APRA authorisation as either a full offering bank or as a Specialist Credit Card Issuer for 'credit card acquiring' whether physical and virtual cards were used. Effectively this meant that only banks could operate as merchant acquirers and the regulatory hurdles to obtain even a restricted banking licence were high. Generally only Australian incorporated entities could apply for a banking authorisation.

The relevant Banking Regulation, which required a banking authorisation for acquiring or issuing, has been repealed and the Reserve Bank of Australia has varied the Access Regimes for the MasterCard and Visa credit card systems and revoked the Access Regime for the Visa Debit system.

The Visa and MasterCard schemes (**Schemes**), which are the two designated payment systems, are now responsible for determining which entities may become card issuers or acquirers under their schemes, subject to a risk management framework imposed by the Reserve Bank.

The new Access Regimes effectively require an issuer or acquirer involved with Visa or MasterCard to be approved by the relevant Scheme. The Schemes are required to be transparent in relation to their eligibility and assessment criteria, as well as for reasons for being rejected. APRA is to be provided with details of who is approved and who is rejected.

A Scheme is not permitted to prevent a participant from being:

- An issuer only;
- An acquirer only; or
- Both an issuer and an acquirer.

No participant in the Schemes can have any fee, charge, loading or any form of penalty imposed on them as a consequence of, or which is related in any way to, that participant's activity as an acquirer, relative to its activity as an issuer in the Scheme.

The Schemes cannot prohibit a participant from being a self-acquirer if the participant can reasonably establish, in accordance with the rules of the Scheme, that as a self-acquirer, it has the capacity to meet the obligations of an acquirer.

The administrator of a Scheme may establish any criteria for eligibility to apply to participate in the Scheme, provided these eligibility criteria are reasonably related

to the risks to the Scheme, or risks to the Scheme's participants, merchants or cardholders that are likely to arise from the participation.

The administrator of the Scheme must establish and apply criteria for assessing applications for participation in the Scheme by eligible applicants and publish the eligibility criteria, assessment criteria and timescales to complete the assessment on their website. The administrator must provide reasons for any rejection within one month of that rejection.

There have been no changes to the law in relation to the provision of financial services related to non-cash payments which require providers to have an Australian Financial Services licence or providers of consumer credit to have an Australian Credit licence. Both these licences are issued by the Australian Securities and Investments Commission.

Related AML/CTF Reforms

As a consequence of the changes to the Access Regime, credit card issuers and acquirers are specified as providing a specific designated service and are now required to become reporting entities subject to the full compliance obligations of the AML/CTF regime. There are also privacy law issues and in particular the issues raised by cross border flows of personal information and data collection.

The reforms impose additional obligations on non-banking acquirers and issuers in terms of compliance, training and employee and customer due diligence. There are follow-on implications for service providers engaged by acquirers and issuers to carry out various services on their behalf.

Consequences of the Reforms

The reforms are the first of many, intended to open up the Australian market to new entrants and to allow innovative systems, driven by technology, to come into the market.

There are implications for all entities operating in the payment sector both in terms of direct legal responsibilities, but also in terms of contractual obligations for entities providing services on behalf of the direct participants in the payments system. Payment processing and platform providers are included in the group which may be impacted by the changes.

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AUSTRIA

BENEFICIARY BANKS FOUND NOT LIABLE FOR THE CONSEQUENCES OF INCORRECT BANK TRANSFERS

A recent decision of The Austrian Supreme Court (*OGH 23.10.2014, 2 Ob 224/13z*) considered the question of whether a beneficiary bank can be held liable for damages incurred as a result of incorrect transfers, which have been triggered by an incorrect account number in the payment order. Furthermore, in making its decision, the court weighed the beneficiary bank's obligation to reconcile the recipient's name with the corresponding account number.

Facts of the case

The plaintiff sought in 2010 to transfer seventeen thousand Euro from her account to a business partner´s account held at another bank. In the transfer order, the name of the recipient was given along with the beneficiary's account number and sort code. Although the account number existed, it did not belong to the intended business partner. The transferred amount was credited to the above specified account, but the account owner remained unknown. The plaintiff made a claim for damages against the defendant bank, based on the assertion that the bank was under an obligation to reconcile the recipient´s name and account number provided.

Merits

In determining the merits of this case, the Austrian Supreme Court clarified that The Payment Services Act (*Zahlungsdienstegesetz*) was authoritative for all transfers, since coming into force on 1 February 2014. Accordingly, only the international bank account number (**IBAN**), as agreed between the customer and the bank, is decisive. The reconciliation of the beneficiary´s name with the corresponding account number is not obligatory.

Furthermore, the court in their decision, stated that the bank shall not be liable for errors or failure to execute the payment transaction, if the IBAN as specified by the customer is incorrect.

In substantiating their decision, the Austrian Supreme Court affirmed that according to the current law, the defendant bank does not have an obligation to reconcile the beneficiary's name with the account number. Moreover, the defendant bank is not liable for any damages incurred by the plaintiff as a result of the transfer to an existing account as specified by the customer, but not associated with the envisaged recipient. In such a situation, the plaintiff´s only avenue for recourse is that of the law of obligations and unjust enrichment.

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ITALY

CONSOB'S COMMUNICATION ON THE DISTRIBUTION OF COMPLEX FINANCIAL PRODUCTS TO RETAIL CUSTOMERS

On 22 December 2014, the Italian Securities and Exchange Authority (*Commissione Nazionale per le Società e la Borsa*) (**Consob**) published a communication concerning the distribution by intermediaries of complex financial products to retail customers (i.e. Communication No. 0097996/2014) (the **Communication**).

The aim of the Communication is to increase the level of protection of retail customers, who are deemed to be the most vulnerable operators in the complex financial products market.

Indeed, in Consob's view, the complexity of the financial products means that retail customers are exposed to higher risks and require constant monitoring to ensure that these customers are not exploited due to their lack of market experience.

Consob, in the past, has observed that the transparency requirements imposed by current regulations are insufficient in ensuring full investor protection and preventing distortions in the placement process of the relevant products.

In the Communication, Consob has adopted a non-exhaustive list of complex financial products and has established good practices to which the intermediaries are subject in their relationship with retail customers.

The rules set out in the Communication build on the existing rules of conduct that intermediaries must apply in providing investment services in Italy, found in Italian laws and MiFID implementing regulations. Such rules of conduct apply, inter alia, to EU intermediaries subject to the Italian establishment regime (i.e. having a branch in Italy). Conversely, those rules do not apply to EU intermediaries providing services into Italy which must comply with the laws and regulations of their home State.

The Communication follows two ESMA opinions concerning "MiFID practices for firms selling complex products" published on 7 February 2014 and "good practices for product governance arrangements" published on 27 March 2014.

Specifically, ESMA identifies complex products and recommends that intermediaries adopt good practices when offering these products, to ensure they are in line with the target clients' profiles and to avoid damaging effects on retail customers.

In the Communication, Consob fully adopt ESMA's position. In particular, the Italian Authority:

a) Explicitly advises intermediaries against offering certain complex financial products, outlined in a specific non-exhaustive list, to retail customers. The list includes:

   – Financial products arising from securitisation transactions (i.e. asset backed securities);

   – Financial instruments convertible into shares, upon initiative of the issuer or subject to certain conditions (e.g. Contingent Convertible Notes or financial products qualified as "additional tier 1" under Art. 52 of Regulation (UE) n. 575/2013);

   – Credit-linked financial instruments;

   – Structured financial instruments not traded on trading venues, in relation to which the reimbursement of the sums paid by the investor is not guaranteed;

   – Derivative financial instruments; and

   – Alternative undertakings for collective investment (**UCIs**);

b) Reminds intermediaries of their duty to apply criteria of coherence between the products offered and the customers' profiles;

c) Reminds intermediaries of their duty to prevent conflicts of interest that can occur in the distribution of complex financial products aimed at increasing the assets of the intermediaries themselves;

d) Invites intermediaries to eliminate incentives to personnel which could accentuate seller conflicts of interest; and

e) Invites intermediaries to make use of the same assessment and simulation methods used for internal purposes within their risk management system, when preparing the information to be provided to retail customers during the distribution process.

