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BULLETIN | EU FINANCIAL SERVICES AND REGULATION

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Welcome to the EU edition of the Financial Services and Regulation Bulletin, featuring a full round-up of the main regulatory and legislative developments in the financial services sector over the past month. Amongst other developments, the European Commission proposed a Regulation on structural reforms to the EU's largest banks and a Regulation on reporting and transparency of securities financing transactions. The EU institutions have continued negotiating legislative proposals on collective investment schemes, deposit guarantee schemes, investment services, and the Single Resolution Mechanism. The European Parliament adopted the proposed Directive on criminal sanctions for insider dealing and market manipulation. Finally, as we reported in a separate client alert, the EMIR reporting obligation started applying on 12 February 2014. For an update on developments in the United Kingdom, please see this month's dedicated bulletin here.

CONTENTS

PROGRESS OF LEGISLATIVE PROPOSALS

1. PROPOSAL FOR A REGULATION ON STRUCTURAL REFORMS TO THE EU BANKING SECTOR

On 29 January 2014, the European Commission published a legislative proposal for a Regulation on structural reforms to the EU's largest banks. The proposal takes into account the recommendations set forth in the Liikanen Report, as well as existing national rules in some Member States, the Financial Stability Board principles, and developments in other jurisdictions, in particular the United States. The Commission proposes to:

- Ban proprietary trading in financial instruments and commodities as of 1 January 2017; and
- Grant supervisors the power and, in certain instances, the obligation to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitisation operations) from a deposit taking entity to separate legal trading entities within the group as of 1 January 2018.

The proposed Regulation would target the EU banks that are "too big to fail" *i.e.*, banks whose failure could have a disruptive effect on the EU financial system and the economy. Pursuant to the proposed Regulation, the following EU banks would be covered by the restrictions:

- EU banks that are deemed to be a global systemically important institution (G-SIIs) under the CRD IV Directive (2013/36/EU); and
- EU banks that for a period of three consecutive years have (i) total assets amounting to at least €30 billion and (ii) trading activities amounting to at least €70 billion or 10 per cent of their total assets.

The Commission estimates that out of the 8,000 banks operating in the EU, only around 30 would likely be affected by the proposed Regulation. The covered banks represent over 65 per cent of the total banking assets in the EU.

Foreign subsidiaries of EU banks and EU branches of foreign banks could be exempted from those requirements if they are subject to equivalent separation rules. That could allow for the exemption of U.S. banks, which have to comply with the Volcker rule.

2. SHADOW BANKING: EUROPEAN COMMISSION LEGISLATIVE PROPOSAL FOR REPORTING AND TRANSPARENCY OF SECURITIES FINANCING TRANSACTIONS

Also on 29 January 2014, the European Commission published a proposal for a Regulation on reporting and transparency of securities financing transactions (SFTs).

The proposed Regulation sets out requirements for:

- Financial or non-financial counterparties of SFTs to report the details of SFT transactions to trade repositories;
- UCITS management companies, UCITS investment companies and alternative investment fund managers (AIFMs) to provide information to investors on their use of SFTs and other financing structures; and
- Counterparties seeking to engage in rehypothecation to ensure certain conditions are satisfied before they have the right to rehypothecation.

The legislative proposal follows the Commission's September 2013 communication on shadow banking.

3. POLITICAL AGREEMENT ON UNDERTAKINGS FOR COLLECTIVE INVESTMENT IN TRANSFERABLE SECURITIES (UCITS V)

On 25 February 2014, the European Parliament and the EU Council reached a political agreement on the proposed UCITS V Directive. The Directive will cover the following aspects:

- Remuneration: At least half of fund managers' variable remuneration would need to be paid in the assets of their UCITS, unless the management of UCITS accounts for less than half of the total portfolio. Payment of at least 40% of variable remuneration would be deferred for at least three years. The European Securities and Markets Authority (ESMA) would be required to issue guidelines on the persons to whom the remuneration policy applies.
- Depositaries: A single depositary would be appointed to oversee investor payments to the fund and act as a custodian of its assets. Depositaries would be required to keep investors' money clearly separate from their own assets and not to act without authorisation and would be barred from investing these funds on their own account and may be deemed liable for any loss of assets, even if they delegate custody of them to a third party.
- Sanctions: Member States would adopt harmonised administrative penalties for funds that fail to comply with national UCITS authorisation and reporting rules. These penalties would include a suspension of authorisation and a temporary or permanent ban from fund management for the perpetrators. Companies could be fined up to 10% of their annual turnover or €5 million, and individuals up to €2 million (the size of the fine would be up to twice the amount of profits made).