Where the intermediaries decide not to comply with the Consob's advice outlined in (a) because they deem that the distribution of complex products is in the interest of the retail customers and that adequate information concerning such products and risks connected with them are provided to investors, other measures, in addition to the measures described in (b) to (e) above, are prescribed aimed at making the distribution compliant with the above mentioned principles.

The relevant decision to distribute the financial products must be taken, on a justified basis, by the top management of the intermediaries, subject to opinions of the controlling corporate bodies and functions.

In any case, the decision to distribute the products should be accompanied by the identification of the relevant investment limits for current and potential customers, taking into account:

1. The customers' socio-economic characteristics (e.g. level of expertise, age, minimum assets held by the intermediary);
2. The relevant quantitative thresholds (e.g. minimum investment thresholds and maximum thresholds of the assets portfolio); and
3. The modalities of the offer (e.g. online channel only application; advanced portfolio advisory service which also includes (i) periodically monitoring of financial portfolio, (ii) review of the adequacy, (iii) interaction with the customer after aforesaid review; etc.).

Moreover, the intermediaries must provide the client with a disclosure concerning the "unsuitability" for retail customers of the distributed products, according to Supervisory Authority guidelines.

The intermediaries shall carry out specific controls during the entire process of the distribution of complex financial products, to ensure the compliance of the process with the aforesaid principles on a continuous basis.

Consob has established that intermediaries must implement the practices outlined Communication as soon as possible and in any event no later than 30 June 2015, informing the Authority of any decisions and measures that have been adopted.

NEW ITALIAN RULES AIMED AT FACILITATING COMPANY FINANCING

Recent amendments to the Italian regulatory framework have had a significant impact on the rules concerning the provision of financing activities and the entities to which such activities are reserved in Italy.

In Italy, the provision of financing activities to the public (i.e. towards third parties, on a professional basis) is generally reserved to banks and other authorised entities (i.e. financial intermediaries).

Financing activities include, inter alia, the activity of credit purchasing.

Non-Italian banks and financial intermediaries are entitled to carry out financing activities in Italy, including credit purchasing, subject to specific passporting, licensing and enrollment procedures.

As anticipated, the legislature has introduced certain new rules potentially affecting the above considerations.

In particular, the 'Competitiveness Decree' (*Decreto competitività*) (i.e. Law Decree no. 91 of 2014, as converted into Law no. 116 of 2014), which contains a number of measures aimed at addressing the various needs of the Italian economy, includes certain provisions aimed at facilitating access to new sources of financing for Italian companies.

According to these rules, the categories of entities entitled to carry out financing activities in Italy have been enlarged so as to include, subject to specific modalities and conditions, insurance companies and securitisation vehicles. These entities are admitted to lend to companies to the extent that:

- The borrower is identified by a bank or a duly enrolled financial intermediary; and
- The bank or the financial intermediary identifying the borrower retains a "significant interest" in the financing transaction. For loans made by insurance companies,

> "significant interest" means an interest equal to at least five per cent of the loan granted by the relevant insurance company. Banks and financial intermediaries will keep the significant interest for the entire life of the loan; unless they choose to transfer the significant interest to other banks or financial intermediaries during the lifetime of the loan. Conversely, the law does not state the threshold for loans made by securitisation vehicles.

In the case of securitisation vehicles, the notes issued to fund financing granted by the securitisation vehicle must be addressed to "qualified investors" only.

In the case of Italian insurance companies, such entities must also (i) have an adequate internal risk and control management systems; and (ii) be adequately capitalised.

To further support lending by insurance companies, the Decree has provided that financing granted by insurance companies falls within the assets that insurance companies may hold as investments for the purpose of complying with their technical provisions (*riserve tecniche*) requirements.

The Bank of Italy and IVASS (the Italian authority supervising the insurance market) must each issue implementing regulations setting forth the operational limits and the other details applicable to lending by, respectively, securitisation vehicles and Italian insurance companies. In this sense, IVASS has already updated the Regulation no. 36 concerning the investments covering technical provisions (*reserve tecniche*) of the insurance companies.

In the same perspective, the definition of UCIs contained in the Legislative Decree No. 58 of 24 February 1998 has been amended. In particular, according to this amendment, UCIs, including non-Italian UCIs (irrespective of any passport/authorisation), may invest in receivables, including those arising from financing granted by the same fund.

Separate to the provisions concerning the financing activities of insurance companies and securitisation vehicles, which expressly qualify as lenders and specify the modalities and conditions according to which they are entitled to grant loans, the above mentioned amendment of the Legislative Decree No. 58/1998 concerning the UCI's definition is less clear and focuses on the investment activities undertaken.

It has been interpreted as seeking to allow UCIs' financing activity, but secondary rules to clarify and describe the modalities and conditions of this activity are still missing.

In addition, the rules concerning the reservation of financing activities have not been amended or derogated. This implies, inter alia, that non-Italian banks and financial intermediaries are still subject to specific passporting, licensing and enrollment procedures in order to carry out financing activities with the public in Italy.

In light of the absence of any details on financing activity of UCIs, and the discrepancy between the above mentioned laws, it is reasonable to assume that a non-Italian UCI is entitled to purchase credits (vis-à-vis Italian borrowers) from an Italian bank, subject to specific limits and conditions.

One structure that might considered would be a sub-participation structure involving Italian banks or financial intermediaries, according to which (i) the UCI would enter into a relationship exclusively with Italian bank or intermediary selling the credit, without having any contact with the Italian borrowers and (ii) the UCI would have the right to obtain a reimbursement for the credit provided exclusively from the Italian bank or intermediary.

Alternatively, non-Italian UCIs may enter into a trilateral agreement with the Italian bank or intermediary selling the credits, and the Italian borrowers, according to which Italian borrowers would reimburse the credits directly in favour of the UCI, but the latter would not be entitled to manage the relationship for them (for example, it would not be entitled to carry out actions to force the Italian borrowers to pay, etc.).

These structures would appear to allow the purchase of Italian borrowers' credit by non-Italian UCIs and to trigger the above described Italian regulatory scenario.

It is understood that secondary rules clarifying the scope and the application of the new rules enabling UCIs to lend to companies are needed in order to remove the uncertainties connected with it.

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MIDDLE EAST

UAE

NEW REGULATIONS FOR THE ISSUANCE OF SUKUK

The Emirates SCA (**SCA**) passed Decision No. 16 of 2014 that established new rules relating to the offering of Sukuk (i.e. bonds). The new provisions apply to all Sukuks that are publicly offered, issued in the UAE and any that are listed in the Market. The rules specifically exempt Government Sukuks from these new regulations.

The new regulations require an obligor to be incorporated within the UAE and not in any free-zone. The Sukuk itself must be approved by the Shari'ah committee of the obligor and have a minimum total nominal value of AED 10 million.

The regulations also stipulate the conditions for approval required by the SCA, including a list of information to be disclosed for both primary and joint listings, as well as the review procedure adopted by the SCA.

The ongoing obligations of obligors, as well as the procedures for trading and winding-up, are listed in these provisions and the SCA reserves the right to penalise, by way of warning or fine to the obligor or suspension or cancellation of the Sukuk, where the obligor violates any provisions of the new law.

NEW REGULATIONS FOR THE ISSUANCE OF DEBT SECURITIES

The SCA passed Decision No. 17 of 2014 that established new rules relating to the offering of debt securities. The new provisions apply to all debt securities that are publicly offered, issued in the UAE and any that are listed in the Market. The rules specifically exempt Government debt securities from these new regulations.