The political agreement follows from the adoption of the general approach on UCITS V by the EU in December 2013, as reported in our December 2013/January 2014 Bulletin. UCITS V now needs to be formally adopted by the Parliament and Council at first reading.

4. POLITICAL AGREEMENT ON THE DEPOSIT GUARANTEE SCHEMES DIRECTIVE (DGSD)

On 3 March 2014, the EU Council adopted the Deposit Guarantee Schemes Directive (DGSD), as set out in the revised text. As a result, the European Parliament may adopt the DGSD without amendment at its plenary session held between 14 and 17 April 2014. The DGSD, which recasts directive 94/19/EC and its subsequent amendments, requires all banks to join a deposit guarantee scheme so that all their eligible deposits of up to EUR 100,000 are protected.

The DGSD will enter into force once it has been signed by both the Parliament and the Council and published in the Official Journal of the EU (OJ), expected in the weeks following adoption by the Parliament in April 2014. Member States will have one year to transpose DGSD into national law from the date of its publication.

5. EUROPEAN PARLIAMENT ADOPTS THE DIRECTIVE ON CRIMINAL SANCTIONS FOR INSIDER DEALING AND MARKET MANIPULATION (CSMAD)

On 4 February 2014, the European Parliament adopted the proposed Directive on criminal sanctions for insider dealing and market manipulation (CSMAD). The Directive is expected to be published in the EU's OJ in June 2014, following which Member States will have two years to implement it.

CSMAD will introduce *inter alia*:

- Common EU definitions of market abuse offences such as insider dealing, unlawful disclosure of information and market manipulation; and
- A common set of criminal sanctions including fines and imprisonment of four years for insider dealing/market manipulation and two years for unlawful disclosure of inside information.

The Parliament's vote follows political agreement in trialogue on CSMAD, reached in December 2013, on which we reported in our December 2013/January 2014 Bulletin.

6. EU COUNCIL PUBLISHES TEXTS OF MIFID II LEGISLATIVE PROPOSALS

On 18 February 2014, the EU Council published the text for the proposed MiFID II Directive and MiFID II Regulation (MiFIR).

The Council and the European Parliament reached a political agreement in trialogue on the MiFID II legislative proposals on 14 January 2014, as reported in our December 2013/January 2014 Bulletin. The Regulation and the Directive will now have to be approved by the Parliament, in order to allow final adoption by the Council once the texts have been finalised in all languages.

7. NEGOTIATIONS ON THE REGULATION ON THE SINGLE RESOLUTION MECHANISM (SRM REGULATION) CONTINUE

On 6 February 2014, the European Parliament voted in plenary to adopt amendments to the proposal for the Regulation on the Single Resolution Mechanism (the SRM Regulation). In response, on 18 February 2014, the EU Council discussed possible adjustments to its general approach to the SRM, in particular:

- The framing of the role of the plenary session of the single resolution board (SRB);
- A review of the thresholds for the involvement of the plenary and of voting arrangements to create a balanced solution for the use of the SRF;
- Limitation of the Council's discretion and the grounds on which it can raise objections to the SRB's decisions, as well as simplification and shortening of the decision-making process;
- A more closely regulated oversight of the SRB over national resolution authorities;
- A more central role for the European Central Bank (ECB) in determining whether a banking institution is failing or likely to fail; and
- Agreement that bail-in (as opposed to bail-out) is the main guiding principle for bank resolution.

The inter-institutional negotiations will now continue, with the Parliament aiming to hold another vote on the proposal before the end of its current legislature in April 2014.

8. EU PARLIAMENT VOTES ON THE DIRECTIVE ON THE PREVENTION OF THE USE OF THE FINANCIAL SYSTEM FOR THE PURPOSE OF MONEY LAUNDERING AND TERRORIST FINANCING (MLD4)

On 20 February 2014, the European Parliament's Committees on Economic and Monetary Affairs, Civil Liberties, and Justice and Home Affairs voted amendments to the European Commission's proposal for the Directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (MLD4).

MLD4 aims to strengthen further the EU's regime to fight money laundering and terrorism financing and ensure that the EU framework is aligned with the standards developed by the Financial Action Task Force, an inter-governmental body developing and promoting policies to combat money laundering and terrorist financing.

Pursuant to the Parliament's amendments, public central registers would list information on the ultimate beneficial owners of all sorts of legal arrangements, including companies, foundations and trusts. Member States would have to make registers publicly available following prior identification of the person wishing to access the information through basic online registration.