The new regulations require an issuer to be incorporated within the UAE, and not in any free-zone and also to have the authority to issue a debt security.

The debt security must comply with the Commercial Companies Law; must not be restricted by the constitutional documents of the issuer; and must have a minimum aggregate value of AED 10 million.

The regulations also stipulate the conditions for approval required by the SCA, including a list of information to be disclosed for both primary and dual listings, as well as the review procedure adopted by the SCA.

The ongoing obligations of the issuer, as well as the procedures for trading and winding-up are listed in these provisions and the SCA reserves the right to penalise, by way of warning or fine to the obligor, or suspension or cancellation of the debt security, where the issuer violates any provisions of the new law.

NEW AML AND ANTI-TERRORIST LAW

The UAE Federal Government has promulgated a new Anti-Money Laundering Law (Federal Law No. 9 of 2014).

This law identifies the actions which constitute money-laundering activities and suspicious transactions, together with the penalties in case of violations. It repeals all previous legislation which is inconsistent with the provisions of the new law.

The UAE Federal Government has also promulgated a new Anti-Terrorist Law (Federal Law No. 7 of 2014).

This law details the activities which constitute terrorist crimes, which include terrorist-financing activities. It repeals the previous UAE Terrorist Crimes Law No. 1 of 2004, together with all previous legislation which is inconsistent with the provisions of the new law.

SAUDI ARABIA

FOREIGN COMPANIES CAN NOW BUY SHARES OF LISTED COMPANIES

Saudi Arabia's Capital Market Authority has announced a relaxing of rules that will allow foreign companies to buy shares on the Saudi market.

Previously, foreigners were only allowed to buy Saudi stocks if they were offered by way of an investment fund or a derivative, but the new relaxed rules will allow foreign entities to register and buy stocks directly.

The change in the rules is in line with efforts to promote growth in the Saudi economy and to allow for increased revenue that is not reliant upon the sale of oil.

THE NETHERLANDS

GOVERNMENT MOVES TO PROTECT DERIVATIVES INVESTORS AGAINST BANKRUPTCY OF INTERMEDIARIES

The Dutch government has published a consultation document on the legislative proposal for the Financial Markets Amendment Act 2016 (**Amendment Act**).

The Amendment Act contains new rules regarding the protection of derivatives investors in the case of the bankruptcy of their intermediary (a bank, investment firm or clearing institution, hereinafter the **Intermediary**). The purpose of this Amendment Act is to segregate the Intermediary's other funds from the derivatives positions entered into for the benefit of its clients with a third party.

The proposed effective date of the Amendment Act is 1 January 2016.

Background

In 2004, the Markets in Financial Instruments Directive (**MiFID**) became effective. Article 13 (7) of MiFID requires that an investment firm shall, when holding financial instruments belonging to clients, make "adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the investment firm's insolvency".

In practice, implementation of this obligation in the Netherlands has been rather complex with regard to derivatives. This is due to the fact that derivatives positions an Intermediary enters into or manages on behalf of clients are not separated from the other assets and liabilities of the Intermediary (legal structures such as trusts do not exist in Dutch legislation).

In 2005 this problem arose during the bankruptcy of *Van der Hoop Bankiers* (a Dutch bank). Clients with derivatives positions were not protected against the bank's bankruptcy: the claims brought against the bank with regard to their derivatives positions were considered as a part of the assets of the bank in liquidation. They could only present their claim to the receiver.

To rectify this situation, a legislative proposal was introduced in 2009 to make it possible to transfer derivative positions to another Intermediary in the case of bankruptcy. The draft legislative proposal was met with criticism and was withdrawn by the Dutch government. In 2012 a new attempt was made to protect derivatives' holders against the bankruptcy of their Intermediary, but this proposal was also withdrawn by the Dutch government.

However, in the same year (2012), the European Market Infrastructure Regulation (**EMIR**) was introduced. EMIR requires, amongst other things, that central counterparties ensure that they are authorised to transfer the derivatives positions of defaulting clearing members affiliated to the same central counterparty to a non-defaulting clearing member. In cases where the remainder is in default as a result of the bankruptcy of the clearing member, such transfers are not automatically possible, at least not without the cooperation of the receiver, according to Dutch insolvency law as it stands. As a result, some central counterparties exercise restraint in entering into a relationship with Dutch clearing members, because they fear they are not able to comply with the demands of EMIR.

In view of the above, the purpose of the proposed Amendment Act is, on the one hand, to keep the derivatives positions of clients outside the bankruptcy of their Intermediary and consequently to protect clients against bankruptcy, and, on the other hand, to arrange that the derivatives positions and the accompanying security held by clients can be transferred to a solvent Intermediary without complications. For that purpose, the separation of a part of an Intermediary's funds is the most important instrument.

Segregation of Derivatives Funds

Based on the present legislative proposal, a new regime will be incorporated in the Dutch Securities Book-Entry Administration and Transfer Act (*Wet giraal effectenverkeer*). All derivatives positions that an Intermediary enters into for the benefit of its clients with a third party are separated from the funds of the Intermediary. All rights and obligations arising from the derivatives positions that the Intermediary has entered into for the benefit of its clients fall within the separated derivatives funds, usually known as the 'corresponding position'. This position concerns both the rights and obligations arising from the positions, as well as the rights and obligations from exchanging securities.

The components of these separated funds are reserved to serve as settlement under the related derivatives positions of clients (in general named 'client positions').

Entering into a corresponding position can be based on various legal concepts. Irrespective of the various legal concepts, the corresponding positions of an institution are part of the separated derivatives funds, if and as long as the corresponding position is related to a client position. Which corresponding position belongs to which derivatives position entered into by a client must be evident from the Intermediary's administration.

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UK

LEGISLATION

PRA CLOSE CONSULTATION ON RING-FENCING

Comments have closed for the PRA consultation paper on the implementation of bank ring-fencing due to come into effect on 1 January 2019.

The PRA is required by the Financial Services and Markets Act 2000 (**FSMA**), as amended by the Financial Services (Banking Reform) Act 2013, to ensure that banks with deposits of over £25 billion insulate their retail banking operations from the perceived 'more risky' corporate and investment banking operations, in order to enhance customer protection and financial stability. The requirements include a provision to ensure that the board of directors of each entity remain separate, with no more than a third of directors allowed to sit on both boards.

Banks were asked to submit their preliminary legal and regulatory structures before 6 January 2015. It has been reported that TSB, Santander, Virgin Money, RBS, Barclays, Lloyds and HSBC have confirmed submission of their ring-fencing plans to the PRA.

The Financial Times (**FT**), citing people familiar with the situation, have reported that Lloyds Banking Group plc have asked for an exemption to proposals requiring a different board for the ring-fenced and non-ring-fenced entity, because over 90 per cent of their new banking operation is to be ring-fenced.

It is also understood that Barclays plc and HSBC Holdings plc are planning to put as little as possible into the ring-fenced entity, in order to boost the size of the remaining entity and therefore lower their costs of funding. For example, Barclays are believed to have proposed keeping Barclaycard credit card and most corporate finance divisions outside the ring-fenced entity. RBS and Lloyds, both banks based on strong lending platforms, have instead sought to operate using as a large a ring-fenced entity as possible.

In their response to the consultation, the British Bankers' Association (**BBA**), the industry body representing banks, stated that they foresee the deadline of January 2019 laid out in the consultation as "extremely challenging" unless operational and functional capacity can be put in place by the regulators.

The BBA stated that the PRA will need to "accelerate decision-making on key aspects of the regulatory regime and ensure that they have sufficient capacity to provide requisite regulatory engagement, and where necessary, approval at each relevant stage in a timely and efficient manner".

Executive Director of the BBA, Paul Chisnall, stated that "we'd like the regulators to try to put in place the new regime as quickly as possible to allow banks to make final decisions about how to structure their businesses".

Standard and Poor's (**S&P**), the ratings agency, has stated that as a result of the ring-fencing legislation, some of the investment banks could be assigned credit ratings as low as BB, also known as "junk" status. Osman Sattar of S&P stated that "although we believe non-ring-fenced entities could remain viable, we think their risk appetite may need to be lowered further and their business models revised. They could also require very high levels of capitalisation and liquidity. This may make them a less attractive investment proposition than they've been over much of the past two decades."

"Banking groups whose systemically-important retail banking units have ratings around the 'A' category could under our criteria have non-ring-fenced entities with ratings around the 'BB' category – or at best the 'BBB' category."

The policy for ring-fencing was originally laid out in the Vickers Report in December 2013. The PRA expect to consult further on the policies in 2015, before publishing their final rules in 2016.

NEW FCA POLICIES TO IMPROVE BEHAVIOUR IN CREDIT BROKING

In response to concerns over the credit broking market, the Financial Conduct Authority (**FCA**) has published a policy statement issuing new rules focussed on tackling bad fee charging practices in the industry. The new rules, targeted towards addressing concerns in certain subprime

markets including the high-cost short-term credit (known in the UK as payday lending) market, came into force on 2 January 2015.

The rules focus on regulating those brokers who charge a fee to the customer. Firms will now be banned from charging fees and requesting details from customers for the purpose of charging fees unless certain information about the firm and the fees are provided to the customer in a durable medium. The credit broker must also ensure that the customer has acknowledged receipt of this information and confirmed awareness of the contents of the notice in a durable medium.

The rules are designed to ensure transparency for the customer about the finance party being dealt with and any fees that may result from the relationship. The FCA has also stated its intention is to cut down the process of firms sharing payment details to other firms which take a fee, as each fee-charging firm will be required to send its own information notice and receive an acknowledgement letter.

There are certain additional transparency requirements for brokers, including having to notify the customer of their legal name and the fact they are a broker (as opposed to a lender) in all financial promotions and other communications. All fee charging brokers will be required to inform the FCA of their web domain names every quarter.

Furthermore, the FCA is requiring that if a customer cancels a credit broking agreement within the 14 days prescribed in the Distance Marketing Directive, the credit broker will be required to repay any sums received from the customer within 30 calendar days.

In producing the policy guidelines, the FCA did not issue a consultation period, as the regulator felt that "the delay involved in consulting would be prejudicial to the interests of consumers". The FCA has made relevant updates to the Consumer Credit sourcebook (CONC) and the Supervision manual (SUP) to take account of these policy changes.

MARKET ABUSE DEFINITION EXTENDED UNTIL 2016

In November, the Government announced the extension of the existing market abuse regime until July 2016. The existing definition of market abuse, under section 118(8) FSMA, had been set to expire on 31 December 2014.

In an explanatory memorandum, HM Treasury noted that the definition of market abuse in the UK is wider than the one prescribed by the EU Market Abuse Directive, and therefore the government had kept the need for this broader definition under review. This extension is the fourth time the expiry date has been extended, having previously been retained in 2008, 2009 and 2011.

The newly published Financial Services and Markets Act 2000 (Market Abuse) Regulations 2014 will retain the existing legislative provisions under section 118(8) FSMA until the EU Market Abuse Regulation (**MAR**) comes into force in 2016. The MAR provides for a similarly broad interpretation of market abuse, functionally equivalent to the UK legislation.

ENFORCEMENT

FCA HANDS OUT £1.1 BILLION IN FINES FOR BANKS RIGGING FOREIGN EXCHANGE MARKET

In the largest fines ever imposed by a UK financial regulator, the FCA has fined five banks over £1.1 billion over the manipulation of foreign exchange (**FX**) benchmarks. The five banks, Citibank N.A., HSBC Bank plc, JPMorgan Chase Bank N.A., The Royal Bank of Scotland plc and UBS AG, were each fined between £210 million and £235 million for their role in the misconduct. The FCA announced that its investigation into Barclays Bank plc was ongoing.

The FX market has an average daily turnover of US$5.3 trillion, of which 40% is traded through London. The spot FX markets rely on a number of benchmarks "fixes", which are supposed to reflect the relative market price between two currencies at particular times during the day. In its investigation, the FCA focussed, in particular, on the WM/Reuters 4pm London Fix and the 1.15pm European Central Bank Fix.

The investigation revealed that between January 2008 and October 2013, groups of traders in the five banks had communicated with one another to try to manipulate the market in a way that ensured that the participating traders would benefit. Traders would typically take one of three roles: 'building' their position, in which the trader would take a large position in the currency and use this financial muscle to push the market in the desired direction; 'giving

the ammo', in which traders at other banks would pass on some of their position to the trader seeking to build; or 'netting off' their position in which the traders at the other banks would ensure they reduced their position in off-market transactions, if they were positioned in the opposite direction to that desired.

The majority of the evidence in the case came through a number of instant chat messages sent between traders. The FCA revealed that groups of traders in these firms formed "tight knit groups" who referred to themselves by names such as 'the players', 'the 3 musketeers' and 'the A-team'. In some of the more revealing messages, traders would celebrate with one another after having successfully manipulated a rate, posting messages such as: "cnt teach that", "sml rumour we haven't lost it", "we… do… dollar" and "we fooking killed it right".

The FCA has announced that it will be implementing an industry wide remediation programme in order to ensure that the root causes of the problems have been addressed going forward. The review will focus on ensuring that the systems and controls in relation to spot FX in order to ensure they are adequate to manage the risk within the banks.

In announcing the fines, chief executive of the FCA, Martin Wheatley stated "today's record fines mark the gravity of the failings we found and firms need to take responsibility for putting it right. They must make sure their traders do not game the system to boost profits or leave the ethics of their conduct to compliance to worry about. Senior management commitments to change need to become a reality in every area of their business."

"But this is not just about enforcement action. It is about a combination of actions aimed at driving up market standards across the industry. All firms need to work with us to deliver real and lasting change to the culture of the trading floor."

The FCA's fines were published in conjunction with further fines issued by the Commodity Futures Trading Commission (CFTC) and Office of the Comptroller of the Currency in the US, totalling US$2.4 billion, and a further £100 million fine by FINMA in Switzerland.

IT FAILURES COST RBS GROUP £56 MILLION IN FIRST JOINT FCA AND PRA ENFORCEMENT ACTION

In the first joint enforcement action taken together by the FCA and PRA, Royal Bank of Scotland Group banks were fined £56 million in relation to an IT failure in June 2012. The fine, which was issued to Royal Bank of Scotland plc (**RBS**), National Westminster Bank plc (**NatWest**) and Ulster Bank Ltd (**Ulster Bank**) (together **the Banks**), related to a software compatibility problem which left over six and a half million customers facing difficulties accessing their money.

In its final notice, the FCA stated that the problem had meant customers of the Banks were unable to access their online banking facilities or obtain accurate account balances from ATM machines, as well as facing difficulties paying some external credit providers.

Following the incident, the Financial Services Authority (the predecessor of the FCA) ordered a skilled persons report into the incident. The PRA and FCA then undertook a joint investigation into the issues. In the meanwhile, the Banks paid out paid a total of over £70 million in redress to customers, including £460,000 to individuals and firms who were not customers of the Banks.

As a result of the investigation, the FCA deemed the IT failings to be a breach of Principle 3 in failing to ensure that the firms had adequate systems and controls measures to identify and manage IT risks. The Banks had failed to take "reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems".

In the FCA's press release, the director of enforcement at the FCA, Tracey McDermott, stated that "the problems arose due to failures at many levels within the RBS Group to identify and manage the risks which can flow from disruptive IT incidents and the result was that RBS customers were left exposed to these risks. We expect all firms to focus on how they ensure that they can meet the requirements of their customers when looking at their IT strategies and policies."