The Parliament will vote on the amendments in the next plenary session (10–13 March 2014). Following the parliamentary elections in May 2014, the new Parliament will begin negotiating the MLD4 proposal with the European Commission and the EU Council.

9. CSDR: FINAL COMPROMISE TEXT PUBLISHED

On 26 February 2014, the EU Council published the final compromise text of the proposed Regulation on improving securities settlement and central securities depositaries (CSDR). The compromise text results from the provisional agreement on the text reached in trialogue in December 2013, on which we reported in our December 2013/January 2014 Bulletin.

The EU Council and the European Parliament will now negotiate the technical details of the proposed Regulation, with the Parliament due to consider the proposed Regulation on 15 April 2014 i.e., shortly before the end of its current legislature.

10. THE MORTGAGE CREDIT DIRECTIVE (MCD) IS PUBLISHED

On 28 February 2014, the text of the Mortgage Credit Directive (MCD) was published in the EU's OJ. The MCD was adopted by the European Parliament and the EU Council on 10 December 2013 and 28 January 2014 respectively, as reported in our December 2013/January 2014 Bulletin.

11. EUROPEAN PARLIAMENT TO CONSIDER THE REVIEW OF THE EUROPEAN SYSTEM OF FINANCIAL SUPERVISION (ESFS) AT 10 TO 13 MARCH 2014 PLENARY SESSION

The European Parliament updated its procedure file on the review of the European System of Financial Supervision (ESFS), which includes the European Systemic Risk Board (ESRB) and the three European Supervisory Authorities (ESAs) *i.e.*, the European Banking Authority (EBA), ESMA, and the European Insurance and Occupational Pensions Authority (EIOPA).

The ESFS procedure file now indicates that the Parliament will consider the legislative proposal during its next plenary session (10–13 March).

12. CRR: JOINT COMMITTEE OF ESAS CONSULTS ON DRAFT ITS ON MAPPING OF ECAIS' CREDIT ASSESSMENTS

On 5 February 2014, the Joint Committee of the European Supervisory Authorities (ESAs), composed of the EBA, ESMA, and EIOPA published a consultation paper on draft implementing technical standards (ITS) on the mapping of the credit assessments to risk weights of external credit assessment institutions (ECAIs) under Article 136(1) and (3) of the Capital Requirements Regulation (CRR).

The CRR provides that risk weights under the standardised approach should be based on, among other things, the credit quality of the exposure, which is calculated on the basis of credit assessments provided by ECAIs. The draft ITS specify the elements that should be taken into consideration to determine the correspondence ("mapping") between risk weights and credit assessments provided by a particular ECAI.

The consultation closes on 5 May 2014 and the EBA is expected to submit the draft ITS to the European Commission by 1 July 2014.

13. CRD IV: FINAL DRAFT RTS ON INSTRUMENTS APPROPRIATE FOR VARIABLE REMUNERATION

On 19 February 2014, the EBA published its final draft regulatory technical standards (RTS) on classes of instruments that may be used for the purposes of variable remuneration under Article 94(2) of the Capital Requirements Directive (CRD IV).

The draft RTS shall ensure that instruments for variable remuneration reflect the credit quality of an institution and incentivise prudent risk-taking. To that end, they prescribe that an institution's long-term interests be reflected in the classes of instruments used for variable remuneration -including additional Tier 1, Tier 2 and other instruments.

The RTS await the adoption by the European Commission and will enter into force once published in the EU's OJ.

14. CRR: EBA CONSULTS ON DRAFT RTS ON MARGIN PERIODS FOR RISK USED FOR TREATMENT OF CLEARING MEMBERS' EXPOSURES TO CLIENTS

On 28 February 2014, the EBA published a consultation paper on draft Regulatory Technical Standards (RTS) on the margin periods for risk used for the treatment of clearing members' exposures to clients under Article 304(5) of the CRR.

The draft RTS specify the level of the minimum margin periods of risk (MPOR) that clearing members may use to calculate the regulatory requirements for counterparty credit risk (CCR). Interested parties may comment on the draft RTS until 9 May 2014. The EBA must submit draft RTS to the Commission by 30 June 2014.