The PRA also identified in its final notice that the banks had failed to ensure that the IT change had been managed in a carefully planned way. In outlining its final penalty, the PRA stated "properly functioning IT risk management systems and controls are an integral part of a firm's safety and soundness and of particular importance to the stability of the UK financial system".

The Banks would have had a combined penalty of £80 million, but were entitled to a 30% discount for early settlement.

SUCCESSFUL FIRST PROSECUTION FOR SFO UNDER THE BRIBERY ACT

In December 2014, the Serious Fraud Office (**SFO**) announced its first successful convictions under the Bribery Act 2010, following the sentencing of three individuals in relation to alleged fraud of over £23 million. These are the first convictions under the Bribery Act since it came into force in July 2011.

Gary West and James Whale, former directors of the companies in the Sustainable Growth Group (**SGG**), and Stuart Stone, a sales agent of an investment firm, were convicted of a number of offences, including conspiracy to commit fraud, conspiracy to furnish false information, fraudulent trading and a number of Bribery Act 2010 offences. They were sentenced to 13, 9 and 6 years in jail respectively at Southwark Crown Court.

The convictions were part of the SFO's investigation into the SGG, which was discovered to have numerous accounting irregularities, relating to false sales invoices and disguised money transfers.

Director of the SFO, David Green CB QC, stated "These three individuals preyed on investors, many of whom were duped into investing life savings and pension funds. As a result, many lost life-changing amounts of money. This successful conclusion of the SFO's investigation clearly demonstrates the harm that this type of investment fraud has on victims and the SFO's ability and determination to bring criminals to justice."

These convictions come less than a month after Stuart Alford QC, Joint Head of Fraud at the SFO had to reiterate that the SFO was taking the Bribery Act seriously after a lack of prosecutions.

In a speech to the Anti-Corruption Oil and Gas Conference 2014, he stated "I believe that the record in respect of the Bribery Act is not nearly as troubling as some people make out. This is a piece of legislation which is taken very seriously, and you will start to see an increase in the number of prosecutions: both from the SFO and other agencies."

UK TRADING PLATFORM COLLAPSES

Trading platform Alpari has been forced into insolvency as a result of the Swiss National Bank's decision to end the Swiss franc cap against the Euro.

On 15 January 2015, the Swiss National Bank abandoned its attempts to fix the price of the Swiss franc against the Euro. The surprise decision, believed to have been in response to early rumours of the Eurozone's quantitative easing plan, resulted in the franc rising by 30%. This was described by some commentators as "probably the largest one-day movement by a major currency since the First World War".

This caught some market participants off-guard, including trading platform Alpari, a UK based trading platform. Alpari, originally established in Russia, allowed their clients to be exposed in certain markets, relying on an ability to match their clients' positions with liquidity in the market. When liquidity in the market dried up, Alpari found themselves unable to cover their cash demands. The firm, which had been planning an IPO in 2015, released a press statement on its website stating that it had been put into insolvency.

Explaining the outcome, the firm stated that the rate move had resulted in the "majority of clients had sustaining losses which has exceeded their account equity. Where a client cannot cover this loss, it is passed on to us".

The firm has moved to reassure customers about their procedures for client money protection. "Retail client funds continue to be segregated in accordance with FCA rules".

BANK EXCLUDES DUTY TO PROVIDE ADVICE WHEN MAKING RECOMMENDATIONS

The High Court has ruled that in certain cases, banks can exclude a duty to provide advice when making recommendations of certain products.

It was held, in the case of Crestsign Ltd v RBS and Natwest [2014] EWHC 3043 (Ch), that although the bank did provide negligent advice, they had successfully excluded the duty to provide advice by providing the relevant terms of business before the transaction. Included in the terms were statements including that the borrower would be acting on its own account and would not be placing reliance on the bank for advice or recommendations provided.

The case centred around Crestsign, a small, family-owned business, who entered into an agreement with NatWest to refinance an existing loan. As a condition of the loan, the finance would only be provided if Crestsign agreed to enter into an interest rate swap arrangement. When interest rates fell in the years subsequent to the finance agreement being signed, Crestsign continued to pay a significantly higher interest rate as a result of the swap. Crestsign claimed damages for negligent advice and negligent misstatement.

In providing his judgement, Mr Tim Kerr QC, stated that “in the present case, I find myself unable to resist the conclusion that the banks successfully disclaimed responsibility for any advice that Mr Gillard [an RBS representative] might give and (as I have found) did give. The Risk Management Paper and the two sets of terms of business were unequivocal; they defined the relationship as one in which advice was not being given.”

“They were clearly drawn to Mr Parker’s [a director from Crestsign] attention before the swap contract was concluded. He rightly understood (and hence sought comment from Mr Bransby-Zachary [another Crestsign director] on the terms of business) that they were not empty words but were intended to have legal effect as part of any contract.”

This case comes in the context of a number of past-sale regulatory reviews conducted by banks at the insistence of the FCA, which have paid out large amounts of redress for missold swaps and derivatives products. This case may demonstrate that the regulatory requirements imposed on banks by the FCA are, in some cases, more stringent on banks than strict legal tests applied by the court.

TRADER PLEADS GUILTY TO LIBOR MANIPULATION

In October, the SFO announced its first conviction in connection with manipulating the LIBOR benchmark. The individual, described as “a senior banker for a leading British bank”, but who has not been named for legal reasons, pleaded guilty at Southwark Crown Court for conspiracy to defraud.

LIBOR is an interest rate benchmark which calculates the average rate at which contributor banks can borrow in the inter-bank market. The benchmark, which is used for pricing billions of pounds worth of financial contracts annually, has been the subject of a number of high profile manipulation scandals, in which traders from major banks sought to profit from altering the rate.

Later in the same month (October), the SFO also announced it had commenced criminal proceedings against Noel Cryan, formerly of Tullett Prebon Group Ltd, bringing the number of persons facing charges for LIBOR related offences up to thirteen.

REPORTS

FCA PUBLISHES DAVIS REVIEW INTO MISHANDLED MEDIA BRIEFING

In December 2014, the FCA released the Davis Review (**Review**), an independent report into the FCA’s mishandled announcement of a thematic review into historic life insurance products.

The Review was commissioned in response to a front page article in The Telegraph newspaper on 27 March 2014, announcing an FCA investigation into legacy life insurance products. The story was based on information provided to a journalist by the FCA, ahead of the thematic review’s formal announcement in the FCA’s 2014/15 Business Plan at the end of the month.

At the time, the article had a significant effect on the share price of a number of insurance companies, resulting in accusations that the FCA had irresponsibly released price sensitive information and created a false market in shares.

The Review, which cost £3.15 million pounds to compile, found that the FCA has used the media "...as a tool of regulation to communicate effectively to firms and consumers about the steps which the FCA was taking to achieve its operational objectives". However, in this case, although the article was "well intentioned", its execution was poorly supervised and executed, which reflected failings in the FCA's media handling procedures.

The Review made a number of recommendations to the FCA, including:

- improving media handling procedures;
- acting under the presumption that the contents of its Business Plans are price sensitive;
- emphasising the impartiality of the prospective investigation in its announcement;
- not pre-briefing thematic reviews; and
- implementing greater controls of the Communications Division.

In its response, the FCA accepted all of the recommendations of the Review, and stated that it has begun the process of implementing changes. The FCA also announced that Clive Adamson, FCA Director of Supervision and the individual to whom a number of quotes in the article were attributed, and Zitah McMillan, Director of Communications and International, have decided to leave the regulator as a result of their role in the scandal and, along with CEO Martin Wheatley and Director of Markets David Lawton, they would not receive their 2013/14 bonuses.

James Palmer, Chairman of the Listing Authority Advisory Panel, commented that "the FCA came close to the line. If the FCA had been a listed or regulated firm, there would have been a potentially serious breach of systems and controls".

REGULATORY APPROACH

PSR OUTLINES VISION FOR FUTURE REGULATION OF PAYMENTS SYSTEMS

In November 2014, the new Payment Systems Regulator (**PSR**) released a consultation paper on its vision for the new regulatory framework for payment systems in the UK. The PSR is the new regulator of payment systems which will become fully operational in April 2015, as an independent subsidiary of the FCA.

Amongst the proposals in the consultation paper is the creation of a Payments Strategy Forum (**PSF**), which the PSR plans to launch soon after the PSR's inception. The PSF will be composed of a broad spectrum of industry representatives and service users, to discuss outcomes for, propose developments to, and monitor implementation of, future industry evolution. In December 2014, the PSR published a draft terms of reference for the Working Group, which will help to develop and steer the PSF.

To coincide with the launch of the PSF, the PSR intends to conduct a wide ranging market review, commencing in April 2015, into the ownership and competitiveness of infrastructure provision.

Other proposals include opening up governance to additional players including service users; a renewed focus on the access requirements for payment systems; and a new set of principles for industry behaviour standards.

The consultation paper closed on 12 January 2015. The PSR expects to publish its final policies and recommendations no later than the end of March 2015.

FCA FOCUS ON COMPLAINTS HANDLING

In December 2014, the FCA produced a consultation paper on proposals for improving complaints handling across all financial services sectors. It follows on from its November 2014 thematic review into the complaints handling processes of retail financial services firms, to identify and mitigate any obstacles preventing effective complaints handling in the future.

The paper consults on a number of policy and procedural improvements firms will be required to make. These include:

- Extending the informal complaint period time limit from one to three days;
- Requiring written communication to consumers whose complaints are resolved informally that they have the right to refer to the ombudsman if unsatisfied;
- Ensuring all complaints data is reported to the FCA;
- Improving the FCA's complaints return form that firms are required to fill out; and
- Limiting the cost of calling financial services firms to, at most, a "basic rate" number.

The thematic review, on which this consultation builds, found that broadly speaking, the retail financial services firms had made improvements in their complaints handling procedures, however there was still room for improvement to ensure that processes were handled in the best interests of consumers, through providing a clear, consistent and fair means of dealing with issues.

The review covered new ground from previous thematic review work on complaints through its forward-looking focus. The review was conducted working alongside fifteen major retail financial firms, including seven banks, two building societies and six insurers, who were asked to conduct self-assessment reviews on their own complaint handling procedures, to provide an insight into the customer journey within their firms and to identify any areas for improvement. It was the first time a self-assessment methodology had been adopted by the FCA for looking at complaints handling. It remains to be seen whether the FCA intends to use this methodology going forward in this area.

Responses to the consultation paper should be submitted before 13 March 2015. The FCA will consider the responses before publishing its new rules.

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UNITED STATES

US BANKING AGENCIES TO CONSIDER BASEL COMMITTEE'S PROPOSED REVISIONS TO CREDIT-RISK WEIGHTING METHODOLOGY

The Basel framework's standardised approach to measuring credit risk (the **Standardised Approach**) prescribes a consistent methodology for calculating a bank's required regulatory capital based on the risk level of its assets. In response to the global financial crisis, the BCBS revised the Basel framework's approach to regulatory capital as part of the package of reforms known as Basel III. In the US, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the **Banking Agencies**) adopted revisions to the Standardised Approach on 2 July 2013, as part of a final rule implementing several aspects of Basel III.

On 22 December 2014, the BCBS released a proposal (the **Proposal**) suggesting revisions to the Standardised Approach to further improve the risk-weighting calculations. The primary objective of the Proposal is to reduce reliance on external credit ratings in risk calculations, with additional goals of increasing risk sensitivity, reducing national discretion, strengthening the link between the Standardised Approach and internal ratings-based approaches, and enhancing comparability among banks. The Proposal puts forward new objective measurements, or "risk drivers," to calculate the risk of assets in several of the main exposure classes. Under Section 939A of the Dodd-Frank Act, the Banking Agencies removed references to credit ratings as a measure of credit-worthiness in their regulations and therefore, US implementation of the Standardised Approach already includes risk drivers that do not rely on credit ratings. Interestingly, the risk drivers proposed by the BCBS employ different alternatives to credit ratings than those adopted by the Banking Agencies:

- **Bank Exposures**: Under the Proposal, risk weighting would not be based on the credit rating of the bank or of its sovereign, and would instead be based on a look-up table of risk weights between 30 per cent and 300 per cent on the basis of (1) a capital adequacy ratio; and (2) an asset quality ratio. In the US, risk weighting for bank exposures is determined according to the OECD's credit risk classification of the bank's home country.
- **Corporate Exposures**: The Proposal would calculate the risk of corporate exposures based on a look-up table of risk weights between 60 per cent and 300 per cent on the basis of (1) revenue; and (2) leverage. Risk sensitivity would be increased through special treatment for certain types of specialised lending exposures. By contrast, all corporate exposures currently receive 100 per cent risk weighting in the US.
- **Exposures Secured by Residential Real Estate**: Currently, residential real estate secured exposures receive a 35 per cent risk weighting under the Basel framework. The Proposal would change this to calculate the risk of these exposures using a look-up table with risk weights ranging from 25 per cent to 100 per cent based on (1) loan-to-value; and (2) debt-service coverage ratios. In the US, all residential real estate secured exposures receive a 100 per cent risk weighting, unless they are (a) first-lien mortgages; (b) on owner-occupied or rented property; (c) made in accordance with prudent underwriting standards; (d) not 90 days or more past due or in non-accrual status; and (e) not restructured or modified (with the exception of certain government loan modification programmes); in which case they receive 50 per cent risk weighting.
- **Exposures Secured by Commercial Real Estate**: The Proposal suggests two possible approaches for these exposures, either (1) treating them as unsecured exposures to the counterparty, with national discretion for preferential risk weighting under certain conditions, or (2) using a look-up table with risk weights from 75 per cent to 120 per cent on the basis of loan-to-value ratio. The US subdivides risk weighting for commercial real estate secured exposures into various subcategories, ranging from 50 per cent for certain types of multifamily residential exposures to 150 per cent for high volatility commercial real estate exposures.

On the same day that the BCBS released the Proposal, the Banking Agencies also released a statement that they will be considering the Proposal with the goal of developing a stronger and more transparent risk-based capital framework for the largest banking institutions. It remains to be seen what effect, if any, the BCBS Proposal will have on the US approach to risk-based capital calculations, but the Banking Agencies stated that any change to the US rules would be made in a manner consistent with the US notice and comment process. Parties interested in commenting on the Proposal should be aware that comments are due no later than 27 March 2015.

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LOOKING AHEAD TO NEW US FINANCIAL REGULATION

The first session of the 114th Congress has convened, and Republicans have control of the House and Senate for the first time since 2006. With their new majorities, Republican leaders are determined to show that they can govern effectively. High on their legislative agenda is reducing the regulatory burden on the economy and scaling back what they perceive as the regulatory overreach of the Dodd-Frank financial reform law.

Since the enactment of Dodd-Frank in 2010, the Obama Administration and Congressional Democrats have resisted any changes to the law. In the last two years, the Republican House has passed a long list of bills to revise portions of the law, but the Senate blocked every Dodd-Frank change passed by the House. However, the total ban on Dodd-Frank revisions changed in the lame-duck session last month. First, Congress included an amendment to the 2015 omnibus spending bill which blocked a requirement that banks "push-out" certain swaps activities to nonbank affiliates. Despite opposition from many, the provision stayed in the bill and was signed into law by the President. Then, Congress cleared a bill with bipartisan support to provide the Federal Reserve with more flexibility in setting capital standards for insurance companies.