NEW REGULATIONS

1. EMIR RTS RELATING TO NON-EU COUNTERPARTIES

On 13 February 2014, the European Commission adopted the Delegated Regulation setting out regulatory technical standards (RTS) specifying the contracts that are considered to have a direct, substantial and foreseeable effect within the EU, and to prevent the evasion of rules and obligations, pursuant to the Regulation on OTC derivative transactions, central counterparties (CCPs) and trade repositories (EMIR). The RTS detail the circumstances under which a contract executed between two third-country counterparties shall be considered as having a direct, substantial and foreseeable effect within the EU (Article 2) as well as the cases where it is necessary or appropriate to prevent the evasion of EMIR rules or obligations (Article 3).

The Delegated Regulation will enter into force 20 days after the date of its publication in the EU's OJ. However, Article 2 will apply from a date six months after the Delegated Regulation comes into force.

2. CRR: REGULATION ON APPLYING FICOD CAPITAL ADEQUACY CALCULATION METHODS

On 22 January 2014, the European Commission published the text of the Delegated Regulation setting out regulatory technical standards (RTS) relating to the consistent application of the calculation methods under Article 6(2) of the Financial Conglomerates Directive (FICOD).

3. CRR: DELEGATED REGULATION ON CALCULATION OF CREDIT RISK ADJUSTMENTS

On 27 February 2014, the text of the European Commission's Delegated Regulation supplementing the Capital Requirements Regulation (CRR) on prudential requirements for credit institutions and investment firms with regard to RTS for specifying the calculation of specific and general credit risk adjustments (Regulation 183/2014) was published in the EU's OJ. The Commission adopted the Delegated Regulation on 20 December 2013.

NEW GUIDANCE

1. ESMA Q&A ON AIFMD

On 17 February 2014, the ESMA published a questions and answers paper (Q&A) on the application of the Alternative Investment Fund Managers Directive (AIFMD).

The Q&A cover: application of the remuneration rules; remuneration rules in the case of delegation of portfolio management or risk management activities; Annex IV of the AIFMD; notification of alternative investment funds (AIFs); and reporting under Article 42 of the AIFMD.

2. ESMA ASKS EUROPEAN COMMISSION TO CLARIFY EMIR DERIVATIVE DEFINITION

On 14 February 2014, ESMA requested that the European Commission clarifies the definition of a derivative or derivative contract under the Regulation on OTC derivatives, central counterparties and trade repositories (EMIR), which currently refers to the list of financial instruments in the Markets in Financial Instruments Directive (MiFID). In ESMA's view, due to the different transposition of MiFID across Member States, there is no single definition of derivative or derivative contract in the EU. In particular, ESMA refers to the differing definitions for foreign exchange (FX) forwards and physically settled commodity forwards across Member States. That may result in an inconsistent application of EMIR.

ESMA asked the Commission to clarify (i) the definition of currency derivatives in relation to the frontier between spot and forward, and their conclusion for commercial purposes; and (ii) the definition of commodity forwards that can be physically settled.

ESMA understands that until the Commission provides clarification, and to the extent permitted under national law, national competent authorities will not implement the relevant provisions of EMIR for contracts that are not clearly identified as derivatives contracts across the EU, in particular FX forwards with a settlement date up to 7 days, FX forwards concluded for commercial purposes, and physically settled commodity forwards.

3. UPDATED ESMA Q&A ON EMIR IMPLEMENTATION

On 11 February 2014, ESMA published an updated version of its questions and answers document (Q&A) on the implementation of EMIR. The revised Q&A clarify issues related to reporting to trade repositories (TRs) such as on how to construct and generate Unique Trade Identifiers (UTI), the reporting of empty/not available fields and the UPI taxonomy.

4. ESMA PUBLISHES MIFID GUIDELINES RELATING TO COMPLIANCE FUNCTION AND SUITABILITY

On 21 February 2014, ESMA published guidelines compliance tables on certain aspects of MiFID:

- Compliance function requirements (ESMA/2013/923).
- Suitability requirements (ESMA/2013/922).

All Member States but Croatia comply or intend to comply with ESMA's guidelines.

JUDGMENTS: ADVOCATE GENERAL ISSUES AN OPINION ON UCITS I

In an Opinion adopted on 13 February 2014 in Case C-88/13 Philippe Gruslin v Beobank SA/NV, Advocate General Jääskinen of the European Court of Justice considered a question whether, in circumstances in which the units of a UCITS have been marketed in a Member State other than that where it is situated, Article 45 of the UCITS I Directive is to be interpreted as meaning that the concept of "payments to unit-holders" also refers to the delivery of certificates for units (unit certificates) to unit holders by representatives of the UCITS in that other Member State. The Advocate General responded in the negative.

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