Finally, last week Congress added an amendment to the Terrorism Risk Insurance Act extension bill which exempts end users from Dodd-Frank derivatives rules. An attempt by Senator Elizabeth Warren (D-MA) to delete the provision was rejected by a 31-66 vote, with 13 Democrats voting against Warren.

With Republicans now in full control of Congress, further changes to Dodd-Frank can be expected. Full repeal or major changes to Dodd-Frank are not likely. The President has promised to oppose any proposals that "water down" his financial reform, and has threatened to veto any attempt to undermine Dodd-Frank. However, Congress can still be expected to move ahead on a number of changes to Dodd-Frank which could attract bipartisan support and gain 60 or more votes in the Senate.

Many Congressional Democrats will oppose any changes to Dodd-Frank. However, a number of Democrats could support some changes, particularly changes supported by financial regulators, who now believe that some provisions of the law are unworkable and need to be changed. In addition, the new Congress is much different than the one which enacted Dodd-Frank. Only 31 of the 60 Senators and 131 of the 237 House members who voted for Dodd-Frank in 2010 are still in office today.

The House Financial Services Committee chaired by Representative Jeb Hensarling (R-TX) will likely approve numerous bills to amend Dodd-Frank, and the full House will likely pass most or all of these bills. The key will be the Senate Banking Committee, where Senator Richard Shelby (R-AL) has taken over as Chairman. Senator Shelby opposed Dodd-Frank and has been a vocal critic of many of the law's provisions, including the structure and funding of the Consumer Financial Protection Bureau. He has supported regulatory relief for small and medium-sized banks, and he is a supporter of cost-benefit analyses for all new financial regulations. His challenge will be shaping Dodd-Frank reforms which can attract enough Democratic support to pass the Senate and avoid a Presidential veto.

The following are potential Dodd-Frank reforms which could be considered in the new Congress:

- **Financial Stability Oversight Council (FSOC) reforms**: A number of proposals have been made to curb the authority of FSOC, including one to rescind its authority to designate nonbank financial firms as systemically important financial institutions (**SIFIs**)

subject to enhanced supervision by the Federal Reserve. Other proposals would require FSOC to give firms an early warning notice that they may be designated as a SIFI, and require public hearings on SIFI designation proposals.

- **SIFI Threshold**: Under Dodd-Frank, all bank holding companies with more than US$50 billion in consolidated assets are automatically designated as SIFI and subject to enhanced levels of regulation and supervision. A number of proposals have been made to raise the asset threshold for enhanced supervision to US$100 billion, or higher, or to use criteria other than asset size for the designation. Financial regulators, including Federal Reserve Board Governor Daniel Tarullo, have supported raising the threshold to allow the Fed to focus on the largest institutions.
- **Volcker Rule**: A senior Federal Reserve Board official said recently that implementation of the Volcker Rule was the Fed's "greatest challenge" this year, and numerous proposals can be expected to delay portions of the rule beyond the statutory implementation date of July 2015. The Federal Reserve announced last month that it would delay the conformance period for banking entities' covered funds activities, and Congress is considering a proposal to delay the conformance date for collateralised loan obligations, which has already been delayed once. Also, Congress could act on a proposal to exempt community banks from the Volcker Rule, exempting banks and thrifts with less than US$10 billion in assets.
- **CFPB Reform**: Although many Democrats will resist any changes, Republicans can be expected to pursue changes to the structure and funding of the Consumer Financial Protection Bureau. One proposal would replace the Director of the bureau with a board of commissioners; another would subject the funding of the bureau to the annual appropriations process. Another proposal would establish an independent Inspector General for the CFPB.
- **Regulatory Relief**: A regulatory relief package for small banks could turn out to be the vehicle for a number of these other Dodd-Frank reforms. Financial regulators have pledged to work with Congress on legislation to reduce "unnecessary burdens" on smaller banks. The House Financial Services Committee is planning to move a regulatory relief bill, and Senate Banking Committee Chairman Shelby has long argued that Dodd-Frank "hurts small and medium-sized banks that had nothing to do with the financial crisis".

Treasury Secretary Jake Lew has said that the Administration will oppose any bill that undermines the Dodd-Frank financial reforms. But the new Republican Congress is determined to pursue bipartisan changes to fix the most glaring problems with the law, particularly changes supported by financial regulators. A Dodd-Frank reform bill which focuses on relief for community banks but which includes other substantive changes could attract enough Democratic support to avoid a Presidential veto.

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CCP RECOGNITION IN THE US AND THE EU: EQUIVALENCE THROUGH DEFERENCE

Last year saw the first authorisations of EU Central Counterparty Clearing Houses (**CCPs**), triggering the first clearing obligation procedure under Article 5(2) of EMIR. A CCP cannot operate in Europe if it does not meet authorisation and recognition criteria under EMIR Articles 14 (authorisation) and 25 (recognition).

Under EMIR, a CCP established outside of the EU may provide clearing services to clearing members established in the European Union only if the ESMA recognises the CCP as a 'third country CCP'.

The objective is to create an efficient and stable international regulatory framework for the global derivatives market by lowering the chances of market fragmentation and regulatory arbitrage between countries.

Status of Non-EU CCP Recognition

On 30 October 2014, the first wave of the EC's 'equivalence' decisions were granted to four Asian jurisdictions (Hong Kong, Singapore, Australia and Japan) through four provisional implementing acts. The US is still waiting for CCP equivalence from ESMA. Why would the EU recognise CCPs in those jurisdictions but not in the US?

If the EU does not grant equivalence status to the US, US CCPs will not be considered 'Qualifying CCPs' (**QCCPs**) in accordance with the Capital Requirements Directive (**CRD IV**) and Basel III risk-weightings. This means that European banks would incur significant costs to clear through US CCPs. This also means that US CCPs would be ineligible to clear contracts subject to the EU clearing mandate.

EMIR Requirements

Article 25 requires CCPs in third countries who provide clearing services to EU-based clearing members or trading venues to be recognised as 'equivalent' by ESMA. This means that the EU must determine that the third country's CCP requirements satisfy the same objectives as that in the EU in order to provide a strong CCP framework that promotes financial stability. The assessment of equivalence is done in an outcome-based approach which means that there is no requirement for identical rules. Once equivalent status is granted through an implementing act and a cooperation agreement is established between ESMA and the relevant jurisdiction, a market participant will be able to satisfy its clearing obligations under EMIR by submitting a trade with an authorised CCP in that third country.

CFTC Requirements

In the US, under the Derivatives Clearing Organisation authorisation process, a CCP must apply to the CFTC to become a Designated Clearing Organisation (**DCO**) or obtain an exemption in order to serve a US person. A substituted compliance regime would allow non-US entities to comply with comparable non-US rules, in lieu of complying with US CFTC rules, when dealing with US counterparties. To make a substituted compliance determination, the CFTC must determine that the foreign jurisdiction's requirements "are comparable with and as comprehensive as the corollary area(s) of regulatory obligations encompassed by" the CFTC's own rules.

Status of Discussions

Many issues of substituted compliance are in the pipeline between the EU and the US and are part of the larger debate to come regarding EU-US CCP recognition. Additionally, there are many new rules that have cross-border implications on both sides of the Atlantic.

For example, EU officials interpret the CCP equivalence test to mean that the US should not require US registration of EU clearinghouses. There are presently three clearinghouses in the EU that are also registered with the CFTC. Regulators have also identified broader issues in discussions regarding cross-border harmonisation. More precisely, in the EC press release announcing the recognition of CCPs in Australia, Hong Kong, Japan and Singapore, Michel Barnier, European Commissioner for Internal Markets and Services, indicated:

"Today's decisions show that the EU is willing to defer to the regulatory frameworks of third countries, if they meet the same objectives as EU rules. We have been working in parallel on assessing twelve additional jurisdictions and finalizing those assessments is a top priority. This includes the US: we are in close and continued dialogue with our colleagues at both the SEC and CFTC as we develop our assessments of their respective regimes and discuss their approaches to deference."

It is widely accepted that both sides also need to enhance cooperation in the joint supervision of dual registrants. There is already precedent for this in past collaborative examinations and information sharing. Dual registration has existed for more than a decade, and dual regulation and oversight should not hinder liquid and vibrant markets. It should provide markets with added confidence by ensuring effective and practical regulatory oversight.

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LAUNCH OF CONSULTATION ON IMPLEMENTATION OF MIFID 2 BY ESMA

In the run up to the Christmas break, the European Securities and Markets Authority (**ESMA**) launched its consultation paper on the MiFID 2 Directive (2014/65/EU) (**MiFID II**) and the MiFID (Markets in Financial Instruments) Regulation (Regulation 600/2014) (**MiFIR**). The consultation paper provided technical advice to assist the European Commission (**Commission**). The consultation paper includes at Annex B draft regulatory technical standards (**RTS**) and implementing technical standards (**ITS**) under the MiFID II Directive and MiFIR.

The consultation will run until 2 March 2015. ESMA will also hold an open hearing on the consultation on 19 February 2015.

The consultation paper runs to over 1600 pages, with Annex B running to over 500 pages and so we have given an overview of key areas of ESMA's proposals, particularly the areas which are now more settled due to the publication of the draft RTSs and ITSs and setting out the draft Regulatory Technical Standards and similar implementing measures.

Investor Protection

The consultation paper addresses four specific aspects of investor protection. This includes: (i) the procedures for granting and refusing requests for authorisation of investment firms (RTS 1: Article 7(4) (information to be provided on application for authorisation)); (ii) the freedom to provide investment services and activities/ establishment of a branch (RTS 3: Articles 34(8) and 35(11) (information to be provided on application to exercise single market passport)); (iii) provision of services and performance of activities by third country firms following an equivalence decision (RTS 5: Article 46(6) of MiFIR, information to be provided by a third country firm applying for authorisation); and (iv) information on costs relating to execution of orders[1].

The new requirements on information on costs apply to eligible counterparties, professional clients and retail clients. Eligible counterparties can agree to a "limited application" of the information requirement unless a derivative is involved, and professional clients can also do so unless they are receiving investment advice or portfolio management or a derivative is involved. As a minimum benchmark, the information requirement is to provide information about "all costs and charges" and, if a firm is "recommending or marketing financial instruments" or a key investor document (KID)/key investor information document (KIID) is required, "full point of sale disclosure" information on costs (which is set out by ESMA in detail) must be given. Third party payments are to be included as part of those costs. Costs must be expressed as both cash and percentage amounts.

There will be a new requirement for all "new" professional clients to have a written agreement in place from 3 January 2017 that sets out the "essential rights and obligations" of the parties, although this does not need to be signed.

Third country

Non-EU firms will only be able to register with ESMA and provide services into the EU from outside of it if they are based in an equivalent jurisdiction and suitability regulated in their home jurisdiction (as determined by the Commission). ESMA's proposal is that only factual information needs to be provided by the firm, plus a written declaration by its regulator stating that it is subject to supervision and detailing the services and activities for which it is authorised. Chapter 2, RTS 3 (Article 34(8) and 35(11), MiFID) sets out the draft regulatory technical standards in relation to third country firms.

Market making and micro structural issues

Chapter 4 of Annex B includes micro-structural issues including setting out organisational requirements for investment firms (Article 17). ESMA explains in detail the issues it needed to consider, and has suggested a set of guidelines following feedback from its discussion paper. The detailed analysis in organisational requirements for trading venues (Article 48) covers matters such as governance, staffing, outsourcing and capacity. It also considers means to ensure stability and necessary controls. In relation to market making, market making agreements and market making schemes, ESMA has clarified when a market making agreement will be necessary and elaborated on the related requirements.

[1] RTS 6: Article 27(10)(a), information on execution data and RTS 7: Article 27(10)(b), format of information on top five execution venues.

Commodity derivatives

The MiFID II provisions relating to commodity derivatives have been some of the most significant amendments to the existing MiFID regime. There will be an extended scope over which commodity derivatives will be regulated as financial instruments and the narrowing of available exemptions from authorisation for those entering into commodity derivatives.

Currently, many entities trading commodity derivatives rely on exemptions to avoid the need for authorisation but MiFID II will significantly amend some of the exemptions normally relied on by commodity market participants. A firm will no longer be able to rely on the dealing on own account exemption in relation to commodity derivatives.

Furthermore, MiFID 2 significantly amends the ancillary activity exemption. The draft technical standard on the criteria for establishing when an activity is considered to be ancillary to the main business is set out at RTS 28 of Annex B.

The ancillary activity exemption will only be available to entities which deal on own account other than by executing client orders in commodity derivatives; and/or provide investment services other than dealing on own account to customers or suppliers of their main business. Those entities seeking to rely on this exemption will have to satisfy the following criteria: (i) each of the two permitted activities, individually and on an aggregate basis, must be ancillary to their main business when considered on a group basis; (ii) that main business must not be the provision of investment services under MiFID, banking services nor acting as a market maker in relation to commodity derivatives; and they must not apply a high frequency algorithmic technique. The exemption in article 2(1)(k) of MiFID that was specifically designed for persons trading in commodity derivatives will no longer be available.

Therefore, the new ancillary exemption will make it difficult for a regulated group to have an unregulated commodity derivative trading subsidiary and the removal of the commodity deal exemption is likely to put an enormous pressure on the agency trading structure used by many commodities groups. If a firm is no longer able to rely on an exemption then it will need to become authorised to carry out the relevant investment services.

Admission of financial instruments to trading on regulated markets

Article 51(6) of MiFID II requires ESMA to develop regulatory technical standards which will specify and clarify a number of aspects in relation to: characteristics financial instruments shall have for being considered eligible for admission to trading on a regulated market; arrangements regulated markets shall have in place concerning certain aspects of disclosure obligations; and access to information.

Eligibility for admission

Focusing on the eligibility for admission of transferable securities, ESMA refers to Article 35 of the MiFID I Level 2 Regulation, which already applies to regulated markets in the EU. This sets out the characteristics of transferable securities that are eligible for admission to trading on a regulated market for example, securities must be able to be traded between parties and transferred without restriction. ESMA conducted a fact-finding exercise with competent authorities to see how these rules were working and found the provisions have proven to be appropriate and no specific problems in supervisory practice have been reported. Therefore, ESMA proposes to use these standards as the basis for its regulatory technical standards under MiFID II.

Disclosure obligations

Article 51(3)(1) of MiFID II requires regulated markets to establish and maintain effective arrangements to verify that issuers of transferable securities comply with obligations of initial, on-going and ad hoc disclosure under EU Law. The obligations stem from the Prospectus, the Transparency and the Market Abuse Directive. ESMA states that although practice varies significantly across regulated markets the respondents to the discussion paper reported that arrangements in place are adequate and that the details should be left to the discretion of each regulated market. As a result ESMA proposes to require regulated markets to adopt a policy to verify compliance by issuers which shall be published on the website of the relevant regulated market.

Major issues still to be developed

The majority of the issues which have not yet been turned into draft RTSs relate to different aspects of calibrating pre and post-trade transparency and other important aspects relating to trading of financial instruments, particularly in relation to non-equity instruments. There are a large number of these issues where further draft RTSs will be produced.

Next steps

The draft RTSs in Annex B will now be reviewed by the European Commission which may redraft them in whole or in part. There is little prospect of ESMA making changes to Annex B. ESMA will absorb comments on the other matters which are more open and then draft RTSs which are likely to be published in Q2 of 2015.

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